

# Linking Money to Mission: A Balancing Act

by

Nonprofit Finance Fund

**Brent Copen, Director, Western Region**  
**Nima Krodel, Manager, Financial Services**

**September 9, 2008**



## *Linking Money to Mission: A Balancing Act*

**It is important for nonprofits to understand that their financial health has a direct impact on their ability to provide high-quality programs to the community.**

**Thus, nonprofits must devote resources to mission and programs while also making sound financial decisions that enable future growth and sustainability.**



# NFF VANTAGE POINT

- Founded in 1980, NFF is the oldest and largest financial institution for the social sector.
- Provide financing, advisory services, and advocacy
- Work with “both sides of the desk”; clients include nonprofits, social enterprises, donors and investors
- Assets of \$75 million; total investment nearly \$1 billion; direct loans, \$170 million
- Federally-certified 501c (3) Community Development Financial Institution (CDFI)
- National, with offices in DC, MI, CA, MA, PA, NJ, NY



## IN TODAY'S SESSION, WE WILL:

- Explore common misperceptions and underlying financial realities about nonprofits
- Explain how finances support (or undermine) programs
- Discuss approaches that build and sustain financially healthy enterprises



Why do nonprofits with excellent programs struggle financially?



# MONEY RULES 101: FOR-PROFIT ENTERPRISE QUIZ

## TRUE OR FALSE?

Cash is fungible (i.e. “liquid”) **TRUE**

Price is determined by cost, consumer, competition. **TRUE**

The consumer buys the product. **TRUE**

Growth eventually increases profits  
or the business fails. **TRUE**

Investment in infrastructure is seen as necessary;  
Overhead is a regular cost of business. **TRUE**

Profits drop to the bottom line  
& are used in the business. **TRUE**



# MONEY RULES 101: NONPROFIT ENTERPRISE QUIZ

## TRUE OR FALSE?

Cash is fungible. **FALSE**

Price is determined by cost, consumer, competition. **FALSE**

The consumer buys the product. **FALSE**

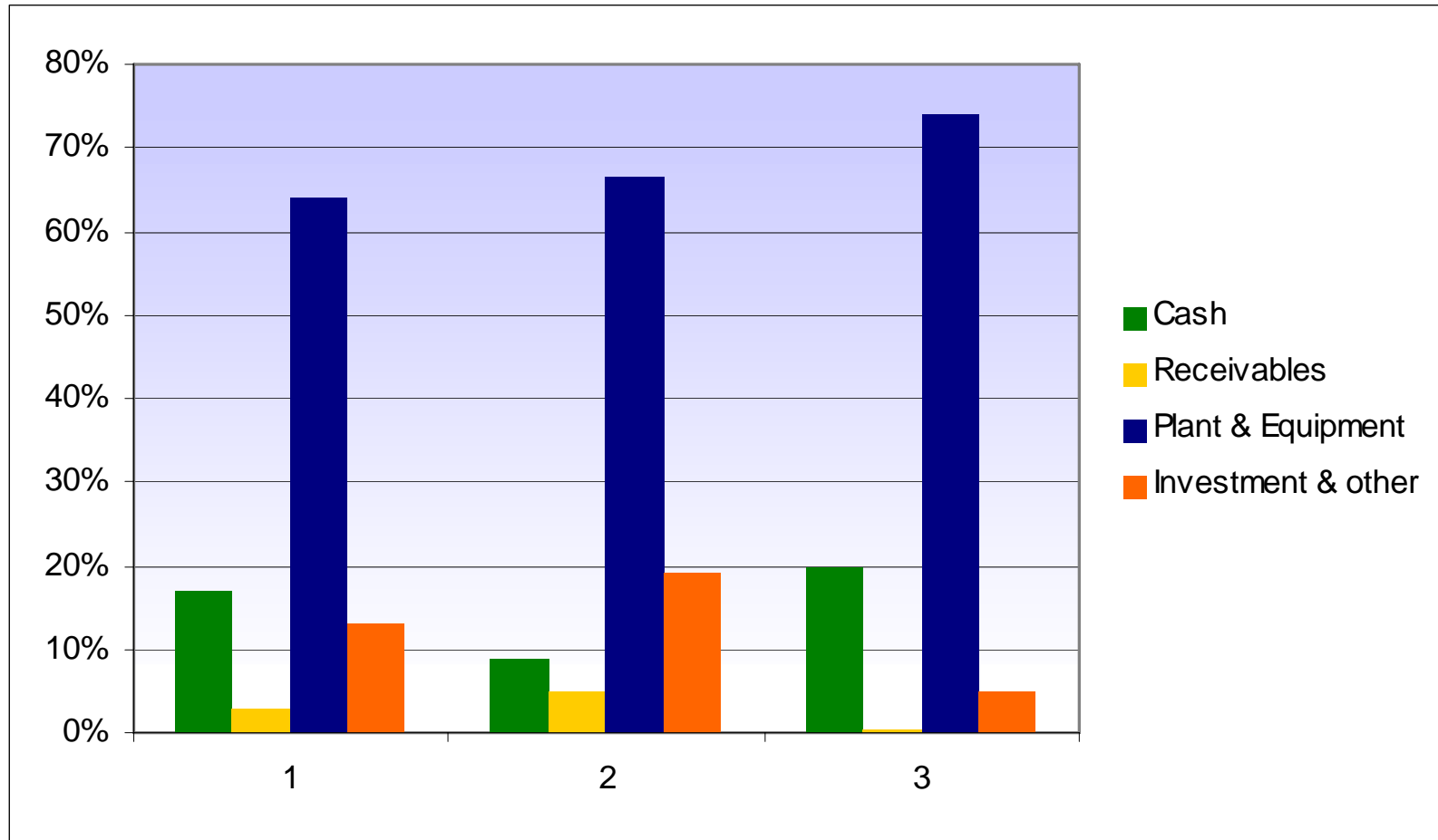
Growth eventually increases profits or the business fails. **FALSE**

Investment in infrastructure is seen as necessary;  
Overhead is a regular cost of business. **FALSE**

