Adapting to Changed Times

By Kathleen P. Enright

Imagine this: a nonprofit leader is riding the rapids of an economic downturn. She must move quickly –cutting expenses in a way that prepares the organization for the future and making a few strategic investments to help shift the way the organization operates. But most of all, she needs a little time and space to assess the situation, gather data and figure out what's next.

That's what she knows she *should* do. However, her reality is quite different from that ideal. Her organization has eight programmatically restricted grants, all on different reporting cycles and time frames. She has two choices: either ask some of the foundations to release restrictions on grants, or decide what to cut based on where the restricted dollars lie rather than on an assessment of what will make the biggest difference to her organization and the constituents it serves.

Her primary source of unrestricted revenue – fees for services – is in sharp decline because the organization's client base also was hard-hit by the recession. And payments on the nonprofit's contract with the city (which already requires a subsidy from unrestricted dollars because of unrealistic overhead limits) won't arrive until more than 90 days after the services are delivered. Though her organization has long been considered one of the best in the city and receives support from a host of local grantmakers, it has only a meager 30 days of operating cash with no board-designated reserves.

An extreme example, you say? The

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Nonprofit Finance Fund's 2009 survey of 986 nonprofit human service providers nationwide suggests that it's a fairly typical scenario:

- Only 12 percent of nonprofits expect to operate above breakeven this year.
- Just 16 percent anticipate being able to cover their operating expenses in 2009 and 2010.
- 31 percent have less than 30 days of cash on hand; another 31 percent have less than 90 days of cash.

Taken together, these statistics paint a grim picture. The vast majority of nonprofits will operate at a deficit this year (and potentially next) without the financial reserves to fill the gaps. The majority of nonprofits already were financially vulnerable before the financial crisis, and pressures from all sides are increasing. Government funders are paying more slowly, foundations are retrenching and demands for basic services are on the rise.

The reality is that even the strongest nonprofits are struggling. As a grantmaker, it's tough to figure out where to start in light of such a bracing set of circumstances. A question to consider is this: How can we help the nonprofits we rely on not merely to weather this storm, but to emerge ready to succeed in the changed environment?

Most management consultants agree that the ability to adapt is a core characteristic of innovative organizations. Adaptive capacity is the ability to monitor, assess and respond to internal and external changes.[1] But how is this capacity built or enhanced? How can grantmakers give nonprofit leaders the flexibility they need to adjust based on changing circumstances, to use their best judgment and to save for a rainy day?

Similarly, most would agree that the presence of a healthy reserve fund – six months of operating costs is the common wisdom – is a shared characteris-

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tic among high-performing organizations. The financial data noted above, and all of our personal experience, suggests that only rare nonprofits have achieved that goal. So what can grantmakers do to help nonprofits?

One thing is certain—nonprofits with access to flexible dollars and financial reserves are much better equipped to weather economic downturns and adapt successfully to other changes in the environment.

Without a doubt, the clearest way to support a nonprofit's ability to adapt and to set grantees on a path to more financial security is to provide general operating support. Reserve funds only can be built when there is an excess of unrestricted revenue over expenses at the end of the year. They cannot be built from restricted grants, government contracts or other targeted dollars. If we truly believe that healthy nonprofits need funds in reserve, we must consider providing operating support more consistently and in larger amounts.

Restricted grants and contracts, though completely appropriate in some circumstances, hamstring an organization's ability to adapt quickly when the world around it shifts. If each grantmaker only looks at its part of the equation – the program or project it supports – the organization as a whole will suffer.

The puzzling part is that this realization hasn't led to broad-scale change in how grantmakers provide funds to nonprofits.

Foundation Center's latest data suggest that general operating support retains its spot near the bottom in the types of foundation grants disbursed, holding steady at about 19 percent of total grant dollars in 2008.

Though data for the entire sector is not yet available, preliminary analysis of 2009 grants for the small number of foundations that report electronically to the Foundation Center suggest some signs of progress. Twenty-six percent of

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the electronic reporters have shown a broader preference for general operating support given the uncertainty faced by grantees. Of the 42 foundations for which data were available for both 2008 and 2009, 11 foundations increased the percentage of their grant dollars devoted to general operating support by 10 percent or more. And only two of the 42 foundations decreased their general operating support by 10 percent or more. Yet, the aggregate percentage of general operating support among these foundations remains less than 20 percent of total grant dollars.

