Funder Role in Adaptation to Change
What helps?

Presented by

Clara Miller, President and CEO
Nonprofit Finance Fund

David Greco, Vice President
Nonprofit Finance Fund

Dynamic Adaptability: Arts and Culture Puget Sound
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Today's Goals

- Review the challenges we face
- Connect "dynamic adaptation" to enterprise finance
- Engage with you on financial concepts and practices that aid mission effectiveness in bad times...and good

Agenda

The Challenge We Face

Adaptability and Enterprise Finance

- Nonprofit enterprise challenges
- Pretty Bad Best Nonprofit Practices (and why they hurt)
- Roles: Builder and Buyer

How Funders Can Help

- What the Field is Saying
- What Funders and Arts Organizations are Doing

Wrap-up and Questions: How Grantmakers Can Support Enterprise Adaptation

Survival is Not the Main Challenge: the World is Changing

Tectonic shifts in economy as a whole underway

- Globalization of markets and labor
- Decline of the pull of place for industrial production
- Information technology explosion

We must adapt in the ways we do our work

- ...what does that mean to funders?
- Enterprise friendly financial practices
- Enterprise savvy financial roles

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Nonprofit and For-Profit Enterprises Are Similar in Most Ways…

But There Are Differences!
Nonprofits Routinely Must…

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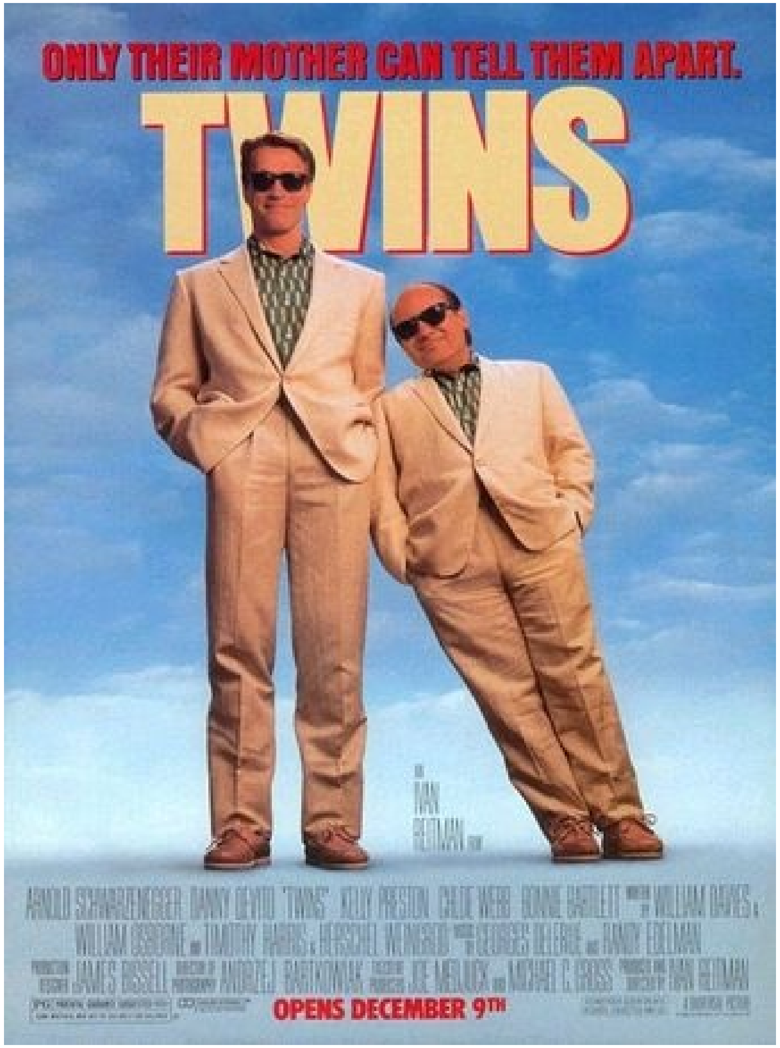

Embrace a market flaw

Operate two businesses

Endure “best practices”

This Makes *Nonprofit* Enterprise Especially Tough…

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Challenges of enterprise

- No profitability in mission business...forever!
- Double charge to capitalization from two businesses

You can't make any $$ doing this stuff!!