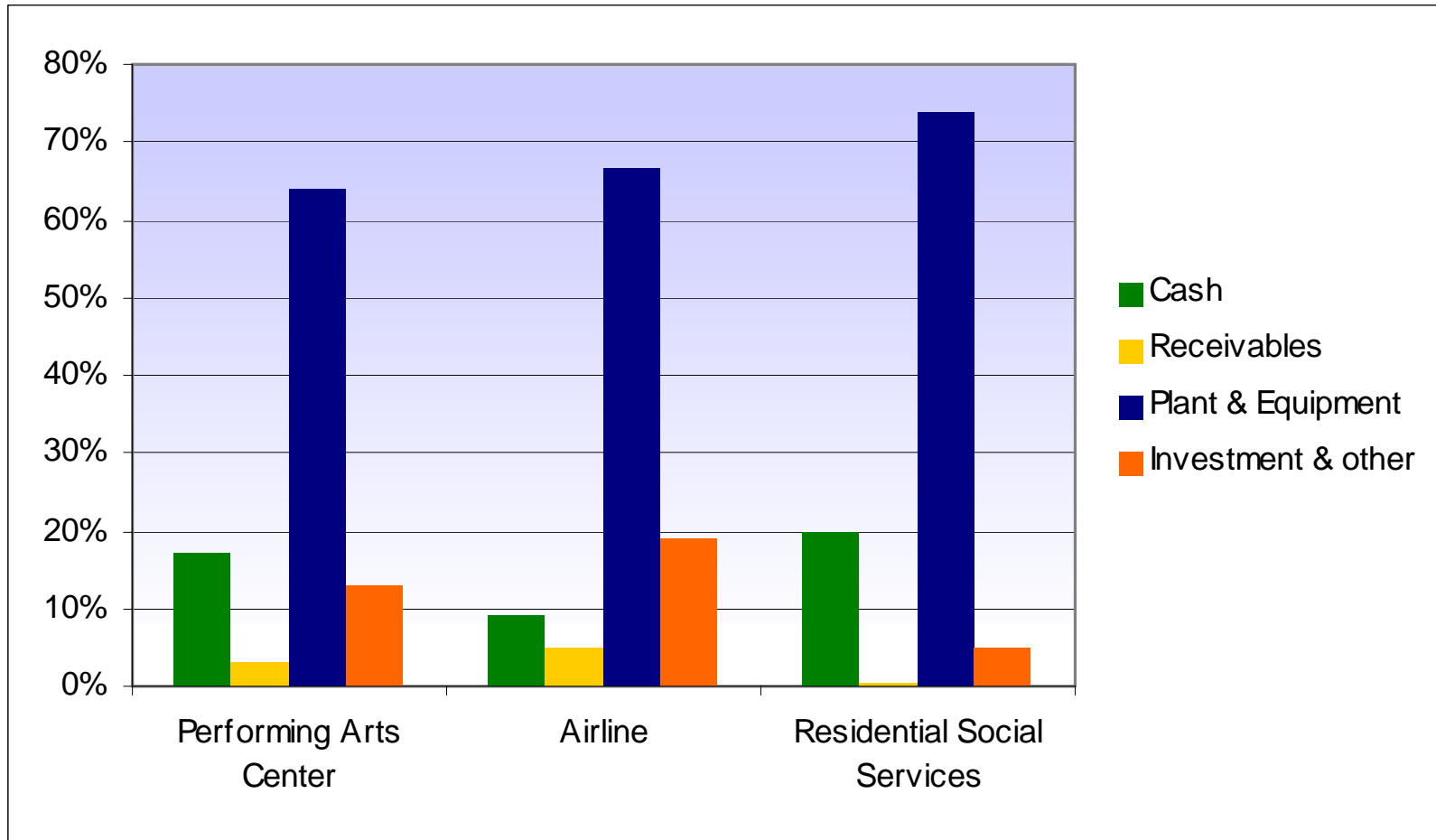
Profits drop to the bottom line  
& are used in the business. **FALSE**



