SCVO

Scottish Voluntary Organisations’

Financial Reserves

2025

Introduction

This paper considers the available literature and data on Scottish voluntary organisations' financial reserves. It looks at academic literature, primary and secondary data. For this paper, 'reserves' are the funds that charities have which can be freely spent on any of its charitable purposes (OSCR). This excludes restricted funds and endowment funds.

Summary

The academic literature highlights the role that good financial management plays in helping organisations deliver their objectives, while ensuring their stability and survival. This is often hampered by a lack of financial management skills, risk aversion and inadequate funding models. Specifically, restrictive funding and short-term contracts significantly limit the ability of charities to build reserves.

This lack of financial management skill is perhaps reflected in the Scottish third sector tracker findings where over a quarter of organisations report not having a target level of financial reserves. As is the point on inadequate funding, where many respondents report having used their reserves to cover a decrease in funding, to cover rising operating costs, or to pay for salary increases.

The Covid-19 pandemic exacerbated the issues discussed above. Many charities entered the pandemic with low levels of reserves and a reliance on a limited number of income sources, often one dominant source. Having said that, calls for charities to diversify their income streams are often impractical and the sector faces challenges in rebuilding reserves and diversifying income in a challenging economic environment.

Key statistics

- Many charities entered the pandemic with low reserves; 25-30% had less than three months' worth of operating expenditure in reserves, and the bottom 10% had less than 35 days.

- During this period, about 51% of charities relied on a single dominant income stream (90% or more of their income from one source), making them vulnerable to shocks.

- In terms of financial reserves, the data shows that for 2023, 17% of charities held less than three months expenditure in unrestricted reserves. Concerningly, this number increases to almost one in three for large charities.

- As of October 20204, (27%) of organisations do not have a target level of financial reserves.

- The number of organisations that believe that their reserves are very important or essential to their short to medium term survival is around half, this increases for those organisations that employ staff (2024).

- Since Summer 2021, approximately a third of organisations reported using their reserves in the last quarter. In October 2024, reserves were most likely been used to cover increased operating costs; a decrease in funding and donations and increases in staff salaries.

- After a sharp increase in Spring 2024, the percentage of organisations that report the current use of their reserves to be unsustainable has returned to levels recorded in Winter 2023 (40%), following a spike to 60%.

- Monthly turnover is relatively stable, with declines often predicted to last for the medium term. More recently, there has been an increase in the number of organisations that consider this decrease a longer-term issue. (2024)

Background

An academic paper published in 2022 and titled 'Financial Vulnerability of Scottish Charities During the COVID-19 Pandemic.' examined how the pandemic affected the financial health and operations of Scottish charities. As we all know, Scottish voluntary organisations played a crucial role during the pandemic, supporting communities and individuals. However, they faced severe financial pressures, including increased demand for services and significant drops in income due to restrictions on activities like fundraising and trading. The key findings included:

Reserves:

- Many charities entered the pandemic with low reserves; 25-30% had less than three months' worth of operating expenditure in reserves, and the bottom 10% had less than 35 days.
- Older charities and those in certain fields (e.g., research, religion, and grantmaking) tended to have higher reserves.
- Stability in reserves levels over time suggests some resilience, though many charities were financially vulnerable at the start of the pandemic.

Income Dependence and Diversification:

- About 51% of charities relied on a single dominant income stream (90% or more of their income from one source), making them vulnerable to shocks.
- Younger charities and those in fields like law and advocacy, housing, and social services were more likely to have concentrated income sources.
- Calls for charities to diversify their income may be impractical without new funding sources.

Income Trends During the Pandemic:

- Many charities experienced steep income declines during 2020, with the median income dropping in real terms. The lower-performing 25% of charities saw income decline by approximately 35%.
- These declines were more severe than those during the 2008-2010 recession.

