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Voluntary Organisations**

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Abstract

Social policy in England has, for some decades now, placed growing emphasis on the contribution of the third sector and considerable expectations are invested in voluntary organisations as a result. Drawing on the benefits theory of nonprofit finance, this paper examines longitudinal patterns in the income profiles of a representative sample of registered charities in England and Wales. We find evidence of a declining reliance on government funding over the 10-year study period (2006-2016). We also show that a significant proportion of voluntary organisations play a multifaceted role alongside the state and market, providing a mix of collective and private benefits through their activities.

Keywords: nonprofit, charity, revenue mix, public funding, income sources

Word Count: 3862

1. Introduction

Social policy in England has, for some decades now, placed growing emphasis on the contribution of the third sector and considerable expectations are invested in voluntary organisations as a result. Policy rhetoric has been supportive but the external environment facing third sector organisations has been challenging. The adverse economic conditions of the post-2008 recessionary period were followed by the austerity and deficit reduction policies of the post-2010 Coalition and Conservative governments, which are ongoing at the time of writing. Clearly, such conditions would be thought likely to affect the ability of voluntary organisations to generate financial resources; they would also be associated with rising demand for services, particularly in relation to the consequences of unemployment, the effects of a more stringent income support regime on individuals and households, and the needs of a growing migrant population (Taylor et al., 2012; Wilding, 2010). Drawing on the benefits theory of nonprofit finance, this paper examines longitudinal patterns in the income profiles of a representative sample of registered charities in England and Wales. We find evidence of a declining reliance on government funding over the 10-year study period (2006-2016). We also show that a significant proportion of voluntary organisations play a multifaceted role alongside the state and market, providing a mix of collective and private benefits through their activities.

The paper begins with a review of the benefits theory of nonprofit finance and associated empirical studies. It then considers issues of data and method. After presenting the results, the discussion centres around the key findings and their implications for our understanding of the roles these organisations play. We conclude by considering the implications for policy and practice.

2. Literature

2.1. Theoretical framework

The benefits theory of nonprofit finance argues that the nature of the services and benefits produced by a voluntary organisation is correlated with its sources of funding (Young, 2007; Young et al., 2010). The theory synthesises and formalises foundational work on the origins of nonprofit organisations and proposes links to the type of financial resources these entities attract. It also specifies a direction to this causal relationship: a nonprofit's role determines what type of revenue sources it attracts (Kingma, 1997; Wilsker & Young, 2010).

First, Weisbrod's (1975) public goods theory contends that nonprofits surface to fulfil unsatisfied needs for public goods i.e. those that are nonrival and nonexcludable such as lighthouses, mountain rescue. Heterogeneous demand for public goods, in terms of quantity and quality, cannot fully be satisfied by the state resulting in space in which nonprofits can arise to satisfy niche or overlooked needs. The benefits theory of nonprofit finance predicts that nonprofits providing public goods would attract support from individuals in the form of donations.

Second, Hansmann's (1980, 1996) contract failure theory explains why nonprofits arise to provide private goods i.e. those that are excludable and rival such as free school meal programs, nursing home care. As a consequence of the non-distribution constraint, nonprofit providers have less incentive than for-profit organisations to exploit information asymmetries in situations where the purchaser is unable to assess the cost and benefit of private goods/services. The benefits theory of nonprofit finance predicts that nonprofits providing private goods will raise funds in the form of charging fees for charitable goods/services provided.

Third, Salamon's (1987) voluntary failure theory provides a basis for understanding government support of nonprofits. The theory contends that government support, usually in

the form of funding, arises as a result of two key factors: the state's superior ability to raise sufficient funds for the provision of public goods/services; and the voluntary sector's comparative advantage in targeting and delivering public goods/services that meet the needs of users. Thus, the benefits theory of nonprofit finance predicts that nonprofits providing public services or those consistent with government priorities will raise funds in the form of state funding (e.g. local or central government grants or contracts).

Finally, there are theories which seek to account for a mix of revenue sources. Hansmann (1981) argues that income from fees and donations indicates a nonprofit provides excludable but nonrival goods e.g. theatres that charge a ticket fee to see a performance but rely on donations to subsidise significant fixed costs. James (1983) hypothesises that nonprofit managers seek to deliver a mix of private and public goods in order to best support mission achievement by the organisation. Thus, the benefits theory of nonprofit finance provides a theoretical basis to link *combinations* of income sources to the *extent* to which an organisation provides private or public benefit, moving beyond binary classifications of their roles.

