Giving back

How to foster a stronger and more resilient charity sector

Gideon Salutin

SMF Social Market Foundation

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Kindly supported by

FIRST PUBLISHED BY

The Social Market Foundation, April 2023
Third Floor, 5-6 St Matthew Street, London, SW1P 2JT

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ACKNOWLEDGEMENTS

We are grateful to Omaze for supporting this work, and to Stack for assisting with survey administration and opinion polling. Of course, we are most grateful to the individuals who committed their time to contribute to interviews which were vital to this report. All views and conclusions remain the author's.

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EXECUTIVE SUMMARY

While charities showed great adaptability in the face of the pandemic, the cost of living crisis may prove even more challenging

- The alarm bells rung by charity financial staff at the start of the pandemic proved premature:
  - Financial losses during the pandemic ended up being minimal and brief, and were borne through institutional adaptation and reserves.
  - Innovative changes from that period should be continued, to build resilience for the future. These include:
    - Novel fundraising methods, attracting new donors using new methods of outreach like Pub Quiz at Home.
    - Greater investments in tech and IT training which improved the connectivity and productivity of the third sector.
    - Stronger commitments to partnerships with the private sector, public sector, and other charities who supported each other through uncertainty and later realised mutual synergies
- It is too early to tell how damaging the cost of living crisis will prove
  - Household budgets should recover, but it remains to be seen what the 'new normal' will look like and whether donations will rebound.
    - Polling conducted by Stack for this project finds that 41% of the British public are donating less than they were three years ago, and 26% expect their donations to continue to decrease over the coming year.
    - When asked why, 80% blamed the rising cost of living, compared to just 17% who blamed the pandemic.
- Coinciding with these crises, Brexit has further destabilised the charity sector, with the government failing to fully replace European Structural and Investment Funds.

The charity sector has been remarkably resilient to recent shocks, though larger charities have fared better than smaller ones

- Overall, UK charity income has held up well in recent years
  - Over the last twenty years, income for charities has risen in real terms from £35 billion in 2000 to £58 billion in 2020.
- However, this aggregate picture masks polarisation between bigger and smaller organisations:
  - Since 2007, charities with a turnover of over £1 million have seen their budgets grow by 28%, adding over a billion pounds a year.
  - Meanwhile, smaller charities (income under £100,000) have lost 26% of their budgets, while medium charities (£100,000-£1 million) have shrunk 17%.
- Rich charities have found innovative ways to grow, using novel approaches to broaden their donor base:
  - For example, 30% of participants in prize draws organised by Omaze (who sponsored this report) rarely or never donated to charity before,

- However, small and medium charities, particularly those in less affluent areas with less name recognition, face structural disadvantages:
    - Although 68% of people would like their donations to go towards local causes, just 33% donate to local charities.

Since 2010, private donations have offset lost government funding – but it is unclear how long this can last

- Since 2010, government funding for charities has fallen 14%. Increased generosity from individual donors and the private sector has thus far compensated for lost government funding.
- However, households and firms may not be able to continue to take the strain:
    - Wage stagnation has started to reduce individual giving, and the cost of living crisis may push public generosity to its limits.
    - 21% of those polled in our survey said they do not expect to be able to donate at all over the next year, with rates highest among low income groups
    - At the same time, state services cuts have caused charities to become providers of first resort for many individuals in need.
- The UK's changing demographics pose potential threats:
    - Individual donors are more likely to be over 55, and skew female, with the highest proportion in London
    - According to our survey, the median total amount donated over the past year was £50, with 18-24 year olds donating the least (£40) and over-75 year olds donating the most (£100)
    - Charities are having to develop new and innovative models to attract younger and different groups, though it is not clear how reliable their support will be given intergenerational inequality.

Solutions lie in looking beyond short term measures and instead instilling long term planning and sustainable financial opportunities across the third sector

- The multiple crises facing charities have highlighted their inability to make viable long term spending plans:
    - This is due to an overreliance on donations which are fickle and vulnerable to market shocks.
    - Likewise, experience of austerity has decreased trust between the public and third sector, and made charities wary of relying too heavily on government as a source of income.
- This must be countered by closer ties and synergies between the public sector and charities, with the former providing new sources of income and the latter providing expertise and project delivery
    - Similar ties could also be strengthened with the private sector to help meet market ESG ambitions.

This report suggests some ways in which government can protect the long term viability of the charity sector. Proposed measures include:

- **Financial support** in the form of a new fund providing competitive grants exclusively to micro and small charities, which often provide services in isolated communities.
    - Increasing government contributions to Gift Aid, as Gordon Brown proposes, would be untargeted, potentially favouring richer charities over smaller ones.
    - Moreover, overreliance on Gift Aid is risky for charities as transfers will decrease when donations fall. This especially endangers charities in times of financial downturns, when demand for their services is highest.
    - A better approach would be to establish a new Micro and Small Charity Action Fund. This would be countercyclical, providing money for vulnerable charities in moments when public generosity is exhausted.
- **Coordination with the public sector** at national, subnational, and local levels to improve service delivery through mutual synergies.
    - At a national level, charities can provide insights generated from experience on the ground, but to apply this they must be included in the policy process through increased connections with legislators and the civil service.
    - Charities should help governments at every level meet fiscal targets like R&D spending plans. This proved effective when charities helped meet national targets in Official Development Assistance.
    - Local authorities should better utilise local charities to improve their communities by including them in policy design and accepting local provision as a new criterion in public service procurement.
    - Additionally, Place-Based Giving Schemes should be managed by local authorities which incentivise donors to fund community-based charities.
- **Proportionate regulation** should replace existing rules, cutting red tape for small charities
    - Currently a charity with just £25,000 annual income must submit similar returns to a charity with over £1 billion in revenue.
    - While these regulations are a well-intended attempt to prevent malpractice, they harm small charities which lack the staff, time, and revenue to meet extreme regulatory hurdles.
    - Regulations should be set proportionate to charity income and public assistance should be made available for smaller charities to access accounting or legal help, analogous to public business support through initiatives like Help to Grow.
    - Grant providers should ensure that reporting requirements are more modest for small grants.

We have also made a number of **recommendations for the charity sector** to help third sector organisations help themselves. These include

- Investment in an umbrella organisation to help lobby for these policies and other needs in the same way industry bodies serve the private sector
    - This organisation would represent the third sector to public and private actors due to increasing need for representation in these areas
    - The organisation would further be able to catalogue and communicate innovations in technology, finance, and outreach developed over recent years to utilise the sector's best practices
- Further, partnerships with the private sector should be established or improved to increase private sector donations and help meet the market's ESG demands
    - While the private sector provides donations to the third sector, these are not spread evenly, as micro and small charities receive just £34 million annually compared to £2.1 billion going to large, major, and super-major charities.
    - To maximise social and economic returns, partnerships should take place over the long term and on an equal footing rather than allowing the private sector to act as a domineering benefactor.

Even minor disintegration of the charity sector in the UK would cause serious social and economic fallout. Households would stand to lose access to organisations that have become welfare providers, including vital resources for education, health, wellbeing, and care. The UK's economy would lose billions in value. The social, economic, and political cost to communities would be immense. Avoiding these outcomes will require new policies as well as political and social discussions on the role of the state and the position of the charity sector in UK society.

However, there are reasons to be hopeful. The resilience and innovation have helped charities not just to survive, but in many cases to thrive. We have seen incredible imagination and adaptability from charities themselves, and huge generosity from the public. Policymakers should show similar flexibility to harness that energy and potential. New funds, new regulations, and new partnerships can ensure that Britain's charity sector thrives over the long term.

CHAPTER ONE – INTRODUCTION

Since 2008, small charities have lost 26% of their income.[1] These organisations are likely to be delivering front line services in isolated communities and act as welfare providers of first resort. Across the country, excess demand on health, welfare and local government systems have led more individuals to turn to charities for help. Throughout fifteen years of austerity, charities were asked to do more with less.

When the COVID-19 pandemic struck the UK in March 2020, the charity sector appeared to be among the most imperilled sectors in the economy. Not only did finance directors expect income to dwindle due to uncertainty; their managers saw increasing demands for services as people scrambled for support. By June, 91% of charities anticipated a lower income in the latter half of 2020 than they had previously budgeted, and many worried they were no longer viable.[2]

These predictions proved pessimistic. A combination of increased savings, government support, and the relative brevity of lockdowns helped charities avoid the worst of COVID-19's economic effects. Additionally, charities demonstrated a remarkable adaptive capacity that helped weather to storm. But after emerging from this tunnel the third sector was immediately hit with the cost of living crisis, which brought increased demand, decreased revenue, and rising inflation. This caused what has been called a "double whammy" which has preoccupied literature on the sector over the past year.

This report attempts to look beyond these dramatic, but temporary, shocks towards discussion of the long-term plan for the charity sector. It is true that the current economic crisis presents serious dangers. However, a single crisis did not put charities in this position. Instead, the rapid flurry of crises have exacerbated and exposed structural financial vulnerabilities which have grown worse over a decade. The resilience exemplified by charities' behaviour throughout this period provides a roadmap to improving the long term resilience of Britain's third sector.

Methods

To understand the challenges and opportunities facing the UK's charity sector, we combined a literature review with primary data collection and analysis. Literature included academic articles, reports, and press sources. In terms of datasets, we used the NCVO Civil Society Almanac and Charity Commission data. In combination, this provided insight into the state of charities.

Simultaneously, we undertook a series of semi-structured interviews with staff employed by registered charities. Interviews were planned to study the financial security of charities, so subjects were generally in positions that demanded in-depth knowledge of charity finances including donation strategies, grant applications, and current expenditure. Some questions related to the charity's experience throughout the pandemic, so interviews were generally held with staff who had worked at the same institution for three years or more. In order to achieve a sufficient spread across the sector, we categorised charities by mission, operating model, legal model, funding model, and size. These are outlined in Table 1, with a detailed breakdown in the appendix. We successfully interviewed charities from each segment in each category in order to hear from every corner of the charity sector and compare their varying experiences.

Table 1: Interview Categories

Mission	Based on **subsectors** reported by the Charity Commission / equivalent in devolved nations
Operating model	Reported **operating model** reported by the Charity Commission / devolved equivalent
Legal model	Based on **legal model** reported to Charity Commission / devolved equivalent and/or confirmation in interviews
Funding model	Financial strategy reported in interviews broken down between **Wide donor base**, **Narrow donor base**, **State funding**, or **Market operations**
Size	Based on annual income reported to Charity Commission or devolved equivalent broken down between **Small** (< £100k), **Medium** (£100k - £1 million) and **Large** (> £1 million) charities

Interview questions related to charities' experience throughout the last three years, including their finances prior to COVID-19, how they dealt with the pandemic, and current experiences during the cost of living crisis. This was followed by questions on their finances, including their donorship, their expectations, and alternative income streams. This addressed how charities may have found new funding sources in response to market shifts. The interviews ended with questions related to how government policy currently helps or hinders their charity and whether respondents would appreciate any particular new policies.

At the same time, a survey was administered by Stack which received responses from 2,513 individuals representative of the UK population between 7th and 13th of February 2023. Questions related to respondent's past donation behaviour, expected future giving, the perceived impact of donations, and views on the wider charity sector. This gave us a unique opportunity to hear from both donors and charities and provided more depth to our understanding of charities' experience.

We then conducted a thematic analysis of the interviews to find patterns that emerged and compared this to quantitative data and findings from the literature review. These were categorised and organised into this report, and structured as follows:

- **Chapter Two: A long term process of decline** outlines the experience of charities over recent decades and why their current struggles are not exclusively caused by recent crises.
- **Chapter Three: The COVID-19 pandemic** provides an overview of early reactions to the pandemic and why panic for the sector's future proved premature.
- **Chapter Four: The cost of living crisis: Contextualising charities' 'double whammy'** describes the uncertain position charities now find themselves in and how they are currently planning (or not planning) for future operations.
- **Chapter Five: Long term problems with short term solutions** explains the deeper structural problems facing the third sector.
- **Chapter Six: Recommendations and conclusions** details methods to address issues explored in prior chapters including providing financial support for small charities, reforming regulations, and improving partnerships

CHAPTER TWO – A LONG TERM PROCESS OF DECLINE

Funding by size

Over the last twenty years, income for charities has risen in real terms from £35 billion in 2000 to £58 billion in 2020.[3] This is largely the result of increasing generosity from the public. Due to investments in reserves, spending generally stays around £2 billion below income in every fiscal year. Since 2000, the total income charities have received in the UK has grown in line with the country's median earnings (Figure 1).

