bond

in association with haysmacintyre

Building financial reserves for resilient organisations

Approaches and recommendations for NGOs

Contents

About Bond

Bond is the UK network for organisations working in international development. We unite and support a diverse network of over 450 civil society organisations and allies to help eradicate global poverty, inequality and injustice. We support organisations to access funding and become financially sustainable through expert guidance, resources and insights.

About haysmacintyre

haysmacintyre is a leading firm of accountants and tax advisors with one of the largest charities and not for profit teams in the country. Our charities and not for profit team represents 40% of our entire business and we act for over 800 clients. International charities are one of our key focus areas, and we work with a wide range of organisations including those working through overseas branches and subsidiaries. We are experienced at completing grant funder audits for a wide range of donors including FCDO, USAID and several European governments.

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Building financial reserves for resilient organisations:
Approaches and recommendations for NGOs
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Executive summary

8 weeks is the median level of organisations' reserves in the sector	**85%** of organisations have 0-22 weeks of unrestricted reserves	**28** organisations studied, with turnover from £1m to £100m

At Bond, we support non-governmental organisations (NGOs) to diversify their income and explore business models to ensure their resilience as organisations. The UK's international development sector is experiencing a perfect storm: dropping public fundraising, continuing lack of clarity over Brexit, the UK's economic downturn, challenges to international non-governmental organisations' operating models, the Department for International Development and Foreign and Commonwealth Office merger, cuts to the UK aid budget, and now a reduction in official development assistance from 0.7% of gross national income to 0.5%. Growing financial reserves and adopting new financial strategies are more important than ever for organisations' sustainability and their work supporting the world's most marginalised people.

For this report, we examined the different attitudes and approaches to financial reserves in the international development sector. And we investigated the organisational policies that underpin unrestricted reserves and how organisations have built sustainable income streams.

We also explored where organisations failed to sufficiently prepare for or withstand considerable funding challenges. We've drawn lessons from these challenges to support organisations to rebuild their reserves and adapt their business models once economic circumstances improve post-pandemic.

Even before the Covid-19 crisis, most UK charities didn't have sufficient reserves. Accountancy and business advisory firm BDO's survey of the largest charities' reserves at the start of 2020 found that the average level of reserves covered only two months of running costs[1]. When fixed assets were removed, this figure more than halved. The University of Birmingham's study[2] of UK-based charities found a median level of reserves to cover just under four months of running costs. These surveys included charities across all sectors in the UK, not just international development organisations.

UK charities working in international development have lower levels of reserves than domestic charities, our research with chartered accountants and tax advisors haysmacintyre found. From a sample of 156 organisations, the mean level of unrestricted reserves was 11 weeks of total spend, with a median of 8 weeks. Having reserves below eight weeks may make it difficult for an organisation to survive a financial shock. Given the low level of reserves in the sector and the uncertainty of 2020 and beyond, organisations have to consider how they are going to transition to new business models. Future donor policy, the need to meet the Grand Bargain commitments, and difficult economic times will make this challenging. NGOs will need sufficient reserves. And the right approaches to managing them will be key.

[1] https://www.civilsociety.co.uk/voices/money-in-the-bank.html
[2] https://www.birmingham.ac.uk/documents/college-social-sciences/social-policy/publications/assessing-financial-reserves.pdf

Here are our recommendations from this study:

Make sure you have a reserves policy

Charities are expected to have a well-thought-through reserves policy. International development organisations should expect a difficult and unstable financial environment over the coming years. Their reserves policies will need to be reviewed regularly against their performance, changing risks and the evolving external environment. Importantly, the policy must be understood, and bought into, from senior leadership and the board to ensure it is followed.

Reserves should be part of your wider financial culture

Organisations should combine their reserves policy with an adaptive approach to financial and operational management. Preserving and building reserves should be a financial priority. Reserves should also be used to facilitate a transition to new business models.

Think long term

It takes a long time to build up financial reserves. The risk of a big reduction in a funding stream, such as the loss of a major grant in a future year, should be factored into the reserves policy early. Boards and senior leadership need to be forward thinking and support the organisation to build up sustainable reserves by running an unrestricted surplus consistently until they reach their target. This will mean having a clear strategy for building reserves through surpluses, two major sources of which are direct unrestricted donations and good cost recovery. The latter will mean having good understanding and support from institutional donors.

Understand the different components that make up your reserves

Organisations should consider a layered approach to their reserves policy, where each major income or expenditure risk is taken into account. The reserves should be informed by the mission of the organisation, not just the core operations. The best examples of this are where the organisation has reserves equivalent to three to six months of running costs for each area of its work regarded as long-term critical. An organisation may benefit from having funds in addition to its free reserves. The rationale for building these extra 'designated funds' could be to make specific investments, allow for large variations in an income stream or a reasonable expectation of an upcoming, and considerable, cost.

Carefully balance your reserves policy

There is a balance of reserves that is just right for an organisation. Minimums are needed to gain donors' confidence. But having a really high level of reserves may suggest the organisation is not using funds sufficiently for their charitable purpose or does not need funding from a donor. Donors should not regard charities that have good reserves necessarily as a concern. There should also be an acknowledgement that different charities have different needs in relation to the reserves held.

Funding supporting and resources

At Bond, we support organisations to access funding and become financially sustainable through expert guidance and insights.

For over 20 years, we've helped our members and the wider sector to access funding, share fundraising insights and shape policy. Here are some ways we can help you:

- Explore the big issues and emerging trends in public fundraising, donor funding and partnerships at our **interactive webinars**.
- Learn new skills and insights with our **highly practical training courses**, which focus on winning and managing FCDO grants, and fundraising from foundations and institutions.
- Check out our **resources and guidance** on diversifying income, impact investing and securing sustainable funds from institutional donors and foundations.
- Find **upcoming funding opportunities** on our regularly updated directory.
- Join one of our **working groups** to share expertise and experiences with other NGO professionals. These groups also undertake joint advocacy in areas, such as institutional funding, commercial contracts and impact investing. Our main Funding Group currently has over 800 members.

