PRO BONO ECONOMICS

The cost of giving

What UK charities need to know about inflation

Jamie O'Halloran & Nicole Sykes | September 2022

Pro Bono Economics uses economics to empower the social sector and to increase wellbeing across the UK.

We combine project work for individual charities and social enterprises with policy research that can drive systemic change. We have helped over 500 charities and worked with over 400 volunteers since our inception in 2009.

High inflation is expected for some time

The UK – and indeed much of the world - is currently experiencing a period of high inflation. This follows on the heels of a difficult period for charities in the UK, and the people and communities that they support.

This briefing by Pro Bono Economics, in partnership with the Charities Aid Foundation, has been compiled to help charities and their trustees prepare to manage inflation's effects in the years ahead.

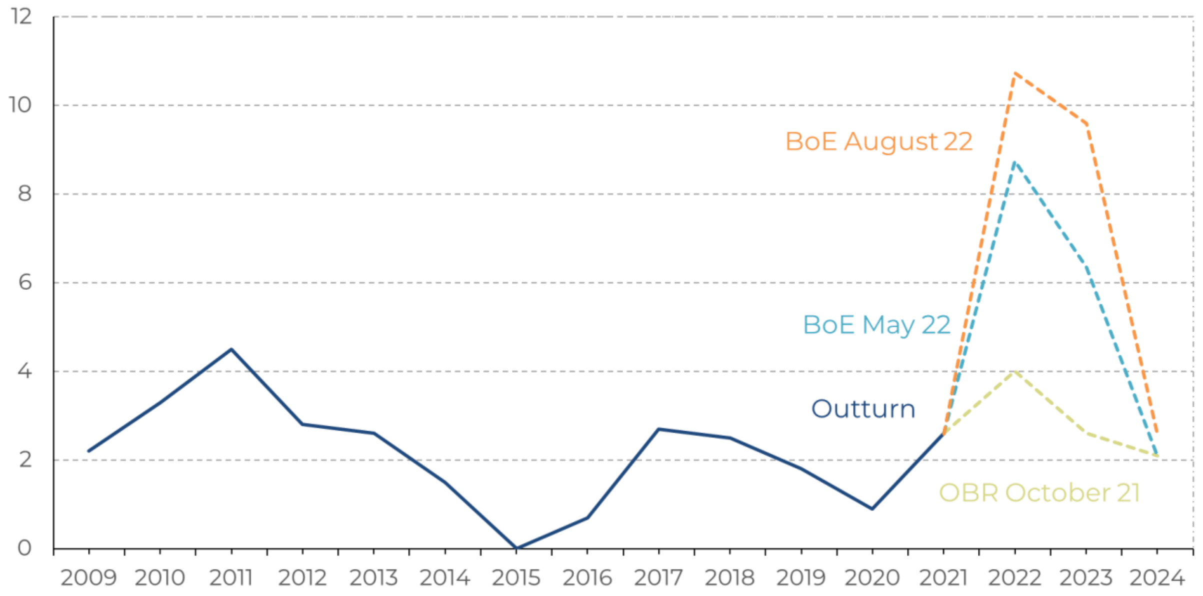
This briefing will cover:

- What inflation means for beneficiaries.
- Its impact on charities' costs and finances.

As charities work to manage inflation's impact, the first thing to understand is how long high levels of inflation are likely to be with us. The Bank of England is expecting inflation to peak late this year at around 13%, but to remain at elevated levels until 2024.

However, it is important to bear in mind that these forecasts are kept under constant review, and there is a lot of uncertainty about them. This is because the price of gas has been fluctuating. Charities should expect to have to keep a close eye on inflation figures for some time ahead.

Figure 1. CPI inflation forecasts



Source: OBR and Bank of England Inflation forecasts

Energy prices affect costs, volunteers and beneficiaries

Rising energy prices have been one of the major drivers of the increase in inflation.

One of the most immediate consequences of this has been rising petrol prices, which have increased 60% in the last 12 months. This has made the cost of volunteering higher for drivers, as well as pushing up the costs for many beneficiaries trying to access services, and staff who drive to work. The RAC currently believes that these prices should decline slightly in the short-term, and the average price did fall by 9p a litre in July.

