



The 2009 Nonprofit Economic Climate: Managing Through a Downturn

Presented by

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Nonprofit Finance Fund: Where Money Meets Mission



Dedicated to keeping nonprofits in balance and in business.

Serving thousands of nonprofit and funder clients since 1980

- \$185 million in loans; over \$1 billion in capital leveraged for nonprofits
- 500+ Nonprofit Business Analyses; 200+ nonprofit finance workshops
- Formed hundreds of strategic partnerships to advance nonprofit sector

Nationwide network of experts in nonprofit finance

- Lending
- Financial advisory services and workshops
- Assistance in preparing for managed change
- Financial advocacy across the nonprofit sector

"[NFF is]... arguably the most influential voice in the ongoing effort to reshape thinking and practice about nonprofit capitalization."

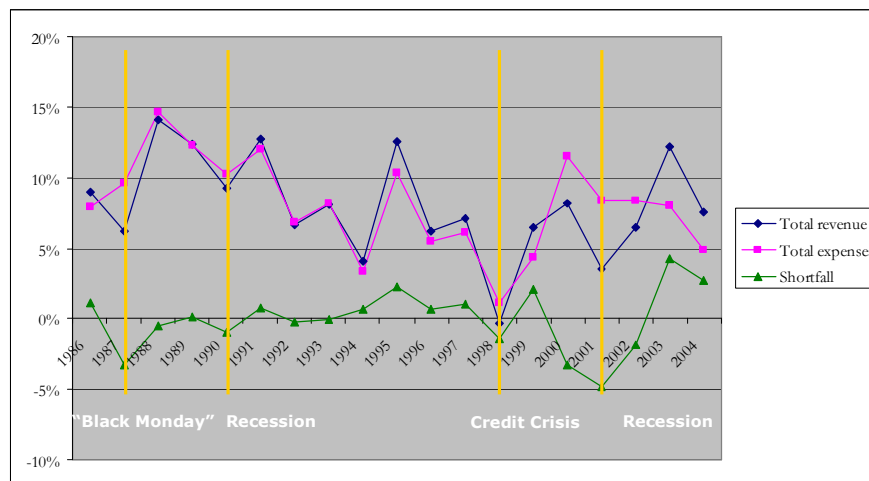
– *The Nonprofit Times*

Agenda



- **Some perspective**
 - Lessons from history
 - Heard on the street: Experiences from the field
- **Assessing Risk: Preparing for a sustained economic crisis**
 - Where money meets mission: the importance of capital structure
 - Evaluating exposure to risk and risk tolerance
- **Addressing Risk: A financial framework with tools and strategies for planning and managing in tough times**
 - Defining what's core
 - Quantifying your options
 - Developing your response
 - Strategic collaboration and realignment
 - Communicating with stakeholders
 - Rinse and repeat

The Changing Effect of Recent Economic Downturns on Nonprofits

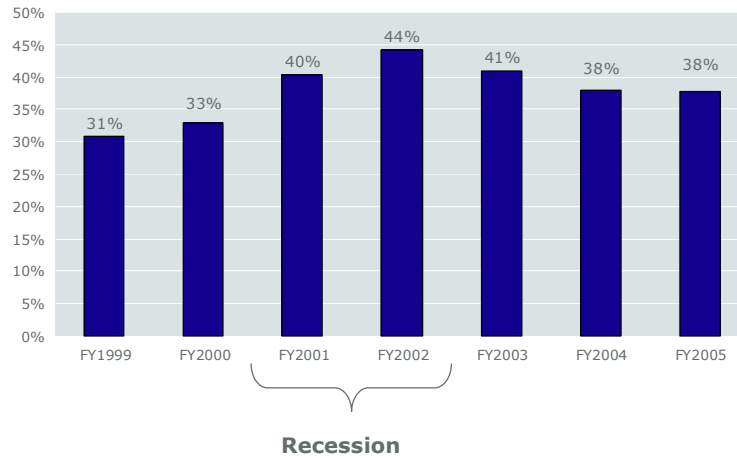


Each line shows percent change in total dollars

What Happens To Nonprofits In A Recession?