Challenges of capital access

- Absence of "equity" or "change capital"
- Lack of capital is pronounced for small to mid-sized program innovators

96% of capital and revenue goes to 20% of nonprofits… the big institutions!

Challenges of bad best practices

- Obsessive focus on expenses (inputs), not results
- Inappropriately restricted revenue and capital
- Overexploitation--doing more for less

We want to give you a small grant to do something very special and different this year… and you should know that our board won't give for overhead…

Pretty Bad Best Practices are fixable…

A Pretty Bad Best Practice:
…Obsession with Overhead

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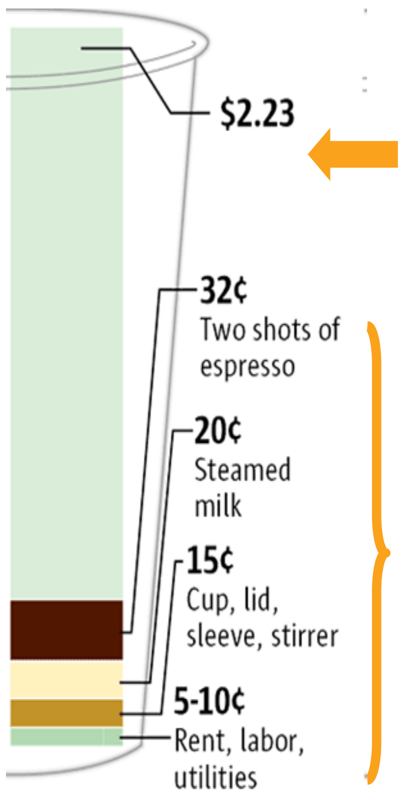
12-ounce latte = $3.00



A. RAYMOND/THE SEATTLE TIMES

Overhead & Profit
74%

Direct Cost
26%

In the for-profit world, everybody is fine with covering full costs with revenue…including overhead and profits! They are seen as a **necessary and regular** part of the business

Our Sector Has Some Quaint Notions, Such As…

"Charities exist to provide programs and services. They fulfill the expectations of givers when they allocate most of their budgets to providing programs. Charities fail givers expectations when their spending on programs is insufficient."

When charities spend more on administrative cost "that means most of your money goes toward such expenses as overhead, administrative staff and associated costs, and organizational meetings, not the programs you aim to support."

-Charity Navigator Website "How Do We Rate Charities?"

A Bad Best Practice: the Easiest "Asks" Pose the Most Enterprise Risk

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Funders make it easier and cheaper to raise $$ for…

Highest Risk

Capital and/or Program Expansion
(build a building, start a new program, expand services)

than for…

Program Continuation
(business as usual without growth)

than for…

Overhead
(administrative expenses: systems, staffing, etc.)

than for…

Capital Maintenance: Physical and Organizational
(depreciation, R&D, retraining of staff)

Lowest Risk

A Bad Best Practice:
Overexploitation of the Enterprise

Donors, funders, boards, government and the public all want nonprofits to do more with less

- Nobody protects from overexploitation
- Restrictions off-load cost but don't eliminate it
- Paying less and less and demanding more and more will ultimately destroy organizations

Funder Roles to Support Adaptability: Builder and Buyer

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Review:

Challenges of enterprise

- No profitability in mission business…forever! So…
- Double charge to capitalization from two businesses

Challenges of capital access

- Absence of “equity” or “change capital”
- Lack of capital is pronounced for small to mid-sized program innovators

Two main flavors of $$:
Capital and Revenue

They play different roles in an enterprise

- **C**apital is for **C**hange (adaptation)
- **R**evenue funds **R**egular operations (getting the job done *now*)

Buyers provide Revenue

Pay for what an organization is already delivering

- Tuition, Ticket Sales, Memberships and Fees
- Foundation, Corporate and Annual Grants/Gifts
- Government Contracts and Vouchers
- Interest and Investment income
- Corporate sponsorships, events
- Enterprise earnings (parking garages, rental properties, restaurants, bookstores, bakeries, etc.)