Go to bond.org.uk/funding

Glossary

In analysing income, we used eight categories of income sources. Descriptions refer to both an income type and an income source, for example, 'government' (source) and 'grants' (type).

Individual giving

Includes voluntary donations from the general public, high net-worth donors and legacies.

Earned charitable income

Generated when fees are paid by an individual for a charity to deliver goods or services that further the charity's objectives. It could consist of fees for services such as training, rent of rooms, research etc.

Earned fundraising income

Generated specifically to raise funds for the charity from individuals, for example, from the selling of donated goods, or admission fees for fundraising events.

Investments

Received as a return on investment assets, for example, property, stocks and shares, or other similar assets.

Government grants

Includes grants from UK government departments, local authorities and other government bodies, as well as overseas governments and supranational and international bodies, such as the European Union, United Nations and World Bank. As an award provided by a funder for certain types of activities, these grants can be unrestricted but increasingly tend to be restricted to the purposes specified.

Government contracts

Fees for the provision of a specific service. This report specifically looks at trends in contracts with governments.

Corporate

Grants and sponsorship from businesses, and any contracts with businesses to provide a service.

Voluntary sector

All income, such as grants and earned income (contracts), from the voluntary sector, including the National Lottery, and independent trusts and foundations.

Reserves

Commonly applies to unrestricted funds held by a charity that are not tied up in fixed assets. It explicitly excludes restricted funds and other types of funds.

Surplus/deficit

In this study, this refers to the net gain or loss in unrestricted funds between financial years.

Mean

A type of average calculated by adding all the values in a sample and dividing them by the number of items.

Median

A type of average that is the value of the middle item in a range placed in order of size of value.

1 — Methodology

Out of a sample of 156 organisations, we investigated a sub-group of 28. We looked closely at how they view their reserves and their experience of running surpluses. We also compared their reserves with other organisations throughout the international development charitable sector in the UK.

Measured in terms of weeks of spend, the organisations in this smaller sample have a median of 12 weeks of total costs and a mean of 15.5 weeks. As these organisations agreed to participate in closer analysis, it is not surprising they have higher average levels of reserves than the wider sector and have spent more time developing an approach and policy to managing their financial reserves. From these organisations, we have included in this report four case studies that illustrate approaches that work well for the selected organisations. We have looked at their expectations for dealing with the current economic difficulties and the role they expect their reserves to play.

The data used in this research has come from a detailed survey of 28 international development organisations ranging in turnover from less than £1m to greater than £100m. The organisations are self-selected but representative of the wider Bond membership in terms of size and type of organisation. This data has been augmented by a desk study by chartered accountants and tax advisors haysmacintyre on these organisations' last four years of annual accounts.

We also interviewed the four organisations to inform the case studies in this report.

Guidance by the Charity Commission to charities on their reserves policy:

When talking about reserves, the Charity Commission focuses its guidance on the role of trustees and their need to "protect and safeguard the assets of their charity". Its main requirement appears to be that a policy exists and that there is a logical, tailored approach. The following quote is from the Charity Commission[3] website CC19 and is among the more helpful guidance on reserves policy.

'The policy should ensure that it:

- fully justifies and clearly explains keeping or not keeping reserves
- identifies and plans for the maintenance of essential services for beneficiaries
- reflects the risks of unplanned closure associated with the charity's business model, spending commitments, potential liabilities and financial forecasts
- helps to address the risks of unplanned closure on their beneficiaries (in particular, vulnerable beneficiaries), staff and volunteers'

To help clarify the recommendations around the reserves policy, the guidance also focuses on what should **not** be considered part of the reserves:

- 'tangible fixed assets used to carry out the charity's activities, such as land and buildings
- programme-related investments, those held solely to further the charity's purposes
- designated funds set aside to meet essential future spending, such as funding a project that could not be met from future income
- commitments that have not been provided for as a liability in the accounts'

The clearest and most useful single statement to explain unrestricted reserve funds and their function is "spending those funds may adversely impact on the charity's ability to deliver its aims".

What is interesting about the guidance is:

- there is no guide as to the size of the reserves
- they imply funds other than the unrestricted reserves could be useful in an organisation

[3] https://www.gov.uk/government/publications/charities-and-reserves-cc19/charities-and-reserves

2 —
An analysis of 28 organisations' reserves

The UK's international development sector is experiencing a perfect storm: dropping public fundraising, continuing lack of clarity over Brexit, the UK's economic downturn, challenges to international non-governmental organisations' operating models, the Department for International Development and Foreign and Commonwealth Office merger, cuts to the UK aid budget, and now a reduction in official development assistance from 0.7% of gross national income to 0.5%. Growing financial reserves and adopting new financial strategies are more important than ever for organisations' sustainability and their work supporting the world's most marginalised people.

For this report, we examined the different attitudes and approaches to financial reserves in the international development sector. And we investigated the organisational policies that underpin unrestricted reserves and how organisations have built sustainable income streams.

We also explored where organisations failed to sufficiently prepare for or withstand considerable funding challenges. We've drawn lessons from these challenges to support organisations to rebuild their reserves and adapt their business models once economic circumstances improve post-pandemic.

We studied the accounts of 28 organisations, looking at their levels of unrestricted funds over the last four years as a proportion of their total turnover, summarised in the graph (1) below. We have divided the reserve levels into five-week segments and one larger segment.