As winter approaches, higher energy costs are expected to have a dramatic effect on households, and are likely to drive up demand for charities' help – both greater demand from current beneficiaries and from increasing numbers of people turning to charities for help.

The government has so far offered help in a number of ways, introducing an Energy Price Guarantee, in addition to a £400 discount to fuel bills for all households in England, Wales and Scotland; a £650 payment to those on Universal Credit, tax credits, pension credit and other means-tested benefits; a £150 payment for those in receipt of Disability Living Allowance; and £300 for pensioner households in receipt of the winter fuel payment.

Prior to the introduction of the Energy Price Guarantee, the Joseph Rowntree Foundation announced that they believed low-income families will hand over 26% of their income after housing costs to pay for gas and electricity in 2023/24, compared to 12% two years previously. The Resolution Foundation estimated that a typical low-income household paying their energy costs by direct debit is now expected to need an extra £418 to pay their energy bills in January-March 2023.

For charities with premises, the rise in energy prices will also directly increase costs. The scale of this is hard to estimate, but electricity prices for very small non-domestic consumers increased 23% between Q1 2019 and Q2 2022, while gas prices for these organisations increased 29%. The government has stated that it will support charities with their energy costs over winter, with an 'equivalent' guarantee for six months and further support for 'vulnerable sectors' such as hospitality. Further details will emerge in due course.

Everyday goods are becoming more expensive

Because energy and oil are used to make almost everything – both to fuel production and in the creation of plastic which is used in a lot of products – the prices of a wide array of goods are rising. The impact of Brexit, staff shortages, high levels of post-pandemic demand for certain goods and services, and global shortages (particularly resulting from the Russia-Ukraine war) are also impacting costs.

Rising food prices are of particular concern and will impact on low-income families and the charities working to support them. Some of the largest rises in food prices have so far been in dairy and wheat-based products.

Low fat milk up **34%**

Flour up **30%**

Butter up **27%**

Pasta and couscous up **24%**

Frozen vegetables up **17%**

Ready meals up **16%**

Year on year CPI, July 2022

But there are many other services and products which are increasing in cost.

- People with homes needing repairs will be affected by the 14% increase in the price of maintenance and repair services, and the 13% rise in the cost of small tools like screwdrivers.
- The cost of furniture has increased 15%, with fridges up 13%, and heaters and cookers up 18%, affecting both the cost of outfitting offices, and having knock-on effects for the poorest – who might struggle to store and cook nutritious food.
- Charities improving people's wellbeing by providing leisure activities will likely be impacted by the 12% rise in the price of sports equipment and the 15% increase in the price of garden products.
- Charities supporting children and young people will be affected by the 15% increase in the price of effects for babies, the 7% increase in the cost of children's clothes, and the 7% increase in the price of children's shoes.
- Animal charities will be affected by a 14% increase in the price of pet products.

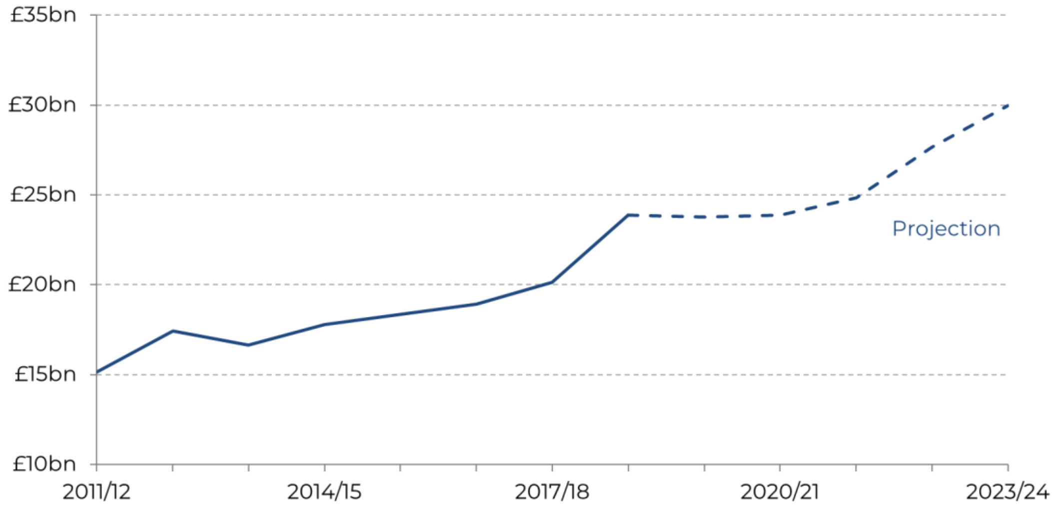
Pressure on staff costs will be difficult to manage