Charity Formation and Dissolution:

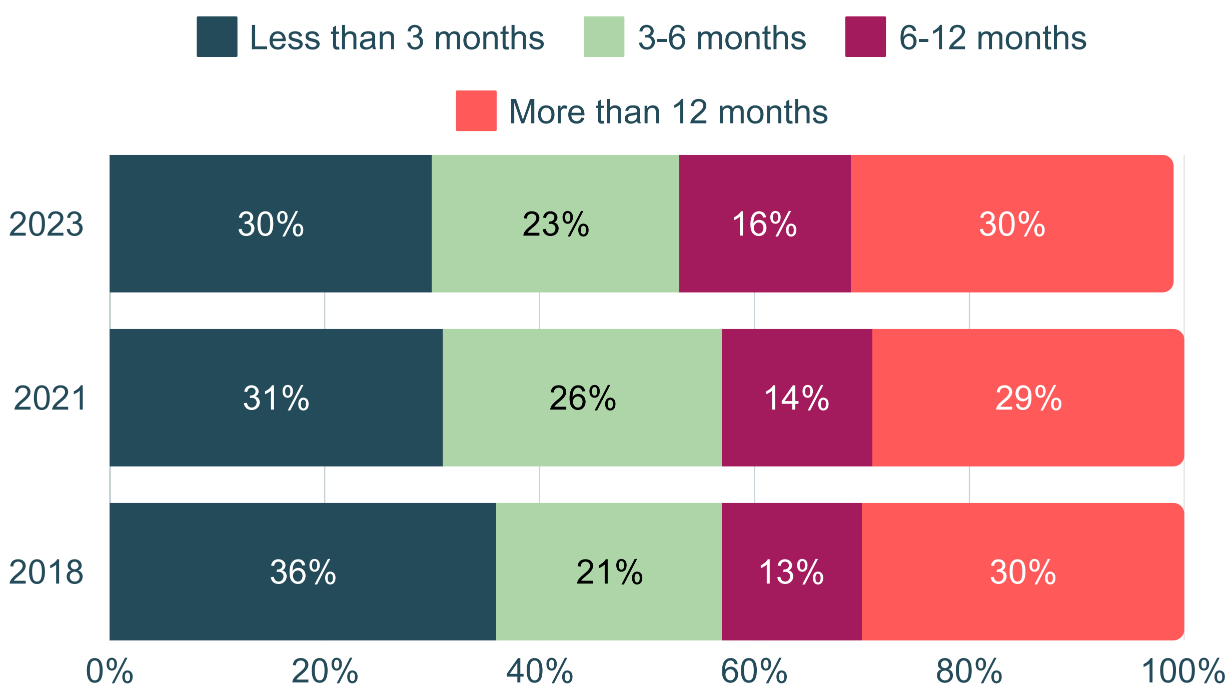
- Charity formations remained steady at around 4% annually but were slightly lower than usual during 2020.
- Dissolutions (charities deregistering) declined during the pandemic and have not returned to pre-pandemic levels, likely due to support measures like furlough schemes and emergency grants.
- There may be a future surge in dissolutions as organizations delayed notifying regulators.

The findings from this paper suggest that the pandemic exposed significant financial vulnerabilities in Scottish charities, including low reserves and income dependence. Despite income declines, large-scale dissolutions have not yet materialized, partly due to government support. However, a delayed wave of charity closures may emerge as these temporary measures end. The sector faces challenges in rebuilding reserves and diversifying income in a challenging economic environment.

The latest iteration of SCVO's 'Sector Statistics' confirms the declines in income and low level of reserves. The statistics show that between 2021 and 2023 the sector experienced a decline of £1 billion in total funds. This decrease in the value of total funds was primarily a results of large charities funds dropping by £2 billion, with average funds for this group falling from £17 million to £12 million. This picture is more mixed across the sector, with housing associations reporting an 15% increase in their average funds over the same period, and small and medium sized charities largely unchanged.

In terms of financial reserves, the data shows that for 2023, 17% of charities held less than three months expenditure in unrestricted reserves. Concerningly, this number increases to almost one in three for large charities. Overall, financial reserves appear to be marginally healthier than before the pandemic in 2018, but worse than 2021. This is primarily due to organisations increase in expenditure and use of reserves – more on that later.

Figure 1. Large charities months of unrestricted financial reserves 2018-2023



Reserves management

In 2022, the Institute for Voluntary Action Research (IVAR)[1], published a paper titled 'Thinking About Charity Reserves.' The report was commissioned in response to the COVID-19 pandemic and subsequent economic challenges, such as rising costs and inflation. These crises highlighted the critical role of financial reserves in ensuring the financial stability of voluntary sector organisations. Many organisations struggled due to insufficient reserves, while others hesitated to spend them. The paper explored how charities in Scotland manage their reserves[2] and aimed to address how reserves can better support organisations and the sector.