# CAPITAL STRUCTURE REFLECTS CORE BUSINESS

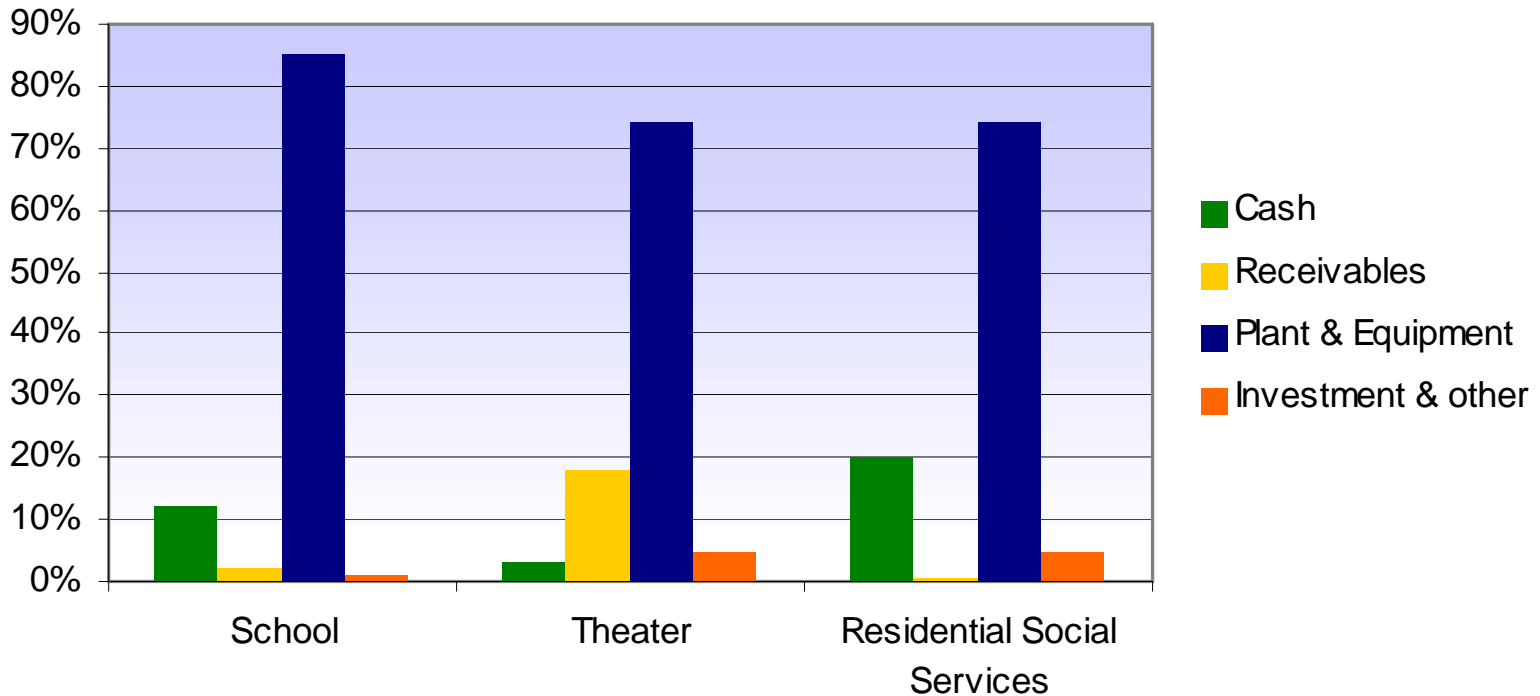


# CAPITAL STRUCTURE REFLECTS CORE BUSINESS

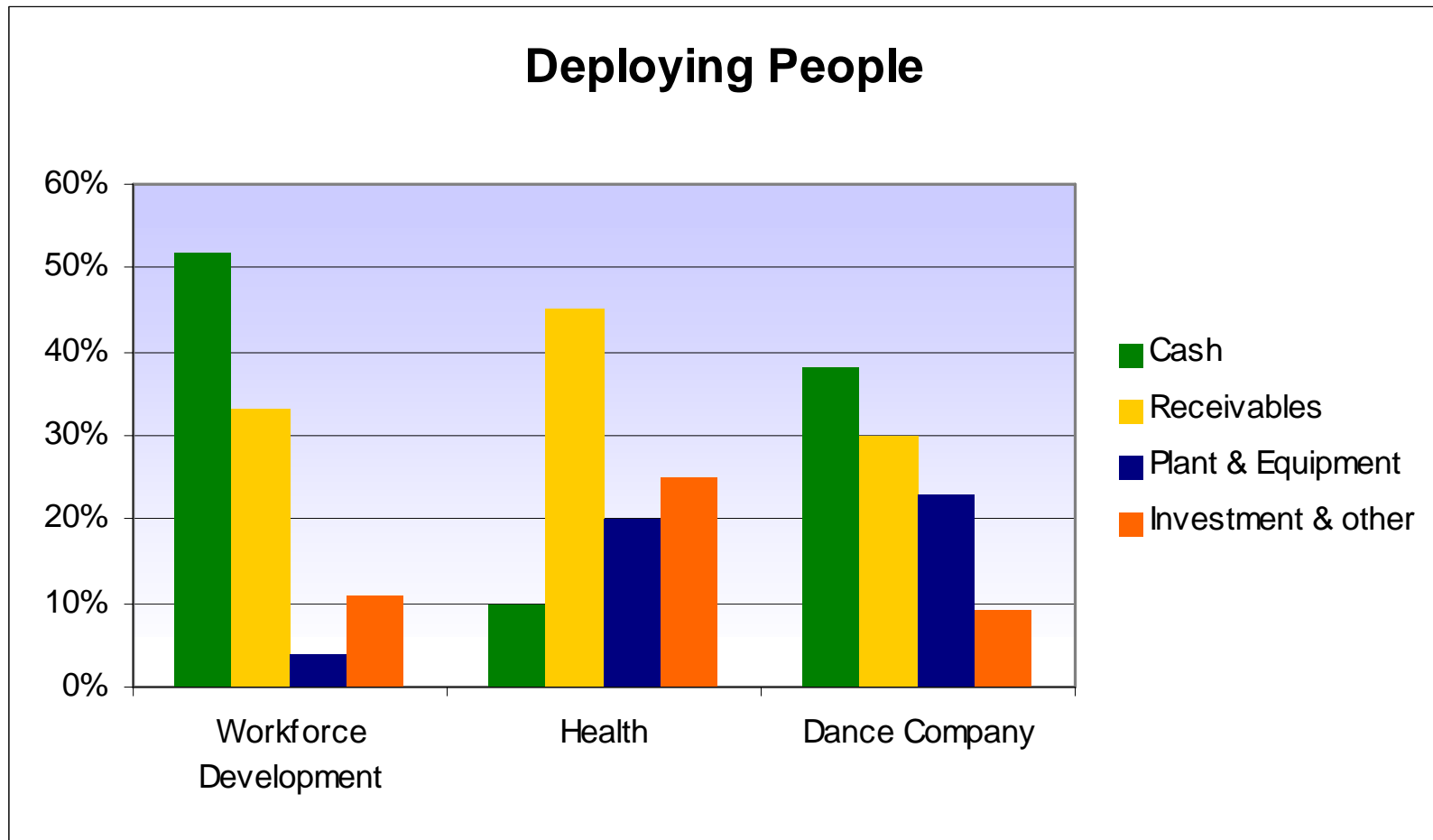


# SAME CORE BUSINESS, DIFFERENT SECTORS

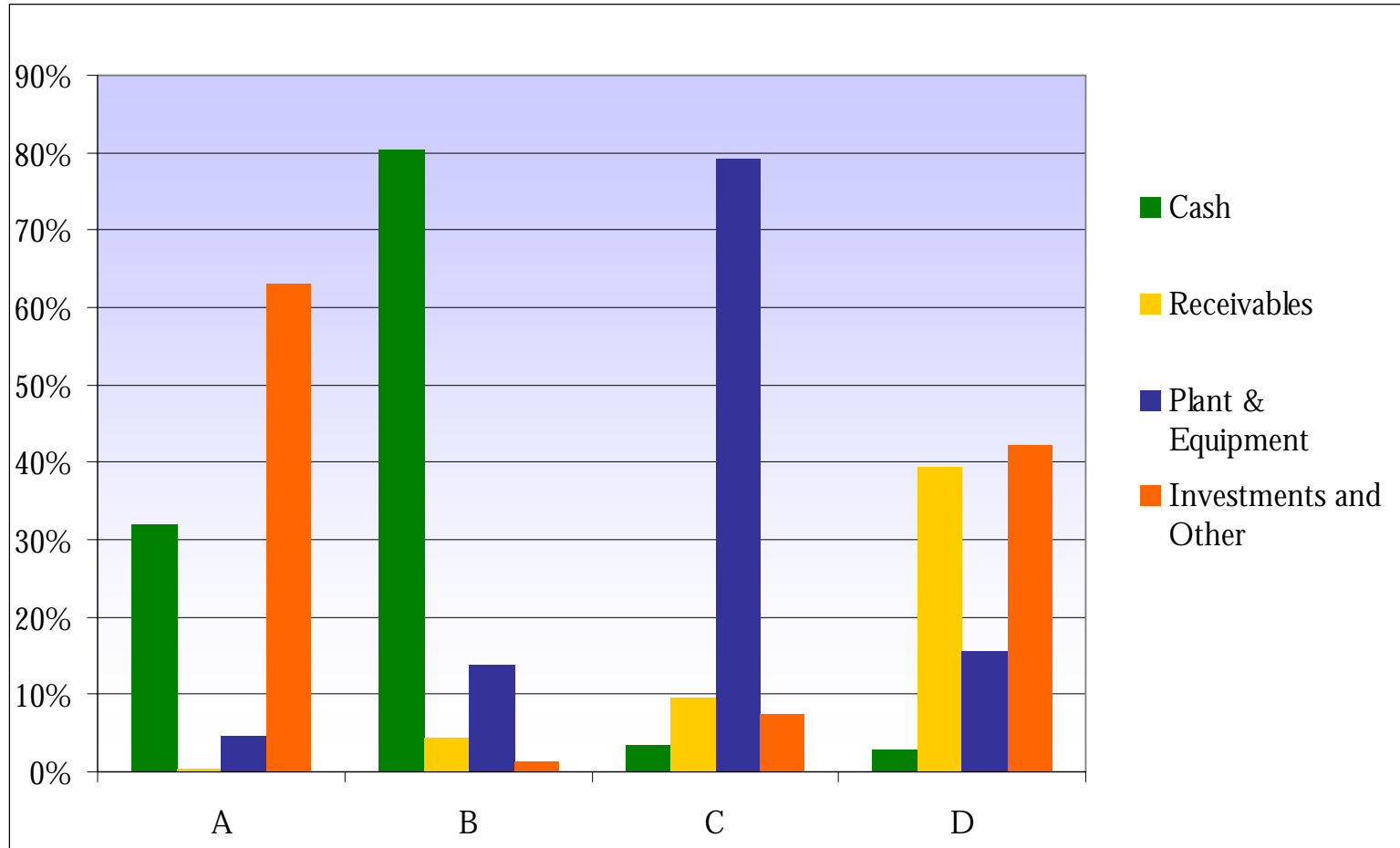
## Providing Seats or Beds



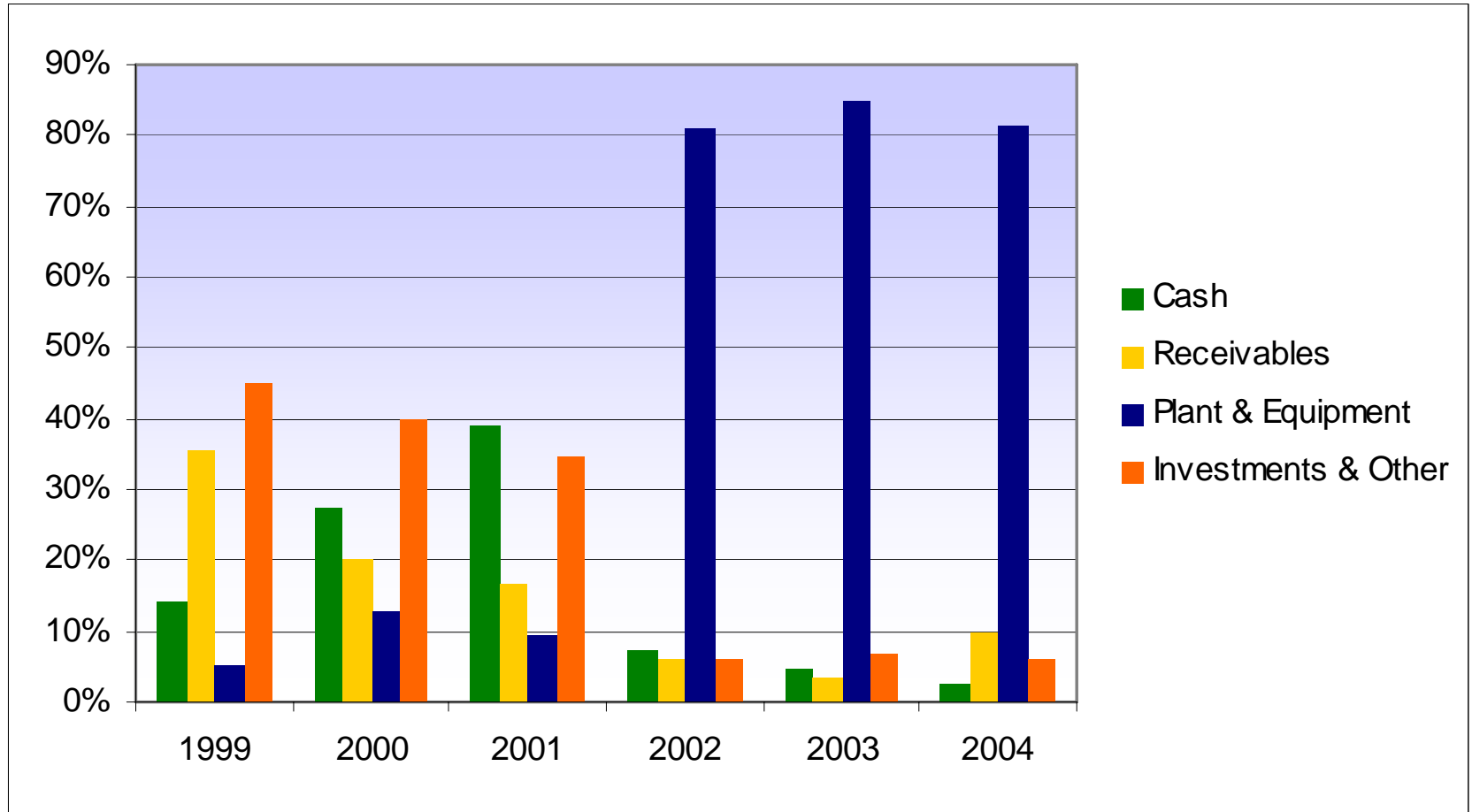
# SAME CORE BUSINESS, DIFFERENT SECTORS



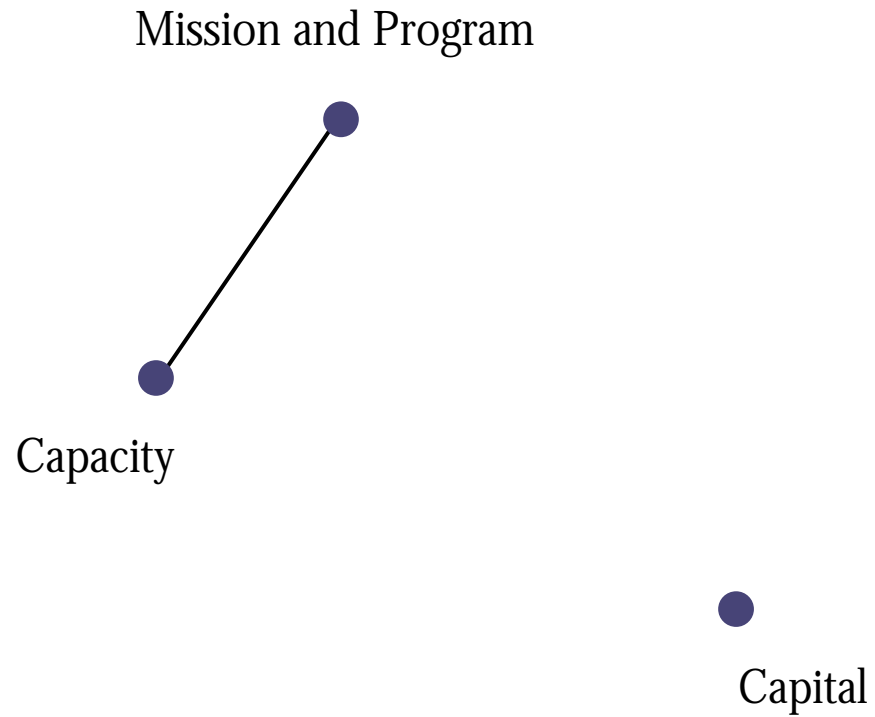
# SAME SECTOR, DIFFERENT CORE BUSINESSES



# SAME ORGANIZATION, DIFFERENT CORE BUSINESS OVER TIME



# THE TRIANGLE

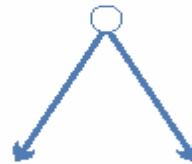


# THE TRIANGLE: A BALANCING ACT

Establishing and maintaining a balance among these three critical components is essential to an organization's long-term health and viability.

## Mission and Program

What you do and why you do it

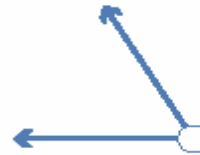


## Capacity



Your ability to do what you do:  
Management,  
Processes, Square  
Footage, etc.

## Capital



What you have and how it is distributed:  
Assets, Liabilities, and  
Net Assets

# Case Study: Next Door Solutions to Domestic Violence



# THE NONPROFIT BUSINESS ANALYSIS: HOW IT WORKS

- Typically takes between four and eight weeks
- Analyze financial information
  - Five most recent years of audited financial statements
  - Current fiscal year budget
  - Brief description of organization's opportunities and challenges
- Evaluate organization's financial health
- Meet with small group of board and staff to discuss findings and possible next steps
- Develop brief report with observations and recommendations
- Present findings to Board of Directors and/or offer follow-up coaching services (if funding is available)



# NEXT DOOR SOLUTIONS TO DOMESTIC VIOLENCE

- Next Door Solutions “exists to end domestic violence in the moment and for all time”
- Organization has grown into Santa Clara County’s most comprehensive domestic violence service agency
  - 37 FTE’s
  - Work out of seven locations
  - Service scope: emergency crisis to longer-term transitional
- The “perfect storm” in 2003 created a serious financial and organizational crisis
- Leadership was forced to quickly reevaluate its staffing and programmatic models