Percentage of Agencies Reporting (post depreciation) Deficits

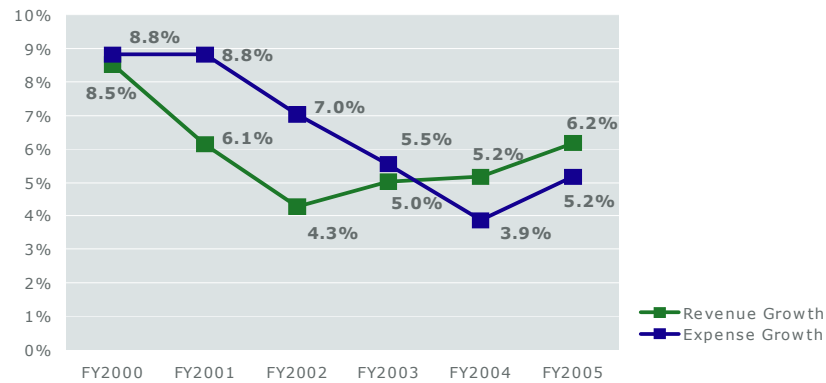


Nonprofits' Expenses Outpace Revenue During A Recession



Rate of growth in expenses generally exceeded the growth in revenue from 2001-2003.

Revenue and Expense Growth Rates



Why Is This Recession Different?



Severity and length remains in question, but it is only part of the story

This period is plagued by a combination of events we haven't seen in any of the market events over the past 20 years:

- Credit markets have seized up
- Employment falling in many sectors
- Housing construction and real estate markets are in decline

What does this mean to the sector?

- Immediate downward pressure on both government and philanthropic funding
- Limited and/or more expensive access to credit
- Nonprofits are likely to emerge from the downturn later than the broad economy

Introduction to the Survey



Nonprofit Finance Fund recently conducted a survey of nonprofits nationwide to assess the real-time financial challenges they face. **The survey focused on surfacing the most critical areas of need, both for the immediate and longer-term durability and effectiveness of the sector.**

Nearly one thousand nonprofit leaders responded to our survey. Survey respondents stretched from coast-to-coast, from large organizations to small, and came from all sub-sectors.

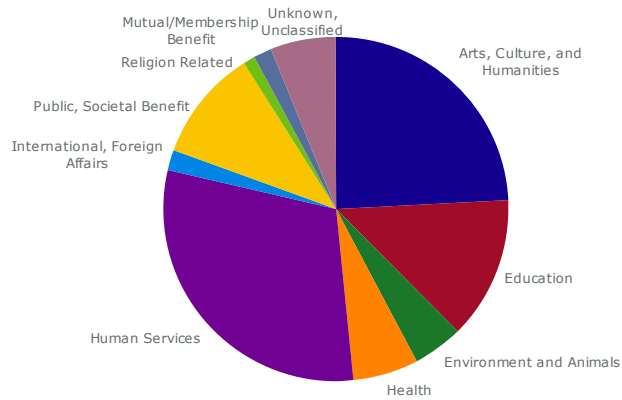
What did we learn from their collective reply?

America's nonprofit sector is financially vulnerable.

What Areas of Need Do Survey Respondents Address?



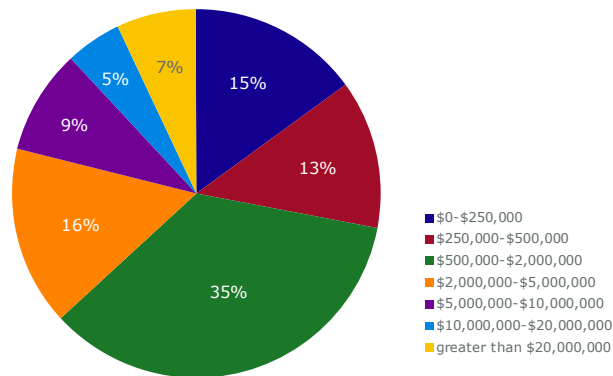
Survey Respondents by Sector



What is the Annual Expense Size of Respondents?