The key findings from the report included:

- Varied Practices: Charity reserve management practices range from basic to strategic. At the strategic end, reserves help charities navigate volatility and invest in mission-driven opportunities.
- Barriers: Strategic reserves management is often hindered by the lack of financial management skills, rigid funding models, and trustee caution.
- Opportunities: Charities that manage reserves strategically consider plans, risks, and financial flexibility. They also explore substitutes for reserves, like lines of credit, which may allow them to hold fewer liquid reserves.
- Impact of Funding Practices: Restricted funding and short-term contracts significantly limit the ability of charities to build reserves. Funders are urged to offer more flexible, long-term, and unrestricted grants to empower charities in their reserves management.

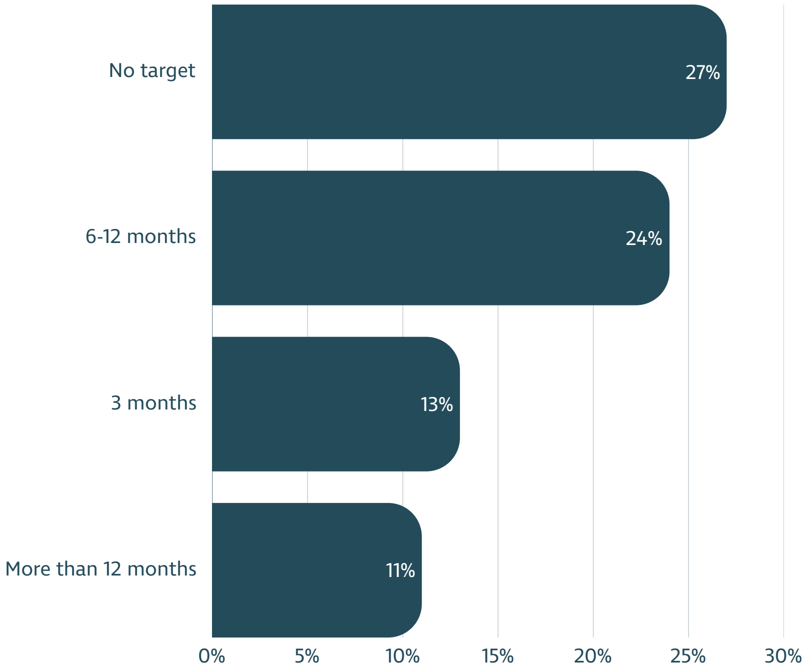
The findings from the 'The Scottish third sector tracker' further shines a light on some of these issues.

In the latest round of data collection (October 2024), the percentage of organisations holding less than 6 months' financial reserves remains stable at 56%. Similarly, the number of organisations that believe that their reserves are very important or essential to their short to medium term survival is 51%.

For the first time, we asked respondents to tell us their organisations target for the number of months' operating costs its financial reserves should, ideally, cover. For just over a quarter of organisations (27%), they do not have a target. A quarter (24%) said six to eleven months; 13% said three months and 11% twelve to seventeen months.

[1] The research was funded by the Scottish Funders' Forum.
[2] The key research questions included: What are the purposes of charity reserves; How do charities build, maintain, and deploy reserves?; How can charities manage reserves better? and What can funders, commissioners, and other stakeholders do to support effective reserves management?

Figure 2. Target level of reserves



In Autumn 2024, over eight in ten organisations reported acting in response to financial challenges. The most frequently reported actions included, applying for funding (58%); using their financial reserves (38%); and fundraising (27%).

For those organisations who were making use of their financial reserves, the most common reasons why included, to cover a decrease in funding or donations (41%); to cover increased overheads and/or day-to-day running costs (excluding staffing costs) (also 41%); to cover staff wage increases or hiring more staff (38%) and to expand the work we are doing (24%).

After a sharp increase last quarter, the percentage of organisations that report the current use of their reserves to be unsustainable has returned to levels recorded in Winter 2023 (40%), following a spike to 60% in Spring 2024.