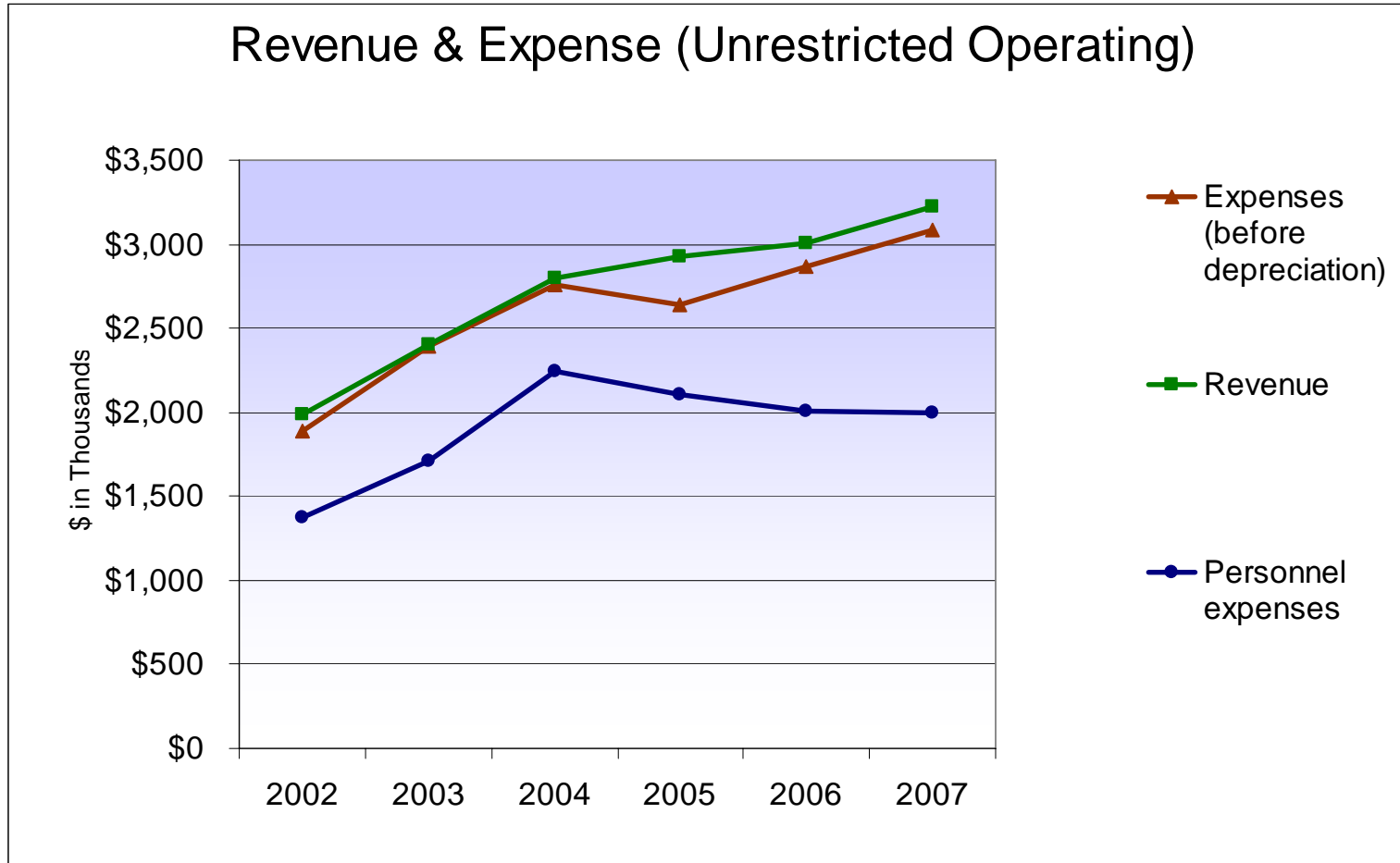
# NONPROFIT BUSINESS ANALYSIS

## SUMMARY OF OBSERVATIONS

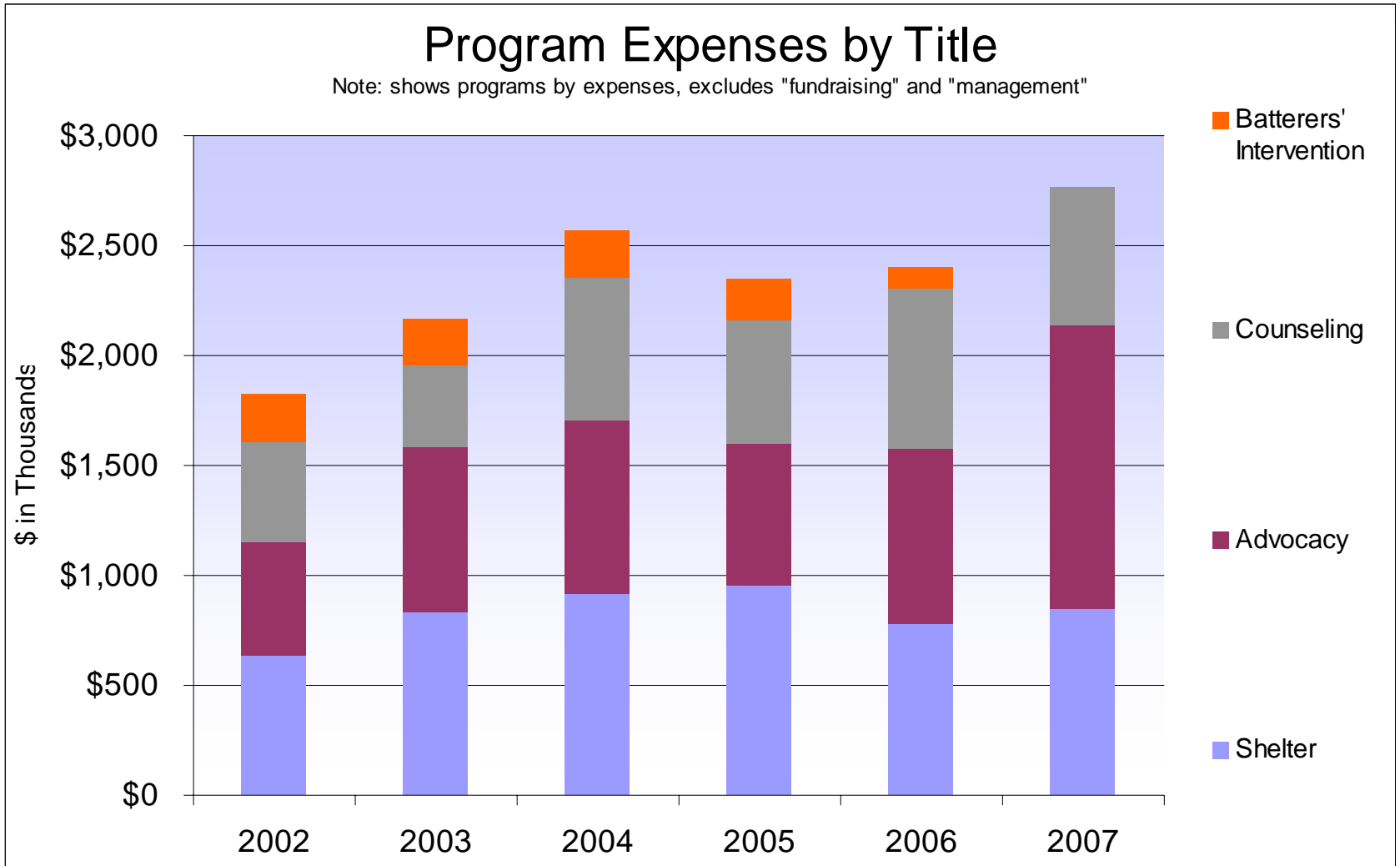
- After a 2003 merger and making difficult organizational decisions to ensure its longevity, Next Door Solutions has generated consistent annual operating surpluses and regained a healthier financial position.
- Earned revenue is central to Next Door Solutions' business model and covers on average 74% of annual operating expenses. Sources of earned revenue are diversified among 26 different government contracts.
- The organization's business model also relies heavily on contributed revenue and management has made recent investments in its fundraising business to improve its branding & communications and expand its individual donor base.
- The cumulative result of consistent operating surpluses has strengthened liquidity and has led to a healthier balance sheet; however, fixed assets continue to depreciate and may require investment in the near term.