2.2. Empirical evidence

Two important streams of empirical work inform this study. The first is characterised by attempts to model the association between the presence and combination of revenue sources and the nature of goods/services (i.e. benefits) provided by nonprofits. Drawing on 2003 data on U.S. nonprofits operating in certain charitable subsectors, Fischer et al. (2011) find that a greater reliance on donations is positively correlated with delivering public benefits, while a higher proportion of earned income as a share of total revenue is linked to a greater propensity to provide private goods. Young et al. (2010) performed a similar analysis on a smaller sample of this 2003 data and discovered the same patterns, as did Wilsker & Young

(2010) when examining survey evidence from a study of nonprofits affiliated with the U.S. Jewish Community Centers Association. Collectively these studies provide initial evidence of the link between the funding sources of nonprofits and the programmatic, mission-related roles and activities of these organisations. However, these studies are limited by the absence of a longitudinal component, difficulties disaggregating between sources of income, and consideration of a limited, unrepresentative number of charitable subsectors.

The second research stream focuses explicitly on the revenue mix of nonprofit organisations and the sector as a whole. Clifford & Mohan (2016) examined the income composition of charities in England and Wales using a representative sample of annual accounts. The study demonstrated the extent to which certain types of organisations relied on different sources of income (six in total): for example, they found that 60% of charities do not receive any significant income from donations, while almost a third derive the majority of their income from government. However, this study was limited to a single financial year (2009-10) and thus was unable to make claims about changes in the distribution of income composition over time. For instance, we do not know whether a greater proportion of voluntary organisations rely on public funding since the beginning of the Great Recession, or if the share of income from donations or fees has declined in the face of public spending austerity (as predicted by theory). Teasdale, Kerlin, Young and Soh (2013) conducted a longitudinal analysis of the relative stability of nonprofit revenue mixes using U.S. Form 990 data for 1998 and 2007. They found no evidence that nonprofits were increasingly adopting mixed revenue strategies, and that they were more likely to rely on a single source of income (donative or commercial).

Both studies provide a roadmap for investigating the income composition of nonprofit organisations. Clifford and Mohan's (2016) approach offers a consistent, disaggregated means of defining income sources, while Teasdale et al. (2013) demonstrate the power of

employing a longitudinal perspective. The next section describes how we have operationalised elements of each study in our research.

3. Data and Methods

We draw on a unique longitudinal dataset detailing the sources of income for a representative sample of charities in England and Wales over a ten-year period (2006/07-2015/16). The term *charity* in this study refers to organisations that at some point in their history have been formally registered with the Charity Commission of England and Wales. The sampling frame for a given year consists of the population of charities listed on the Charity Commission's Register of Charities (Kane et al., 2013). Stratified random sampling - by organisation size, which is measured using categories of annual gross income - is then applied to construct a representative sample of charities per annum. Nominally, the sample for a given year contains a census of the largest organisations (Over £100m), ~90% of charities with income between £10m-£100m, and then declining fractions of other charities as organisations size decreases. In reality these sampling fractions (and sizes) vary over time, with implications for the calculation of sampling weights. The pdfs of the annual accounts for each member of the sample are downloaded from the Charity Commission's website and sent to a specialist unit where the financial information is extracted. The information is then imputed into a database managed by the National Council for Voluntary Organisations (NCVO) and coded into meaningful categories (e.g. income from donations, number of staff and volunteers); this is done using a combination of manual and semi-automatic approaches in a four-stage process – see Kane et al. (2013) and Clifford and Mohan (2016) for an account of this work. The result of this sampling process is a rich longitudinal dataset that is suitable for examining change using a consistent, representative set of organisations over time during a recessionary period (Kane et al., 2013).