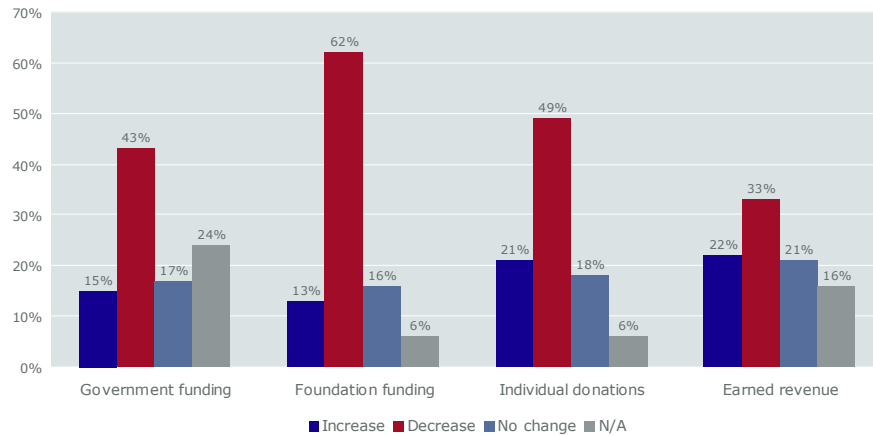
Most Survey Respondents from Small-to-Mid-Sized Nonprofits



What Are Organizations' Revenue Expectations for 2009?



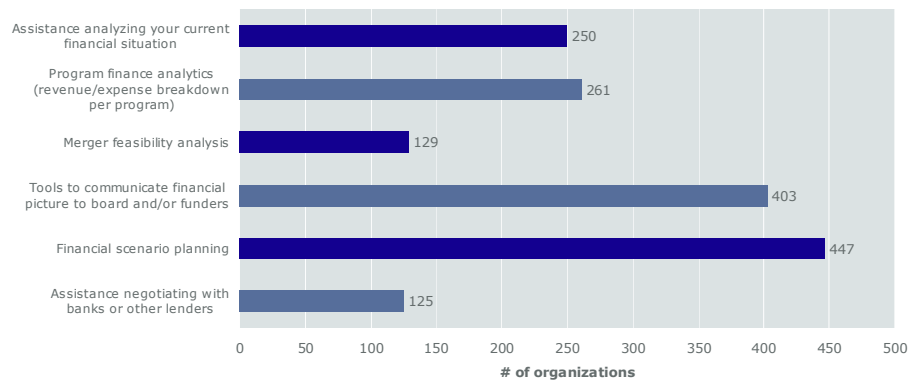
Organizations are bracing for funding cuts from all types of donors



What Type of Technical Assistance Would Be Helpful?



Nonprofit leaders expressed interest in tools to help them manage through the crisis



Summary of Key Findings



The Financial State of Nonprofits

- Only 12% of all respondents expect to operate above break-even this year.
- Just 16% anticipate being able to cover their operating expenses in both 2009 and 2010.
- 31% don't have enough operating cash in hand to cover more than one month of expenses, and another 31% have less than three months' worth.
- In 2009:
 - 43% anticipate a decrease in funding from government
 - 62% anticipate a decrease in funding from foundations
 - 49% anticipate a decrease in funding from individuals
 - 33% anticipate a decrease in earned revenue
- 52% of respondents expect the recession to have a long-term (2+ years) or permanent negative financial effect on their organizations.
- 93% of lifeline organizations that provide essential services anticipate an increase in demand in 2009.

Summary of Key Findings: What Are Nonprofits Doing?



Actions Nonprofits are Taking or Considering

- Develop a 'worst-case scenario' contingency budget: 65%
- Reduce staff or salaries: 41%
- Freeze all hires and current staff salaries: 48%
- Reduce or eliminate programs: 39%
- Collaborate with another organization to provide programs: 42%
- Use reserve funds: 43%
- Delay payments to vendors: 23%
- Speed up the collection of receivables: 22%
- Engage more closely with board through more frequent reports and meetings: 59%
- Hold conversations with funders to explain situation and projections and/or to discuss the use of currently restricted grants: 48%

Your Organization's Response



What challenges or opportunities is your nonprofit experiencing this year?

What are you expecting for next year?

Where are the opportunities?



- **Reconfirm your organization's alignment with core mission**
- **Examine the evolutionary possibilities**
- **Encourage and embrace creative thinking**
- **Consider bold, internal changes**
- **Changes made during crisis can lead to emergence as more disciplined and, in turn, stronger enterprises**
- **Implementing and institutionalizing good financial management practices can position our organizations for a stronger tomorrow**

"You never want a serious crisis to go to waste."

