

Linking Money to Mission: A Business Approach for Managing Nonprofit Finances

Brent Copen, director of the western regional office of the Nonprofit Finance Fund, and Nima Krodel, manager of financial services for the Nonprofit Finance Fund (NFF), emphasized that the money and finance piece of capacity building is an often overlooked and yet critical function at nonprofits. NFF provides financing, advisory services and advocacy for a strong and financially viable nonprofit sector.

The discussion initially focused on “Why do nonprofits with excellent programs struggle financially?” The question generated lots of responses, ranging from “admin caps,” “don’t present true costs,” “over focus on programs” to “competition is huge” and “compete with a variety of issues.” In addressing these financial issues, Brent stressed that it is important to understand that money is emotional, and that knowledge must replace this emotion. Although it takes time and effort to learn finance, it can be done. Ask questions often!

The importance of knowledge was stressed further in a slide entitled, “True or False?” Brent showed six statements that were 100 percent accurate or “true” statements for the for-profit world but were completely false in the nonprofit world. While nonprofits value corporate managers as board members, the fundamental differences between nonprofit and for-profit businesses can confuse even the best-intentioned financial experts on your board. Key topics of this workshop included: understanding the capital structure of an organization; the triangular relationship between mission, money and program; and review of an actual case study of a domestic violence service organization.

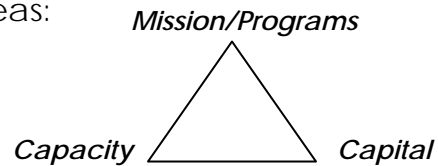
The Capital Structure

The balance sheet, or statement of position, provides a snapshot of the capital structure of your organization. Everything that exists on your balance sheet is the sum of all the decisions the organization has made to date. (Accompanying PowerPoint slides show different organizations’ assets)

The Triangle

The "triangle" consists of three separate areas:

- a. Mission/programs
- b. Capacity
- c. Capital



Establishing and maintaining a balance among these three critical components is essential to an organization's long-term health and viability. Mission and programs includes the reason the organization exists, what it does and why. Capacity is the ability to carry out the mission and involves management, programs, facility, communications and fund development. Capital is the resources acquired and distributed by the organization including assets, liabilities and net assets. The triangle is and can be compared to an organizational ecosystem. Any change in one area affects everything else.

Case Study: Next Door Solutions to Domestic Violence

Prior to the conference, the Nonprofit Finance Fund conducted an in-depth analysis of the finances of Next Door Solutions (NDS) to provide a case study for this institute. Kathleen Krenek, executive director, volunteered to participate in the process known as NBA, nonprofit business analysis.

NFF provides nonprofit organizations a financial diagnostic tool – which uses historical financial information to evaluate the organization's financial health – presents their findings to the Board of Directors and then recommends follow-up coaching services, which often include help finding funding for these services. The goal of the NBA is to identify the story behind the numbers in order to help guide next steps.

Next Door Solutions is Santa Clara County's most comprehensive domestic violence service agency. In 2003, a merger with another organization was intended to achieve a more favorable economy of scale by reducing administrative and other costs. NFF's graphs of the historical results of the merger told a different story with an unintended result. The increased revenues were overwhelmed by even faster-rising expenses, especially in personnel costs, that resulted in a loss of unrestricted operating revenue.

Faced with this dilemma, the executive director did what most in her position would do – cut back on administration costs. However, in organizations that provide services like shelter services, such cutbacks led to chaos. The Board of Directors and executive management initially

disagreed about how best to restore financial health. But the executive director then made a difficult decision and quickly laid off more people. "It was hard. It was difficult. But we did it," Kathleen said. "We took a step back and focused on our core competencies. We had to better understand what our organization did best and let go of programs and projects (with expensive personnel costs) beyond our capacity. We had to ask ourselves, what do we do best? How can we leverage what we do best to help battered women?"

NDS stopped providing a batterer's intervention program and recently eliminated a counseling program as well. While very labor intensive, the programs reached few. Services could be better delivered through other organizations within the community. "The business of Next Door Solutions is not simply growth, but impact," Kathleen said.

The results of its new focus were immediately apparent in NDS financial statements. In 2004, the records indicated a slight surplus in unrestricted operations. By 2006 and 2007, NDS balance sheets revealed historical operating surplus. Consistent operating surplus guarantees the organization's future viability. According to Kathleen, "We have 40 partnerships now and a wealth of programming!"

Lessons Learned

- Reserves generated from past surpluses kept NDS alive during the merger period. Unrestricted net assets are key to maintaining financial health.
- Cultivate and maintain a strong sense of team commitment to the organization's mission, especially when making cutbacks and/or layoffs.
- Make sure the board understands the finances.
- Keep the budget alive and vibrant through quarterly updates. Avoid reliance on a fixed budget for the entire year.
- In projecting revenues for the budget, avoid estimating income that has a low probability of materializing. If some revenue has less than a 50 percent estimated probability, it is better not to include it in the projected budget.

Business Choices

Nima Krodel summarized five potentially helpful solutions commonly advocated for organizations facing financial instability.

- (1) Growth: Accelerating growth can help for-profit organizations in times of financial instability. It is not often useful for nonprofits. In the nonprofit world, it is often necessary to raise more operating/overhead capital for each program added.
- (2) Launch an Earned Income Venture: In the for-profit world, the success rate for new business is lower than we think. In the nonprofit world, we cannot assume that an earned income venture will not fail. Earned income ventures can divert management attention from the core business and dilute focus on core competencies. In the nonprofit world, healthy fiscal policies focus on increasing unrestricted net income.
- (3) Owning Property: Although owning property can inspire successful capital fundraising drives, this success can crowd out the fundraising needs for operations. Upfront costs are often underestimated, while ongoing costs are frequently overlooked.
- (4) Endowments: They sound like a sure winner. Unfortunately, even a fairly large endowment of \$1 million produces small amounts of annual income. Fundraising for endowment money may drain energy, time and contributions from other development efforts. Alternatives suggested for endowments include board-designated cash reserves, infrastructure reserves, and/or "rainy day" or emergency reserves.
- (5) Mergers: As is true in the for-profit world, most mergers generate more problems than expected up front. It is most important to give careful thought to the culture and fit of the organizations, the concerns of donors and other funders of each organization, and the realistic financial effect on the organization. Remember, partnerships and joint ventures can often accomplish the same objectives as a merger in a more stable, predictable and flexible manner.