In addition to dealing with duplicate observations and invalid values for some of the key financial variables, the analysis is restricted to registered charities with an annual gross income of at least £500,000. This is consistent with Clifford and Mohan (2016) and ensures that the financial information is the highest quality it could be: charities above the stated threshold are subject to Statement of Recommended Practice (SORP), a set of guidance and requirements charities should (and in many instances must) follow when preparing their annual accounts. These steps result in an unbalanced panel of 62,272 observations for 11,066 individual charities over ten financial years. Second, we apply the weights outlined in table 1 to adjust for differences in the probability of being included in the sample by income bands. Third, we convert all financial figures to April 2015 prices using the Retail Price Index - Jevons (RPIJ) measure of inflation. Finally, we create a balanced panel of charities with income of at least £500,000 that were sampled in every financial year: this produces a data set with 23,270 observations for 2,327 charities.

In this study we analyse variation in the *share* of total income accounted for by a particular funding source - not the monetary value of these sources - as this provides better insight into income profile and role of voluntary organisations (Young, 2007). We define thresholds marking the relevance of a particular source in terms of its share of total income: a source is *significant* if it accounts for at least 10% of total income; *important* if it accounts for at least 25%; *majority* if it accounts for at least 50%; and *dominant* if it accounts for at least 90% (see Clifford & Mohan, 2016; Teasdale et al., 2013).

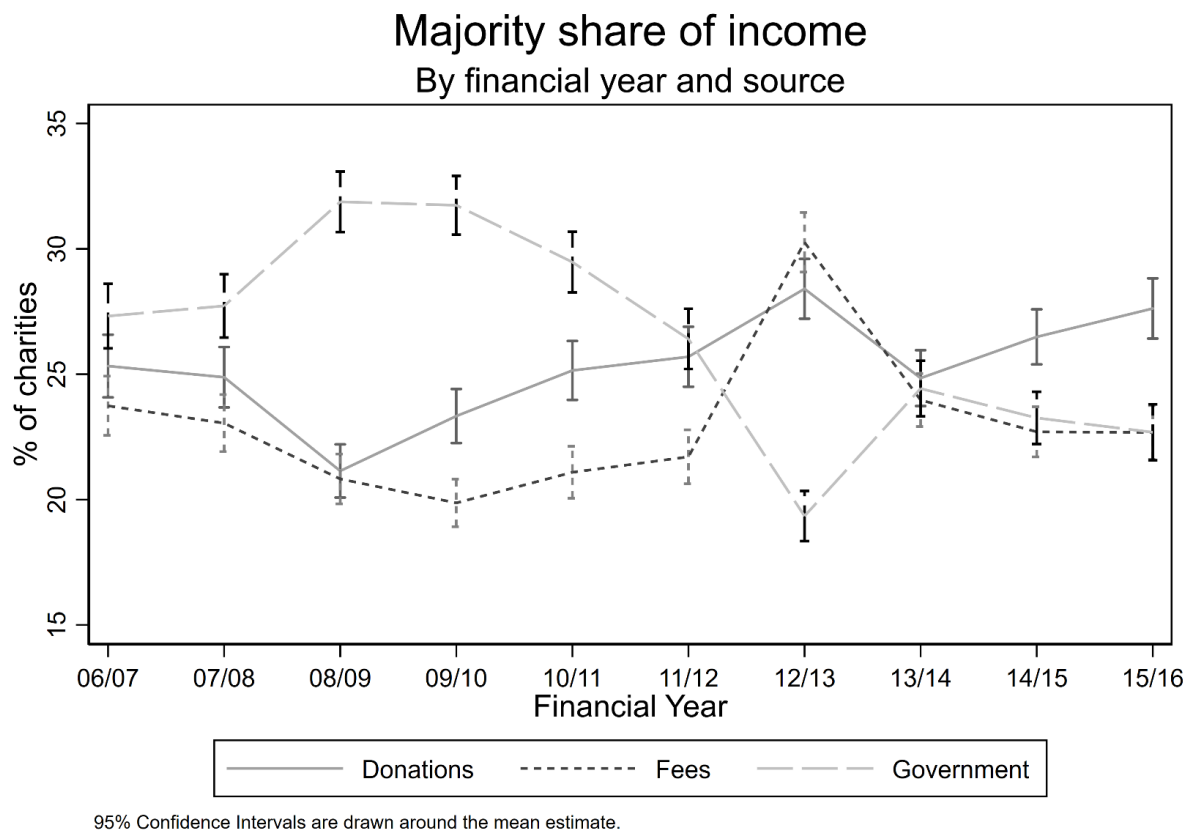
We define six sources of income based on the approach adopted by Clifford and Mohan (2016): donations/raised income from individuals; fees from individuals; government; voluntary sector and National Lottery; internal; and other.