Goals: Reliable, repeatable, exceeds expenses

Builders provide Capital

Pay for change in the organization

- From all sources, often buyers (retained earnings, individuals, foundations, government, corporations)
- Funding around a multi-year plan, can be expansion, contraction, quality improvements and more

Goals: pays for deficits, attracts buyers, “exits”

Funder Role:
Builders and Buyers are Different

Buyer (Revenue)	Builder (Capital)
Ongoing	**Episodic**
Accountability is straightforward Did you do what I paid you to do? Did I like it?	**Accountability is complex** Investment over time, adjusting strategy along the way, to build a sustainable enterprise that prompts other people to buy program reliably…
Success → Do it again	**Success → No more capital needed**

Funder Role: Builders and Buyers are Different

	Buyer	Builder
Role	I'm buying tickets to a play	I'm providing the capital you need to create a new arts participation program
Exchange	Here's $20. See you Saturday PM at 8:00	Here's $1 million. How long until your revenue will consistently support the new activity?
Success	That was a good deal. I'd like to buy tickets for the whole season.	Got a contract with the schools? Tuition coming in nicely? Congratulations. You don't need capital for a while.

Beware the Pig Pen Effect …

Project and Capacity Building grants are sometimes "build" grants in "buy" clothing

There's a lotta stuff around projects...