Examples from annual reports

"After earned income, our charitable programmes required £10m in donations to operate (21/22: £9.9m). This continued to far exceed the net fundraising we were able to generate (£6.1m during 22/23, £6m during 21/22). Whilst a non-recurring surplus on the discontinued Erskine Glasgow Home operation positively impacted the result for the year, there remains a considerable gap between our sustainable revenues and expenditure. We drew down a total of £4.8m from our reserves to fund our operations during the year (21/22: £0.5m)."

Erskine

"The financial results highlight the significant pressure the organisation has been under with recruitment pressures, staffing gaps and compliance concerns. The step to restructure has impacted into financial reserves and it is expected that to rebuild these reserves will take time and significant hard work with budget pressure being high for the next 24 to 36 months"

Brother of charity services Scotland

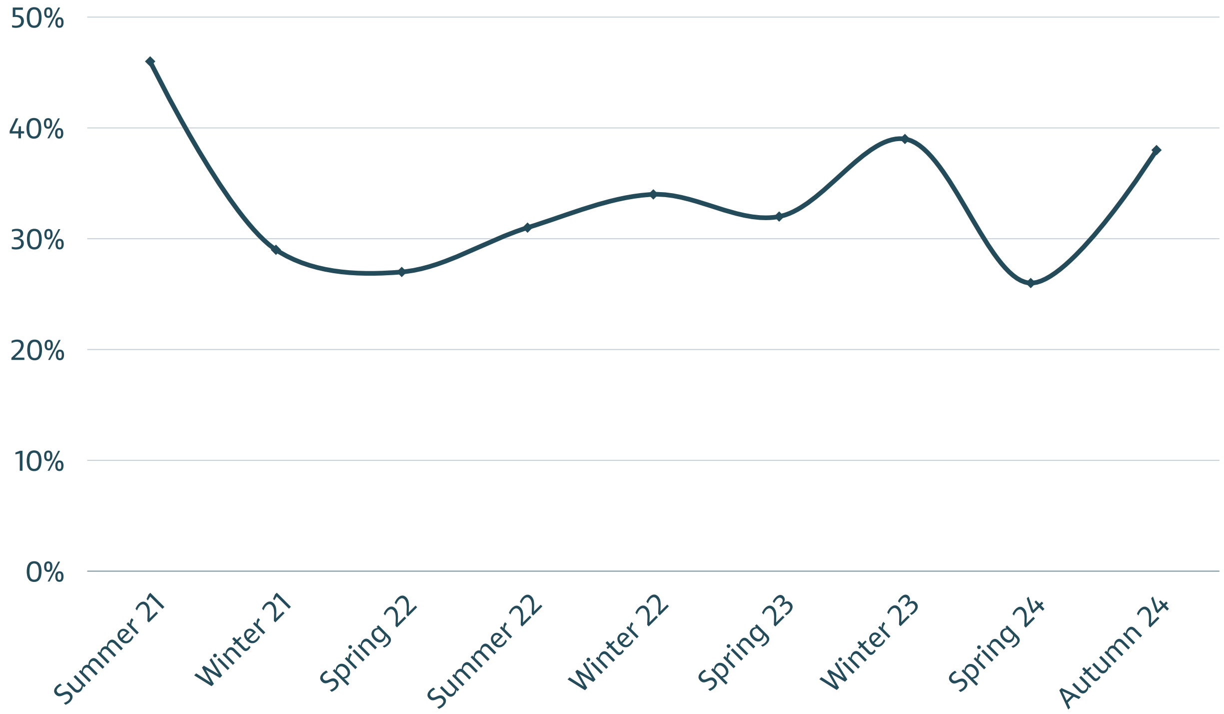
"The Directors, recognising consecutive years of deficit draining the reserves, have put plans in place to increase income, reduce costs and exercise greater financial control. A freelance fundraiser has been engaged to supplement the efforts of our fundraising officer, focusing on obtaining unrestricted grants and donations. The Chief Executive and her team have increased the number of activities that generate direct income. Every opportunity to reduce costs is being considered and some changes have already been implemented. A monthly financial review meeting now takes place with at least one director present. The Directors are confident these actions will ensure the operation of the charity remains viable and reserves can be increased. The Trustees and the Chief Executive have also increased their efforts to identify opportunities to collaborate with other organisations in the private and third sector to ensure vulnerable families in Leith receive the support they need"