4. Results

4.1. Marginal distribution of income shares

We revisit one of Clifford and Mohan's (2016) central questions: What proportion of charities receive a majority share of their income from a particular source? Figure 1 shows that, of registered charities with an income of at least £500,000, the percentage of organisations receiving a majority of their income from donations varies between 21% and 28% over time, and income from fees from individuals in connection with their charitable activities between 21% to 30%. The percentage of charities receiving a majority of income from government ranges from 19% and 32%, and was highest between 2008/11; since 2013/14, the figure has not been higher than 24%. For a given financial year, overlapping confidence intervals suggest there is no difference in the proportion of organisations receiving a majority of their income from two or more sources. For example, in 2007/08 we estimate that 25% and 23% of charities received a majority of income from donations and fees respectively; however, the intervals overlap, therefore we cannot conclude that more organisations were reliant on donations than fees. We can also compare across years using the intervals: for example, we cannot claim that more organisations were reliant on income from government in 2008/09 (32%) than 2010/11 (29%). A relatively small proportion of charities receive the majority of their income from the voluntary sector, from internal income generation, or from other sources (6%, 6% and 3% respectively – not shown on graph). In total, 89% of charities receive the majority of their income from just one of these six sources.

Figure 1. Percentage of charities that receive a majority share of total income from a particular source, by financial year



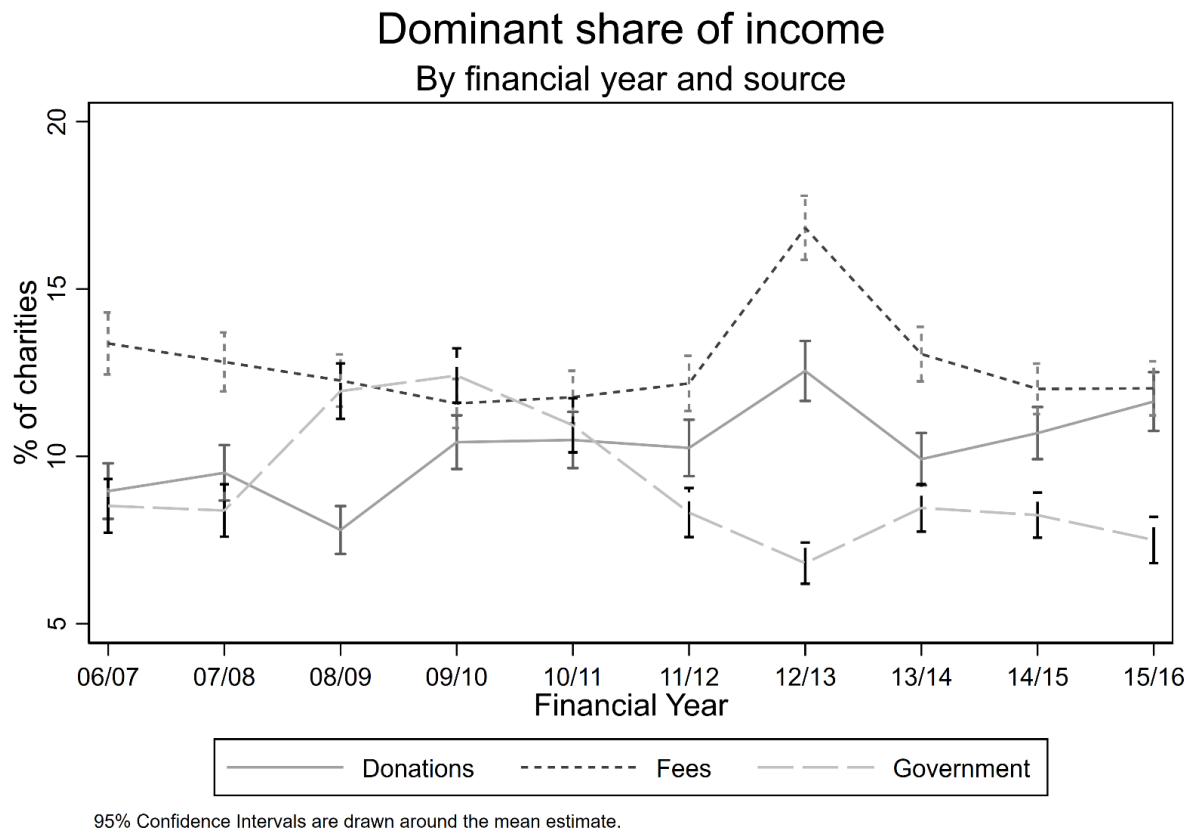
Note: Estimated percentages have been adjusted to account for the sampling design. Analysis of the accounts of 11,066 charities with an income of at least £500,000 (2006-2016).