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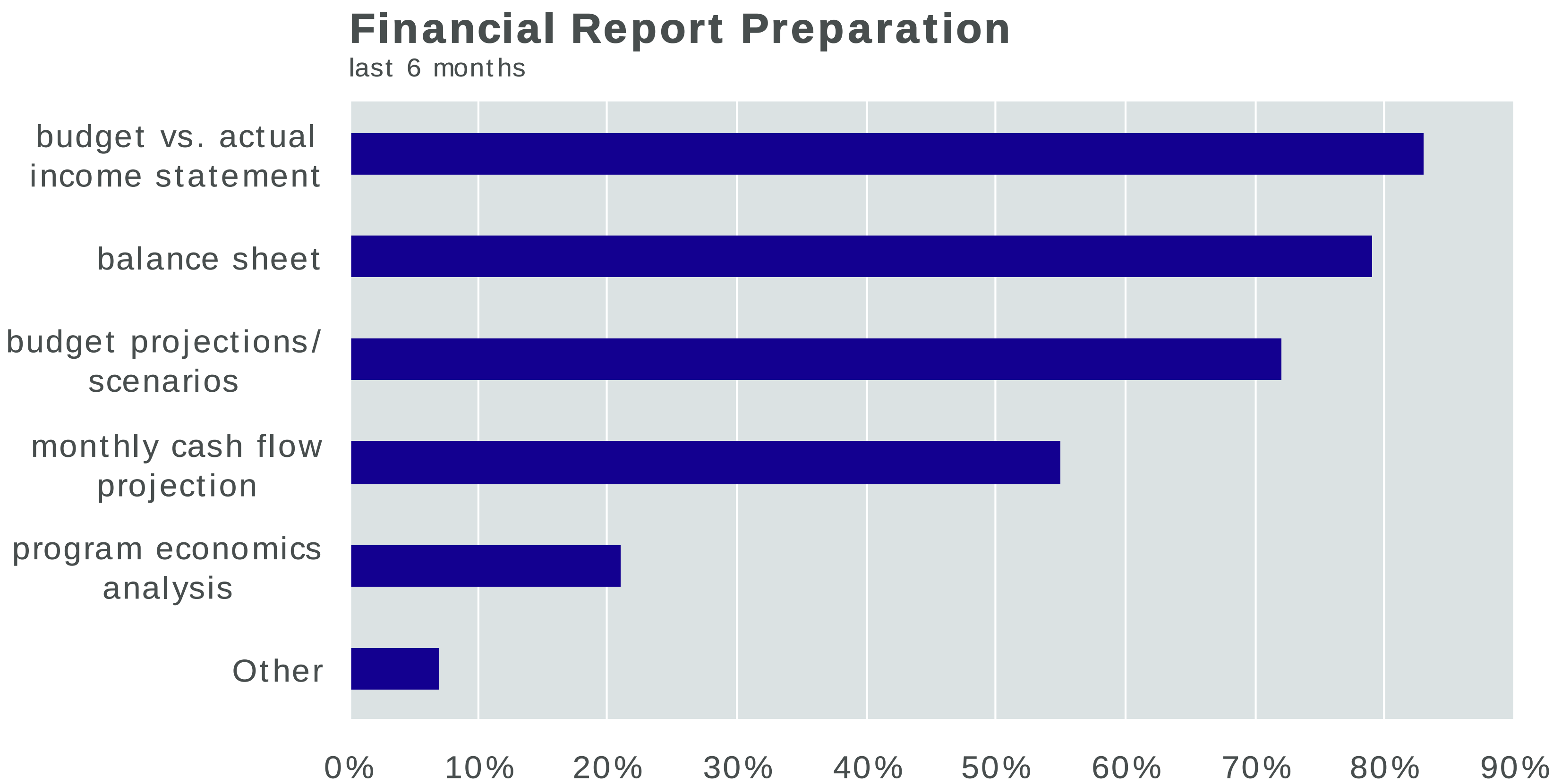
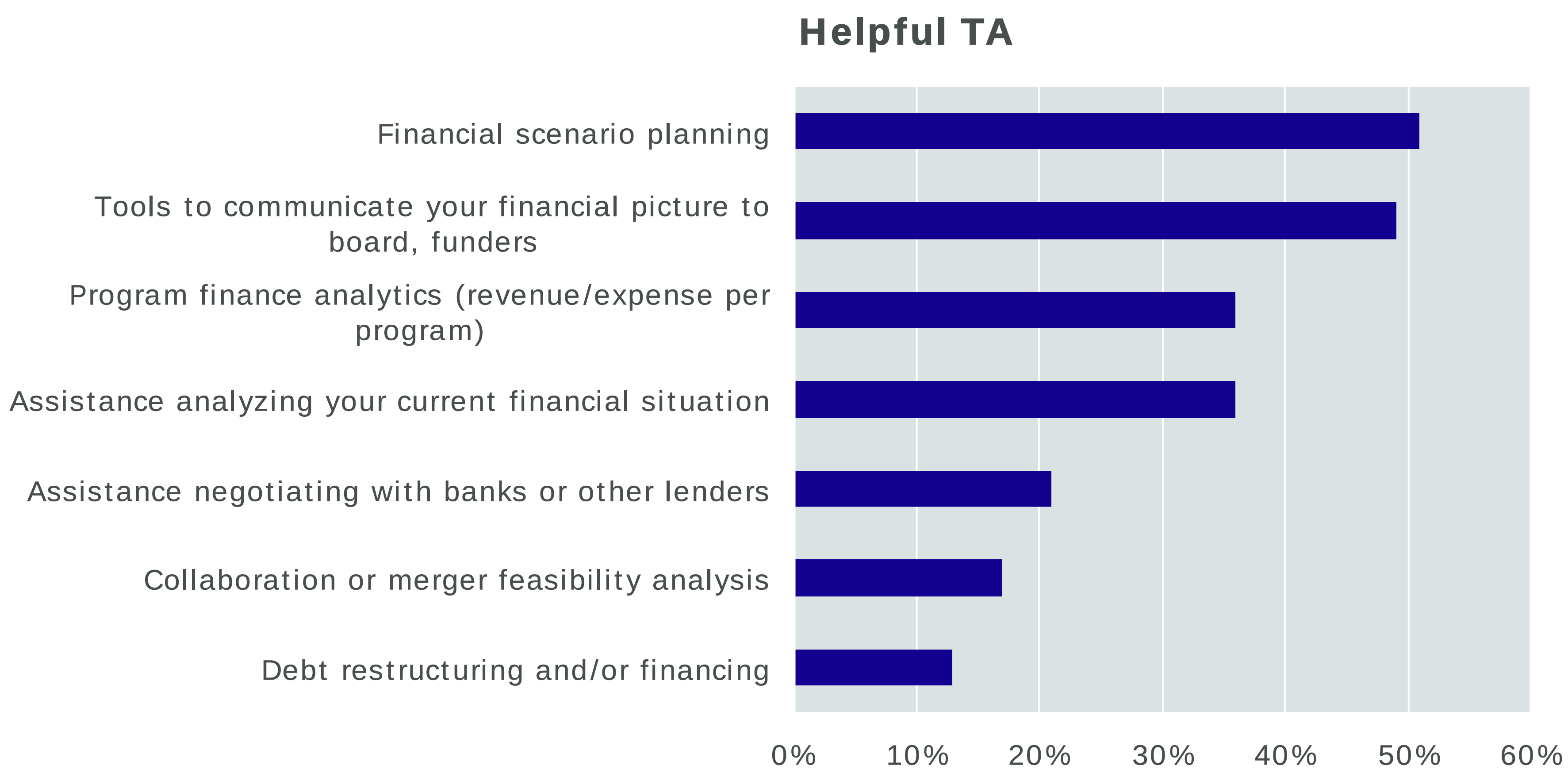
What the field is saying:
Financial basics are in evidence