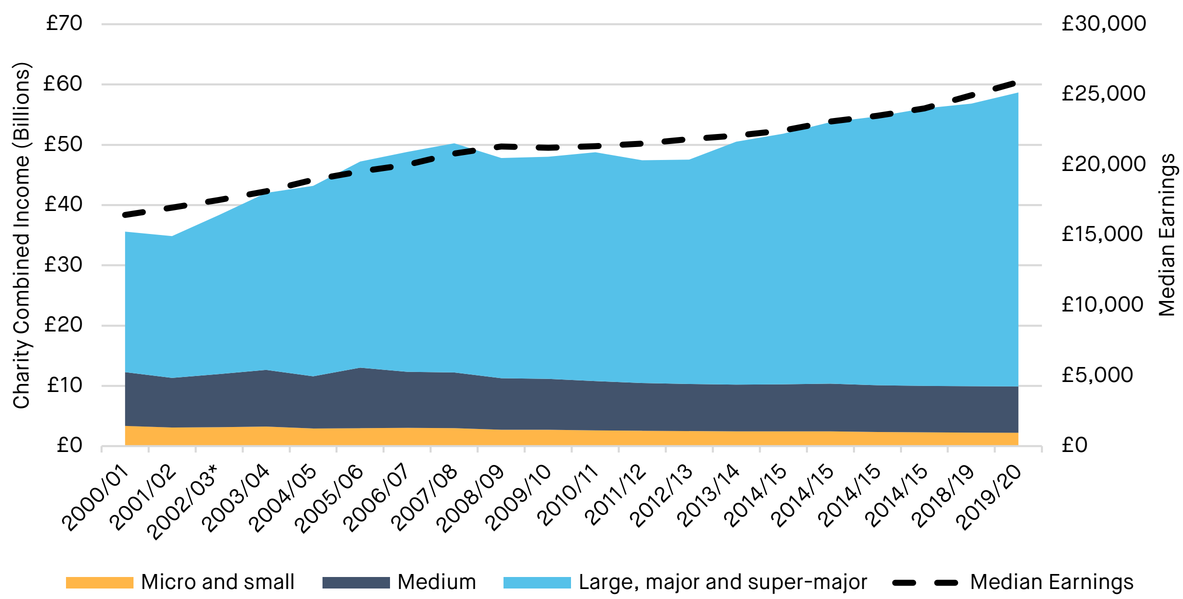
At the same time, there has been relatively little change in the number of charities. At an aggregate level, this represents impressive growth in revenue for the sector over the last 20 years. However, it has come alongside rising inequality: large and very large charities have done ever better, whereas smaller charities have shrunk (Figure 2)

Table 1: UK Charities by Size and Income

Size	Income margins	Total revenue (£m)	Population in UK
Micro	Less than £10,000	2,217	74,242
Small	£10,000 – £100,000		58,546
Medium	£100,000 – £1m	7,684	26,253
Large	£1m – £10m	16,010	5872
Major	£10m – £100m	18,984	782
Super Major	More than £100m	13,783	64

Source: NCVO Civil Society Almanac

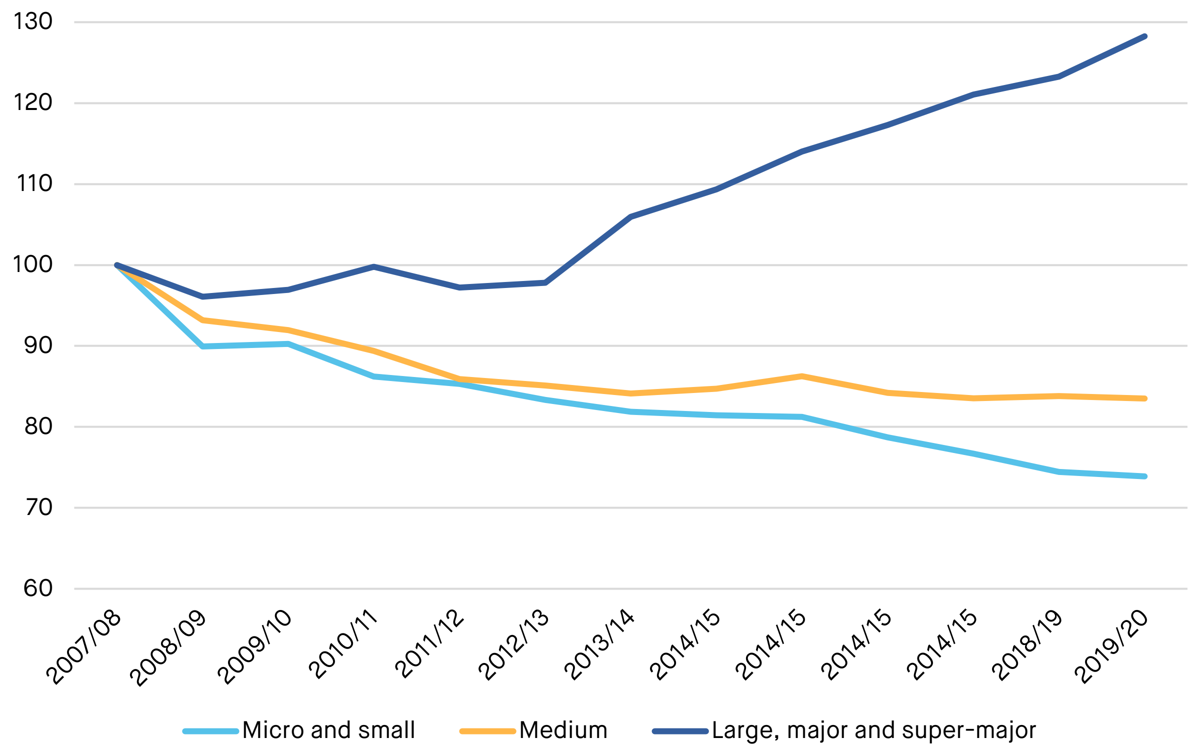
Figure 1: Overall income by size of charity



Source: NCVO Civil Society Almanac 2022; ONS; SMF analysis

80% of UK charities are defined as small, with annual income less than £100,000. Between 2007/08 and 2020, small charities lost 26% of their budgets, while medium sized organisations, those with income between £100,000 and £1 million, lost 17% (Figure 2). If this trend continues, by 2030/31 small charities will receive half the income they did in 2007/08. Over the same period, larger charities with over £1 million in annual income have seen their budgets grow by 28% and have collectively increased their real income by over £1.1 billion every year. Since 2000, large charities have more than doubled their annual income.

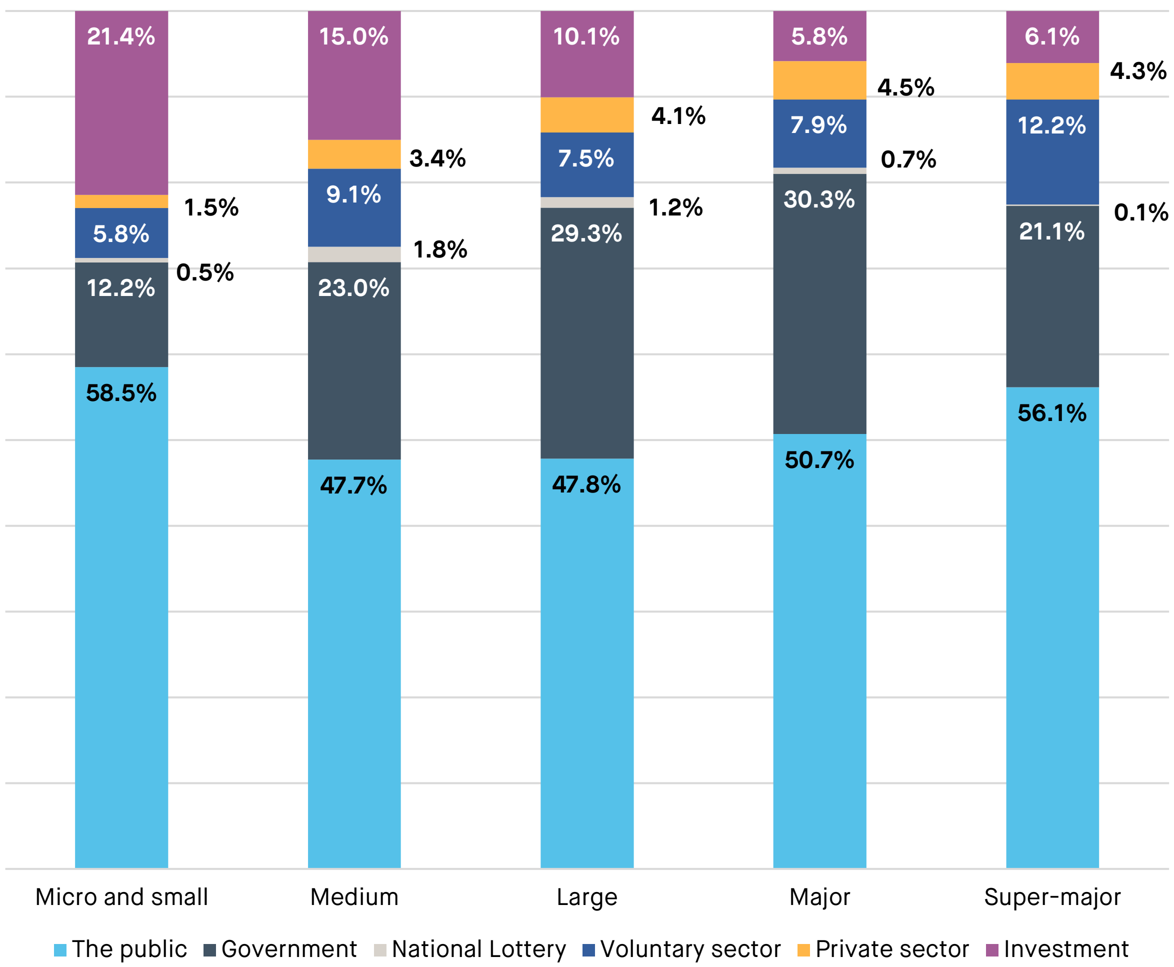
Figure 2: Charity income by size indexed to 2007/08



Source: NCVO Civil Society Almanac 2022; SMF analysis

The rise of "super major" charities is worth highlighting. These are charities with over £100 million in income, and their number increased from 26 in 2008-09 to 45 in 2015-16, and to 98 as of 2023. Organisations like the Nursing and Midwifery Council and the People's Dispensary for Sick Animals have joined their ranks in recent years. Over the same period their share of the sector's income increased from 15% to 20%.[4] According to NCVO research, these charities are more likely to operate internationally and less likely to provide domestic services, meaning they cannot be trusted to fill the gap in provisions left by austerity.[5] They generate income from a similar mix of sources as other charities, with the largest amount coming from individuals (Figure 3). In other words, they are largely fishing in the same waters as smaller and medium size charities, and outcompeting them.

Figure 3: Average income sources by charity size



Source: NCVO Civil Society Almanac 2022; SMF analysis

Large charities also enjoy the benefits of name recognition, which one super major charity we spoke to highlighted as a powerful asset in winning billions of pounds worth of donations.

> *"[Respondent's charity] has such a fabulous brand name, it's internationally recognised and respected. There's a lot of charities who've really struggled since the financial crash of 2008. If you go back quite some time now…if you're a charity who's wanting grants from the government, or grants from local authorities, you've had a hell of a time of it. For us, where we have a very different offering, I think we've maintained a very robust and healthy financial position."*

As the respondent explained, working at a super major charity provides advantages smaller charities lack. Donors who flock to these big household names may lack familiarity with their local shelter down the road. That has given these larger organisations greater ability to replace money lost from government funds, whereas smaller organisations have never recovered.

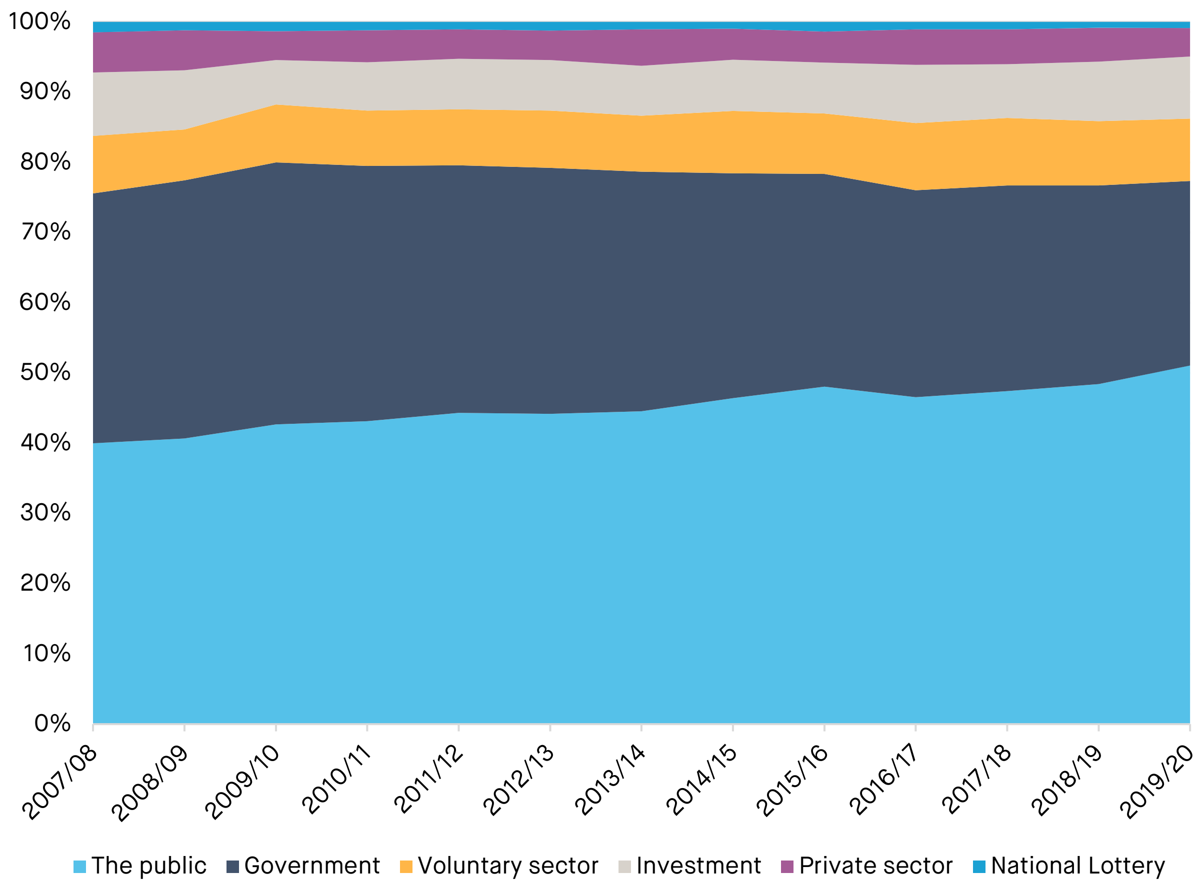
Funding sources

Replacing lost public funding in the wake of austerity has been a challenge for much of the third sector, with growing financial pressure on local authorities since 2010 limiting their ability to fund charities. Certain councils have had to cut all of their voluntary sector funding, according to an organisation in Scotland.