-Rahm Emmanuel

The NFF Triangle



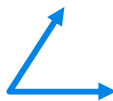
Mission and Program

What you do, and how you do it.



Capacity

The people, space, and processes that allow you to do what you do.



Capital

What resources and assets you have to work with.

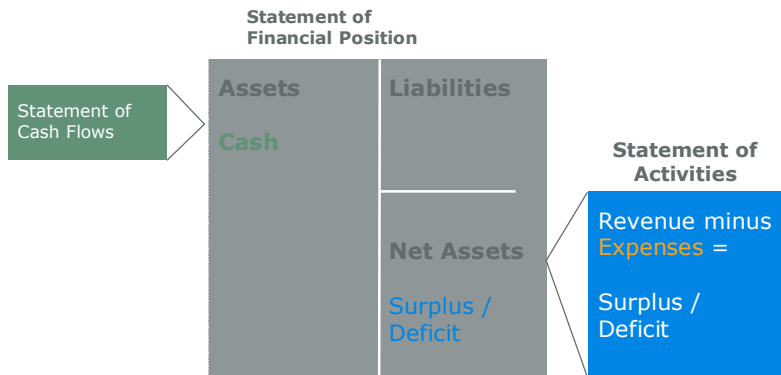


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Nonprofit Financial Statements



The Two Bottom Lines

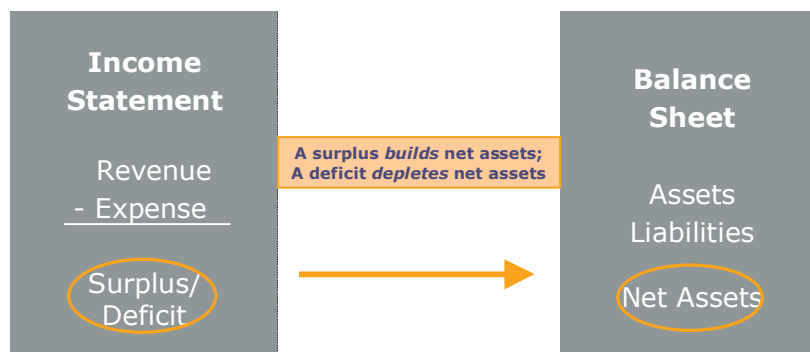


Income Statement: Surplus/Deficit

- Income Statement reflects the annual results of a organization's operations

Balance Sheet: Net Assets

- Balance Sheet provides a picture of overall financial health



Assess Risk: Quality of Financial Information



What financial planning and management tools do you currently use to assess your situation?

Common reports

- Year-to-date actuals vs. budget
- Balance sheet
- Monthly cash flow
- Revenue and expense by program

Are they giving you the information you need?

Tools are not a substitute for making hard decisions.

Assess Risk: Impact on Financial Performance



How do you answer these questions?

- **How might the reliability of your organization's revenue streams be affected in an economic downturn?**
- **Will the recession lead to increased demand for services and, if so, how will you respond?**
- **Will costs have to be cut, and if so, which costs?**
- **How will your organization deal with these potentially competing effects?**
- **How might changes in revenue streams and cost reduction strategies affect operating results?**
- **How will changes in your operating performance affect your organization's balance sheet?**

Assess Risk: Know your Balance Sheet



First things first: Know where you stand

- **Cash** – How much? How “liquid?”
- **Receivables** – Are they slow to collect? Are any at risk for collection?
- **Fixed Assets** – How will you address maintenance issues?
- **Line of Credit** – How do you manage cash flow? Are you using debt appropriately?
- **Temporarily Restricted Net Assets** – Do they fully support your core programs?
- **Reserves** – Do you have them? Suitable to your needs? Agreement on use?

Understand your balance sheet



Know where your organization stands. Your condition will inform the urgency and types of action leadership should take

- Is your organization operating now from a position of strength or weakness?
- Can you afford a deficit and if so, how large?
- What is your risk tolerance?

If your balance sheet has...

- No cash or receivables
- A fully drawn line of credit
- Little or no reserves available to management
- Significant wear-and-tear of fixed assets

...There are no dollars immediately available to draw on in challenging times.