. . .But important financial planning tools are not as widespread

What the field is saying: We're looking for help



What NFF sees the field is doing

Strong interest in financial literacy

- Ex: Clinics, workshops and coaching focused on arts organizations

Some progress on “pretty bad best practices”

- More general support
- BBB/WGA, Charity Nav & G’star reform overhead view

Debt strategies for both operating and capital

- Ex: Single choreographer modern dance loan program
- Ex: New Market Tax Credit Finance for arts

Capital Funding Innovation

- Ex: Leading for the Future w/new accounting treatment

Our Goal: A Rational Approach to Financing Mission Success

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Grantee role:

- fully articulates capital and revenue needs in a plan
- decides how to move forward with plan, including how money is spent
- reports to "builders" (capital investors) on progress toward sustainable new level of operations
- reports to "buyers" (revenue providers) on program accomplishments as a whole, annually

Funder role:

- understands and is clear about funding role and intention
- requires information appropriate to funding role
- expects grantee to decide how best to spend money
- expects financial discipline and good communication

Where incremental opportunities lie…

Foundation staff need support, too!

Room to improve more pretty bad best practices

- Think “net grants”
- Think outside the grant…and the enterprise

Focus on outputs, not inputs

- Focus on common reporting rather than common application
- Encourage comparables rather than benchmarks (ignore overhead and fundraising cost)
- Organize accountants and other funders to use build/buy style accounting in regular practice

Our Shared Challenge…

Connecting *money* with mission

- Funding practice that allows arts and arts organizations to both survive and adapt:
  - Survival: Reliable revenue to fulfill program expectations NOW, *and*
  - Change: Access to capital to adapt continually as the environment continues to evolve

- Keeping an eye on the real risk: declining artistic vibrancy

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Thank you

To learn more about NFF,
visit us at www.nonprofitfinancefund.org

Clara Miller
President & CEO

David Greco
Vice President, Western Region