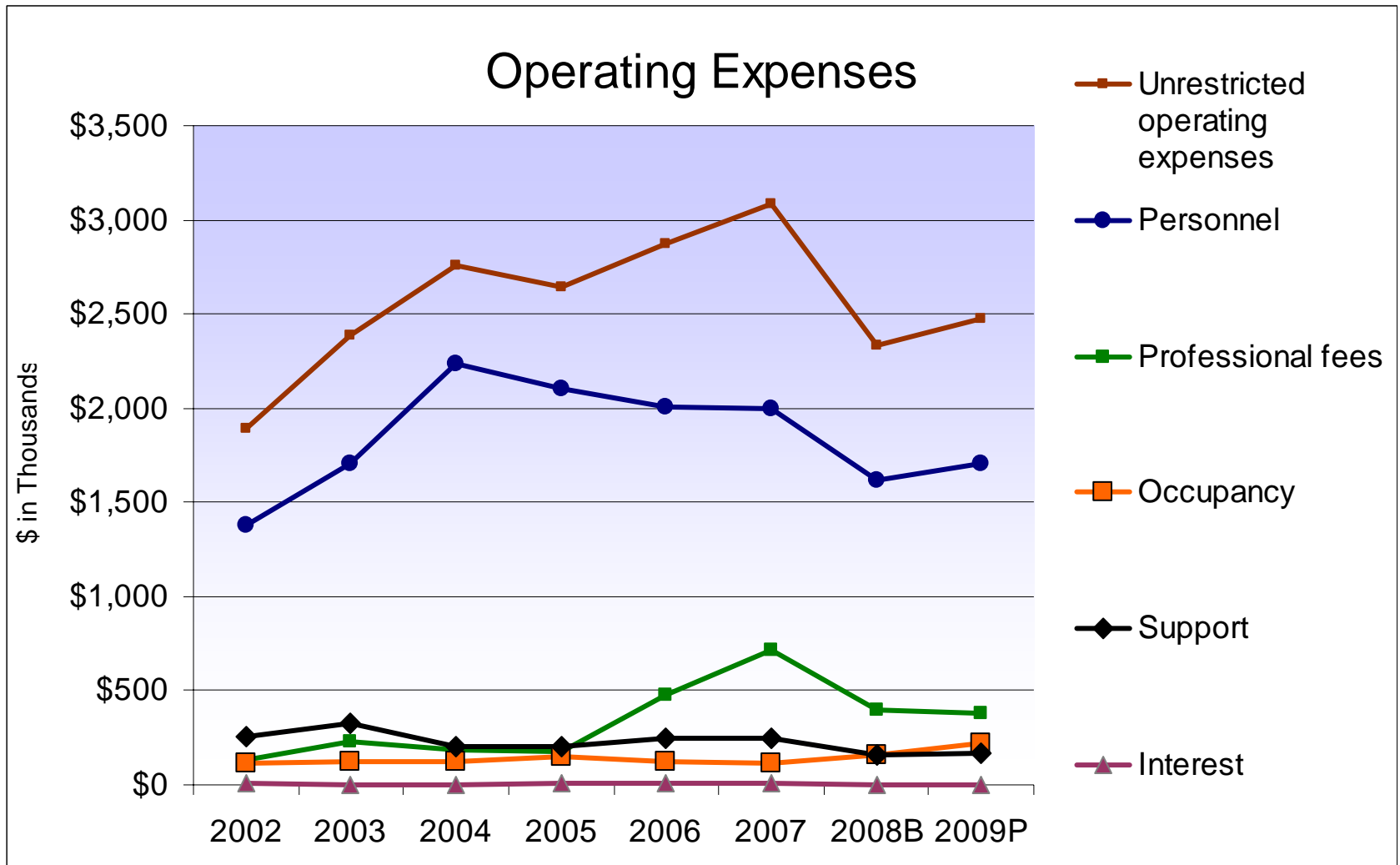
Due to the merger and financial challenges, leadership made the difficult decision to reduce staff and focus on its core competencies...



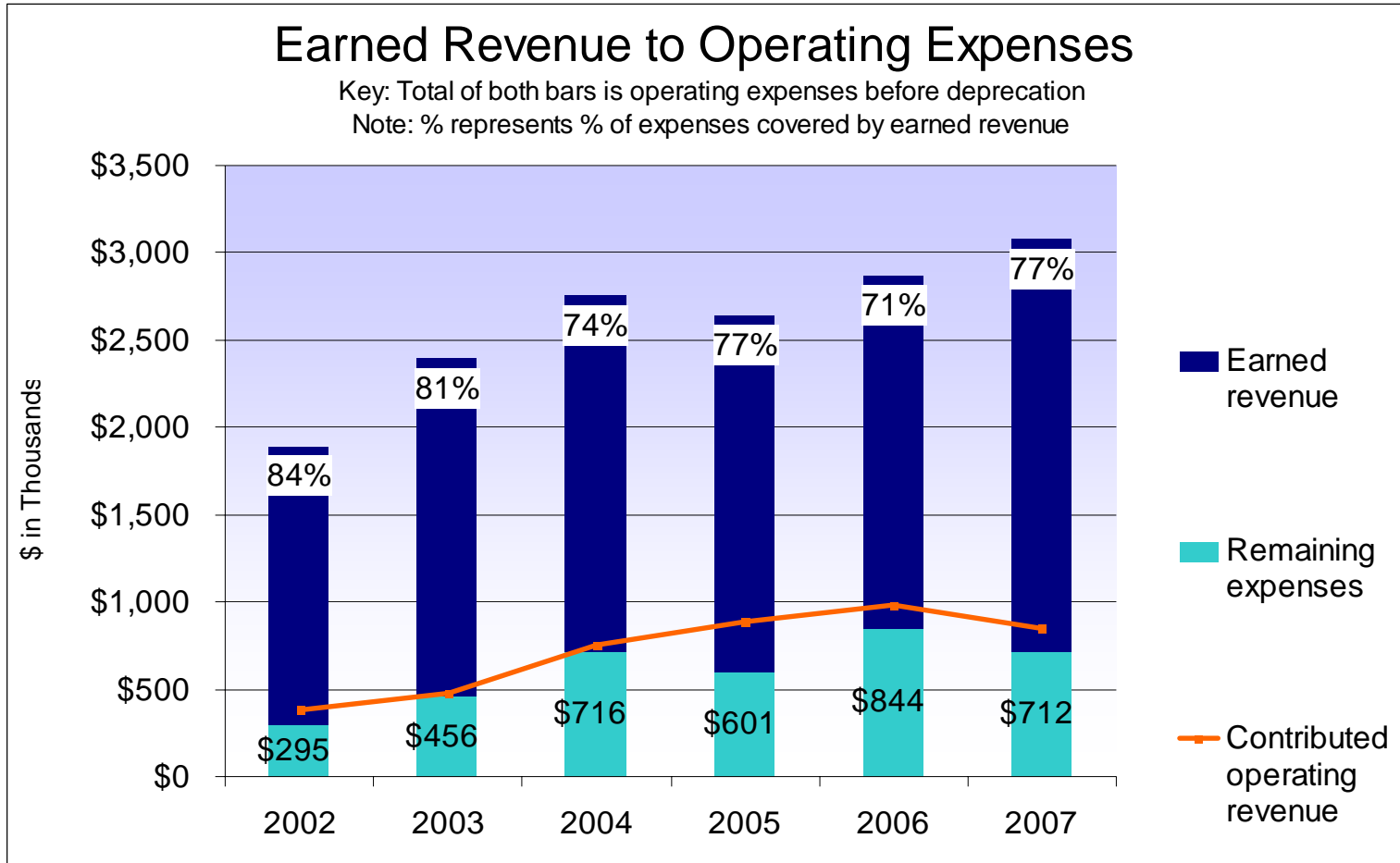
...eliminating its Batterers' Intervention program and expanding its advocacy work.