Rising staff costs will be one of the major ways in which inflation affects charities' expenditure. On average, the charity sector spends over 40p in every £1 on staffing costs according to the NVCO Almanac. Were the sector's expenditure on staffing costs to keep up with inflation, the sector would need to find an additional £3.8bn by 2023 and £6.1bn by 2024, compared to 2018/19 (based on current expectations).

It is clearly unlikely that an increase in pay on such a scale will take place, but pay rises will be important to help charity sector staff struggling with the cost of living and to ensure the sector can keep up with competition for staff from the rest of the economy. New research by the Law Family Commission on Civil Society found that charity sector staff are paid 7% less per hour on average than similar people working in different sectors. This wage gap widens and peaks at 9.6% for those between the ages of 46-50. Meanwhile, Bank of England data suggests businesses increased wages 5.6% in the year to May 2022, while charities' wage growth was up just 3.8%.

The impact of rising staffing costs will vary across the sector, as many very small charities do not have paid employees. But if the barriers to hiring that all-important first member of staff rise unsustainably high, that will make growth for small organisations much more difficult.

Figure 2. Total staffing costs in billions if costs kept up with inflation



Source: NCVO Almanac

The average		
£500,000	£1 million	£5 million
charity would need to find		
£36,715	£73,430	£329,650
in 2023 to ensure its staff are not financially worse off		

Inflation will eat away at the value of donations

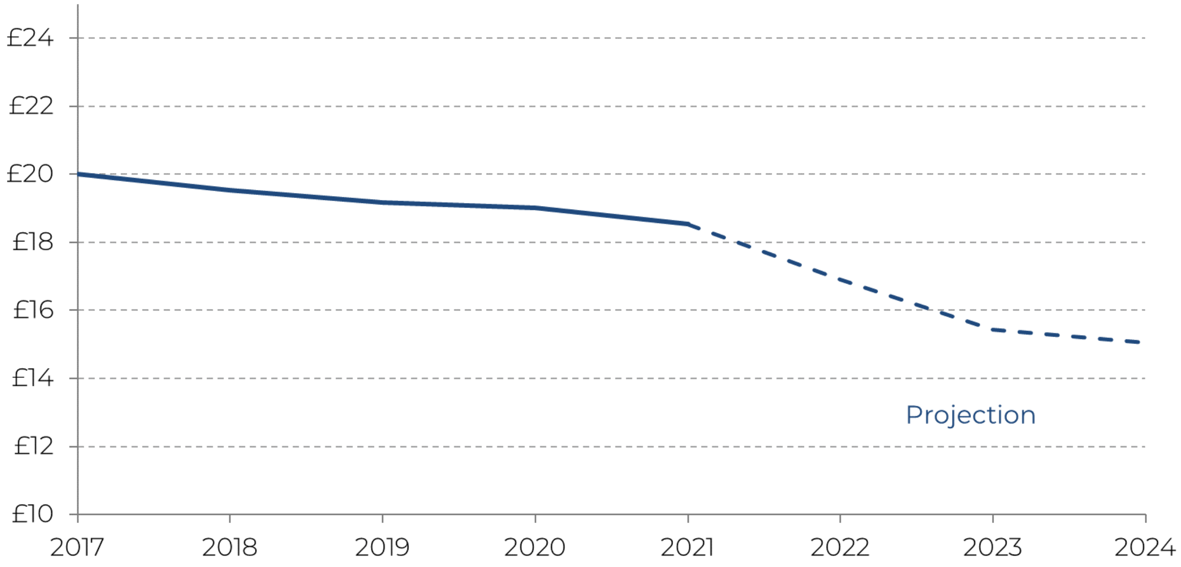
According to CAF's long-running UK Giving research, for the past five years the average donation made in the UK has been roughly £20 a month. This means that the average donation has not been keeping up with inflation, even during a period of relatively low inflation.