> *"We're asking people to do the same or more with less resources at a time when they're already on their knees. And at some point, that's got to be unsustainable… And I think there's always this assumption from the state…that the sector will be there to pick up the pieces. But at the moment we're seeing some local authorities like councils who've cut 100% of their funding to the sector for commissioned services like social care…If you do that, there isn't going to be a voluntary sector in your area."*

Government data corroborates this picture of declining public funds. Prior to 2010, government, and the public accounted for around a third each of charity income. Since 2010, government funding has dropped to a quarter, with public funds increasing to over half (Figure 4). This has made charities increasingly reliant on generating donations from the general public in order to survive.

Figure 4: Income source for charities over time

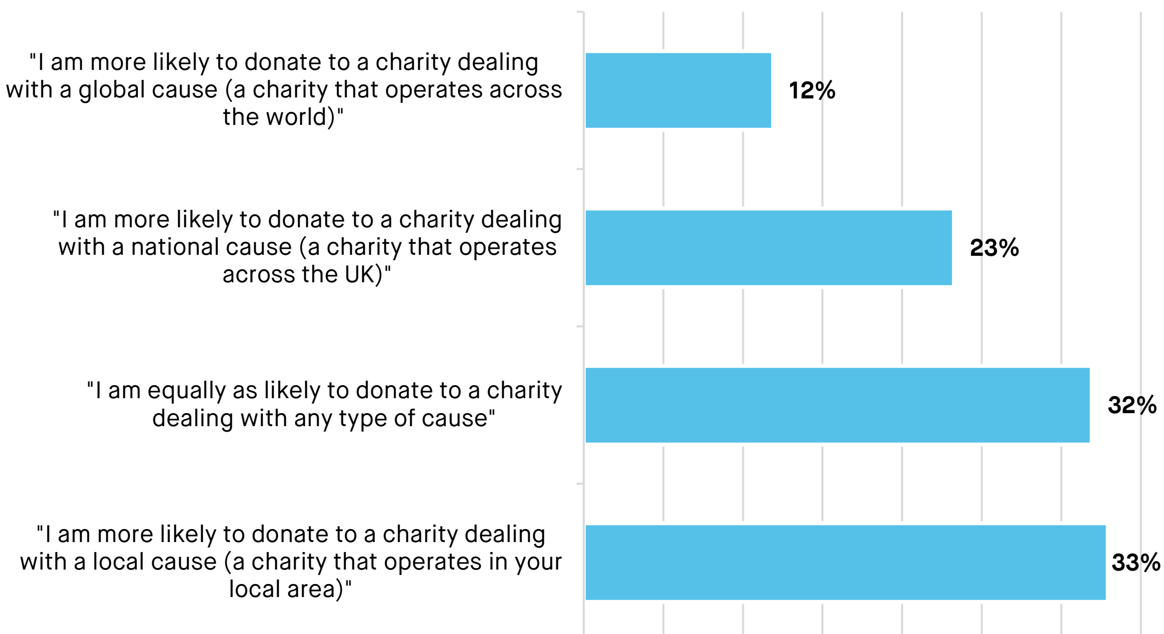


Source: SMF analysis of NCVO Civil Society Almanac 2022

The increased generosity of the public, stepping in to replace government funding over recent years, has been remarkable. Ordinary citizens gave £19 million to charities in 2007/08 in real terms. By 2019/20, that had risen to £30 million.[6] This increase has been steady since 2008 and helps explain how so many charities have been able to keep their doors open despite the loss of government funding. Yet the shift has benefitted some charities over others – in particular, as we have seen, those with stronger brands and public awareness. It is also asking a lot of the general public to expect them to allocate funding in an equitable or efficient way.

To illustrate the point, just 33% of participants polled by Stack in 2023 responded that they are more likely to donate to a charity operating locally than one working on national or international causes (Figure 5).[7] Younger people are particularly unlikely to donate locally, with just 21% of donations from this demographic going to local causes, which could present a long term challenge to the sector. This contrasts with data that shows six in ten people prefer that local groups solve social problems, compared to just 8% who preferred larger national/international organisations.[8] Some of those larger charities may be better, some may be worse. But the upshot is that public goodwill towards smaller and more local charities is not backed up by cash, leaving them vulnerable and struggling.

Figure 5: Likeliness of donating to causes by locality



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

Such concentration is likely also a result of increasing regional disparity. Local charities are overwhelmingly reliant on local donors, who are likely to have less to spare since average incomes have fallen over the last fifteen years. London charities have an average income three times that of the rest of the UK.[9] On a more granular level, there is very little correlation between a local authority's income deprivation (and hence need) and the amount of money charities operating there have.[10] Though this does not necessarily mean charity expenditure is being malapportioned, but it does indicate an extreme degree of capacity and resources is centred in the capital. Statistics on finances in local authorities imply that local charities working on the ground lack the funding capacity required to address disparity in their area. This was a trend long before the pandemic and is likely to continue as long as regional inequality remains pronounced.

Local charities' experience

Small and medium sized charities tend to work directly with those in need, and are able to fill cracks left by the state and larger organisations. In many areas they have effectively become first responders, providing care and services to residents in distress. This is particularly true in isolated communities that find state providers inaccessible, either due to the time or cost of transport.

The same holds true for charities that include national bureaus and local offices. While the national office continues to receive a comfortable amount of donations, local offices are forced to demand more funds from the national bureau and rely on centralised allotments. One staffer who works with local branches out of the central office described the long term issues:

> *"There's a long term process of decline going on there. We're starting to develop our new strategy and part of that has to look at how we can reduce [local branches'] costs. We've got 130 [local offices] and that's not very sustainable in the current world. So we're looking at how we can make create a more sustainable model for our local activity than having separate organisations which don't really share their back office."*

The respondent warned that in the near future this would probably involve cutting down on the amount of local offices in the country. Over the next few years this could deprive rural areas of vital services and worsen accessibility in deprived areas.

One respondent explained the long-term process of decline for local outlets as the result of combining high costs with low income. Local retail stores like charity shops which contribute to charity missions saw a decline in revenue which was exacerbated by (but not started by) the COVID-19 lockdowns. Further, respondents also reported local commercial activity to be less lucrative as market products have changed, become more centralised, more privatised, or faced competition with online marketplaces. As one respondent working with the elderly explained:

> *"At one point, we sold travel insurance to older people, when you couldn't get it anywhere else if you were an older person…We still sell home insurance, and we're getting back into travel insurance, but there's many more providers now than there used to be so. So that change in the wider economic world, and how older people buy things, has had an adverse impacts on our overall income streams. And that's been quite hard for our local [offices] to adjust to as well."*

Over the last few decades the market has created commercially viable competitive products that put small charities at a disadvantage. Up to this point, these organisations have failed to find marketable alternative products to replace lost revenue streams, exacerbating the loss of local and small charities.

CHAPTER THREE – THE COVID-19 PANDEMIC: PLANNING FOR THE WORST

In 2020, charities expected the worst. A survey released that September found that 85% expected a negative impact on their income relative to pre-crisis expectations, while 68% expected demand to increase.[11] Yet for a majority, this proved premature. Plans were drawn up for the worst-case scenario, but for a majority this proved unnecessary. Charities survived (and some thrived) through damage mitigation and adaptation.

Direct effects

When the UK first locked down in March 2020, charities faced considerable risk. Income streams that the sector traditionally relied on were immediately cut off, including face-to-face collections, in-person fundraisers, and retail sales.[12] The uncertainty led to donations and subscriptions being cancelled.[13] Some charities we spoke to reported that those who still wished to donate pivoted towards NHS charities, abandoning previous recipients. Charities with major investments saw their portfolio plummet over the market turmoil that spring.[14] Finally, given unexpected demands on the Exchequer, there was a looming threat that national and local government funding could be cut further. As a result, charities saw their income threatened from multiple sources.

At the same time, frontline staff were witnessing a spike in demand, particularly for those providing services and advice. For example, one charity working within health explained, "*The biggest change was for our support services…The demand on our support services and the support line for information quadrupled pretty much straight away from when the first lockdown happened. We were inundated with support requests.*" Mental health charities faced an increased caseload as the psychological toll of the pandemic came to be felt. Animal welfare charities had to deal with higher rates of abandonment and abuse, the result of financial pressures and emotional stress respectively. There were some roles within charities that were totally unable to work, including research teams who needed access to labs. For the most part, however, charities were under increasing demand pressures whilst money was drying up. This was particularly difficult for small and medium sized charities which lack the adaptive capacity and resources of larger organisations– the sorts of charities, we have seen, that went into the pandemic on the back of a funding squeeze.

Limiting the damage

Firstly, despite charities' fears, the government stepped in quickly to provide financial support. In early April 2020, the Treasury provided £750 million in cash grants for frontline charities to meet the increased demands and cover core costs.[15] Importantly, £370 million was targeted towards small and medium sized charities then under the greatest threat. One interview respondent noted how *"extra money that came through the pandemic helped us sustain some services and organisations that would otherwise have gone."*

Such support was seen as an investment by the government, as then-Chancellor Rishi Sunak pointed out: *"Charities are playing a crucial role in the national fight against coronavirus, supporting those most in need…This will ensure our key charities can continue to deliver the services that millions of people up and down the country rely on."*[16]

In addition, many charities furloughed staff using government retention schemes. By July, 164,000 staff had been furloughed, or 19% of sector workers.[17] Government provision of 80% of these staff's wages effectively added to the £750 million cash grants, helping to decrease costs at a critical time.[18] In addition, although donations had at first appeared threatened, government furlough schemes and other initiatives kept many household budgets afloat. This was reflected in a rebound in fundraising. By June, overall donations to charities were higher than the same period in 2019.[19] Most charities interviewed reported their donations bouncing back by late 2020. With more macabre implications, many charities reported higher legacy donations than usual as a result of higher mortality in the UK.

Importantly, the original lockdown was much shorter than predicted, lasting approximately three months. This meant the plans decided (and in some cases enacted) by charities which predicted longer closures left the organisations with more breathing room than expected. By the time subsequent lockdowns were implemented charities had revised plans and budgets that helped them cope. The combination of government funds and operational flexibility allowed most charities to survive.

Adaptation

In the face of new challenges, charities proved financially and structurally nimble, making considerable adaptations to endure, and in some cases evolve. Many that had relied on volunteer-led outdoor fundraisers, such as sponsored runs and walks, embraced new methods during lockdown, like Pub Quiz at Home. These were able to sustain some of their pre-existing support and even expand to reach those who might never have attended in-person events. Charities which used these methods reported how online fundraisers generally brought in less revenue than face-to-face fundraisers, but also cost significantly less, and so helped address their financial challenges. Internally, many charities reported having reorganised staff into frontline services to meet demand. One charity which works with older people found new work by partnering with local councils to deliver meals and food. They explained how their work was key to service delivery in local authorities.

> *"We became an emergency service locally…Lots of local [offices] turned themselves into emergency services that did a lot of food delivery for all the people stuck at home…In lots of places we were very central to [statutory services] and in a few we were actually running them on behalf of the whole community."*

Another charity providing advice and information rapidly trained furloughed workers, such as office-based custodial staff, to respond to the increase in calls demanding information:

> *"Some of the areas of our work all of a sudden didn't have any work anymore….Our office services team didn't have anything to do anymore, because we didn't have an office anymore… But on the support service side of things, there was huge demand. So we started to train up people from across the organization to move them to the Support Services Team, so that they could deal with that influx."*

The charity sector showed incredible dexterity in response to the pandemic, of which there are other examples. One charity created a new department to triage urgent demands for services and respond rapidly to those most critical. When a cancer charity realised emergent vaccines would be inadmissible for certain patients they initiated a task force to work with governments and the private sector to develop alternatives. Another reported hiring private marketing consultants as part of a new financial restructuring strategy. These expansions and partnerships proved fruitful by giving charities access to new funding streams just as existing ones were under strain.

Indeed, a majority of the organisations we interviewed reported emerging from the pandemic as strong or stronger than when they entered. Three factors explain this surprising outcome. First, multiple charities we spoke to told us that the reorganisation demanded by lockdowns had improved their stability and strengthened long term financial outlooks. As one environmental charity described, they were forced to recognise vulnerabilities in funding streams and embrace more resilient models. In this case, it meant pivoting from a few medium-risk government grants to many low risk sponsors who pay for membership

."If you're charging 500 companies…and a few drop out here and there, you've shrunk by a little bit…Membership income is much lower risk…With our government income profile we'd get [up to] seven government funders. So if two out of those seven drop out you've got a big problem. I wouldn't want to go back."

Post-pandemic, that charity has maintained the shift away from government grants and prefers to spread the risk of dropouts across hundreds of members. The pandemic acted as a trigger for them and others to address pre-existing challenges.

A second source of improvement through the pandemic came from the rapid technological uptake that may have otherwise taken years. This increased the productivity of certain charities in a way that seems to have been sustained. A charitable company funded by retail sales helped diversify their income through new online technology:

"We changed from selling on [physical] markets to ecommerce. Then we went back to the market but maintained ecommerce. Now we maintain the markets [and] the wholesale operation. Since then we've been steadily growing."