Dr Bell's family centre

Putting it in perspective

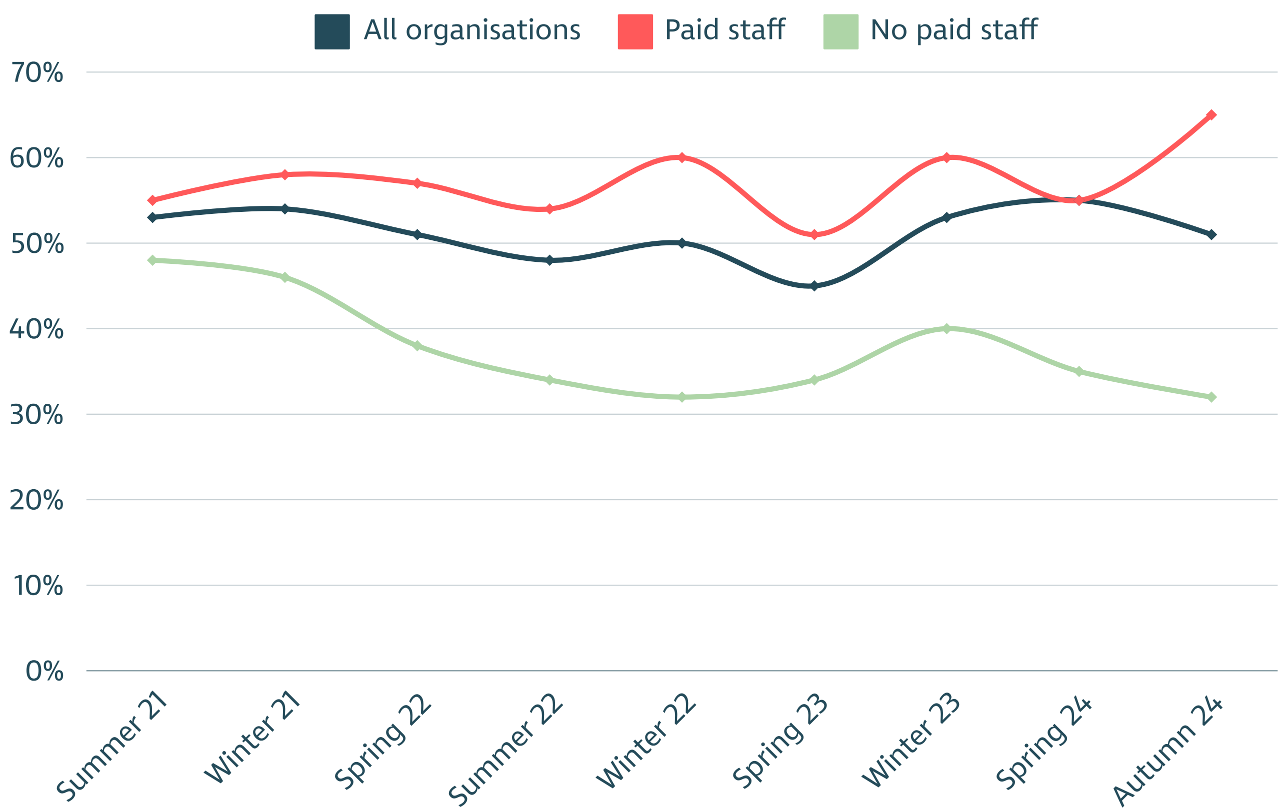
Looking at the data over a longer period, since Summer 2021, many organisations have faced significant financial challenges because of the pandemic followed by the cost-of-living crisis. Nearly half of the organisations (46%) in wave one said they had used their financial reserves in the previous 16 months (from March 2020 to July 2021). In the following waves, there is a drop in organisations reporting that they had used their reserves in the last three months as they recover from lockdown restrictions imposed during the pandemic. However, since August 2022, as the cost-of-living crisis has intensified, the data show growth in the percentage of organisations that have been using their reserves. By waves five (Winter 2022) and six roughly a third of organisations said they had used their financial reserves in the three months preceding the data collection. By December 2023, 39% of organisations had used their financial reserves in the four months preceding, a pre-pandemic high.