What proportion of charities are almost exclusively funded from a particular source?

Following Teasdale et al. (2013) we employ a threshold of 90% in terms of share of total income to identify charities who are highly reliant on one source – see figure 2. One in ten charities receives at least 90% of its income from donations over the entire period; 13% receive at least 90% of total income from fees in connection with their charitable activities; and 9% receive at least 90% of income from government. There is minor variation in these figures over time, with the exception of pronounced peaks and troughs for government and fees. However, small differences between years can represent thousands of organisations

when applying these estimates to the population of registered charities. In total, 37% of charities receive at least 90% of their income from just one of these six sources.

Figure 2. Percentage of charities that receive a dominant share of total income from a particular source, by financial year



Note: Estimated percentages have been adjusted to account for the sampling design. Analysis of the accounts of 11,066 charities with an income of at least £500,000 (2006-2016).

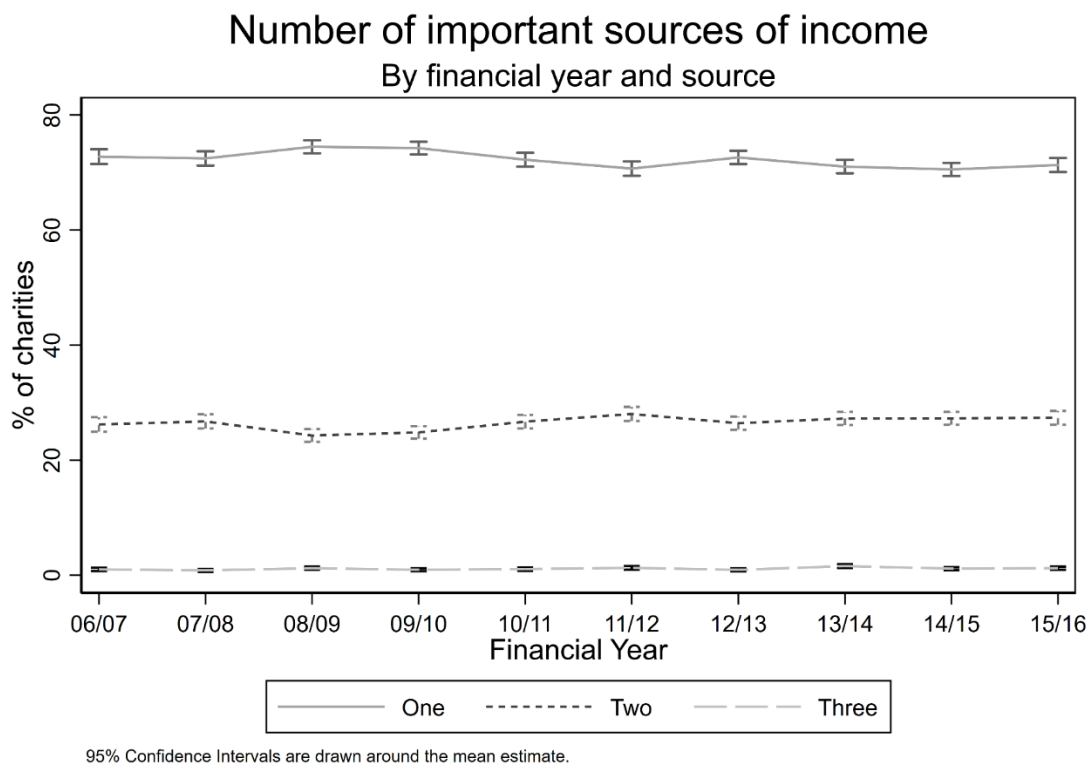
4.2. Multivariate Distribution of Income Shares: Identifying Groups of Charities