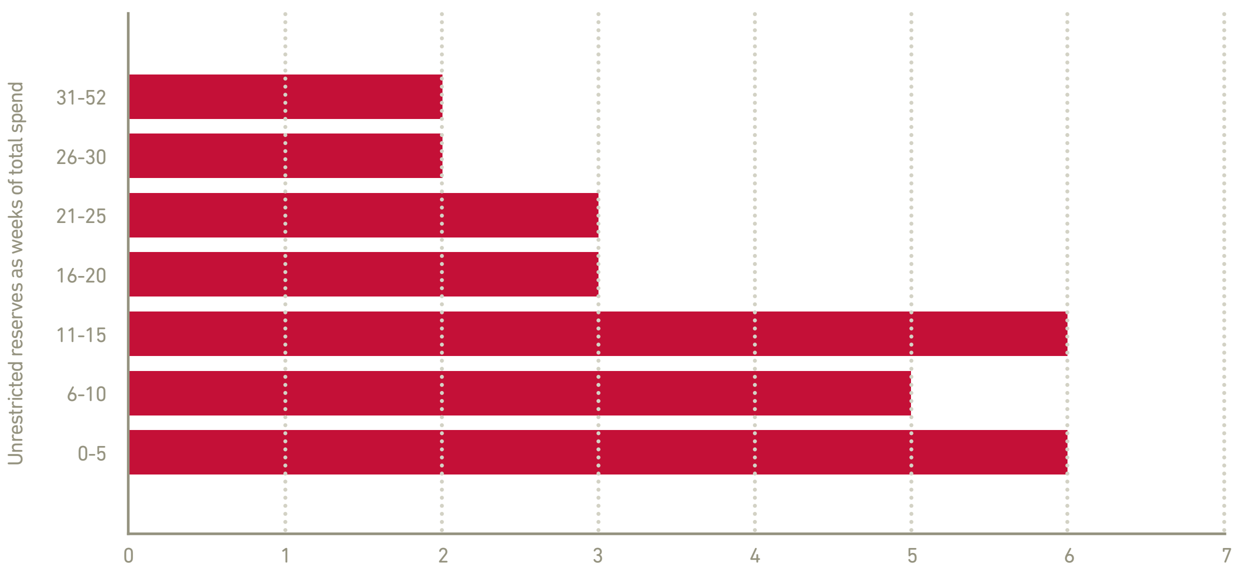
The graph shows the spread of reserves among the 28 organisations. In this sample, there are fewer at the lower end of reserves and relatively more with 'above average' levels of reserves.

- The median level of reserves in this sample is 12 weeks
- The mean level of reserves in this sample is 15.5 weeks

These 28 organisations, as a group, have stronger levels of reserves than the sector as a whole. Carrying out a wider study of 156 international development organisations, we found:

- The median level of reserves in the sector is 8 weeks
- After excluding the eight lowest and eight largest levels of reserves, the mean is 11 weeks
- 85% of organisations have unrestricted reserves of between 0 and 22 weeks
- There are a handful of organisations that have such high levels of reserves they could be measured in years

Figure 1: Showing the sample group of 28 organisations and their levels of unrestricted reserves



Developing a reserves policy

Among the organisations surveyed, there was a wide range of interpretations and operationalisation of their reserves policy.

Of the 28 organisations, 13 (46%) explicitly focused on unrestricted reserves and 4 (14%) said they look at levels of both unrestricted and restricted reserves. Interestingly, three organisations (11%) said they just looked at restricted funds[4]. The remaining organisations saw their reserves as either risk based, based on programme demands, or calculated as core costs for the organisation.

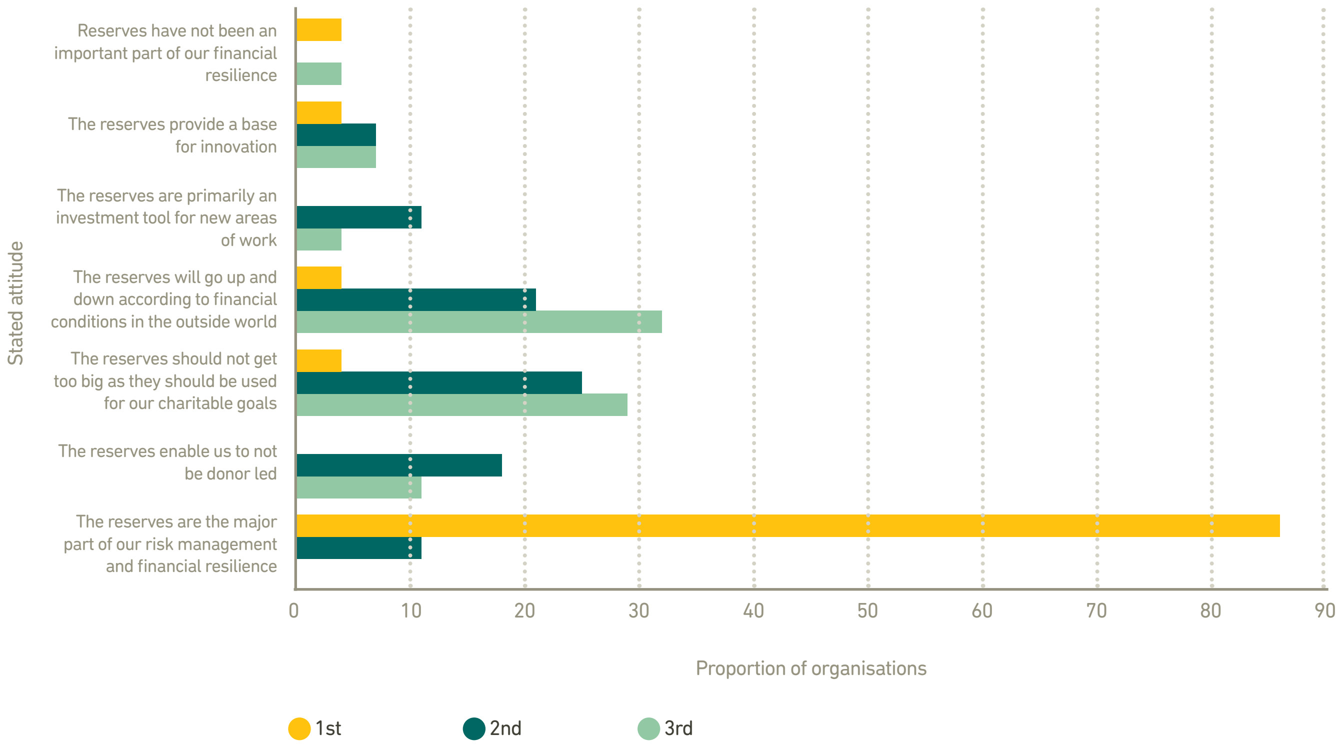
The Charity Commission guidance states restricted funds should fall outside the definition of reserves but that they may have an impact on the levels of reserves that need to be held. This appears to be the interpretation that some of the organisations have taken, when they describe their policy as being risk based or are looking at the programme demands for the coming year.