Figure 3. Organisations that have used their financial reserves in the last three-four months, Wave 1 to Wave 9



In each wave, approximately half of the organisations said that access to financial reserves was essential or very important for short- and medium-term survival. Organisations that employed staff were historically more likely to say that access to financial reserves was more important than organisations without employees.

Figure 4. Breakdown of organisations that say access to financial reserves for short- and medium-term survival was essential or very important by whether they have paid staff, Wave 1 to Wave 9



Turnover

Since wave one, we have also asked organisations to tell us if their monthly turnover has increased, decreased or stayed about the same over the preceding three-four months. As per figure 5, the number of organisations reporting a decrease in monthly turnover was highest in Summer 2021. There was also a significant spike in Winter 2023, before returning to historical levels

Figure 5. Changes in organisation's monthly turnover, Wave 1 to Wave 9

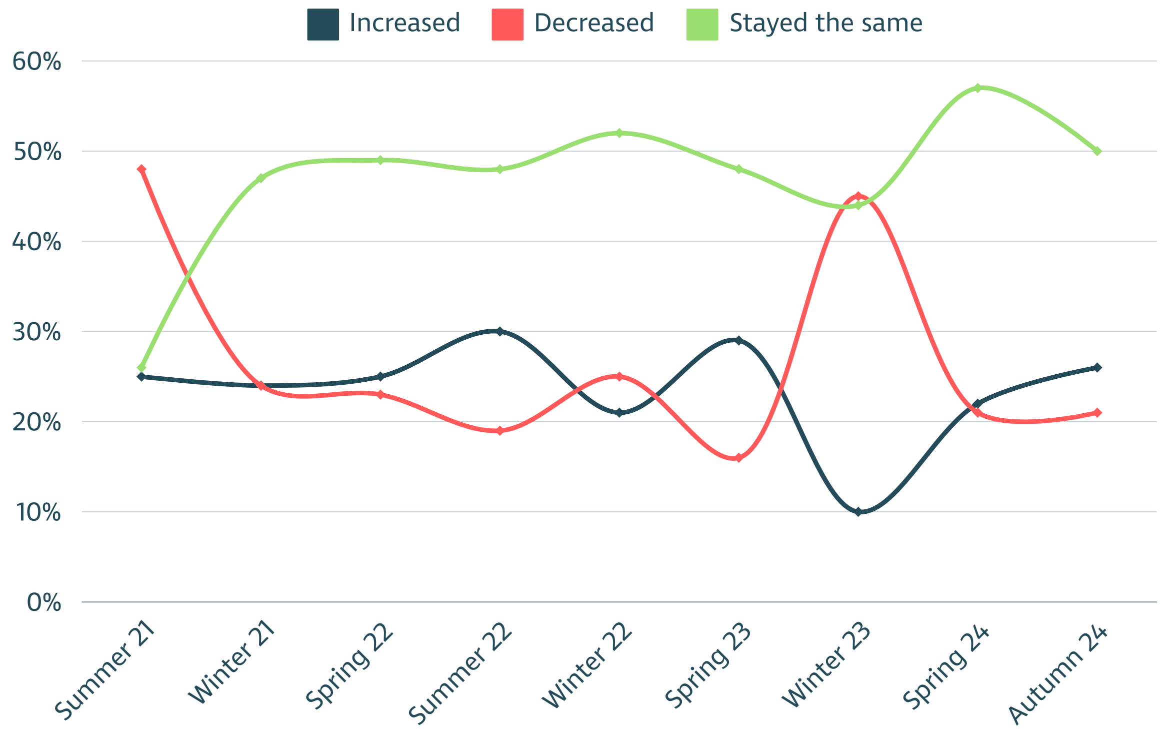
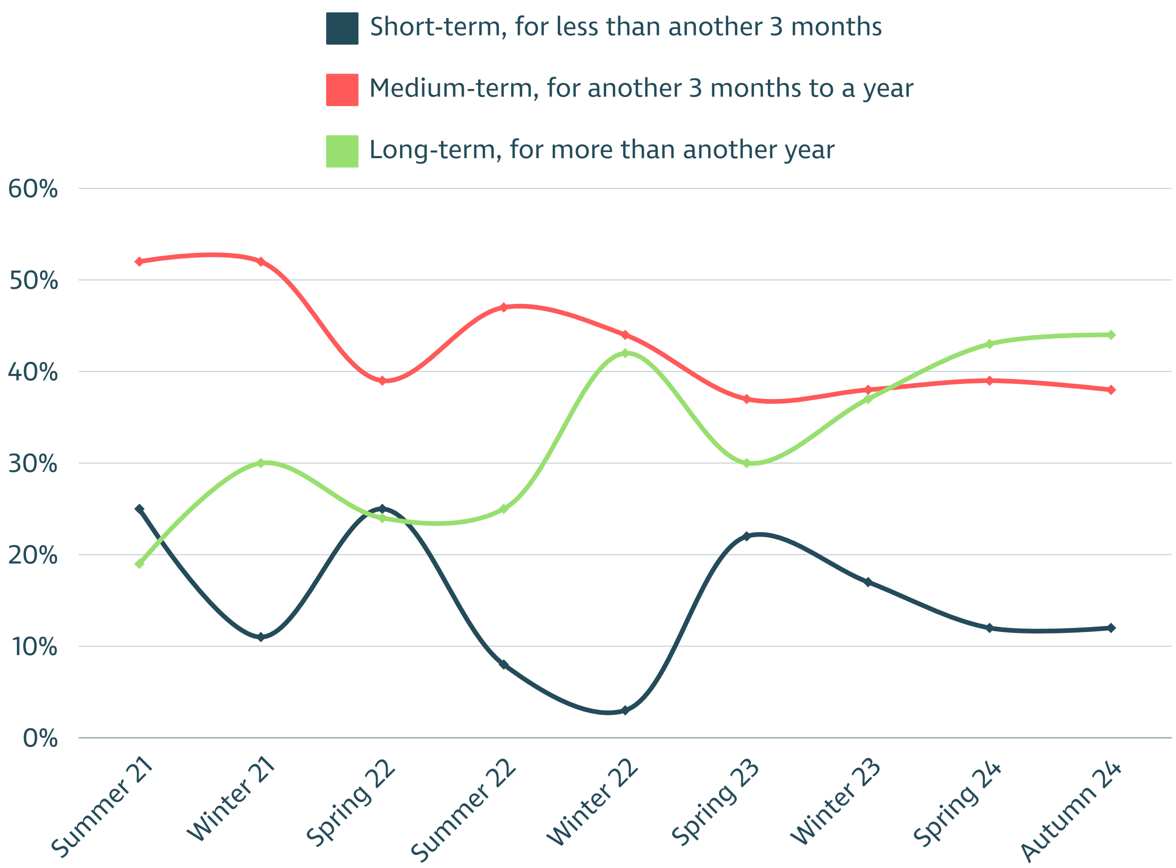


Figure 6. Organisation's perception of reduced turnover, Wave 1 to Wave 9



For organisations reporting a decrease in monthly turnover, we ask them to tell us how long they anticipate this decrease lasting. Historically, the most frequent response has been for the medium-term, but in the last two rounds of data collection (since Spring 2024), more organisations consider this reduction in income to be a longer-term issue, figure 6.

Recommendations

The IVAR paper makes several recommendations, including:

- For organisations: Access training on financial management, integrate reserves management with strategic planning, and communicate reserves policies transparently.
- For Funders: Provide flexible, unrestricted, and long-term funding to enable charities to manage reserves more effectively. Engage in dialogues to assess reserves management based on each charity's unique circumstances.
- For Regulatory Bodies: Offer practical guidance and training for charities to manage reserves and improve access to credit facilities.

Overall, the report encourages a shift toward strategic reserves management across the sector. Charities, funders, and regulators are all called upon to collaborate in creating a more resilient and dynamic sector, with reserves that support both stability and growth.

While these recommendations are sensible and commendable, without the necessary resources to implement them, many organisations will continue to struggle to manage their reserves effectively - balancing immediate stability with future ambitions.