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America's Greatest 'Public Works'

By Clara Miller

America's most crucial infrastructure is strained to the breaking point, but few Americans notice it. That's because it's not the bridges and tunnels and other public works that are at issue — it's the nonprofit groups that have been doing more with less for so long that the public has come to accept overtaxed and poorly financed community services and a tattered social safety net as business as usual.

The mounting stress on nonprofit organizations did not begin with the current recession. For many groups, the troubles started in the downturn that deepened after the 2001 terrorist attacks, and while organizations managed to survive, they never regained their financial stability.

As the nation faces a far more serious financial catastrophe, it is time to change the way all nonprofit groups are financed and at the same time, persuade board members and major donors to join nonprofit leaders to push for new spending on charitable organizations that will assure the best results for the dollar.

No longer can Americans expect social problems to get solved by Band-Aid solutions, emergency grants, below-cost reimbursement rates and project grants with multiple strings attached.

Instead, foundations, donors, nonprofit-board members, policy makers, and others who care about a strong social infrastructure need to embrace a long-term view, in some cases sacrificing immediate short-term gains for a much greater shared return in the future — an "equity-holders ethic" for both nonprofit organizations and the economy as a whole.

Front-line nonprofit managers who achieve the impossible on a regular basis through determination and small miracles may feel that they don't have the luxury to think beyond the current crisis. The leader of a program to prevent child abuse is probably focused on the question: "How will we keep this child safe tonight?"

But as economic pressure mounts, she needs to be supported by more people who are also helping answer the question: "How will the organization keep children safe over the long haul?" And that role — the role of an equity holder — is not currently being filled in the nonprofit sector.

In the ideal business world (not currently in evidence) the drive for bargains by buyers, or short-term profitability by those looking for a quick profit, is tempered by the role of the equity holder. The equity holder's role is to protect and improve the value of the business so that the "equity stake" (frequently in the form of stock) will increase in value.

Equity holders seek to protect their ownership stake by keeping others from taking steps that improve short-term results at the expense of the long-term value of the business. For example, an equity holder might object to selling goods and services at too low a price for too long, working without adequate capital infusions or adequate infrastructure, and tolerating poor management and so-so results.

In the nonprofit world, board members' ideal role is to look out for the interests of the ultimate equity holders — the public — protecting the nonprofit enterprise so it can fulfill its mission, sometimes over many years. The end goal is not so much profitability and financial returns but to maximize the benefit to the public — preventing child abuse, for example.

But the ethos in today's nonprofit world encourages everyone to do just the opposite. Board members, managers, grant makers, and government officials are so determined to ensure that nonprofit organizations deliver more for less that they regularly lose sight of their role as protectors of the organization's capacity to deliver quality services as long as the need for them exists, and to get the highest-quality results that will have the largest social payoff to the public.

It may seem counterintuitive to suggest that the way organizations can most powerfully achieve their missions is to "just say no" when a foundation or government proposes cutting the amount an organization will be provided in overhead, while urging organizations to do more with less. But that is what board members — and grant makers — must do if they want to build organizations that will make a difference, instead of just caretaking groups that are too weak to do the job America needs them to do.

Board members, donors, and other people who play powerful roles in the nonprofit world must insist publicly that charities are paid fairly for the services they provide. That means taking into account all the costs incurred from a new project and guaranteeing that revenue will flow in regularly and reliably.

If an organization is expected to make a big change in its operations, such as spreading out to dozens of new locations, it must be given access to adequate investment capital. This financial ethic will enable sustained results rather than the burn-out heroism and hollowed-out capacity that now characterize many front-line nonprofit organizations.

It's no wonder that the equity holder's role is largely absent from the nonprofit world. A look at nonprofit accounting standards reveals a fundamental challenge: There is no distinction made between money coming in to pay for organizational growth, and that devoted to paying for service delivery.

When nonprofit groups report their finances, they are required to combine capital and operating revenue on their income statements, obscuring visibility into the portion supplied by donors who are building the enterprise, and those — typically governments or individuals — that buy services.

Such figures need to be broken out and made widely available so everybody can understand what financial resources it really takes to build a successful organization. Then governments and individuals can determine whether they are purchasing services from a truly effective group, organizations can learn from one another, and capital infusions are not mistaken for regular revenue, thus distorting the financial picture.

Coupled with visibility into how nonprofit groups spend the money they need to build a solid organization and then deliver services, everyone, especially the public, needs solid data about nonprofit performance in addition to the current stream of anecdotes on exceptional and almost invariably positive cases that now characterize much evaluation.

By focusing more on outputs (what happened?) than on inputs (what went in?), and developing data systems to capture them in a comparable format that is possible for both nonprofit workers and outsiders to use, everyone can learn more about what is working and what is not, a vital question at a time when government and private money will be stretched further than ever. Moreover, organizations and their "equity holders" — boards, major contributors, and senior managers — will be able to learn from the experience of others who are working toward the same end.

A caveat: Overreliance on easily measurable and short-term results alone can be problematic. Many nonprofit activities that provide the greatest social return on investment, such as education or health research, may take years for pronounced results to appear. Thus, simple 'go, no-go' decisions based solely on short-term results are often counterproductive.

The struggles faced by many organizations that deliver critical services make it crucial that government and donors understand how their actions — often in the name of financial best practices — have hobbled the groups they mean to support.

"Red herring" measures like overhead rates are part of a harmful system of misguided rules that make it difficult for a nonprofit organization to spend money on the things that will strengthen itself. Boards of directors and senior managers of these organizations need to stand up as "equity holders" for the public and insist that these practices are abandoned or improved.

Let's make 2009 the year when we recognize that nonprofit organizations — like all healthy enterprises — need capital investment, reliable and adequate revenue, and operations that can draw on working capital, reserves, and reinvestment to sustain good results. And 2009 can be the year when all concerned embrace — and simplify — measurements of success that are central to enabling nonprofit groups to achieve their missions and serve the public.

Change in the basic practices and concepts of nonprofit finance — however painful and foreign to charity leaders — will ultimately yield a new era. In 2009 the greatest risk to America's social fabric is that we continue with business as usual and fail to recognized that investing in the unseen infrastructure of the nonprofit world is arguably just as important, if not more so, as investing in other public works.

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