When the respondent was asked whether they felt the pandemic had positive effects, they responded that "*Organisation-wise, I would say [COVID-19] was positive. Because it pushed us to change and support people in different ways that we didn't know before or didn't try.*"

Finally, new collaborations were formed as organisations reached out to each other and to external partners for help. For instance, two charities reported much improved coordination with government and the private sector which formed lasting partnerships that continue to this day. These interactions built on financial and operational changes to help some charities emerge stronger following the pandemic.

Effects of COVID-19 over the long term

Despite the positives of COVID-19 for charity reorganisation, over time it has become apparent that the pandemic has harmed the sector in two important ways. The first was that smaller charities were unable to adapt with the same speed as larger organisations. The second was the spending of reserves that left many charities vulnerable.

While smaller and medium-sized charities had access to government funds, they lacked the adaptability and flexibility large organisations enjoyed. One manager at a large charity described the expensive preparatory work which helped them weather the storm in March 2020:

> *"We were already prepared, or we had prepared, to move into a more agile way of working. Hybrid was a big part of that…We hadn't rolled it out yet, but we were ready to press the button. So we could transition quite quickly into a functioning remote working environment. People already had laptops and VPN because IT connections were already set up. While we hadn't done it in practice, it was a pretty seamless change."*

Technological transitions are expensive. Larger organisations were prepared because they had access to the cash required, but smaller organisations were caught largely unawares, forcing them to research, purchase, and learn new IT protocols on their limited and squeezed budgets.

Financially, the damage inflicted on reserves caused lasting problems to many organisations. Despite new funding, adaptations, and planning, many charities had to dip into reserves to keep afloat. According to a 2022 survey by Pro Bono Economics, ¼ of charities used reserves to survive the pandemic, with those charities holding no or negative reserves increasing from 9% in April 2020 to 28% in February 2021.[20] This was particularly true for smaller organisations less capable of forming partnerships, paying for adaptations, or applying for grants.

Despite this, organisations were confident that following the pandemic reserves could be steadily rebuilt. Despite enduring an extremely uncertain and tumultuous time, the charity sector survived the pandemic's effects in relatively good health. Many interview participants described feeling confident in the later stages of COVID-19 that they could return to normal, provided the economic situation stabilised. Unfortunately, as we discuss in the next chapter, that has not proved to be the case.

CHAPTER FOUR – THE COST OF LIVING CRISIS: CONTEXTUALISING CHARITIES' "DOUBLE WHAMMY"

Like the pandemic, the cost of living crisis has increased costs for charities while increasing demand for their services. Coming so soon after COVID-19, however, it has been harder for charities to respond, reeling from the one-two punch, leading one participant to call it a "double whammy."

According to one organisation, threats from the current economic crisis can be divided into four problems: increasing demand for services, staffing issues, inflation, and ruptured income streams. In many cases charities have been forced to enact the 'worst case scenarios' developed for (but evaded during) the COVID-19 pandemic:

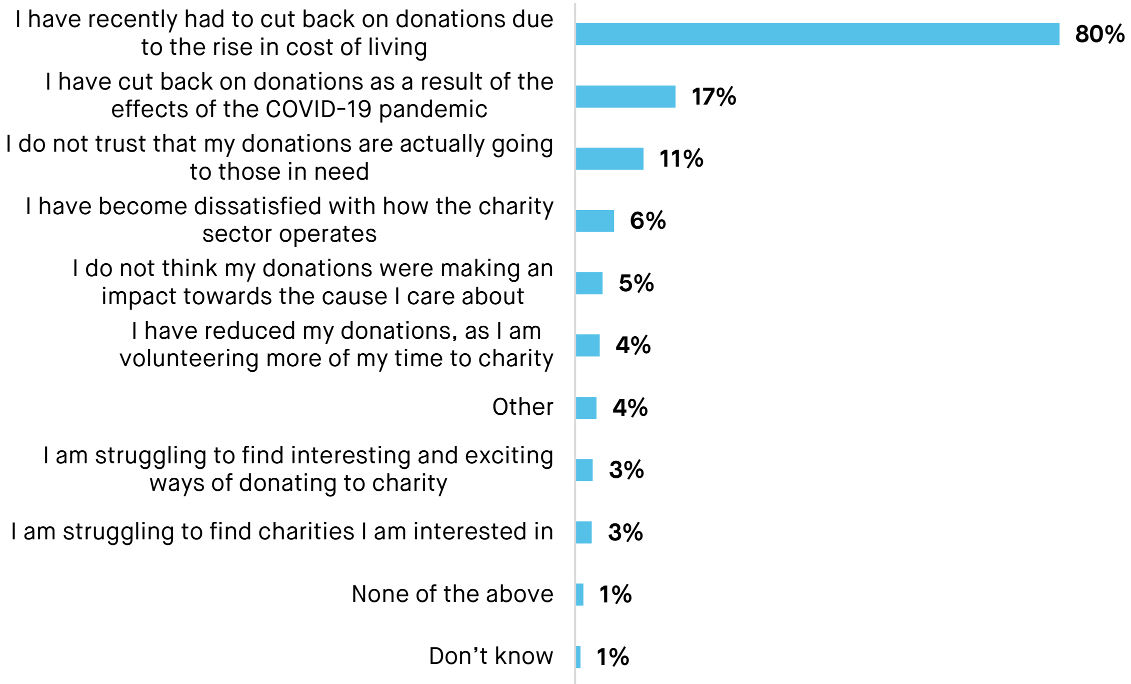
> *"We planned for the worst in 2020 and it was much better than expected. However we're planning for the worst in cost of living. And for me, cost of living is a bigger crisis than COVID...People are feeling the pinch hugely from their own bills, and money is tight. The government's 80% salary scheme kept people in jobs so they didn't feel that under COVID....Let's see how cost of living plays out. but we are expecting it to be much more severe for impact than COVID."*

Similar sentiments were echoed across the sector. Yet it remains too early to say how long this will last and therefore what kind of damage the third sector will suffer in the short term.

During the pandemic, household finances proved surprisingly sound, due to a mixture of government support, adaptation, and increased savings opportunities. However, the current crisis, due to a variety of factors including the war in Ukraine and inflation, coincides with a withdrawal of support.

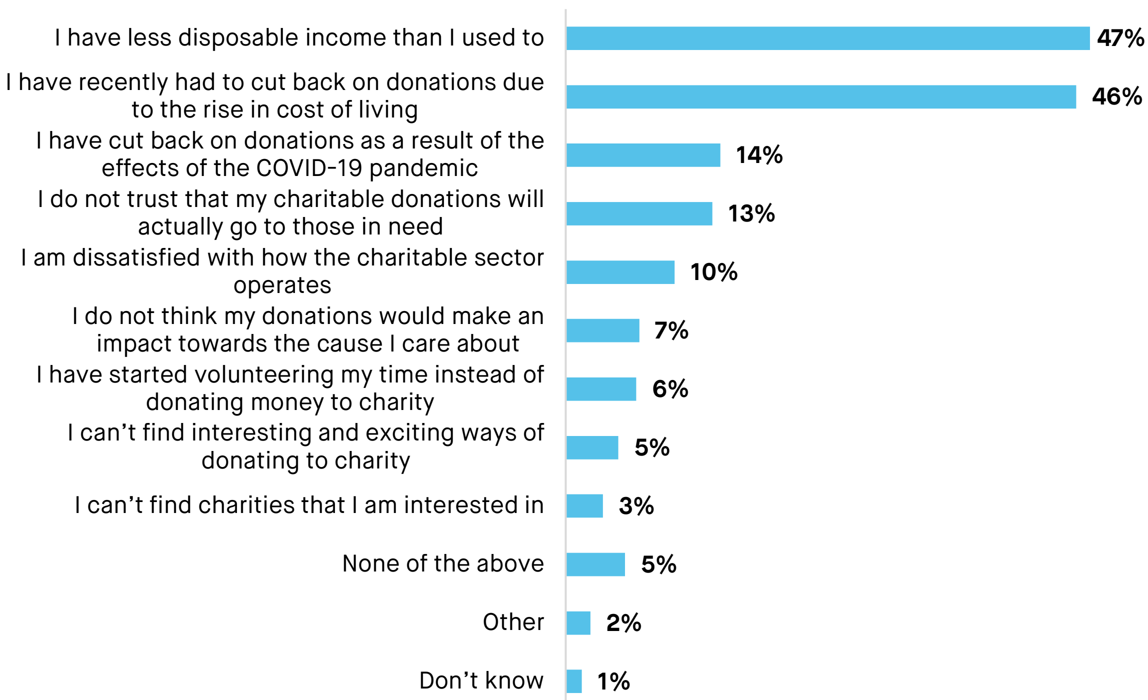
As the previous interviewee described, the 'magic money tree' that sprouted during the pandemic no longer bears fruit and those facing extremely high bills are therefore turning away from state support and towards the third sector. The survey administered by Stack found that 41% of respondents who gave to charity in the past three years are now giving less money, with 80% claiming it was due to the cost of living (Figure 6).[21] Just 57% of respondents expect to donate to charity this year compared to 73% last year, while 21% do not. This rate is consistent for households making up to £46,000, while those with higher incomes tend to donate more. 80% of those donating less than they did three years ago blamed the cost of living, while 47% of those decreasing donations over the next twelve months pointed to having "less disposable income" (Figure 6 and 7). In comparison, just 17% listed the effects of the COVID-19 pandemic (Figure 7).[22]

Figure 6: Reason behind those donating less to charity than they did three years ago



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

Figure 7: Reason behind those who expect charitable contributions to decline in the next twelve months



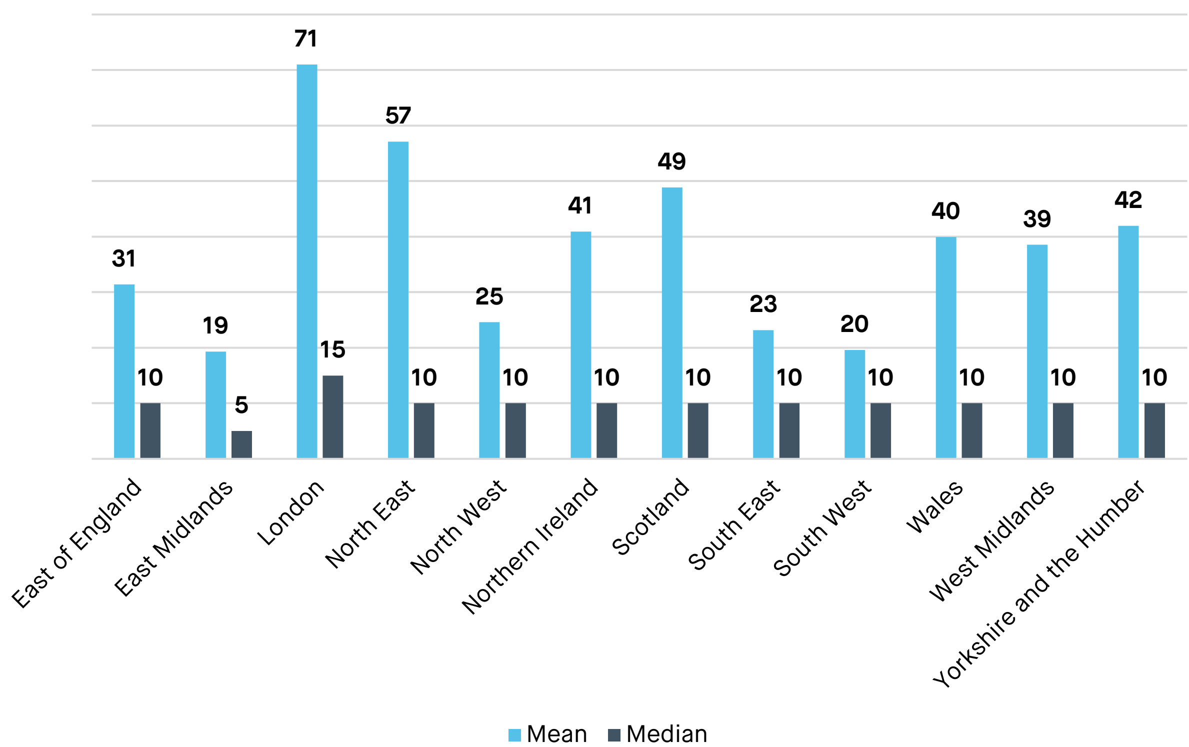
Source: UK Charitable Giving Survey, Stack Data Strategy 2023

Inflation

Inflation, similarly, has hit charities on both demand and supply sides. By eroding household income streams and increasing living costs, it has led more people to rely on charity services. Yet at the same time, inflation decreases the value of existing donations and grants while increasing core costs.

Donors often fail to uprate their donations in line with inflation, decreasing their real value. Pro Bono Economics researchers point out that the real value of a £20 monthly subscription placed five years ago – the standard rate at the time – will be worth £14.90 by 2024.[23] Stack's survey found that just 24% of respondents could donate more than £20 in a single donation, and 53% could only give between £1 and £10. Donation capacity was lower outside of London, arguably where charity is needed most (Figure 8).

Figure 8: How much would you be currently prepared to pay for a single donation to your favourite charity? (£)



Source: UK Charitable Giving Survey, Stack Data Strategy 2023[i]

[i] Two outlier responses were cut from this data due to their listing over £10,000.

