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PERSPECTIVES ON NONPROFIT STRATEGIES FROM WOLFBROWN

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THIS ISSUE FEATURES:

Broadening Our View of Nonprofit Capitalization

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Broadening Our View of Nonprofit Capitalization

Endowments have been called the "Holy Grail" of nonprofit finance. Nonprofits aspire to develop endowments as relief from the burden and uncertainty of annual fund raising. Many foundations have fashioned "stability" and "sustainability" strategies around endowment building, usually in the form of a challenge investment that triggers a capital campaign. Endowments are excellent targets for planned giving programs, which can be within the reach of organizations of all sizes.

Funders and grantees have discovered over the years, however, that endowments, although a valuable element of an overall financial strategy, are not panaceas for organizations with structural deficits. They do not guarantee the continuity of an organization—organizations can still work themselves into a financial hole by outspending their income. **Building endowments without development of fiscal discipline, fund-raising capacity, and cash reserves is insufficient to guarantee fiscal health.**

It is especially important to realize that **endowments do not obviate the need for fund raising**—they are one piece of a total income picture that includes continued vigorous donor cultivation and stewardship. Indeed, a good annual fund-raising program is a prerequisite to successful endowment building, as the organization's existing individual donor base is typically the backbone of an endowment campaign. Such a campaign asks people to transfer some of their assets out of their personal control and turn them over to the nonprofit—in essence, to make their annual donation decision in perpetuity. That is a high standard for an organization to meet with a donor—it usually requires some pre-existing relationship.

Funders and nonprofit managers are beginning to think more expansively and creatively about how to set assets aside in new ways that can be more liquid, flexible, and potentially responsive than endowments to changing organizational needs in a changing environment.

continued on page 2

continued from page 1

"Risk capital" or revolving funds, where the corpus is accessible under certain circumstances, are one type of alternative. Such a capitalization strategy falls somewhere between annual fund raising and endowment funding. The organization uses the funds as a buffer against downside financial risk of organization expansion, innovation, or change. The organization can only borrow from the risk fund. The requirement of repaying the fund within a set period of time necessitates the development of a realistic business plan for the new enterprise.

The overall point is that **different groups need different capitalization strategies**, and that every group should have such a strategy in place (e.g., five percent of budget each year goes into a risk fund, all bequests go into endowment, working reserves are kept at 30 percent of annual budget, investment in fund raising should be at least 15 percent of budget every year).

We have asked three distinguished and experienced thinkers in the realm of nonprofit management to add their ideas to this brief discussion of organizational capitalization strategies: **Andrea Rogers of the Flynn Center for the Performing Arts**, who has used endowment as part of an overall financial strategy; **Ben Cameron of the Doris Duke Charitable Foundation**, who is thinking about how best to help grantees invest in the future; and **Russell Willis Taylor and Gail Crider of National Arts Strategies**, who have written thoughtfully and provocatively about the issue of nonprofit capitalization.

Andrea B. Rogers

Executive Director & CEO
Flynn Center for the Performing Arts

At the right time, in addition to other strategies, and with careful management of investments, endowments are wonderful.

In 2000, the Flynn Center had a solid track record for annual giving, was largely debt free, had built up adequate cash reserves, and had just completed a major capital expansion. We were fortunate to receive two millennial challenge grants (one from the Ford Foundation and one from the Doris Duke Charitable Foundation).

> Both foundations recognized that sustaining the Flynn's leadership role would require another big step—the development of endowment.

Both funders supported five-year investments in programming, provided a contribution for endowment, and required a significant endowment match. The grants spurred a $6 million endowment campaign, successfully completed in Summer 2005. As part of the campaign, we raised a Bridge Fund for Excellence, so by 2005, as the programming investments ended, the combination of the Bridge Fund and endowment distributions enabled us to replace them.

Now, as pledge payments build the endowment, our five percent distribution is twice the value of the grant funds it replaced, helping us deal with rising costs. The endowment is thus exciting for two important reasons. First, it enables the Flynn to fulfill its commitment to increased support for programming. Second, it provides an essential contribution as programming and operating costs rise faster than revenues.