There was a tendency among larger organisations to describe their reserves policy as either risk based or based on a core cost calculation (which often aimed for about 13 weeks of those costs). The smaller organisations had policies that resulted in required reserves of between 4 and 52 weeks. Of the organisations surveyed, only nine organisations (32%) said that they were expecting to be below their policy level of reserves this year. This shows that this sample is likely to be more resilient and in a stronger financial position than many organisations in the sector.

Why organisations should build reserves

In this study, we asked organisations which statement best defines their attitude and approach to their reserves. We asked them to rank their top three choices. These are laid out in the graph (2) below.

Figure 2: Showing the top three attitudes to reserves among all organisations in the sample, answering the question 'Which of the statements is most relevant to your organisation?'



[4] The Charity Commission guidance is clear that restricted funds should not be considered part of the reserves.

The results showed:

- A clear majority (85%) of the organisations sampled saw their reserves as a 'major part of their risk management and financial resilience'.
- Many of the same respondents also felt that 'reserves should not get too big as they should be used for charitable goals' and 'the reserves will go up and down according to financial conditions in the outside world' reflected their approach.

Both of these indicate a traditional and orthodox approach to reserves; that is, they fulfil a smoothing and risk management function for an organisation. By contrast, five organisations (18%) saw their reserves as a resource for innovation and three saw them as an investment tool – both indicating they saw the reserves as a mechanism for change and an opportunity for the organisation to be strategic and invest in their charitable aims.

It is worth noting that of the organisations that describe their reserves as an investment or a base for innovation, just under half had the highest level of reserves in the survey.

Case study: The Leprosy Mission of England and Wales

A medium-sized organisation with a multi-layered reserves policy designed to support its work in countries other funders don't invest in

The Leprosy Mission of England and Wales supports hospitals and training colleges that combat leprosy. It has a turnover of around £8m. Legacies bring in a good source of income but this sometimes means income can be unpredictable and uneven.

Continuity of funding to partners is very important, so the organisation aims to keep at least three months of total spend (including grants) as a reserve. These reserves are explicitly mission focussed, rather than focussed on just core costs, so they are measured as a proportion of total spend. The charity has designated funds on top of its reserves, holding an additional £700k to help smooth out the legacy income. It also has a property reserve of £430k, ready to be invested in a new property, which could be a hospital or office.

As the organisation increases its portfolio of grants, for example with the Foreign, Commonwealth and Development Office or other donors, it recognises this could move its work towards countries donors want it to work in and away from others that are strategic but more difficult to fundraise for. It has designed its legacy reserve fund to support the countries it struggles to fundraise for.

The charity's large reserves support and help it invest in fundraising. It can match funding by donors, which has allowed it to take on more work with confidence and from diverse funders.

The Leprosy Mission of England and Wales had the highest total reserves (if we include designated funds) in the sample of 28 organisations, in terms of weeks of spend. Its approach to reserves, with different layers and pots, reflects its income profile and helps support its partners.

What prevents an organisation from building reserves

The graph (3) below shows the most common issues that prevent organisations from building reserves.

Figure 3: Showing the top three attitudes to reserves among all organisations in the sample, answering the question 'Which of the statements is most relevant to your organisation?'

Our research showed:

- Over half the respondents (64%) said 'lack of opportunity' is the most common issue that prevents them from building reserves and implies if they were given an opportunity, many would like to be able to run a surplus and build their reserves.
- For some organisations (11%), there has not been the need to build up reserves recently, as the organisation felt their reserves were sufficient and within or above policy.
- One organisation had been unable to build up reserves because the 'primary driver has and continues to be static/declining unrestricted income'.
- Another response suggested that organisational culture inhibits running surpluses. One organisation explained this as 'in-built resistance to cost management and reduction from certain key parts of the organisation'.
- Interestingly, many respondents (46%) were concerned about what donor attitudes would be if the organisation built up their reserves. By contrast, no organisation considered the position of the Charity Commission as a bar to building reserves. Some respondents (18%) expressed that their board members prevented them from building their reserves. The board is ultimately responsible for ensuring funds are being used for charitable purposes but it also has a responsibility to ensure the financial resilience of the organisation. Building reserves is a delicate balancing act, with donors, trustees and organisational staff all keen to spend money directly on programmes as efficiently as possible without compromising the resilience of the organisation. Boards and senior leadership need to be forward thinking and support the organisation to build sustainable reserves by running an unrestricted surplus consistently.

Case study: Village Water

A small organisation that has built reserves over several years and is preparing for a drop in income

Village Water is charity that works in Mozambique and Zambia, focusing on public health interventions such as handwashing, latrines and safe water. Over several years, it has built reserves through favourable exchange rates and other savings. It has a turnover of around £800k and reserves of around £200k, which is above its reserves policy.

The charity has a multi-layered reserves policy that currently adds up to £120k, which includes three months of core costs totalling £60k and another £60k to support three months of spend by a portfolio of partners. It encourages partners to hold their own reserves but recognises this is not always possible. With its current levels of reserves being above £120k, the organisation is looking to make investments that would benefit its work, such as the purchase of a new vehicle.

The charity has traditionally had a healthy flow of unrestricted income, such as from community groups, but unfortunately these lines of income are currently about 40% below what they normally have been. It has received some funding from government to build boreholes and pumps. The organisation receives funds from trusts, and while it has seen a drop in income from some it is more hopeful for next year. It knows that to attract funding from trusts it needs to have reserves neither too low nor too high.

To counter the drops in income, the charity is carrying out regular finance reviews and has developed a shorter planning horizon so it can adapt funding based on programme demands. It is prepared for reserves earmarked for partners to go down to a level of eight weeks if necessary, as there is a plan in place to manage it. It expects to maintain UK costs reserves at about three months.