Similar issues apply to corporate and government grants, which may remain fixed in nominal terms. One interviewee explained of a three year grant that began in late 2021:

> *"I applied for funding in January 2021…I built in an inflationary cost of 2.5% per year on that and inflation's 11% at the minute. So I called back that funder and asked if there was any way we could renegotiate some of that money, and they can't because that pot's from a few years ago…What are we going to do around that? There's only so much we can cut back on or we're going to have to put some of our own money into the organisation."*

Inflation also limits participation in fundraising drives, as donors are unlikely to demand pledges from friends and family when they worry it will add social pressure during a time of significant financial stress.

Inflation's bite also endangers a charity's long term stability as the real value of reserves shrink. As Paul Rubens of *Charity Digital* writes, "Charities are left between a rock and a hard place due to inflation – they need reserves to protect themselves from the effects of inflation, but these reserves diminish in value alarmingly rapidly at current inflation levels."[24] Front line service charities, including health, social services, law, and housing, held on average eight months of reserves in the 2019-20 fiscal year.[25] Current levels of inflation will have eaten away six weeks of that total, without factoring in pandemic spending.

One respondent noted the inexperience charity finance departments and financiers have in dealing with inflation. "*The UK has been quite lucky with inflation. Inflation has been 2% for over a decade, and now bang, it's up to 10%…Charities have not seen this – the people working in charities have not seen this – for over a decade*." Annual inflation rates have not been as high as their current rate in the UK since the 1980s, which has meant most staff have no working memory of dealing with these crises. It has left them inexperienced in a time where a steady hand is desperately needed.

Inflation and other factors have also increased core costs. Many charities have had to pay higher rents on their properties along with higher energy costs. Yet the third sector is not taking this lying down, restructuring their work and finances to maintain viability. Some charities interviewed had moved, downsizing their properties rather than their staff. Another had transitioned to a four-day work week to avoid paying for heating and energy. These measures have kept many charities afloat, but they now face a cliff edge next winter as government support for energy costs is set to be withdrawn this June.

Staffing and labour

Staffing has been a particular challenge over the past two years, with charities facing similar labour shortages as the private sector. Inflation has caused pay expectations to increase, and some charities have been able to meet them. Other charities reported giving bonuses or 'cost of living payments' to staff to help cover costs, though these generally fail to keep pace with inflation. Annual increases to the national living wage have also increased costs for charities, especially those employing workers who are paid the minimum wage such as in retail shops.

Yet even in charities that can afford to increase wages, higher pay failed to prevent retention issues. When asked about this trend, a Scottish charity worker explained why workers are leaving, even where they are getting more money: "*Everybody is knackered, everybody is really tired, and that impact on the workforce is really hard*."

Volunteering is similarly down. The Charities Aid Foundation's 2022 UK Giving Report notes that just 6.8% of people volunteered in 2021-22 compared to 8.8% in 2019, causing what Pro Bono Economics labelled a "social recession."[26] This implies labour pressures will hit those charities reliant on voluntary labour as well.

Beyond internal pressures, charities are facing competition for labour with the private sector. In 2018, charities spent 40p of every £1 on staffing costs.[27] This is set to worsen as unemployment rates remain unprecedented in the living memory of most charity managers, pushing wages higher. If staff expenditure in 2018 kept pace with inflation the sector would require an additional £3.8 billion in 2023 and £6.1 billion in 2024.[28] One manager described the problem: "*Our workforce is our most important asset and they are feeling pressure from energy bills and food bills, and may well decide that they want to go to an organization or another sector, which pays more money*." With the ability to increase prices, the private sector has an extra tool in its belt compared to charities. This problem was brought up in another interview.

> *"The biggest risk we had through this was losing our core team to other job opportunities that offer money that we could not offer. The biggest concern for me is to keep my core team, to retain people. Because there are other bigger companies that can offer better increases of the salary. It's shaking the recruitment market…Now I don't know yet, but it feels like maybe the labour sector will go bonkers again."*

The state of the labour market has exacerbated what was already a challenging situation for charities competing with private sector employers for staff. Today charity sector staff are paid 7% less than those with similar qualifications in the business sector.[29] That gap has grown through the current crisis: in 2022, businesses had increased wages 5.6% year-on-year while charities only managed 3.8%.[30] This is partly a consequence of grants failing to keep up with inflation. As one charity explained

> *"The salaries they pay us for our staff are the salaries we were on eight years ago. Now we have increased their salary every year, but we have had to take the hit. We have had to find the money for that…How do you expect organisations to run something for the same price it was eight years ago?"*

After eight years of inflation, that grant was finally uprated this year, but the uprating of just 3.94% is less than half this year's inflation, with no recognition for the past eight. Problems of this nature have existed for years but remained below the surface due to low interest rates and low inflation. Now, they are surfacing, heaping pressure on charities at a time they can least afford it.

Effects of the crisis over the long term

Not everything can be blamed on the current crisis. The outsourcing of what has historically been state responsibilities has increased since 2010, while income for many charities have fallen in real terms. Sectors under particular strain are the same sectors where the government has decreased state services, including in health, migration, and welfare. One charity seeing increasing demand explained: "*Charities are there because government is failing or not doing enough. If not we wouldn't exist…I think that any austerity plans will have an effect on charities becoming more needed*." Those caring for older people, for children, and for the military also noted distress. These are areas where charities are not meant to be providers of primary support, yet thirteen years of austerity have forced them into a position of welfare providers.

Some have warned that the current economic crisis poses a greater threat to charity's survival than the pandemic. This is hard to determine, and many large charities said it was 'too early to tell', noting the premature panic in the early months of COVID-19. As one respondent explained "*We're not at that point nationally of being worried that these pressures mean we can't provide services. They're management challenges, rather than anything that threatens our longer-term viability*." Large charities generally spoke confidently of being able to weather this storm as they did during the pandemic. However, the respondent added, "*It may feel rather different if you're in a small local charity, which is already struggling to balance the books*."

There are indications that the economic impacts of the current squeeze will last longer than the 2020 lockdown, and this is particularly true for smaller charities who lack much financial room for manoeuvre due to reserves which were emptied during the pandemic. As one interviewee pointed out, this makes it pointless to compare the relative danger of either the pandemic or the later cost of living squeeze:

> *"There are quite a number of people saying they think this is more significant. But it's partly more significant because of the situations that charities were in from the pandemic. It's not actually about the crisis itself. It's about the backdrop to that, and how other organizations are able to respond."*

This endangers small and medium sized charities' long-term viability as they battle increasingly obstructive economic headwinds.

Brexit

Enacted in the midst of multiple crises, it is hard to disaggregate Brexit's effect from other issues. That said, there are valid reasons for concern. Firstly, EU structural funds had benefitted UK charities by providing £10.1 billion at current exchange rates in budget transfers from 2014-2020, with allocation decided by devolved parliaments.[31] This was accompanied by £8.6 billion in matched funding domestically. However, not all these funds went to charities, and a study of 2015 transfers estimated UK charities would lose £307.4 million annually at current exchange rates as a result of Brexit.[32] Under current withdrawal terms, fund transfers are set to cease in December 2023, by which time the Department for Levelling Up, Housing and Communities was meant to launch a suitable replacement funded from Westminster. However, the promised revenue is a fraction of what had been provided.[33] The programme has also been beset by delays, and is now promised to begin in the 2023/4 financial year. [34] One respondent explained

> *"There are going to be organizations that close because of the loss of [EU Structural and Investment Funds] because there's not the same level of funding coming into the sector as there was. If we get our funding we'll actually increase in size. But obviously, if we don't get that funding, we will have to make a significant amount of staff redundant here at the end of March."*

A separate interviewee pointed out that "The UK SPF, which was supposed to replace EU funding streams, hasn't materialised for way too long. I think it's now just that they have set up the fund and it's being dispersed. It's nowhere near what was available in the past."

In response, a coalition of voluntary organisations wrote to the Department for Levelling Up, Housing and Communities (DLUHC) saying "*While we welcome the commitment to funding voluntary organisations where their services are at risk due to EU funding tailing off, this is not a strategic approach to meeting the ever-evolving needs of communities in the long term*."[35] This uncertainty has destabilised charities and made long-term planning impossible.

Beyond direct funding, many charities have been cut off from wider supply chains which had provided resources and staff. One charity staffer explained "*If you look at social care and health care, I think it's undeniable that Brexit made a difference in terms of staff availability, and I think it's a component driving the crisis in those particular sectors as well.*" The same interviewee explained that even for those in safer sectors "*There's some charities who sit in particular supply chains that require goods from abroad, in particular from the EU*" that could see higher costs.

Finally, there are particular issues for British charities receiving donations from individuals and funders still in the EU. While there is a nominally liberal regime on cross-border donations, they are generally accompanied by cumbersome regulations which can only be met by large charities which enjoy the staff, time, and expertise to comply with them.

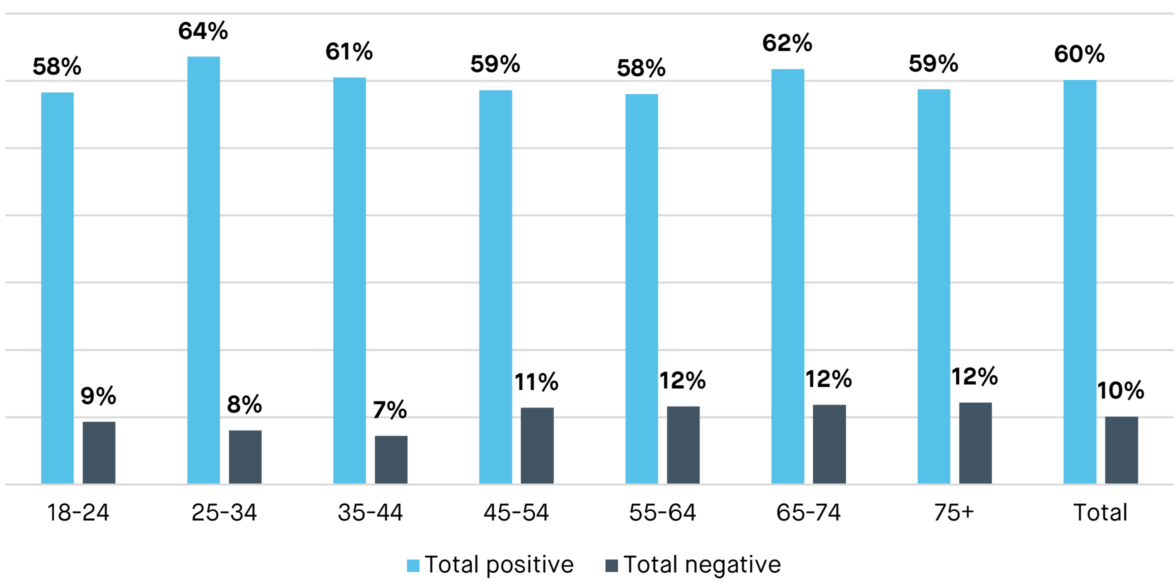
CHAPTER FIVE – LONG TERM PROBLEMS WITH SHORT TERM SOLUTIONS

Long term outlook: Changing demographics and income sources

Most charities now compete for donations within a single demographic. Donors are generally over 50, women, and are in socioeconomic grade ABC1. Their image gives them the nickname 'Dorothy Donors.' Historically, younger groups and men been relatively difficult to reach.

The vast majority of charities we spoke with told us that expectations on them from the public and donors were the same as they were five years ago. Just like the profile of donors, this has remained generally static despite the recent crises that have engulfed charities. Major scandals have involved the charity industry, such as that involving Oxfam in 2018. This erupted after allegations surfaced accusing Oxfam's staff of sexual exploitation and abuse during their work following a devastating earthquake in Haiti in 2010. This caused trust in the wider charity sector to decline over the subsequent two years from its average up to 2018.[36] Yet as of 2022, the Charities Aid Foundation report that trust has returned to its historical average.[37] 60% of respondents in our survey reported positive views of the charity sector compared to just 10% with negative impressions. Interestingly, this was consistent across ages, implying that younger people feel favourably disposed towards charity in principle, even if they have not yet been persuaded to put their money where their mouth is (Figure 9). Recent experience may have boosted this impression, with 62% agreeing that charities played a key role helping people cope with the cost of living crisis. This experience is consistent with long term patterns that charity staff explained in which temporary dips in trust generally rebound over time.

Figure 9: Perceptions of the charity sector by age



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

Prior to 2020, most charities were hoping to diversify beyond their traditional base. Yet this assumption was challenged by experiences during COVID-19, as explained by one staffer:

> *"Pre-pandemic the perceived wisdom was that income diversification is the best thing you can do…But [during the pandemic] some charities had a fixed set of donors or funders who were supporting them pre-pandemic and were just not decreasing their giving. In terms of internal income diversification, it's not very diverse, but they might still be able to survive because they didn't have income streams dropping all the time."*

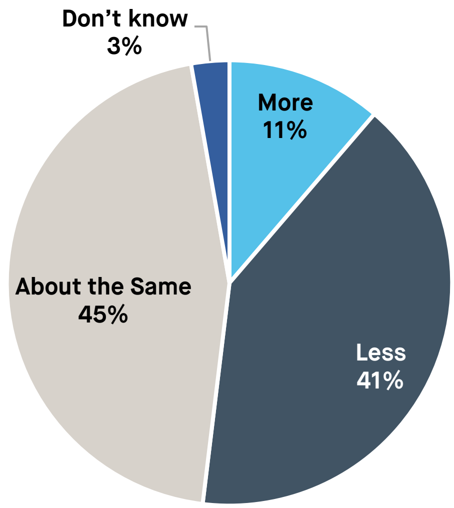
This experience was echoed in other interviews. Despite being advised to draw on a wider range of revenue sources, many charities have found that the stability provided by existent donors has proven more valuable to their work than any potential increase in funding. One charity finance director explained how prior to the pandemic they had attempted diversification but found new donor bases more unstable and likely to lapse:

> *"Before the pandemic, we were trying to diversify that sum. So, you know, we were doing initiatives that were appealing to much younger audiences. But I think our clear demographics are socio economic groups A, B, and C and what would traditionally be thought of as Dorothy donors…and that's been pretty consistent for the long term."*

On the verge of launching a new brand campaign, the respondent's charity plans to market to their older core. Large charities in the short term appear less in need of funds and more in need of stability.