According to Their Income Profile

We construct income profiles by counting the presence or absence of *important* funding from that source. In order to do so, we define six binary variables using a threshold of 25% of total income, which indicate whether a particular source is ‘important’ or not, and we group charities according to their important source(s) of income. Figure 3 displays the percentage of charities that have one, two or three important sources of income. Most charities only have

one important source of income (~72%). Government is the most common important source for 22% of charity-years, while fees and donations account for 20%. There is a small but statistically significant degree of variation in these figures over time: for example, 27% of charities in 2008/09 derive their only important source of income from government, compared to 16% and 18% in 2012/13 and 2015/16 respectively. However, there is less temporal variation observed for other important sources of income.

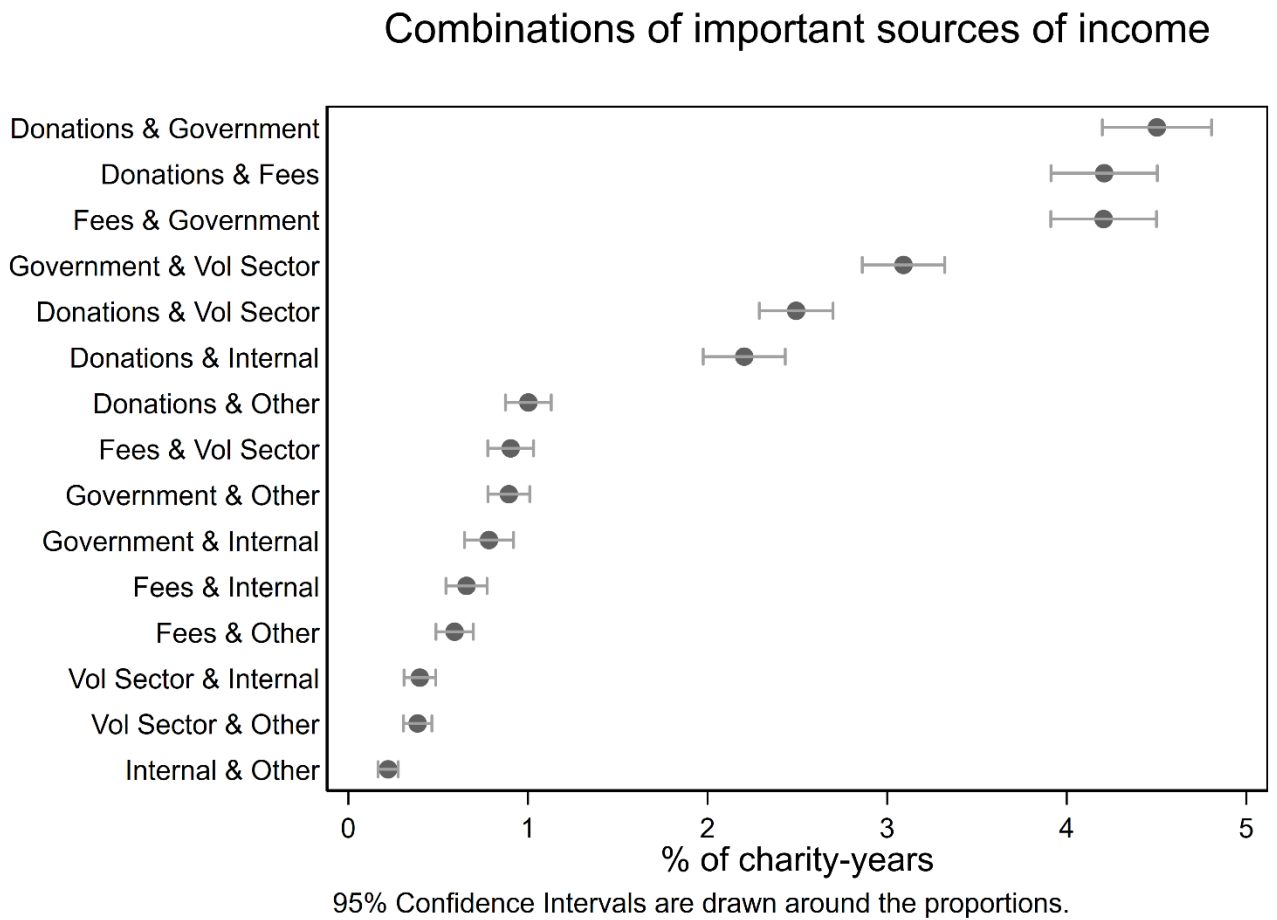
Figure 3. Percentage of charities with one, two or three important sources of income, by financial year