3 —
How to build your reserves

To generate a surplus and build reserves, an organisation needs to have a good income and expenditure strategy. In this section, we look at the two ways you can take to do this.

1. Build your reserves by generating income

The size of an organisation can determine how it can best generate an income and build reserves. As part of our research, we asked organisations to identify their top income streams by growth and their current net unrestricted surplus contributions. We then broke them down by organisational size.

Figure 4: Showing the top three income streams by growth over last three years and current net unrestricted surplus contribution of sub-sample of 13 organisations declaring over £2m

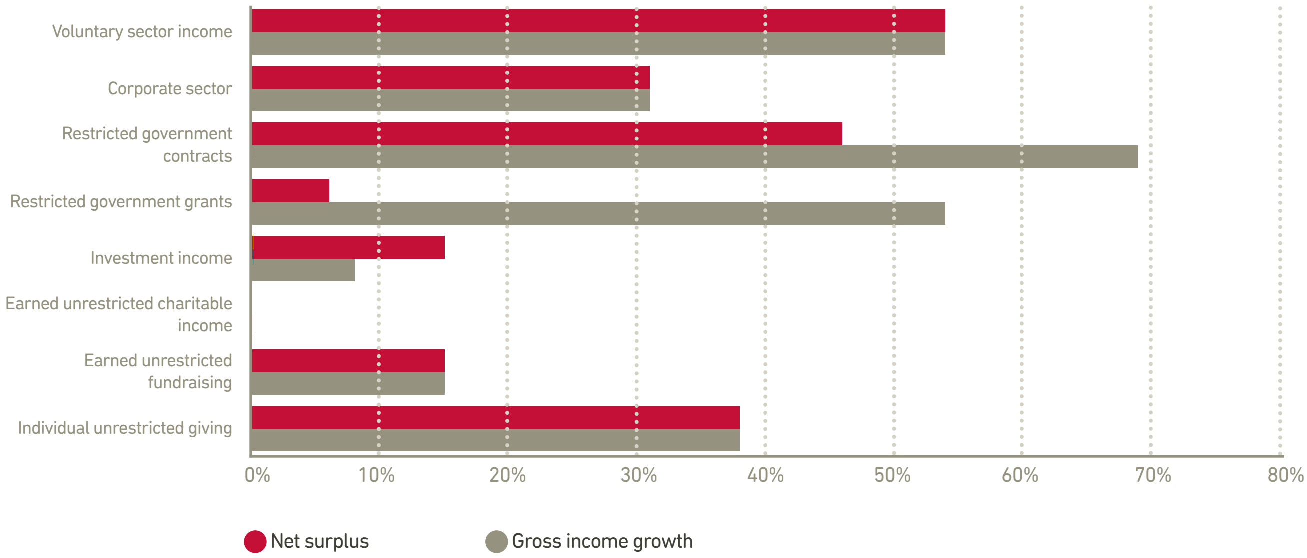
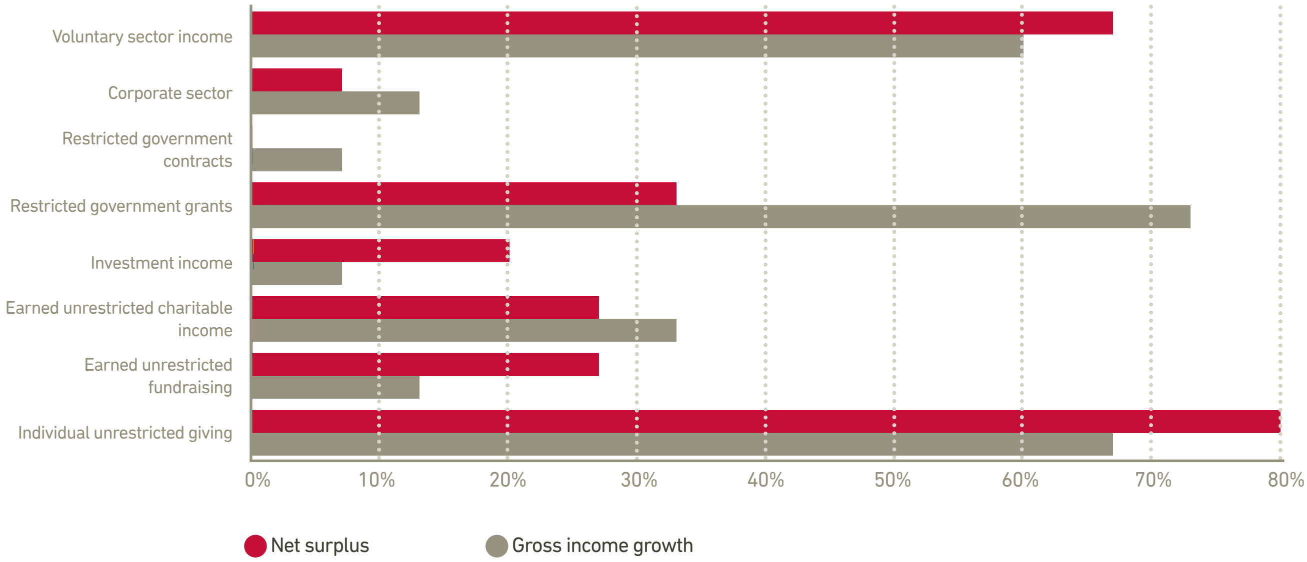


Figure 5: Showing the top three income streams by growth over last three years and current net unrestricted surplus contribution of sub-sample of 15 organisations declaring under £2m



Individual giving is the most effective way to build a surplus regardless of the organisation's size

- Fourteen of the 28 organisations (50%) said individual giving was the best way to build reserves, as it yields good surpluses.
- Of the 15 smallest organisations, all but 3 (80%) said individual giving is one of their top surplus earners.