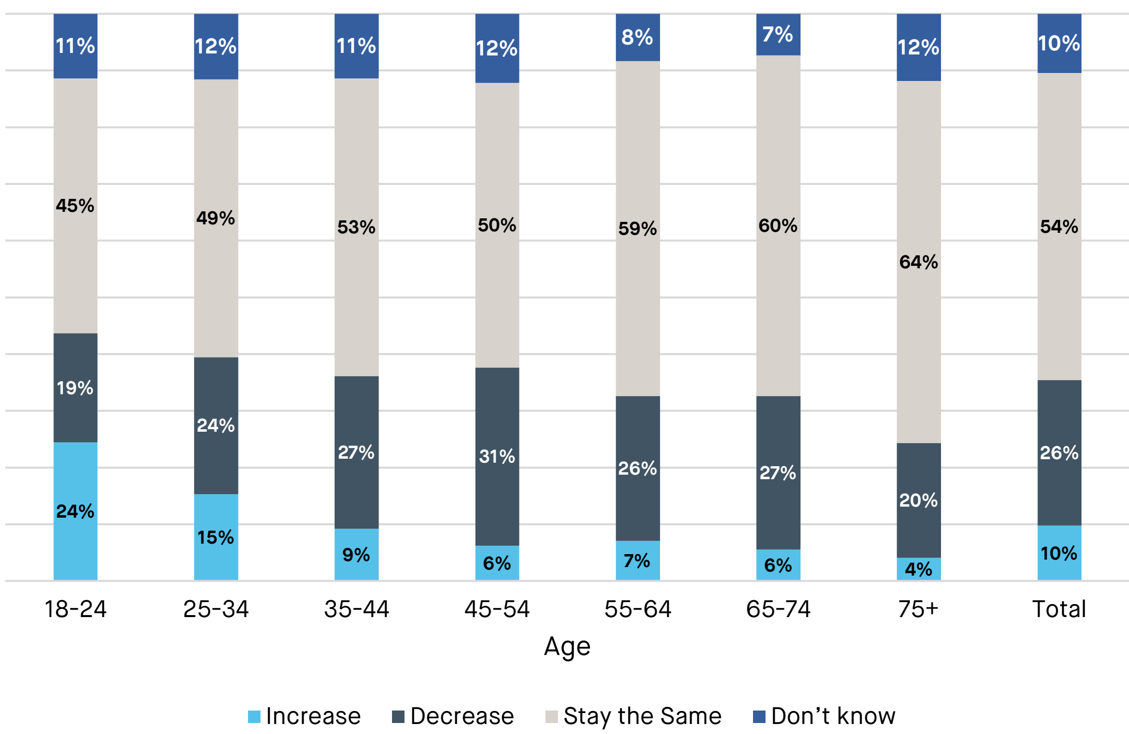
It is worth noting many charities also spoke of long term concerns for those reliant on donations. The British public has proven extremely generous, stepping up their funding to compensate for government grants which have been lost over the past thirteen years. However, over-reliance on donations is risky, leaving charities vulnerable to changes in the market. According to Stack's 2023 survey, 41% of donors are now donating less than they were over the last three years, leaving charities with a net loss in donations (Figure 10). Looking forward, just 10% of donors expect their giving to increase over the next year, while 26% expect further cuts (Figure 11). Concerningly, this includes older donors, of whom 20% expect to decrease donations, despite historically being the foundation of charity fundraising.

Figure 10: Would you say that you are donating more, less, or about the same amount of money as you were three years ago?



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

Figure 11: Thinking about the next 12 months, do you expect your overall contributions towards charitable causes will increase, stay the same, or decrease?



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

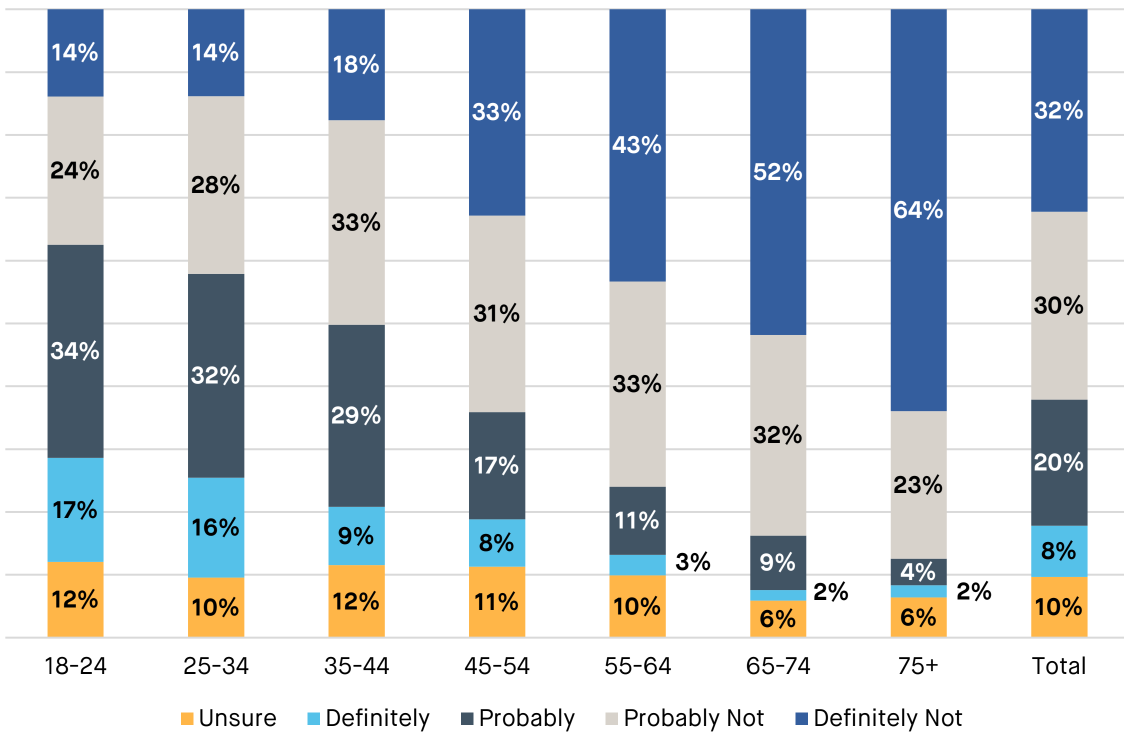
Over the coming decades as these older generations pass on, multiple charities reported fear that income would wane. Thus far, each successive generation has tended to ‘age in’ to charitable giving, increasing donations as they get older. Yet charities feel less confident that will be the case for younger generations today because of their relative lack of resources. Low economic growth and obstructed productivity over the past fifteen years has limited the wealth younger generations enjoy. As donations have historically been linked to median earnings, lower wealth have caused reasonable concern across the sector as they plan for the future.

A particular issue is legacy giving, when the deceased bequeaths part or all of their holdings to a charity, often in the form of property. One charity reported already seeing a negative trend in legacy donations as those near the end of their life have less giving capacity than previous generations. High property costs and other income pressures may therefore prevent future generations from giving, as one respondent worried:

> *“Legacies is an important part of our income mix and provides a really solid base on which we build everything else…But we’re a bit worried we're not doing enough at the moment to create something for tomorrow and obviously, there’s lots of discussion in the sector about whether the era of legacies is running out because of what's happened with housing.”*

In response, some organisations are discovering new methods to market towards a younger group. Two methods stand out. Firstly, charities can use traditional fundraising practices tailored for younger groups. This usually involves “active” programs like runs and walks. However, these come with high costs, and require a large turnout to make a profit. 62% of those polled by Stack said they ‘Probably’ or ‘Definitely’ would not participate in an active event. Although younger demographics were more likely to say they would do so, interest in the method was generally unfavourable (Figure 12). Most charities which invest in active fundraising reported maintaining a greater overall focus on older donor groups through alternative methods.

Figure 12: Likeliness to participate in a charity event or challenge (e.g. a charity run) over the next 6 to 12 months, by age



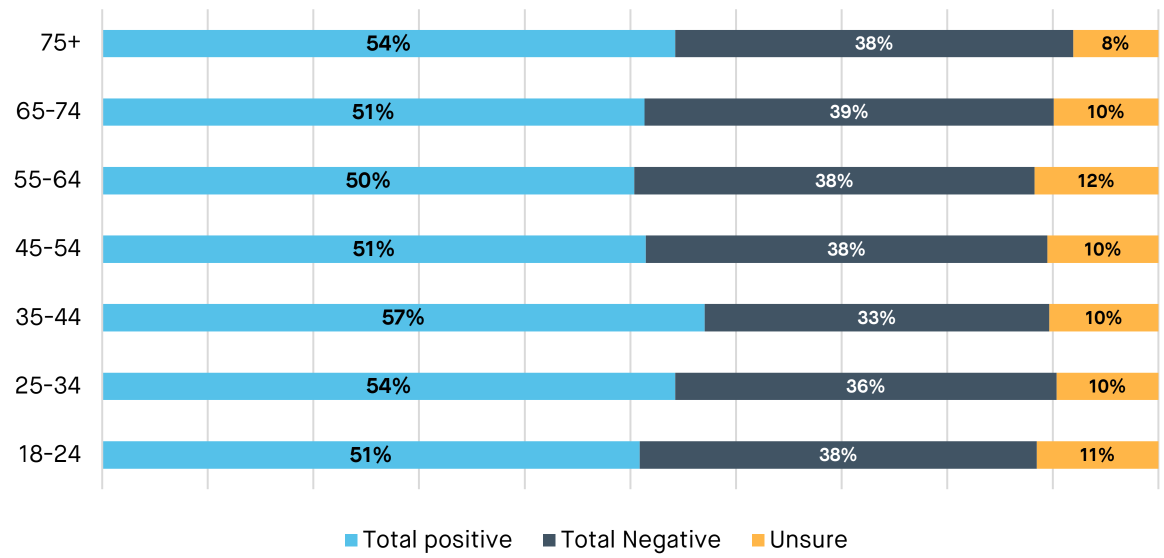
Source: UK Charitable Giving Survey, Stack Data Strategy 2023

The second method which was reported to successfully target younger brackets are lotteries. Recently, major and super-major charities in the UK have begun offering lotteries with various cash prizes ranging up to £25,000. A similar model used by Omaze, who sponsored this report, offers a prize draw in which consumers buy the chance to win a prize, often in the form of property. Both charities interviewed for this report that use lotteries reported success in targeting younger audiences. According to one:

> *"We are finding that the demographic of our donor base is shifting, but there's a very clear reason why…The age of our donor base is becoming younger. And that's specifically linked to us developing and promoting and investing in a lottery product…which is a monthly subscription where you pay each month to be entered into a lottery…What we have found is that a younger demographic gives to the lottery products, so therefore, our donor base has over the last two years shifted."*

This has potential benefits for larger charities hoping to entice younger groups into donations. According to Stack's survey, 30% of Omaze participants rarely (17%) or never (13%) donate to charity, indicating the model has attracted demographics that have not been reached by donation drives. Further, interest in these draws are largely consistent across age groups, while donations are more likely to skew towards older demographics (Figure 13).

Figure 13: How likely if at all would you say you are to participate in a charity prize draw or lottery? (by age)



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

However, its benefit to small and medium sized charities is questionable. The high price of a monthly prize is more than what many small charities can afford and would require a broad reach to entice a sufficient number of individuals to pay for their chance to win. As such, the method may have limited appeal to those organisations most in need, even if it could bring benefits to larger members of the sector.

Over the short term, charity finances for larger organisations appear sound. Smaller organisations face greater insecurity, however they too have more to fear from long term trends in demographics and donation behaviour. It remains to be seen how far the public will be able to compensate for funding which used to be provided by the state.

Short termism in the charity sector

The reduction in government funding for the charity sector has thus far been compensated by increasingly generous public donations. However, many interviews noted how donations are vulnerable to market trends, and more likely to favour larger charities, leading to greater uncertainty. Unable to even guarantee job security for their staff, small and medium charities cannot plan for long term requirements or projects. This has taught teams valuable skills in adaptability that served them well during the last three years, but leaves most time and energy spent on short term budgeting, as explained by one manager:

> *"I don't think we really plan according to context. I think we just navigate through it...I mean, once we knew there was a pandemic, then we adjusted our budget and thought, "okay" [...] But before the pandemic or before the cost of living crisis? We didn't really plan for that. We don't. We just try to adapt."*

Another respondent referenced Gordon Brown and his effort to stabilise the economy in explaining the difficulties of charity sector short-termism when responding to the cost-of-living crisis.

> *"We want to get out of boom and bust. We don't want to say "Right, let's shove all the resources and attract more staff to help with the cost-of-living crisis" which then abates in 2024 or 2025. And then we'd find that we've got too many staff and not enough income, and then we go through another restructure. So we're trying to flatten that business model out ourselves."*

Achieving such consistency is difficult when intake streams are extremely volatile and vulnerable to external shocks. As the respondent noted, dealing with an economic crisis is made trickier by the likelihood that it will increase demand, and the uncertainty over how long that surge will last, and thus how far the charity needs to structure. Although small businesses in the private sector deal with the same shocks, and many as a result go under, it is in some ways harder for charities that additionally have to deal with increased demands in times of economic volatility. Those that do are able to boost their income by raising prices, while charities generally see their income decline.