A study of the top 100 largest grantmakers in Los Angeles County (with a 24 percent response rate) conducted in mid-2009 reveals some promise as well. In this study conducted by the Center on Philanthropy and Public Policy at the University of Southern California, 33 percent of responding foundations expect the proportion of their general operating support grants to increase in 2009 compared to previous years. Another 58 percent suggested general operating grants would remain the same and only 8 percent said that general support would decrease.[2]

It will be interesting to see if there is significant movement sector-wide once full data for 2009 are available.

CREATING THE NEW NORMAL

Though we haven't yet witnessed a sea change, many individual grantmakers are making productive changes in the way they do their work in light of the economic crisis. They are releasing restrictions on program grants; they are simplifying their grant application processes; and they are showing broader preference for general operating support.

The GEO community's hope is that these adjustments will be embraced as part of the "new normal" for doing business—a new normal that focuses on the variety of ways that philanthropy can be more broadly supportive of nonprofit results.

One particularly compelling example is the Boston Foundation's recent announcement that it is making a series of substantial shifts in the way the organization does its grantmaking in order to provide the type of support its community needs the most. This change came about after several years of listening to community feedback, conducting research to understand key contributors to nonprofit financial health and participating in efforts to look carefully at the way state government contracts affect nonprofit financial performance.

As a result, the foundation is making larger, multiyear investments with a significant portion given as general operating support. Annual grants from discretionary funds can be as high as $150,000, which is nearly three times the size of the typical grant prior to this change. The foundation also has done away with term limits, meaning there's no longer an arbitrary limit on how long a single organization can receive funds from the foundation. If an organization is performing well and remains aligned with the Boston Foundation's goals, it feasibly could receive support indefinitely. Similarly, the Boston Foundation realized its grants process was set for the foundation's convenience, not that of its grantees. The Boston Foundation now has moved to a rolling grantmaking process rather than having just a few annual deadlines.

At the same time, the Boston Foundation got clearer about its own goals and the role the organization is best positioned to play to achieve them. Clarity about organizational goals and the measurable impact the foundation strives to create makes the decision to give operating support an easier one.

Paul Brest, president and CEO of the Hewlett Foundation, and Paul Shoemaker, executive director of Social Venture Partners Seattle, recently engaged in an online exchange that illustrates the fact that operating support continues to inspire deep passions and continuing disagreement. Despite the fact that these are two of the most vocal advocates for general operating support nationally, they uncovered an area of disagreement that I would characterize this way: Paul Shoemaker believes that restrictions on grants are almost never appropriate and Paul Brest, citing the importance of alignment and using the exceptional example of providing funding to a large university, makes the case that general operating support is one of a number of tools of philanthropy that grantmakers must learn to use sophisticatedly. He believes that project or program support is indeed appropriate at times. Despite this disagreement, both Pauls agree that, as a sector, we give general operating support too infrequently and in amounts that are too small to be meaningful.

If there ever was a time to expand the use of general operating support, it is now.

If this experience of economic turmoil can teach us anything, it is the importance of supporting capable people who are close enough to the action to be able to adapt quickly to the changing circumstances around them. The goal is not to just enable nonprofits to meet today's priorities, but to provide support in a way that lets them build strong organizations for tomorrow. ■

Kathleen P. Enright is president and CEO of Grantmakers for Effective Organizations (GEO). The 2010 GEO National Conference will be held in Pittsburgh on April 12–14, 2010.

Notes

1. Christine Letts, William Ryan and Allen Grossman introduced the concept of adaptive capacity in *High Performance Nonprofit Organizations: Managing Upstream for Greater Impact* (New York: John Wiley and Sons, 1999).

2. The Center on Philanthropy and Public Policy at University of Southern California, *Prospects for Foundation Philanthropy in Los Angeles during Uncertain Times: A Research Brief* (Los Angeles: October 2009).

ONLY 12 PERCENT
of nonprofits
expect to operate
above breakeven
this year.

12

JUST 16 PERCENT
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anticipate
being able
to cover their
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in 2009 and 2010.

16

31 PERCENT
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31