Building a good supporter base can take years. Larger organisations that have more resources are able to invest money in understanding their supporters and creating innovative fundraising campaigns to generate income. But smaller organisations often have loyal supporters, particularly those who have a direct connection to the charity. Smaller organisations may also be able to take a more nimble approach. This makes this income stream a comparative advantage for smaller organisations in trying to build surpluses and therefore reserves.

Voluntary sector income is seen as a reliable and flexible source of income that can also contribute modest levels of surplus.

Voluntary sector income makes a similar contribution to individual giving for both small and large organisations. It was rarely scored as the best way to generate a surplus, but it was in the top three for 17 organisations (61%). This is technically a restricted source of income, so it's a testament to its flexibility that organisations see it as a good way to achieve an unrestricted surplus. This kind of income was particularly important to smaller organisations, both in gross growth and in the generation of surplus.

Income from restricted grants has been a steady area of growth for organisations.

- Eleven of the 15 smaller organisations (73%) said restricted grants were one of their top streams for income growth, but less so a source of surplus (33%).
- Almost all of the larger organisations that saw this as a source of growth (86%) also saw it as a source of surplus.

Larger organisations could see income from restricted grants more positively as a source of surplus because relative to smaller organisations they have the scale and leverage to agree favourable grant conditions. Smaller organisations stated a great deal of scepticism that this income stream could be a source of surplus: 'our area of focus means we haven't been able to identify funders willing to invest outside of our service provision'.

Even larger organisations have experienced the difficulties of building financial resilience from restricted grants: 'few donors willing to provide entirely unrestricted funding. Where funding is for restricted purposes, contribution for central costs is often one of the areas subject to the most restrictions/negotiation'.

Government contracts is the income stream with the most stark difference between small and large organisations.

- Government contracts barely featured as an income stream for small organisations, with just one small organisation (7%) seeing it growing and none seeing it as a source of surplus.
- Six out of 13 large organisations (46%) identified government contracts as a way to generate a surplus with 9 (69%) seeing growth in this stream.

Government contracts are likely to be a better way to generate income for larger organisations as they have the internal resources and skills to manage complex government contracts and money to pre-finance. Government commissioners prefer to award contracts to larger organisations because they see smaller organisations as risky.

Larger organisations identified corporate support as a growth area.

- Corporate support could be either unrestricted or restricted income, but overall it does achieve unrestricted surpluses commensurate with its growth.
- The same larger organisations that saw their corporate income grow (31%) also regarded corporate support as a high source of surplus.
- Corporate support was less regarded as a growth area (13%) or a source of surplus (7%) for smaller organisations.

Earned fundraising income and earned charitable income allows some organisations to build a surplus but it is not right for all organisations.

- Larger organisations tend to benefit from earned fundraising, with 33% seeing growth and 33% seeing it as a source of surplus. Even small organisations claimed similar percentages (33% and 27% respectively).
- Earned fundraising appeared to be a more difficult income area in 2020, as opportunities for this income stream have been among the hardest hit. Nearly all the organisations for whom earned fundraising is an important income stream (86%) expected it to be among the most affected.
- Smaller organisations are comparatively better at raising income through earned charitable fundraising, as they tend to have a niche that can be monetised. These were investigated in the Bond Financial Trends Report[5]. No large organisations in this sample saw charitable earned income as either an area of growth or a source of surplus.

Case study: Overseas Development Institute

A large research organisation that experienced financial difficulties in 2018 but has built its finances and reserves again over the last couple of years

The Overseas Development institute (ODI) experienced financial difficulties which meant it had to use a substantial amount of its reserves. The organisation has since been on a path to rebuild its reserves by running a surplus and has gone from having a sizeable deficit to a healthy surplus.

At a challenging time, the ODI's reserves helped it turn around its finances in a measured way with minimal disruption. One of the things it leaned from the experience was that it was able to recover its finances by increasing its income and the diversity of its funders with improved cost recovery, rather than only through cutting expenses. Its operations generated a sufficient operational surplus that meant it could invest from within the operational budget.

The organisation's finances have now improved, so it has taken a risk-based approach to update its reserves policy. In future, the ODI will be aiming for reserves of between three and six months of payroll costs plus 25% of operating costs, in addition to setting aside contingency budget for specific risks.

The ODI has annual expenditure of £36m so will be looking for reserves of between £4m and £7m. This would be five to nine weeks of total spend for the organisation, which is slightly low when compared with a median of eight weeks for the wider sector. ODI has chosen this approach because a high proportion of its funding is restricted, with a large part of that being passed through as sub-grants to partners. Its partners are often used to fixed-term contracts of work and have financial models that would support that. ODI believes by being agile and identifying its funding risks, its two-layered reserves policy will be sufficient and help it manage its finances with targeted precision.