- **Borrowing to replace lost income is rarely appropriate.**

Months of Liquidity: Rule of Thumb



What is the right amount for YOUR organization in this economy?

Months of Expenses Covered by Liquidity	Operating Situation
0	Crisis – Scrambling for cash, delaying payment to vendors, overdrawing checking account.
Less than 3 months	Cash is tight – Relying on line of credit, delaying payment to vendors.
3-6 months	Room to breathe – Can do some long-term thinking. Little room for “rainy days.”
6+ months	Handles more risk – Able to withstand increasingly acute shocks such as large facility repairs, funding cuts and possibly recessions.

Measuring Liquidity



$$\text{Months of Cash} = \frac{\text{Total Cash}}{(\text{Total Expenses} / 12)}$$

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

How do we begin to assess the health of our financial situation?



Understand Operating PERFORMANCE

Determine STRENGTH of Our Balance Sheet

Acknowledge Our Ability to Handle RISK

Plan Our Response

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Address Risk: Planning for the future



Where you've been → Where you are now → Where you're going

Statement of Activities

Revenue
Earned
Contributed
Expenses
Personnel
Professional
Occupancy
Support
Interest
Surplus/Deficit

Balance Sheet

Assets	Liabilities
	Net Assets

Budget

Revenue		
Budget	Actual	Variance
Expenses		
		Surplus/Deficit

Leadership Requires Making Decisions



- **Good financial decision-making requires timely, accurate and transparent financial information**
 - Be prepared to work with and adapt to imperfect information
- **Tools are only as good as the assumptions behind them**
- **Tools are not a substitute for making difficult decisions**
 - Beware of the knowing-doing gap
- **Being honest first with ourselves allows you to begin the exercise of discovering options**
- **External communication and buy-in are essential but not before you've done your internal due-diligence**

Focus, Focus, Focus



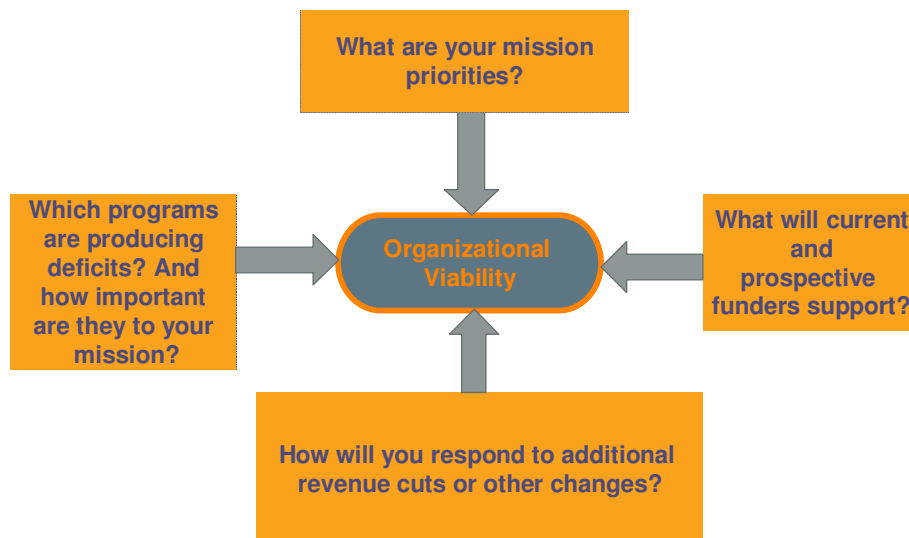
Revisit your mission and define your priorities:

- Which activities are core to your mission?
- Are they positive financial contributors or do they need subsidy from other programs?
- What are the non-negotiables in your budget?