Leadership also cut back on “support” expenses and invested mostly in program-related activities.



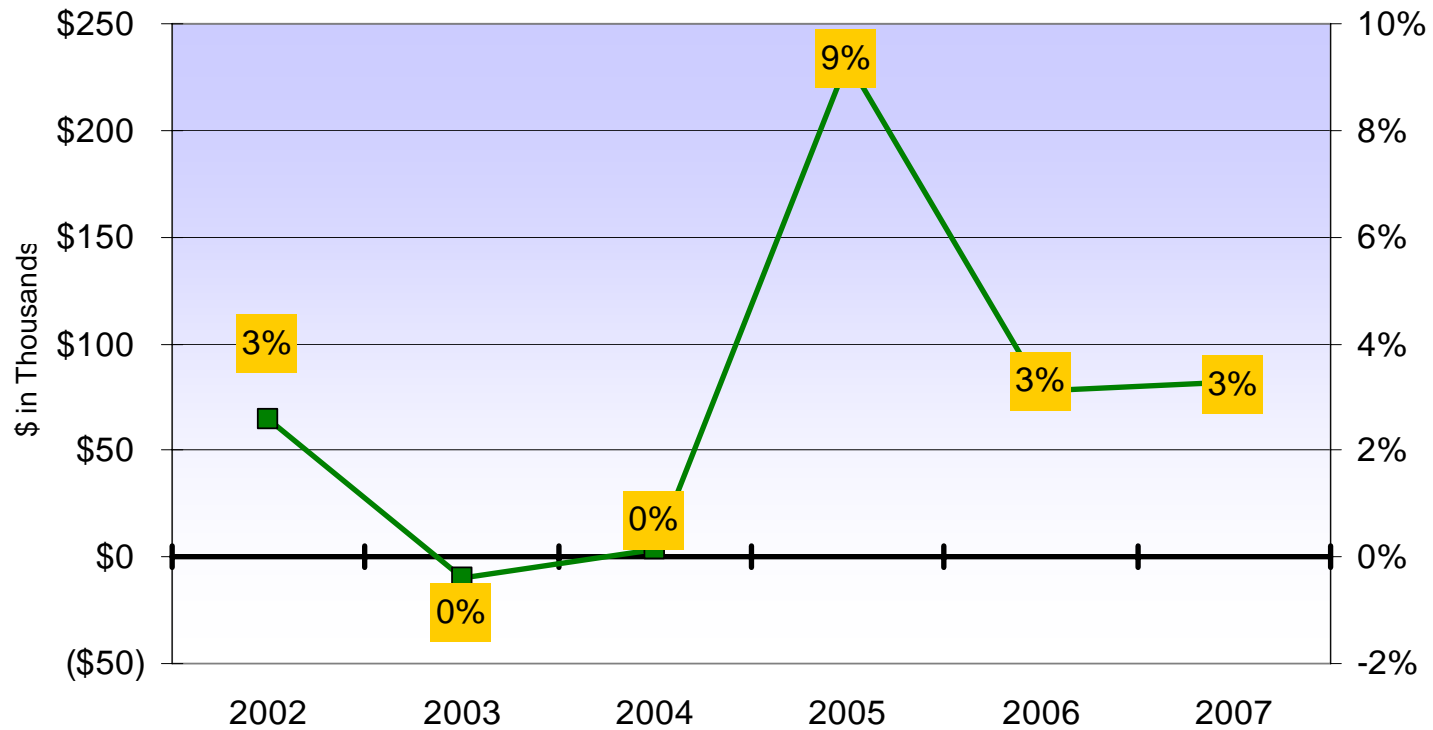
However, given that contributed revenue has become an increasingly important component of Next Door Solutions' economic model, recent investment have been made in the fund development "business" .



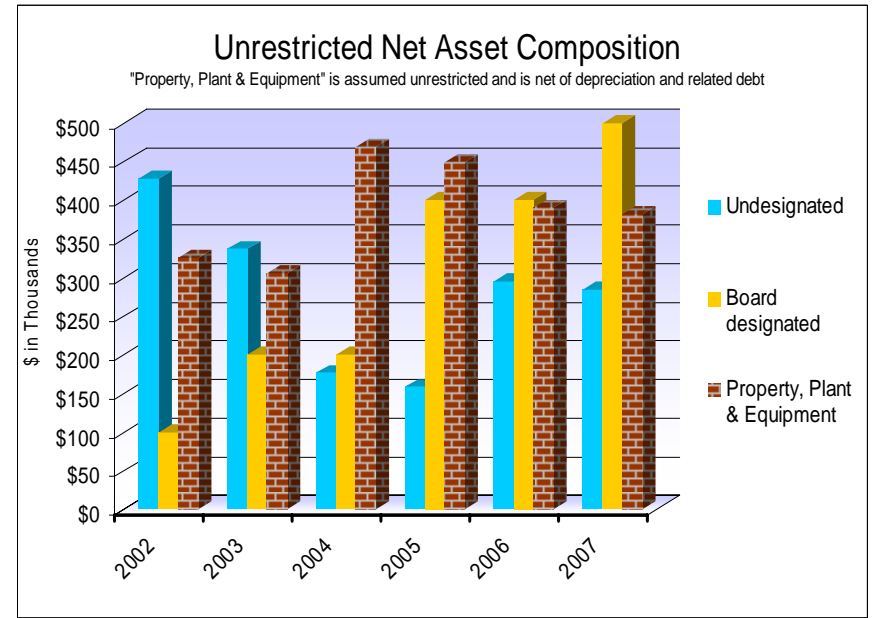
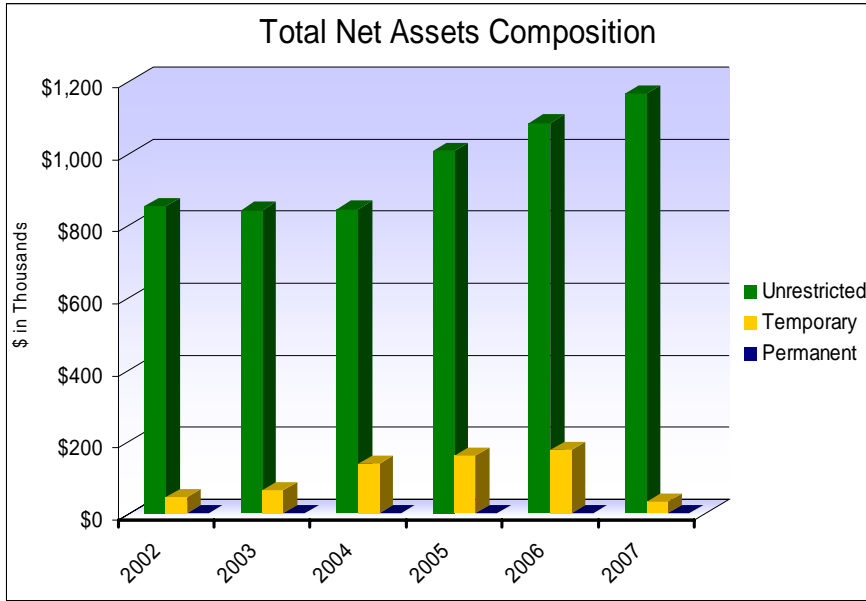
The financial outcome of these organizational and programmatic decisions was improved operating performance for Next Door Solutions...