[5] https://www.bond.org.uk/resources/financial-trends-2018

2. Build reserves by managing costs effectively

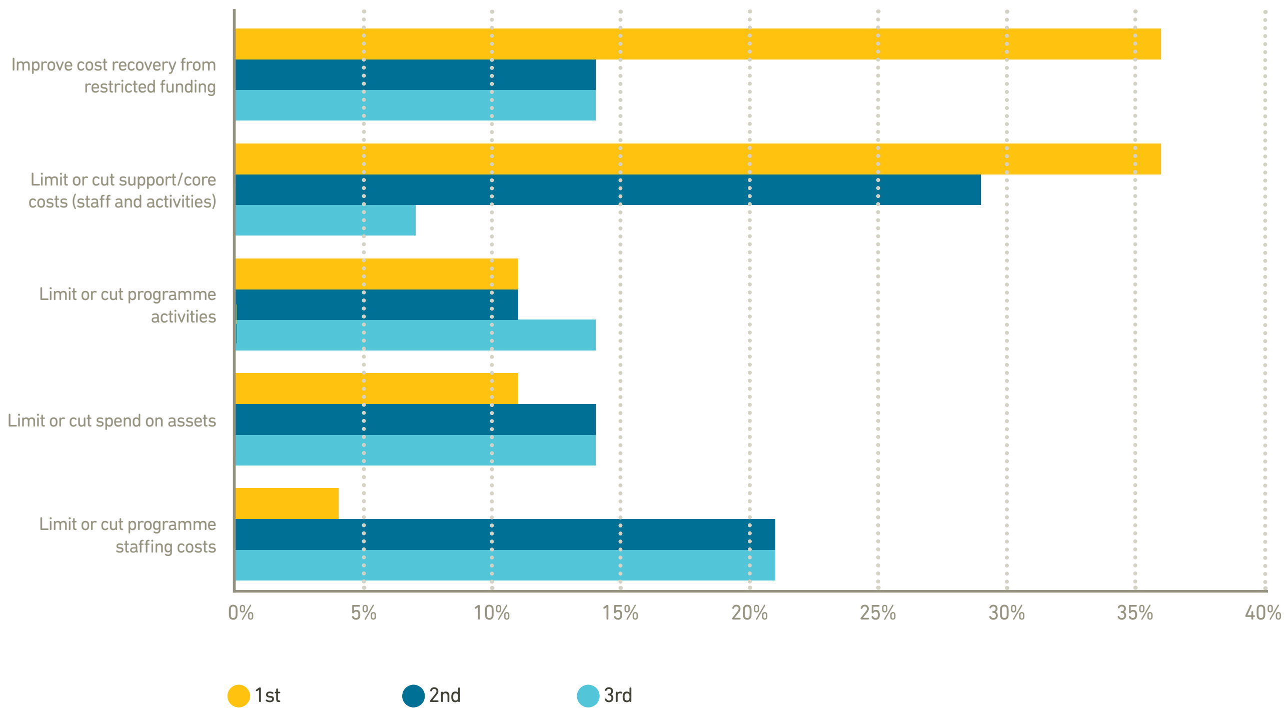
Income is not the only way to build a surplus. You can also do it by managing costs better, which may be easier than generating income. As part of our research, we asked the participants to identify how they reduced costs within their organisation. The responses are shown in the graph (6) below.

The most popular way to reduce costs and generate a surplus are by getting better cost recovery from restricted grants and reducing support costs.

- Reducing core costs is easier for an organisation to argue for or agree as these don't challenge the charitable objectives (though care should be taken to ensure this does not compromise the charity's ability to meet its legal or contractual requirements).
- But improved cost recovery (say from restricted grants) requires taking money from direct programme costs and paying for core unrestricted funds (such as building reserves) and needs the agreement of funders.
- Improved cost recovery also requires funders to give true cost recovery for their grants and also a level of understanding within the organisation on the true cost of delivering its work.
- Improved cost recovery is likely to be more popular than cutting programme activities directly because it's easier for finance directors to engineer, but it is ultimately the product of a negotiation with funders.

There are a considerable number of organisations (36%) that say they will cut programme activities to achieve a surplus and others that will also cut programme staffing (46%). It is clearly a dilemma for organisations, as often it will come down to a choice between delivering the programme in the communities they work in and building financial resilience for the organisation. This is a delicate balancing act, where delivering the programme should be a priority while also working to ensure the organisation is sustainable and can continue its work.

Figure 6: Showing attitudes to using cost cutting to manage surpluses



4 —
Organisations' financial expectations going forward

Income levels are expected to drop

The UK's international development sector is experiencing a perfect storm: dropping public fundraising, continuing lack of clarity over Brexit, the UK's economic downturn, challenges to international non-governmental organisations' operating models, the Department for International Development and Foreign and Commonwealth Office merger, cuts to the UK aid budget, and now a reduction in official development assistance from 0.7% of gross national income to 0.5%. The impact of these are still becoming apparent.

As part of the survey, we asked organisations what they expect the outlook to be over the next couple of years.

- Seven organisation (25%) thought they would be largely unaffected.
- Two (7%) thought they may have to close.
- Nine (32%) plan to use their reserves to manage their resilience.

While all income streams are under pressure, in most cases this is in proportion to the historical surplus an organisation has had from a particular income stream. The one exception is the reduction in government grants and contracts, where many are expecting this to be disproportionately difficult. Historically, these have been a good source of surplus for larger organisations, so not only are these organisations losing the funding that contributes to their core costs and programme funding, they also have to use other funds, including reserves, to compensate for the loss. Nearly all the large organisations identified government grants and contracts as the greatest area of loss over the coming years.

NGOs are looking at ways to reduce their costs

Despite the organisations taking part in our research generally having more reserves than the average organisation in the wider sector, they are still looking to identify other coping strategies alongside using their reserves. Only seven organisations (25%) said they expect to be largely unaffected by the current financial crises, while nine (33%) said they had dipped into reserves.

Case study: Ecologia Youth Trust

A small organisation with limited funding but investing in reserves

Ecologia Youth Trust is a small organisation with branches in the UK that also works in Russia, Uganda and Kenya, helping communities to support women and children, including orphans. It also helps support schools and small-scale agriculture. The organisation has a turnover of around £500k, and a large part of its costs are small-scale grants to partners.

A few years ago, Ecologia Youth Trust received a one-off large donation and made the decision to keep £50k of this as reserves, something it had not been able to do before. It tries not to use the reserves as they perform important functions:

- The reserves are a kind of insurance policy that can keep the organisation supporting its partners when there are gaps in income.
- Donors like to know the organisation has a sufficient reserve before giving grants, as this shows it has a strong financial base. Having reserves acts as a kitemark of financial responsibility.

Ecologia Youth Trust raises unrestricted funds by running a volunteer programme and through individual giving. Since the Coronavirus crisis, the organisation has not been able to run the volunteer programme, so income from that stream has fallen to zero. It has continued to receive strong support from individual supporters; however, it cannot be certain that will continue at the same level in the coming year.