Once you define what is core to your mission then define programs as:

- What we **MUST** do
- What we **SHOULD** do
- What we **WANT** to do

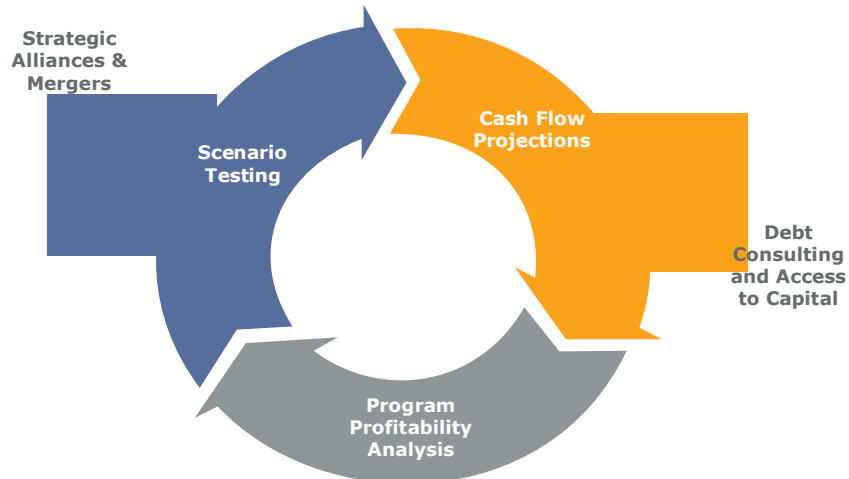
Can You Answer The Tough Questions?



Quantifying the Challenge & Planning the Response: NFF Framework



Financial & Organizational Assessment



Quantifying The Challenge: Cash Flow Projections



Recessions impose severe constraints on cash flow and cash availability

Ensure more visibility into the future by developing a physical landscape of the timing and reliability of cash in and cash out

- Distinguish between **"cash flow" issues (timing of receipts) and "cash" issues (shortage of cash overall)**
- Prepare cash flow projections on a monthly basis (if not weekly in times of crisis) and continually update based on actuals vs. projection

Cash flow projections enable management to estimate how much cash it should keep on hand and, if appropriate, how much short-term debt it may need to access for the extra tough months.

Uses:

- To instill cash management discipline
- As part of your standard reporting package to the Board/Finance Committee
- To support your conversations with funders, bankers and other stakeholders
- To inform and guide achievement of mission and program objectives

Monthly Cash Flow Projections: Basic Structure



	Month 1	Month 2...
A. Beginning Cash	100	120
B. Operating Cash In	50	
C. Operating Cash Out	20	
B-C Net Cash From Operations	30	
D. Net Non-Operating Cash	-10	
A+(B-C)+D Ending Cash	120	
	$100 + (50 - 20) - 10$	

What Are Some Ways Nonprofits Can Manage Cash Flow?



1. Accelerate receivables
2. Access an internal/ external line of credit
3. Delay payables
4. Draw on reserves
5. Access restricted cash (BEWARE!)

Which of these are viable strategies for the long-term health of an organization?

Quantifying the Challenge: Debt And Access To Capital



A line of credit can help address periodic or recurring **CASH FLOW** issues, allowing your organization to bridge timing gaps between the expenditure of funds and receipt of offsetting revenue. In so doing, you preserve existing cash, whether it be for a rainy-day or future opportunity.

By securing a line of credit, particularly when times are good, you build your banking relationship and credit history.

Conversations with your banker must be ongoing, deep, and fully transparent. Be prepared to talk beyond the numbers:

- Short- and long- term plans for the organization
- Multiple scenarios for potential reductions or loss in funding
- Funding commitments / contracts for next 12 months (at minimum)
- Evidence of reporting and processes in place to measure progress against budget and ability to course correct
- Management team with the ability to lead through changing economic and funding environment

Quantifying the Challenge: Program Profitability Analysis



Program economics analyses are designed to help answer the following questions:

- Which programs subsidize other activities and overhead?
- Which programs require subsidy from other fundraising or program activity?
- How might we do business differently so that our programs and capacity are fully and collectively supported?

Program economics analyses are used to:

- Inform strategic decision making around sustaining, growing or cutting/changing programs
- Evaluate any trade-offs between bottom-line and mission contributions
- Enable well-informed responses to operating changes
- Allocate resources among competing priorities

Using Program Profitability Analysis to Assess Risk



Assessing the underlying economics of programs can inform decisions about whether and how to cut costs—and where to focus fundraising efforts based on an analysis of each program's contribution to the bottom line AND to mission.

Nonprofit organizations often make decisions to maintain deficit programs critical to their mission. The key is to understand the size of, and identify the source for the subsidy needed to cover, these deficits.