AGE

HOW WILL YOU ENGAGE THE FUTURE?

WolfBrown guides foundations, government agencies, and nonprofit organizations in fulfilling their missions. Services include program design and evaluation, strategy development and sustainability planning, resource development, impact assessment, audience and cultural participation research. We invite you to visit our new website at wolfbrown.com.

There is a danger in this scenario that we recognize. It is certainly our goal to grow annual revenues to keep pace with increased costs. We have introduced new sponsorship and major gift strategies and gradual fee increases. And we raise funds specifically for education as many donors are partial to our education programs. Finally, we have launched a Planned Giving Initiative with long-time patrons. The goal is to secure unrestricted end of life gifts toward a board-designated endowment that would be more flexible during downward market fluctuations than donor restricted endowments.

Ben Cameron

Program Director for the Arts
Doris Duke Charitable Foundation

The 10th Anniversary of the Doris Duke Charitable Foundation led us to a comprehensive review of our ten years of arts grant making during which we dedicated significant resources to helping organizations build endowments. Grantees have told us of the value of that funding: the importance of guaranteed income; the role of endowment drives in focusing their boards, raising board and community giving levels, and animating staffs; and the ultimate validation and elevated profile of the organization. We are understandably proud of the impact of our funding.

That said, we also learned that endowments may not be an optimal strategy for all groups.

Organizations can be overwhelmed by the demands of endowment drives and, in many cases, may need reserves or annual support more urgently. Given the inherent emphasis on perpetuity, endowments for young or founder-led organizations may be premature, a question especially apt for many modern dance companies and performing arts ensembles that we wish to support.

Arts organizations are facing enormous new pressures in audience erosion and the impact of technology. While for-profit businesses often have access to significant capital for research, experimentation, and implementing new strategies, this is rarely so in the nonprofit performing arts. Our new chapter in grant making will offer "transformational capital"—funds that organizations can spend in aggressive attempts to reposition themselves for the future. We will offer grantees significant resources, the assurance of multi-year investment, and the maximum flexibility to pursue new strategies, encouraging a holistic approach to change (embracing programs, capital structure, and organizational culture). We hope this new approach will not only enable organizations to reposition themselves and support artistic excellence more strongly for the future, but will also spark discussion about the value of multi-year investment, measurement matrices, and flexibility in funding approaches.

Russell Willis Taylor

President and CEO

Gail Crider

Vice President
National Arts Strategies

NAS believes that organizations need to focus on liquidity first, so that senior managers do not spend their time putting out financial fires, distracting from organizational mission and strategy. Using unrestricted resources (time and money) to chase restricted resources may weaken the overall financial position if not undertaken carefully. Defining and raising capital requires clarity in analysis as to how much and why each type is needed. In all financial planning and fund raising, the revenue and expense mix must be congruent with the mission and underlying strategy for the organization. For example, for the purposes of mission achievement, it might be better to raise working capital, unrestricted, or temporarily restricted assets to improve the organization today than to tie up large amounts of capital in permanently restricted endowment assets.

Shaping a balance sheet is similar to creating a three dimensional work of art.

It should include a base to hold the weight of the organization, appropriate symmetry to give flexibility,

and enough shape to be understood and warrant the trust of donors. One size never fits all. The appropriate layers of capitalization depend on the organization's current business strategy, long term vision, and mission. To assess the financial strength and strategy of their organizations, leaders should examine yearly cash flow cycles, the organization's history of deficits/surpluses, the nature of organizational risk—short and long term, and the level of trust and support among donors, and then ask: would spending money today better achieve our mission, without putting the organization at an unacceptable level of risk?

Board and management must take a realistic and nuanced view of financial plans, and avoid the illusory if emotionally attractive belief that any sum of money will eliminate risk entirely and make an organization less complex to run. When donors give money that is restricted in perpetuity, they are telling us that they know how the money should be spent better than we do. When we accept it without question, we are agreeing.

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