For charities, there is a behavioural challenge associated with this. If the donor population is in the habit of giving £20 as standard, charities will need to focus on changing that behaviour and creating a 'new normal', where the average donation is higher.

There is also an immediate technical challenge. It is estimated that 31% of all charitable donations are made via direct debit. Long-standing monthly direct debits fall in value over time, and this devaluation is a particular problem during this current period of high inflation. Using the Bank of England's most recent inflation forecasts, we project that this £20 in 2017 will be worth a mere £15.30 next year and £14.90 in 2024.

As inflation also eats away at household finances, many people are likely to cut back on charitable giving. But encouraging supporters on direct debits to increase their direct debit levels will be an essential strategy for many charities, alongside encouraging donors to give more as standard where they can.

Figure 3. The 'true' value of an average donation in 2017 across time



Source: PBE analysis of Bank of England, MPC August projections

Further to this, the most recent data from CAF's UK Giving research finds that total donations in the first half of this year were worth £5.7bn. We calculate that by the end of the year that sum will be worth £5.2bn, a reduction of 8.5% due to inflation.

Grant funding and contracts will also be affected

While a comparably smaller source of income for the charity sector than donations, grants and contracts play an important role in charity sector funding. For example, VSCEs won 7,330 government contracts worth £17bn from April 2016 to March 2020. At this time particularly, when prices are rising so significantly, charities are being encouraged to ensure that they account for inflation properly in their bids for funding and contracts. Contracts may have clauses related to inflation - more specific advice about contracts is available here.

Meanwhile, grant-makers played a very important role in supporting the sector through the pandemic – data from 360Giving found that £2.4bn of grants were made during the pandemic. Most of these grants went to smaller charities, with an income between £100,000 and £1m per year. During the pandemic, 15% of charities that work with people of a particular ethnic or racial origin received a grant - a larger proportion than any other charity type specialising in particular users. This reflects efforts by funders to target and reach communities disproportionately affected by the pandemic and minimise inequalities.

Grant-makers may have to step up again as inflation rises – particularly their approach to large and multi-year grants, which will diminish in spending power in a significant way over the coming months and years. A three-year £100,000 grant or contract awarded in 2022 will be worth £90,660 next year and £88,300 in 2024, based on current Bank of England forecasts.

Charities will also be considering the costs involved in applying for grants over this process. Recent research found that medium-sized charities (revenue between £100k - £1m) spend 35% of their grant funding on applications for funds. That limits the amount of grant funding that can be spent on beneficiaries. During a period in which every penny counts for many organisations, there will be additional pressure for grant-makers to adjust their processes in order to reduce the cost of applications.

Inflation will also eat away at reserves

Inflation also eats away at savings. For charities, this is particularly important in the context of reserves.

Many charities have lower reserves now than they did prior to the pandemic: nearly one in four charities used reserves to survive during the pandemic, and the number of charities with an income over £500,000 that have no, or negative, free reserves increased from 9% in April 2020 to 28% in February 2021. This was necessary in order to both survive and meet need, but it has left many charities less resilient as they now face the cost of living crisis.

Building back those levels of reserves and maintaining them at appropriate levels will be particularly challenging during a period of high inflation. If charity expenditure rises in line with the Bank of England's inflation forecasts, the value of reserves held by charities will quickly fall.

Prior to the pandemic, charities with income between £500,000 and £1m had on average 4.21 months of expenditure held in reserves as cash.

By 2023, those reserves would cover just 3.48 months of activity if expenditure by those charities rises in line with inflation.

This means that a typical charity with an income of £1m in 2021 would need to increase its reserves by £73,430 by 2023 to make up that gap. This doesn't account for any reduction in reserves the charity might have experienced during the pandemic.

Prior to the pandemic charities with income between £1m to £10m had on average 3.78 months of expenditure held in reserves as cash.

By 2023, those reserves would cover just 3.13 months of activity if expenditure by those charities rises in line with inflation.

This means that a typical charity with an income of £5m in 2021 would need to increase its reserves by £329,650 by 2023 to make up that gap. This doesn't account for any reduction in reserves the charity might have experienced during the pandemic.