Using Program Profitability Analysis to Assess Risk

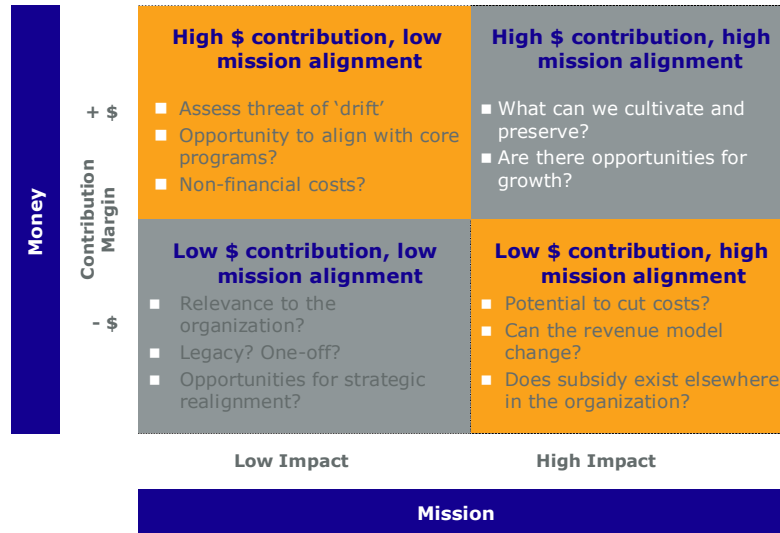


The analysis involves preparing a spreadsheet that uses a budget or a completed year's income statement.

- Assigns all direct revenue and expense to each program - Identify items that are directly tied to programs.
- If a program goes away, what revenue and expenses go away?
- Program "bottom-line" shows the impact on the overall bottom-line if the program went away.
- All supporting expenses (management, occupancy, fundraising, administrative, etc.) are examined separately.

This analysis is part art, part science; it is for **internal use only**; and requires the judgment of the Executive Director.

Program Profitability Analysis: A Visual Tool



Planning Your Response: Scenario Testing



Scenario testing provides a means to explicitly and transparently communicate in financial terms the viability of plans for the future

Determine how and under what circumstances you will mid-course correct

- Consider which expenses you can reduce, eliminate or postpone
- Evaluate how cuts will impact delivery of mission and economic viability
- Consider ways to increase revenue, if once reliable sources seem questionable.
- Ensure new revenue opportunities are "net" positive

Identify the triggers that lead to Plan B, Plan C, etc.

- For example: if X% of revenue doesn't arrive by Y, we will cut Z% of expenses)
- They will be different for every organization

Planning Your Response: Scenario Testing



Don't wait until the wolf is at the door. Knowing how and when you will react can prevent emotion-based decision making

Scenario planning can be as complex or as simple as you need it to be:

- **What would we do differently if budgeted revenue dropped 10%? 20%? 30%?**
- **What do we think the likelihood is of receiving funds from each revenue source within each program?**

Plan for a worst case scenario. It's always easier to take drastic action when you consider it before your MUST take it

How Will Each Scenario Impact Your Organization's Long Term Health?



What will be the implications of your scenarios on your organization's ability to withstand risk?

- **Which scenarios produce deficits? Surpluses?**
- **Will deficits deplete cash or result in larger debt obligations?**
- **Will you need to delay payments to vendors?**
- **Will surpluses be converted to cash savings or invested in fixed infrastructure?**
- **If revenue grows, will receivables grow?**

While a strong balance sheet doesn't guarantee strong programs, strong programs require the support of strong balance sheets

Merger or Alliance: What is the Difference?