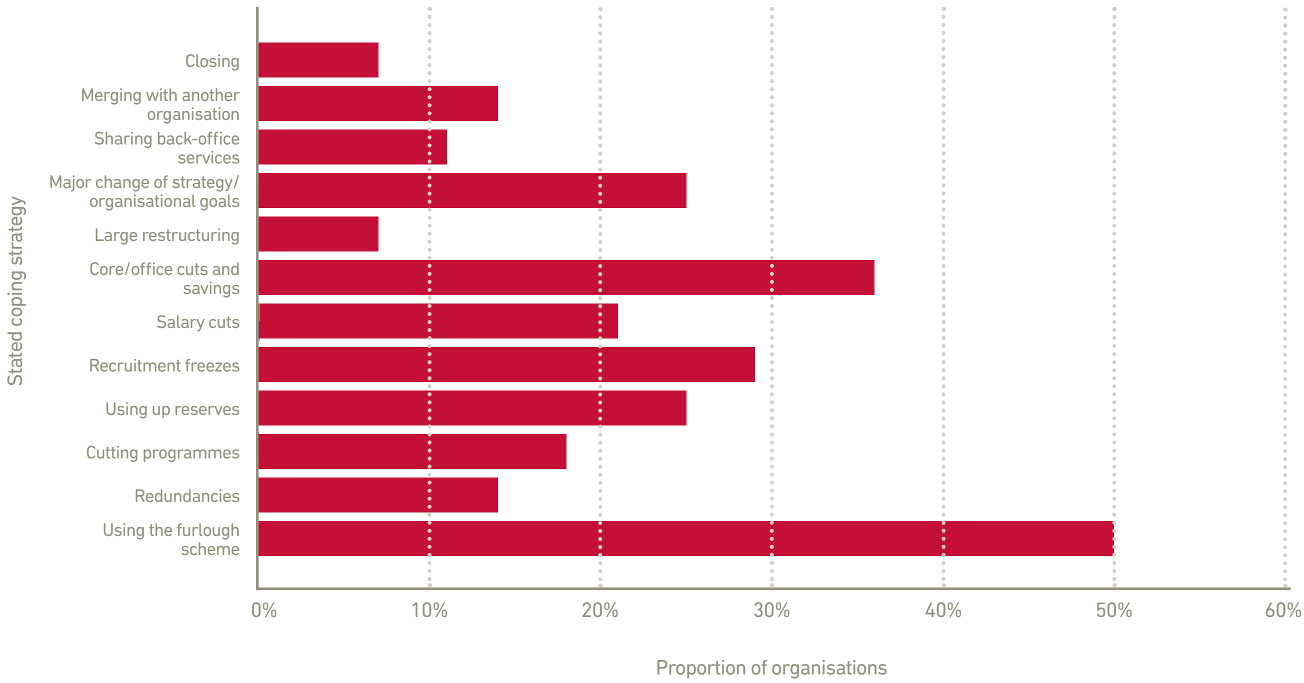
The organisation has a very small team of staff and low core costs, so the reduction in income has an almost direct impact on the flow of funds to partners. It tried using the furlough scheme but this merely resulted in lower fundraising. It is now grappling with the dilemma of trying to continue to support its programmes and the communities it works with, while keeping a sufficient level of reserves. Ecologia Youth Trust is now more committed to building levels of reserves for the coming year to ensure it can support its international projects.

Our research showed:

- Organisations are using a range of cost-saving strategies to survive; in particular, the furlough scheme is popular, with 50% of organisations using it as a way to manage their costs.
- Eight organisations (28%) have used recruitment freezes.
- Six (21%) have used salary cuts.
- Four (14%) have already started redundancies.
- Reducing office expenses is also a popular way to reduce costs, especially as many may not currently be using offices because of social distancing.

These actions will in many cases be unavoidable given the downturn in all types of income. All will be very disruptive to the organisation. Though some are temporary changes (for example, staff reductions), many will result in permanent changes. Having sufficient reserves would either smooth the way to a more sustainable business model, or avoid the need for short-term painful cuts.

Figure 7: Showing the coping strategies of organisations facing current financial challenges



5 —
Lessons learned

As part of the study, we gave respondents the chance to share the most important things they had learned about their reserves.

Many organisations explicitly mentioned that reserves were essential to their organisation's survival. One pointed out that they valued their 'prudence with regard to reserves, thankfully we had been holding reserves in excess of our policy'. Another organisation put a figure on it: 'reserves are key – and more than six months is entirely reasonable'.

In total, 7 of the 15 smaller organisations (47%) highlighted the importance of their reserves. They said the importance and value of reserves was an important thing they have learned, compared to just 1 of 13 of the larger organisations (8%). Just under half of all organisations (46%) said they planned to look at revising their reserves policy for the long term, incorporating what they had learned this year and how things might be improved for the future.

As an example of holding reserves to support partners, a 'small and flexible' organisation said they had learned about 'carefully manag[ing] our reserves which were at a level sufficient enough to enable us to continue supporting partners and response[sic] to the most urgent needs. The importance of building reserves in previous years has been highlighted, as well as the importance of loyal supporters who understand our work'.

Many organisations said they had learned it was important to have a flexible and agile business model. This was especially true among larger organisations. In the context of funding, a larger organisation described the need for an 'up to date (digital) approach to fundraising'. Another said 'liquidity is a top priority. Agility is essential – rapid decision making has been required e.g. repurposing programmes to Covid which has helped maintain cashflow and donor goodwill'.

Sometimes, very agile or flexible financial models can be an alternative to high levels of reserves and a way to manage an organisation if reserves are very limited. One organisation had learned to 'anticipate and model; think ahead beyond the current FY and think what you can do now to reduce the impact of later FY shocks. Be agile in your resourcing models and contracts to enable you to shrink and expand. Review all your costs annually and don't just "renew" without a competitive procurement process'.

Given that the two most cited ways to achieve financial resilience were agility/flexibility and strong reserves, one would expect that the strongest organisations would reflect both. However, sometimes, high levels of reserves may mean organisations don't feel the need to be agile. And if an organisation has to rely on agility alone, this could result in non-strategic decisions.

Building surpluses into the context of an overall agile financial model appears to be the best approach to programme and organisational development. They should positively feed off each other; an agile approach could help build surpluses and greater reserves would definitely create opportunities to be more agile.

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