Charities and donors can both take some action

The totemic issue of inflation is one that no charity and no donor can overcome simply or totally. But in order to continue to effectively support people and communities in these demanding times, both charities and donors can take some steps to be as prepared as possible to manage inflation.

CAF's top tips for charities and donors looking to act on inflation's impact are below.

Charities

Review your fundraising strategy

Overall charity engagement remains below pre-pandemic levels. Consider how you are fundraising post-pandemic and your digital journey for donors.

Consider how existing resources can go even further

Look at whether you could make savings on utility bills in the same way as households. Reassess how any cash reserves are held.

Focus on your existing donors

It's typically cheaper to retain donors than it is to acquire new ones. Think about how you communicate your impact and need for support at this time.

Donors

Offer more flexible funding

Prioritise unrestricted donations or loosen some of your usual requirements for grants. Consider topping up previous donations to account for inflation or providing more flexibility with existing grants or loans.

Reassess your chosen causes and organisations

It may be time to reassess your giving strategy to ensure your funds are going where they're needed most.

Individual donors should ensure they claim Gift Aid

Every year more than £560m of Gift Aid tax relief is left unclaimed, meaning it doesn't end up with the charities delivering frontline services.

Summary

High levels of inflation are expected to persist for many months. This presents profound challenges for charities – for their staff, volunteers, beneficiaries, donors and finances. The one thing that every charity, regardless of size or structure, can do to prepare for this period is to increase their understanding of the impact of inflation on their environment. This briefing is designed to aid charities in doing that.

Charity costs are set to rise as a result of inflation. In particular:

- The rising cost of **energy** and other goods has already affected beneficiaries, volunteers and staff but is set to get worse. Charities' energy costs are also set to be impacted.
- Charities will have to increase **staff costs**. But were the sector's expenditure on staffing costs to keep up with inflation, the sector would need to find an additional £3.8bn by 2023 and £6.1bn by 2024, based on current expectations.

Inflation will affect charities' income. Not only will the public have less available to give but:

- The value of the **average donation and direct debits** will decline. The average donation has been stuck at £20 since 2017. Using the Bank of England's most recent inflation forecasts, we project that a £20 direct debit set up in 2017 will be worth a mere £15.30 next year and £14.90 in 2024.
- The value of multi-year **contracts and grant funding** will decline. A three-year £100,000 grant or contract awarded in 2022 will be worth £90,660 next year and £88,300 in 2024, based on current Bank of England forecasts. It is essential that inflation is taken into account when bids and applications are being made.

Additionally, inflation will eat into charities' **reserves**. For example, prior to the pandemic, charities with income between £500,000 and £1m had on average 4.21 months of expenditure held in reserves as cash. By 2023, those reserves would cover just 3.48 months of activity if expenditure by those charities rises in line with inflation. This means that a typical charity with an income of £1m in 2021 would need to increase its reserves by £73,430 by 2023 to make up that gap.

Pro Bono Economics will continue to provide the social sector with the economic analysis it needs at this challenging time, while CAF will continue to support charities and donors with research, advice and through its product offering.

Methodologies

To estimate the impact of inflation on charity staff costs, we utilise the NVCO Almanac's data on staffing costs and the Bank of England's August projections for inflation. We then estimate how much more money would need to be spent on staff salaries if charitable expenditure were to increase with inflation, assuming that the same proportion of expenditure is spent on staff wages.

To estimate the impact of inflation on donations, we utilise CAF's UK Giving Report to estimate the value of the median donation over time using the Bank of England's August projections. In addition, we use unpublished CAF giving data from 2022 to estimate the value of the first half of 2022's donations by the end of the year.

To estimate the impact of inflation on contracts and grant funding, we utilise the Bank of England's August projections to estimate the value of various-sized grants and contracts over the course of three years.

To estimate the impact of inflation on reserves, we utilised data from previous research by Clifford & Mohan 2020 on cash reserves held by charities prior to the pandemic. We then estimate the value of these reserves in current prices and estimate the amount needed to ensure they stay at the same value they were at before the pandemic, assuming that reserves were not spent down in the meantime and charitable expenditure increases in line with inflation.

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