Merger

Corporate change



Alliance

No corporate change

Focus on strategy



Focus on operations

Six to nine months



Open-ended time frame

One Board of Directors



Multiple Boards of Directors

Act as one



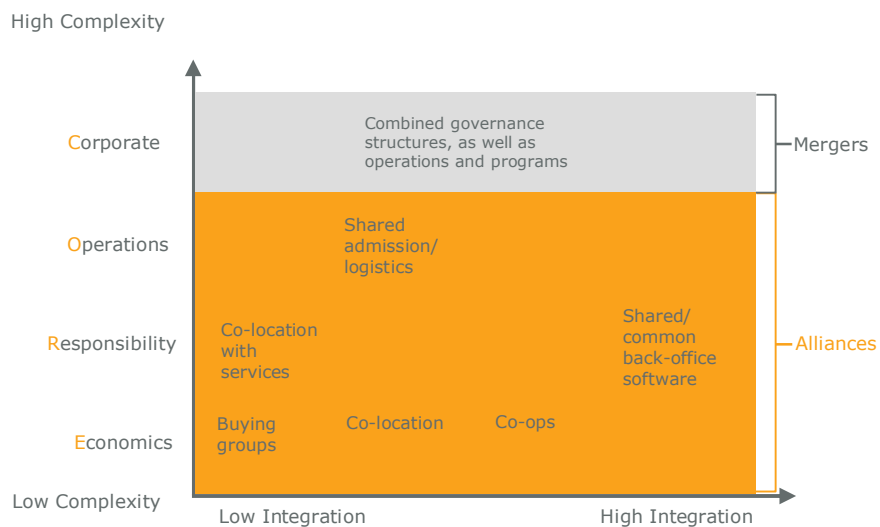
Multiple corporate interests

Market sees one



Market sees many acting as one

Mergers and Alliances: Examples of a C.O.R.E. Continuum of Collaboration



Strategic Realignment



The organization will want to conduct an in-depth financial analysis and multi-year evaluation that may include:

Income Statement:

- What sources of revenue does the partner bring? Will they increase/decrease/diversify?
- Will there be cost savings? What costs will increase? New expenses?
- What are the revenue and expense dynamics of individual programs? How much fundraising support does each require?
- What transitional and one-time start-up expenses will be incurred and how will they be financed?

Balance Sheet:

- How will the merger/affiliation affect current and long-term capital structure? Liquidity?

When To Consider a Merger



Organizations should merge when *they don't feel that they must*

This may sound glib, but...

...once organizations feel the pressure to merge, they've probably already lost a lot of their value, not to mention their ability to run as a going concern

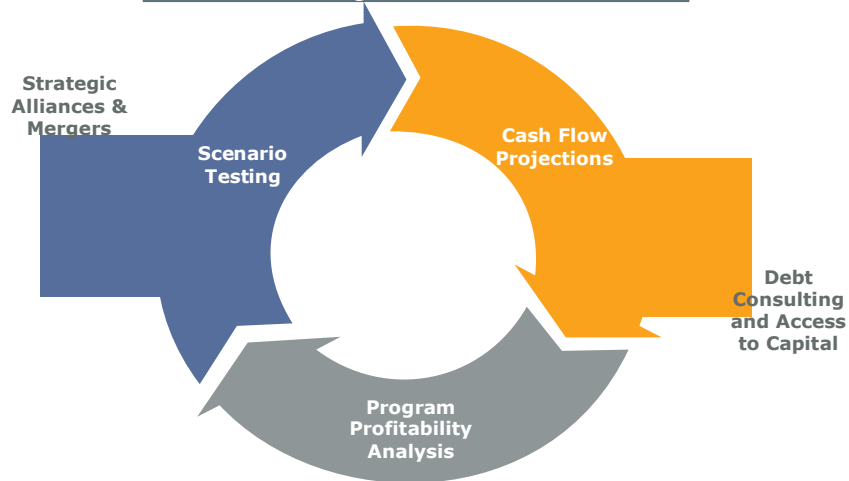
How to proceed:

- **Talk and communicate: Boards/ Management**
- **Find shared values and common mission goals**
- **Involve advocates & funders**
- **Seek examples & involve those who have been successful**

Quantifying the Challenge & Planning the Response: NFF Framework



Financial & Organizational Assessment



Communicate Early and Often



Engage your staff in conversations about options

- Staff may have some of the most creative ideas and solutions

Bring your alternatives to the Board for decision making

- Remember your Board has a fiduciary duty to safeguard the organization's assets

Stay in front of donors—don't pull back. Tell your story regularly

- Be candid about the impact of the economic climate on your programs and organization
- Communicate your strategy and plan to adjust
- Focus on positive messaging. Emphasize your commitment to mission and the urgency of your needs