A significant part of the charity sector, however, comprises organisations with more than one important source (~26%). Figure 4 presents types of income profiles for charities with two important sources of income. The most common combinations of important sources are donations and government, donations and fees, and fees and government respectively; there is little variation in the percentage of charities with specific income profiles over time. For the small subpopulation of charities that have three important sources of income (1% of the

overall sector for a given year), 0.2% of charity-years receive an important share of income from individual donations/fundraising, government and fees associated with charitable activities (see the supplementary online document for full details of the combinations of three important sources).

Figure 4. Percentage of charities with combinations of two important sources of income



Note: Income sources are defined in Table A2. A charity-year is an observation for charity i in financial year j . Figures represent the mean percentage of charities with that combination over the study period. Analysis of the accounts of 11,066 charities with an income of at least £500,000 (2006-2016).

Discussion

The nature and evolution of the role of voluntary organisations, especially during periods of economic turbulence, is of scholarly and substantive importance (Fischer et al., 2011). Using longitudinal, rich data on the sources of income of U.K. voluntary organisations, this paper illustrates how the benefits theory of nonprofit finance sheds light on the roles voluntary organisations play alongside the state and private sector. We highlight key empirical findings from our work.

First, we find evidence of an enduring high degree of reliance on a single source of income in the sector. We observe that 89% of charities receive the majority of their income from just one of six sources of income in a given year, while 37% receive at least 90% of their income from just one source. This is somewhat consistent with the empirical work of Teasdale et al. (2013) and the theoretical claims of Hansmann (1987) i.e. that the nonprofit sector can be neatly bifurcated into organisations reliant on donative and commercial revenue sources. However, our ability to disaggregate income sources paints a more nuanced picture. There are differences in the proportion of organisations reliant on certain sources over time: 32% of charities received a majority of their income from government in 2008/09 and 2009/10, compared to 23% in 2014/15 and 2015/16. As expected, reliance on donations is highest when reliance on government is lowest.

Second, there is evidence that voluntary organisations play multifaceted roles. A significant proportion of charities (27%) receive an important share of income from two sources in a given year, and there are important differences by charitable subsector: culture and recreation charities are likelier to have two important sources (37%), while those in education are less likely (13%). For the sector overall, the most common combination is donations and government, which represents organisations providing public goods and services. The next most common combinations are donations and fees, and fees and government; the former identifies charities delivering both public and private goods, while the latter indicates the

provision of private goods and public services. These patterns support the contention that the sector and individual organisations themselves are becoming ‘hybridised’; that is, having multiple, distinct revenue sources leads to the adoption of values and practices from both the state and the market (Billis, 2010; McKay et al. 2015). Another claim made by the hybridity literature is that a balanced revenue mix is unsustainable over time (Billis, 2010; Teasdale, 2012). Our analysis of a consistent set of organisations across the study period does not support this claim: much like the overall sector, individual organisations were highly likely to retain their income profile over time, both in terms of the number of important sources of income and specific combinations.

There are a number of limitations that must be acknowledged. We only capture formal voluntary organisations that are registered as charities, which likely underestimates the proportion of organisations reliant on income from donations, fees and the voluntary sector in particular. We focus exclusively on charities with at least £500,000 in annual income and thus the patterns in income reliance and profile are likely different for smaller organisations (and most charities are below this threshold). Finally, the analysis did not disaggregate by *type* of income e.g. government grants vs contracts; this likely masks differential patterns in the degree of reliance on certain types of income.

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