With donations falling and government support cut off, many smaller charities have looked to corporate and public grants for support. These are generally short-term morsels given on a one-off basis. Such a reliance leaves charities unable to make long term financial decisions and leaves their organisation constantly vulnerable. As one charity worker explained, "*For volunteer organisations…they're living so much hand to mouth that if you don't have certainty over your funding for next year, then you are putting your stuff on a redundancy notice and you're losing staff and all the implications that flow from that*."

Prior to 2010, government funding helped cushion the blow of economic turmoil by steadily and reliably providing for charities. Yet since the 2009/10 fiscal year, government funding has declined. While larger charities were able to compensate through increased donations, the recovery from the Great Recession has been stymied for smaller and medium sized organisations. Instead of a lifeline, most charities interviewed reported seeing government grants as unreliable and therefor felt extreme reluctance towards applying for them. A charity worker described their frustration with the government's grant-making process in responding to the COVID-19 pandemic.

> *"One of the one of the first negative effects we saw was when a lot of our government income dried up either in 2020 itself, or in the early part of 2021. Either the funding actually ended, and we couldn't renew it. Or we knew that…it wasn't going to be renewed because the government said that the budgets had shrunk…Even if the budgets hadn't shrunk, there was so much uncertainty…that there was no way they could commit to us and say yes, someway or another we will renew your grants. It was just 'We still love you. But these are tough times. And you know, I can't promise anything.'"*

The problems described here were highlighted during the first lockdown of 2020 but had been a prevailing issue for over a decade by that point. Though the first burst of income in April 2020 helped charities weather the first lockdown, it left long term cuts unacknowledged.

Many charities noted particular anger that they are so often applauded publicly by state representatives while their grants are cancelled or reduced. Trust in charities is higher than most other parts of society, and politicians generally echo this support.[38] Internally, however, this often results in the buck being passed across levels of government to avoid responsibility. This was described by one charity in Scotland:

> *“We get caught up in this really complicated triangle where local authorities say, ‘oh, the Scottish Government don't give us multi-year funding, so we can't give it to you’. And then Scottish Government go, ‘oh, Westminster, don't give multi-year funding to us, we can't give it to you’, and everybody wants to push it further down the line. But what we see is that actually, we're at the bottom of the chain…By continually saying that we can't have that security, it's giving a very clear signal that we're at the bottom of the pecking order.”*

This not only keeps charities from making long term plans but further damages relationships. Partnerships with the private sector are unreliable given the volatility of charity income streams, while trust in the public sector decreases. The combination of declining donations, reliance on grants, and political irresponsibility has allowed charities to remain in an unsustainable state of constant vulnerability.

CHAPTER SIX – RECOMMENDATIONS AND CONCLUSIONS

Over the past fifteen years the charity sector has been extraordinarily successful in riding out an unprecedented set of challenges. Overall, income is up £10 billion since 2007.[39] 48% of this income today comes from the public, rising to 56% among super major charities (Figure 3). Despite concerns during the pandemic and the unpredictable nature of the cost of living crisis, large charities currently appear perfectly capable of financing their ambitions. Further, their willingness and ability to innovate in the face of extraordinary obstacles has provided them with a firmer foundation than many gave them credit for in early 2020.

In contrast, small charities that operate in a local radius face a different reality. Since 2007, they have lost 26% of their annual income (Figure 2).[40] This has caused substantial harm to Britain's charities, as 80% of the UK's third sector is classified as small or micro organisations. These often provide front line services or act as welfare providers of first resort to residents in isolated communities. New shocks including the end of EU structural funds and their frugal replacement have added to their distress.

The pressure on small charities is arguably the result of an efficient marketplace prioritising good behaviour and allowing unpopular charities to fail. However, this argument neglects structural biases that make charities compete for funds in an uneven marketplace. Larger charities are able to operate on a national level and can advertise to a national or even international audience if they wish to increase public donations. Small charities in contrast do not have the money to sustain large marketing campaigns. Further, potential donors are limited to the local area. There is little reason a resident in Hammersmith would donate to a charity providing local services in Hull, no matter how essential those services are to Hull's population. The growth in Britain's regional wealth inequality has exacerbated this problem and partially explains the decline in income small charities have seen since 2008.[41]

But finances do not tell the whole story. As many interviews made clear, smaller charities also lack access to opportunities and face disproportionate regulations. The following recommendations seek to mitigate these structural barriers and improve the situation not only for charities but also for British society more broadly.

Financial support

In 2022 Gordon Brown said that "*Charities know that however hard they try, and even when they stretch their creativity to its limits, they cannot do enough*." As such, the former prime minister claimed that "Raising Gift Aid from 25 per cent to 30 per cent could help charities do more."[42] Gift Aid currently allows charities to claim an extra 25% of each donation from HMRC, provided the donor agrees and pays either income or capital gains tax. Based on 2022-23 behaviour, this would cost the Exchequer an extra £268 million per year.[ii] A separate option, floated by the Law Family Commission for Civil Society, suggests automatically applying Gift Aid to donations rather than requiring donors to register.[43] Researchers estimate this change would cost £380 million annually.

Alternatively, new funds could be established to fund charities through other means outside of Gift Aid. This is in line with Danny Kruger MP's report for government in 2020 on how to sustain the community spirit evidenced during the first lockdown. Kruger's report included recommendations and evidence for providing the third sector with new responsibilities to deliver and design public services, alongside new funding sources for the third sector.[44] The first involved a matching scheme similar to Gift Aid but applied to market activity. However, there were two funds Kruger sought to establish which would have injected more immediate cash. These included a Community Recovery Fund consisting of a £500 million one-time payment to charities similar to that provided in April 2020. A scaled-down version was introduced by Chancellor Jeremy Hunt in the 2023 spring budget, which apportioned £120 million to charities on a one-time basis.[45] The second lever proposed is a Levelling Up Communities Fund, which would funnel £2 billion into levelling up projects to be delivered by local charities and trusts rather than local councils.

There are, then, two primary options for providing finance for small organisations. One would increase provisions from Gift Aid, either by increasing rates as per Gordon Brown's suggestion or altering technical aspects. The alternative would see new cash grants provided for small organisations through similar mechanisms as were used at the beginning of the pandemic.

Increasing Gift Aid provision has two problems. Firstly, it is poorly targeted. In the year to April 2022 almost half of all Gift Aid funds went to charities with over £1 million in annual income. Just 29% went to small charities.[46] Although small charities are those under the most severe financial strain, Gordon Brown's plan fails to bring them into focus. The second problem is Gift Aid's vulnerability to market pressures. Gift Aid is similar to a matching scheme in that it provides funding based on public donations. This leaves it vulnerable to market shocks which may cause declines in charity donations, such as recessions or scandals involving the third sector. Ideally, government support to charities should be counter-cyclical, leaning against rather than exacerbating funding volatility. Almost no charities we spoke with demanded any changes to Gift Aid, though some mentioned that regulations and reporting requirements related to it are excessive.

[ii] Extra risk assessments demanded by HMRC in the 2022-23 fiscal year caused delays in some payments to charities, meaning this estimate may be 3% lower than long term outlooks according to HMRC.

While extra cash from Gift Aid would be accepted by small charities desperate for fresh income, few that were interviewed considered it their first priority. One explained "*It's not really something I've looked at*" while another said, "*We're obviously very keen to retain it, but we're not actively influencing.*" After prompting, some organisations cited frustration with spending delays and regulatory requirements inherent to Gift Aid provisions, but none demanded the rate be increased.

The alternative would build on charities' experience of government support during the pandemic. In April 2020, the government responded to COVID-19's effects on the third sector by rapidly providing £750 million to frontline charities, £370 million of which was targeted to smaller charities.[47] A majority of funds were distributed by the National Lottery Community Fund, based on grant applications, including £310 million earmarked for small and medium sized funds in England and Wales.[48] £60 million went to the same sized charities in Scotland, Wales and Northern Ireland. £110 million was later held back by the then Department for Digital, Culture, Media and Sport who took over distribution and allocated funds towards other organisations providing emergency support.[49]

Given the Government's strained finances today, new transfers from government to the charity sector should be targeted towards those most in need. Government funds offer a secure alternative to donor financing. To help right the ship for smaller charities after 15 years of decline, a new Micro and Small Charity Action Fund should be established specifically targeting micro and small charities across the UK. This would provide cash grants based on a competitive application process exclusively available to small and local charities. Such a fund would provide the added benefit of being untethered to the donation market, thereby acting as a stabilising mechanism during tempestuous periods. This would allow small charities to fund projects over the long term, which many reported being impossible under today's short-term conditions.

COVID-19 funding provides a blueprint for potential ongoing agreements between the government and third sector. To avoid costs of additional bureaucracy, funding can be allocated through The National Lottery Community Fund (TNLCF) which proved capable under unprecedented conditions in 2020. In the time between the fund being announced on 20 May 2020 and October of that year the fund had successfully disbursed more than 95% of the money available.[50] TNLCF's knowledge of the charity landscape and fraud-prevention measures would further advantage delivery. This stipulation would also avoid the hurdles of creating a new agency and give charities a funder with whom they are already familiar.

It remains to be seen how the Government will provide the £120 million in additional funding announced in the 2023 Spring Budget.[51] While it was encouraging to see the Government acknowledge the mutual importance and insecurity of the charity sector, a one-off untargeted payment will do little to secure vulnerable organisations over the long term. The announcement should therefore be viewed as a steppingstone towards an enduring funding mechanism to be targeted towards small and local charities.

Coordination with the public sector

Coordination with the state can improve service delivery and help draw out mutual synergies. The Law Family Commission on Civil Society compiled two years of research and interviews in order to present policy recommendations to reinforce Britain's third sector.[52] A central plank was a demand for better coordination between state actors and charities. The commission suggested an annual event to connect civil society groups with civil service and government personnel, as well as representation for charities in formal consultation structures. To act upon this advice, charities should coordinate with the national government and accelerate connections with local authorities to assist in long term planning.

National government

By increasing coordination with charities, legislators and policymakers in national government and devolved parliaments can improve service delivery while improving economic efficiency. Charities enjoy widespread support across parties, but this rhetoric does not always translate to action.

Charity staff are well acquainted with needs in their area and can assist legislators and civil service staff by providing the expertise and experience gained from working on the front line of service delivery. This fact was recognised by Gus O'Donnell, former cabinet secretary, who recently demanded charities play a larger role in policy design because "*I know from my time as head of the civil service that it's all too easy for ministers only to talk to the people who'll tell them what they want to hear — charities tell them what they need to hear, which is far more important for the health of the country*."[53] New opportunities for mutual interaction should be established and maintained on a regular basis to improve the work of the national government.

Beyond advice, one charity manager brought up the potential for third sector organisations to assist in meeting national mission targets. From 2015–2021, parliament mandated 0.7% of gross national income be spent on official development assistance, and overseas charities received a portion of this to fund their work with beneficiaries.[54] Although the 0.7% commitment was abandoned in 2021, commitments remain, including a government goal to spend 2.4% of GDP on research and development by 2027.[55] Charities can play a supportive role to accelerate these missions by accepting funding in coordination with state objectives, with public finances being spent to meet national targets through charity initiatives. Increasing the quantity and quality of interactions between the public and third sector could yield impressive benefits for both parties.

Local authorities

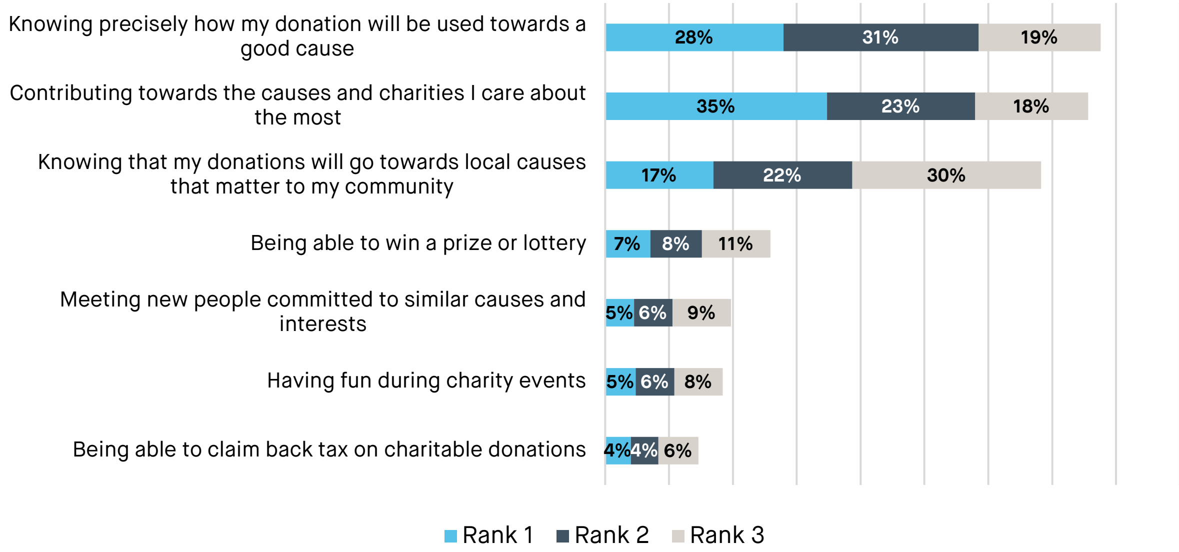
As observed throughout this report, charities providing front line services to local communities are struggling. This is particularly true in remote communities where charities have relatively low income. At the same time, funding cuts have strained local council finances. Better coordination between both parties can develop mutual synergies that improve service delivery in communities while reinforcing local charities. As one respondent explained,

> *"There is more understanding in local authorities [than devolved and central governments] about the role the sector plays locally. And there is genuinely an understanding of that and a valuing of that…But when the chips are down they're going to protect their own services…What I think is missing is that overall assessment of what do we need to do locally and who is best placed to do that…Could we have a wider look at who's doing what…and what we actually need in this local area?"*

To increase opportunities for local charities, local authorities should accept social value and local provision as new criterion in public service procurement decision-making. This would advantage local charities when they apply for projects, providing them with new funding streams and new opportunities to benefit their beneficiaries. Such coordination proved successful during the pandemic, when local charities worked with local authorities to provide for the community. Secondly, while charities are tasked with delivering welfare services, they are often locked out of the policy design process which inspired them. This deprives designers of experienced insights and leaves charities without a say in the area. Local charities should therefore be included at every stage of the process from initial design stages to implementation. Initiatives could mimic local enterprise partnerships which have successfully aligned private sector actors with local authority needs. As front-line agents, charities have insights that could prove valuable if utilised effectively.[56]

Beyond this, local councils can do more to support local charities through Place-Based Giving Schemes (PBGS) like community foundations and council funds. These pots collect resources to benefit a defined location.[57] Donors are encouraged to donate to the local pot which then provides grants to local causes and are generally interested. Our survey found 68% of respondents consider a charity's impact on their local community when deciding who to donate to, ranking it just below the charity's cause and transparency (Figure 14). Local communities and mayors across the UK have seen success in collaborating with local donors to increase funding for their area. By developing a reliable asset to which local charities can subscribe local councils can provide small charities with a key factor demanded in a majority of interviews held for this report – a stable income stream.