## Unrestricted Operating Results After Depreciation

% Represents Value as a percent of expenses



...and this has strengthened Next Door Solutions' overall financial situation and ultimately its capacity to effectively deliver its mission.



# NONPROFIT BUSINESS ANALYSIS

## SUMMARY OF NEXT STEPS

- I. Ensure leadership has access to robust financial data to use as a decision-making tool.
- II. Develop a financial plan to support program and fundraising plans; carefully examine future capital structure needs.
- III. Examine the organization's capacity and plan for expanding the fundraising "business."
- IV. Prioritize ongoing profitability at the enterprise level.



# LESSONS LEARNED & ONGOING CHALLENGES

## Lessons Learned:

- Ensure appropriate staffing model is in place and cultivate a strong sense of “team” that is committed to the organization’s mission
- Focus on core competencies, even if this means removing “good” programs
- Do not cut too deeply into administration; it may undermine your ability to effectively deliver on your mission
- Make good use of your board, both for fundraising and governance
- Prioritize reserve-building and recognize the relationship between your reserve base and your programmatic “risk-taking” tendencies

## Ongoing Challenges:

- Ensure finance and fundraising departments are high-quality, predictable and consistent; *Fundraising for these “non-sexy” activities is very difficult, but absolutely vital!*
- Integrate strong communication practices among service delivery, finance and fundraising departments; make sure you are not “leaving money on the table” and leverage everything!
- Implement policies and procedures to retain institutional memory and avoid constantly reinventing the wheel



# Business Choices



# BUSINESS CHOICES: “Solutions” to Financial Instability

1. Grow the organization
2. Launch an earned income venture
3. Buy property instead of leasing
4. Build an endowment
5. Merge with another organization



# GROWTH: GOOD OR BAD?

- For the most part, nonprofits cannot charge fees to direct recipients and/or to third parties that cover the full costs of delivery
- Thus, nonprofit programs typically “lose a buck on every widget” and need to engage in “subsidy” businesses such as fundraising
- However, as nonprofits grow their programs, they must raise more operating capital — every year, forever...



# EARNED INCOME VENTURE: GOOD OR BAD?

Let us assume that nonprofits pursue earned income ventures in order to generate dollars that can support programs.

- Earned income ventures carry risk
  - *In the for-profit sector, the majority of new businesses fail and those that do not only generate profits of 2-3%.*
  - *Why is your nonprofit's venture going to succeed?*
- Earned income is not a “magic bullet” for funding shortfalls
  - *To be successful, earned income ventures must provide net income*



# EARNED INCOME VENTURE: GOOD OR BAD?

- In order to launch a successful earned income venture, nonprofits must:
  - *Thoroughly assess venture's feasibility (evaluate and plan)*
  - *Evaluate venture's fit with mission and core competencies*
  - *Test the venture's ability to generate net income*
  - *Secure access to funds to cover early losses (debt is rarely appropriate in start-up)*



# OWNING PROPERTY: GOOD OR BAD?

- Ownership provides a financial asset that can be sold at a future date
- Having a "permanent home" may make an organization more attractive to some funders and clients
- Nonprofits are often exempt from real estate taxes, which can provide significant savings
- Owning a property can inspire a successful capital fundraising drive



## HOWEVER...

- Upfront costs are often bigger than projected
  - *Down payment and financing fees*
  - *Moving and transition costs*
  - *Hard costs (purchase and renovation)*
  - *Soft costs (legal, architectural and engineering fees)*
- Ongoing costs (post-acquisition) are often overlooked
  - *Utilities, maintenance and insurance*
  - *Debt repayment*
  - *New staff and systems to support program and infrastructure growth*

# OWNING PROPERTY: GOOD OR BAD?

- Being a landlord is a separate business
  - *If something breaks you fix it*
- Nonprofits should build reserves for ongoing maintenance and replacements
- Owning a facility requires commitment to the property as integral to program delivery



# ENDOWMENTS: GOOD OR BAD?

Endowments can provide earnings that an organization can use as revenue, potentially reducing annual fundraising needs

## HOWEVER...

- A sizable endowment is required to yield significant interest and dividends
  - *\$1 million principal @ 5% will yield just \$50,000 per year (gross)*
- Building endowments can cannibalize other fundraising efforts
- Building and managing endowments can take energy away from mission and programs



# NFF ON ENDOWMENTS

- Endowments should ideally be established only when an organization has so much excess fundraising capacity that it is able to start a new subsidy business
- There are occasional exceptions to this rule, such as when an organization accepts a large, one-time gift (or a bequest) from a donor who insists the funds go into an endowment



## Reserves may be a more useful first option

- Board-designated Cash Reserve for Operations
  - *Internal line of credit to bridge funding delays*
  - *NOT to replace lost income or cover ordinary expenses*
- Infrastructure Reserve
  - *Building maintenance, systems replacements, first year of salary for new staff, etc.*
- Rainy Day (emergency) Reserve
- Investment Reserve
  - *Essentially an endowment but with board authority to use the principal for other purposes if necessary*

# MERGER CONSIDERATIONS

- Consider the following questions:
  - Will the merger be a good mission and cultural fit?
  - What will be the savings versus the costs of merging?
  - How will major funders react to the merger?
- Prepare and analyze financials for the merged entity, e.g.:
  - What will be the additional sources of earned and contributed revenue?
  - What will the current and long-term capital structure look like?
- Remember, there is a spectrum from collaboration, to partnership, to joint venture to full merger
  - Consider all options, testing less permanent ones first



# TAKEAWAY #1: NONPROFITS NEED PROFITS

- Many business choices are risky; a cash cushion can help manage this risk.
  - *Risk minus Cash = **Crisis***
- Surpluses need to be sufficient to:
  - *Pay for the annual “wear-and-tear” of PP&E*
  - *Finance investments in new fixed assets and/or improvements that may not be fully financed through a capital campaign,*
  - *Cover any debt principal payments*
  - *Contribute to growth and savings*
- Surpluses are an indicator of good management and increasingly recognized as such by the funding community



# TAKEAWAY #2: OWN YOUR NUMBERS

Making sound business choices requires:

- Reliable, accurate and timely financial data
- Understanding this data and using it to tell your financial story
  - *Transparently*
  - *Without apology*



## Nonprofit Business Analysis (NBA)

A dynamic dialogue to help your management and board evaluate your financial capacity for growth and change

- Capital project
- Change in leadership
- Financial challenges
- Program expansion

## Workshops

- Half- and full- day seminars exploring strategic and financial issues to help you make the right business decisions

## Advisory Clinic

- Two-day intensive and hands-on training for nonprofits in a common sector. Participants learn how to read and interpret their own financial documents, communicate financial condition and needs and consider business opportunities in a peer setting

## Systems Replacement Plan (SRP)

- 20-year forecast for necessary infrastructure requirements such as major repairs, potential replacements

# NFF LOANS

## Working Capital Loans

- Provide funds to manage your cash flow needs

## Facilities Loans

- Provide financing for your facility projects such as acquisition, construction, and leasehold improvements

## Equipment Loans

- Provide financing for your equipment purchases



**Learn more about us:**  
**[www.nonprofitfinancefund.org](http://www.nonprofitfinancefund.org)**