Figure 14: Ranking which of the following are most important when donating to a charity



Source: UK Charitable Giving Survey, Stack Data Strategy 2023

Proportionate regulation

Many charities interviewed for this report cited frustration with what they see as disproportionate regulations and reporting requirements necessary to access grants and donations. While most are supportive in principle of the Charity Commission, devolved regulators, and HMRC's work monitoring charity finances, they felt this mission had been taken to an extreme. There is widespread frustration over the substantial proportion of grant or donation incomes eaten up by the many hours necessary to comply with perceived unnecessary paperwork.

Public sector regulations

When asked what policies they would like to see change in the British context, one respondent spoke for many of their peers when they called for legislators to begin "considering the proportionality of the work required to comply." Moving on, they explained,

> *"The UK Government often doesn't think about charities when it introduces regulations...We're an afterthought at best most of the time. And ideally it would be nice if charities were contemplated more in the beginning of compliance legislation and what would be proportionate for us. For example, the consent stuff on fundraising in GDPR...from the EU was overly onerous...Was it proportionate to the problem at hand? No, I don't think it was."*

As another respondent claimed, "*Legal requirements use so broad a brush that it captures everybody…You can't treat all charities or all organisations with the same brush.*" For example, the Charity Commission currently demands the same requirements on tax returns for all charities with incomes between £25,000 and £1 million except for certain constraints on how funding is categorised.[58] The only major difference when a charity crosses the £1 million benchmark is that, rather than use an independent examiner, their accounts are checked by a statutory auditor to verify underlying records. These rigorous reporting requirements are a well-intentioned attempt at preventing impropriety in the charity sector, but imposing them regardless of charity size means those organisations with the least income must spend equivalent energy on fiscal governance as those with the most. Charities with only one or two staff members are meeting similar conditions to prevent financial misconduct as one managing over £1 billion.

If the Government wants to support the charity sector, and particularly to help struggling smaller charities, it should conduct a thorough review of the regulatory burden on charities. A recent paper by Regulatory Policy Committee Chair Stephen Gibson and colleagues, published by the SMF, explained the ways that government initiatives to reduce regulatory burdens can be effective. In order to be successful, they should have clear government support, robust independent analysis, careful prioritisation of the small number of regulations that are most costly to comply with, and sustained engagement with stakeholders.[59] HMRC should work with the Charity Commission and devolved regulators to ensure that regulation is reasonable and proportionate.

Our interviews indicate a number of places such a review could start. For example, easing some of the requirements around the European General Data Protection Regulation (GDPR) could be a Brexit benefit now that the UK is no longer part of the European Union.[60]

In general, the Government could do more to recognise the varying capacities to meet the administrative burdens across the charity sector. At present, there are differing requirements based on income bands, but these are so minor that they make very little impact on the practical burden. Reporting requirements on smaller charities should be eased, cutting red tape for those who cannot afford to navigate it, with demands rising on a sliding scale proportionate to overall income. There could also be scope for the Government to provide and/or coordinate in-kind support with the administrative tasks that smaller charities find challenging. Larger charities have greater capacity to employ specialist professional staff to deal with finance, tax, compliance, reporting and the like. That is harder for organisations that do not have sufficient scale to have employees or even volunteers that do not work on core activities.

The Government could help by funding or providing direct support – for example, providing accounting or legal help. Or it could coordinate private sector organisations – accountancy, law or consultancy firms – that might wish to provide such support on a pro bono basis as part of their corporate social responsibility activities. Such assistance would be analogous to public business support through policies like the Help to Grow initiative or the management support organisation Be the Business.[61]

Grant monitoring requirements

Similar complaints were lodged against grant application requirements. A medium-sized charity explained the problem with smaller grants: "*Say we have a grant from the council for £6,000. The amount of monitoring we have for that is so time consuming in comparison to some of the bigger funds.*" This is a burden shared by large and small charities alike. However, smaller charities are particularly squeezed by their inability to apply for large grants, as they lack the capacity to complete required objectives. Additionally this same deficiency makes applying for small grants infeasible if they are accompanied by onerous reporting requirements which require more staff or hours.

Government regulators and/or umbrella bodies should advise grant makers to estimate the cost of their monitoring requirements and set them proportionate to the overall grant amount. At minimum, the costs of monitoring and reporting should not exceed the grant amount and should be costed into the funding. To inform grant makers, umbrella organisations and government policymakers should work together to set a target proportion of grant funds that should be spent on monitoring, which may vary by charity subsector.

Recommendations for the charity sector

Although the state has an important role to play in determining the future of the third sector, charities have already shown their ability to rise to difficult challenges in recent years. Their task is to build on that progress. The double whammy of COVID-19 and the cost of living crisis forced charities into adaptive strategies that proved successful for the long term. Many of these changes were the result of fresh partnerships with other third sector organisations or with the private sector that helped charities expand their impact. The lessons learned through these interactions should continue to be enacted, not only to help charities survive, but to thrive.

Umbrella institutions

To this end, charities should invest in an umbrella institution which can accurately represent the charity sector in methods similar to those practiced by industry bodies. In particular, the organisation should defend the interests of smaller charities that at present are most vulnerable and most easily overlooked. One person interviewed cited the Federation of Small Businesses as an aspirational example.

> *"One of my colleagues used to be [in government]. And he tells a story about when he would meet with a small business, they would tell them their own story. And then on the way out the door, they would go 'Oh, and remember that the Federation of Small Businesses is calling for X at the moment!' My aspiration is that as a sector, we should be able to do that... And we're not joined up enough to do that at the moment. I think people are all so involved in fighting for their own bit of the world that we're not doing that joined up stuff. And so we could certainly be a bit stronger and a bit more consistent in giving those messages."*

Through their current responsibilities, umbrella organisations such as Locality, Charities Aid Foundation, and the National Council for Voluntary Organisations have developed the human capital required to understand and communicate with the third sector but lack a defined mandate to represent them as a united front. An umbrella organisation would be tasked with analysing the position of all members in their industry and lobbying government on key issues relevant to their financial stability. This would also help build connections with government at national, sub-national, and local levels as well as develop relationships in the civil service.

Beyond representation, an umbrella body could coordinate improved data collection and amplify best practices. The impressive innovation and adaptive capacity charities demonstrated over the last three years should be codified and resultant lessons should be spread for other charities to apply. This will require improved data collection, with member charities submitting simple but specific information that can be evaluated by the organisation. Much of this data is already submitted to the Charity Commission and its devolved equivalents, however an umbrella organisation could use the data to provide best practice advice for other charities. For instance, evidence-based advice on financial practices could help new charities build reserves or diversify their funding sources.

The Association of Charitable Foundations represents a model for this institution, but it only represents the largest 440 charities who collectively have assets worth £50 billion.[62] Yet, it is the rest of the sector that is in most need of a voice. An umbrella institution could, as needed, advise flexibility requirements on grants recommending that inflation be taken into account, advise charities on long term planning, or recommend better targeting in government funding allocation. The limited input charities have had on issues like the UKSPF evidenced why representing the third sector's interests to government is now required.

Private sector partnerships

But partnerships should not stop there. More businesses and charities should coordinate to provide the private sector with tools and training to meet local and ESG goals and provide charities greater funding and networking opportunities. The Law Family Commission claims this has the potential to not only improve the state of charities in the UK but also allow businesses to improve their impacts. There is an indication that recent crises have incentivised this. A survey published early during COVID-19 indicated that one in three charities were collaborating with other third sector organisations to improve their security, and one in ten were collaborating with businesses.[63]

While charities stand to benefit by improving their ties to government administrators, opportunities are also available in the private sector. A front line manager at a charity explained; "*If the government is really interested in businesses and organisations becoming more socially minded, then there should be some sort of help for businesses that are trying to do good.*" Charities have the opportunity to do so as private enterprises are increasingly trying to meet market and investor demands to improve their Environment, Social, and Governance (ESG) impact. Similar to how they might serve the state, charities can assist businesses by providing real-world expertise and access to information.

To achieve the most positive results these partnerships should take place on equal footing. One charity gave an example in which a theatre had contracted an autism charity to produce a video to help those with autism navigate the venue and prepare for their visit.

> *"So [the theatre] paid them like a service provider. But that had led to this really good partnership where they really cared about what the organization did… It felt like an actual partnership. A lot of the time people use the word partnership to talk about how different bodies, whether that's statutory sector or private sector, interact. And it's not a partnership at all. But this one felt like everyone was benefiting. Everybody was a winner in that scenario."*

In the above example, most cases would have ended with a simple private sector donation to the registered charity. However, both parties expanded beyond that and as a result saw an improved impact. The charity gained an ongoing source of income and the theatre expanded their ESG work. The two continue their collaboration today.

Despite ESG's prominent role in public conversations today, private sector donations to the third sector remain low and uneven. The private sector collectively contributed just £34 million to micro and small charities in 2019/20, while contributing nearly £2.1 billion in combined income to large, major, and super-major charities (Figure 15). This leaves small charities with little private sector support.[64] As part of the expanding coordination between local authorities and charities, more should be done by all parties to deepen ties between local charities and the private sector. This may involve mutual involvement in policymaking, better opportunities for interaction through shared events, and ongoing programs to find synergies between all sides.

Figure 15: Total income from the private sector in 2019/20 by charity size (£ million)

Source: SMF analysis of NCVO Civil Society Almanac 2022

Conclusion

Ultimately, British policymakers will have to engage in an open and honest conversation on the future of the welfare state and the position of the third sector. The UK could move to an American style model, where the charity sector takes a larger role in the provision of services, but this requires charities to be better funded than they currently are. Some people believe this would be a good thing. One respondent claimed "*Philanthropy in the US is much more tax advantageous and we could take a leaf out of their book on that front because clearly those charitable donations have good outcomes.*" Yet many others believe this would be a regressive step, returning the country to an era when the poorest and most vulnerable depended on the goodwill of the wealthy for survival.

Alternatively, a future decline in British charities may push the state into providing more direct benefits, pulling the UK into a model comparable to continental Europe in which state interventions leave little room for a thriving charity sector. As one interviewee put it, "*[In] Germany, they don't have many charities because the government does much more. Then charities don't need to fill the gap.*"

As is often the case, the British model remains stuck between the two poles either side of the Atlantic, as an unstable and sub-optimal compromise. The fragile state of the charity sector is hastening a decision. The same respondent continued: "*I think we're moving in the UK to a model where charities are expected more and more to pick up some of the gaps…and the government is not doing enough.*" This is untenable. Charities cannot be both the targets of and responders to economic hardship. The insights gathered in this report lay a foundation for a necessary wider conversation on how to reinforce the UK's charity sector for the long term.

APPENDIX

Mission / Subsector	Operating Model	Legal Model	Funding Model	Size
Community initiatives	Makes grants to individuals	Association Charitable Incorporated Organisations (Association CIOs) or Charitable Companies *Employs paid staff with wide voting membership and delivers services through contracts* *Trustees not liable*	A few big voluntary donors	Large (> £1mn)
Housing	Makes grants to organisations			
Overseas aid	Provides other finance			
Poverty relief	Provides human resources	Foundation Charitable Incorporated Organisations (Foundation CIOs) *Employs paid staff and trustees but no wider membership,*	Many Small voluntary donors	
Health	Provides building/facilities/open space			Medium (£100k – £1mn)
Sports, Arts and Culture	Provides services			
Public Service and Military	Provides education/advice/info	Charitable Company *Corporate body with/without wider membership but unlike commercial companies they can't distribute surpluses and operate in best interest of charity*		
Children's, Education, and Training	Advocacy & Information			
Environmental	Sponsors/undertakes research	Unincorporated Associations *Wide membership but no corporate structure and relatively small assets*	Government Funding	
Religious	Acts as umbrella or resource body			
Elderly & Disability	None of the above (describe)			Small (< £100k)
Animal		Trusts *No corporate structure or wide membership, few staff*	Investment / Sales	
Human Rights / Diversity				

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