Strengthening Community-Led Organizations by Understanding Full Costs

Presented by
Kristine Alvarez
Director
Nonprofit Finance Fund
April 2017

Overview: Nonprofit Finance Fund® (NFF)

NFF, a nonprofit 501(c)(3), has served thousands of nonprofits and funders since 1980. Our impact:
- Over $250 million in loans, $30 million in re-grants and $1.4 billion in leveraged capital
- Over 1000 customized financial consultations
- Hundreds of partnerships and publications advancing financial awareness and friendlier funding practices for all nonprofits

Serving the nation from several local offices
- Northeast: Boston and New York City
- Mid-Atlantic: Philadelphia
- West Coast: San Francisco and Los Angeles

Introductions

Name, Organization

What are the top-of-mind challenges to your funding practice?

OR...

What do you hope to gain from our time together?
Agenda

Welcome & Introductions
Structural Challenges to Funding Effectively
Understanding Business Model and Full Cost
What Kind of Funder are You?
Common Ways Capital Grants Go Wrong
Wrap-up

We All Want to Find What Works and Scale it

"Rules" of Nonprofit Finance

In the nonprofit world...
- Client often does not pay for the product (i.e. homeless do not pay per night for a shelter)
- Nonprofits rely on third parties (donors and funders) to pay for the cost of products and services.
- Donors and funders want most of their contribution to go directly to the people served.
- Overhead and profits are often seen as unnecessary and unrelated to achieving the mission.
Mission Support (Subsidy) Business

Since nonprofits can rarely charge prices sufficient to cover the full cost of their core mission programs, they require support businesses (a.k.a. the “subsidy” business)

Common subsidy businesses include...
- Sweat equity (underpay, overwork, low benefits, use of volunteers)
- Fundraising
- In-kind contributions
- Investment income
- Real estate (rental income)
- Earned income ventures

When core revenues grow, subsidy business must also grow in proportion.

Aligning Grants to Grantee Needs Begins by Understanding the Business Model

Business model: how an organization makes and spends its money in the service of its mission.

It is influenced by:

- Community Need
- Stages in Life Cycle
- Business Model
- Funding Landscape
- Vision & Strategy
- Capital Structure

What is the organization’s business model? Does it have the capacity for long-term resiliency?

What is a Sustainable Business Model?

Repeatable and reliable revenue
Ongoing operating costs

Q: How much greater than 1?
A: Enough to fund liquidity needs, guard against risk, and periodic investment in adaptation
Surpluses are Necessary to Cover the Full Costs of Business

Nonprofits need to cover the full cost of delivering programs

Full cost includes:
- Full costs > Operating Exp
- Operating Exp > Program Exp

Agenda

Welcome & Introductions
Structural Challenges to Funding Effectively
Understanding Business Model and Full Cost
What Kind of Funder are You?
Common Ways Capital Grants Go Wrong
Wrap-up

Defining Two Different Types of Money: Capital & Revenue

There are two flavors of funder money: Capital and Revenue

They play different roles in an enterprise
- Capital is for Change (adaptation, growth)
- Revenue funds Regular operations (routine)

Both Capital and Revenue are necessary for mission success
Do You Provide Build or Buy Money?

Buy Money (Revenue)
- Funds to do what the grantee already does
- Pays for day-to-day operating expenses and margin for full costs
- Recurring in nature

Build Money (Capital)
- Funds to change what the grantee does
  - Growth (launch or scale a program, expand to new places)
  - Improving or launching a subsidy business
  - Buying/renovating space
  - Significant investment in IT, HR, fiscal, etc.
  - Retrenchment/downsizing/merger
- Episodic in nature

Builders and Buyers are Different

<table>
<thead>
<tr>
<th>Buyer (Revenue)</th>
<th>Builder (Capital)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ongoing</td>
<td>Episodic</td>
</tr>
<tr>
<td>Accountability is straightforward Did you do what I paid you to do?</td>
<td>Accountability is complex A journey together, adjusting strategy along the way, to build a sustainable enterprise that prompts other people to participate in the buyer role</td>
</tr>
<tr>
<td>Success ➔ Do it again</td>
<td>Success ➔ No more money in</td>
</tr>
</tbody>
</table>

Example: Builders vs. Buyers

<table>
<thead>
<tr>
<th>Role</th>
<th>Exchange</th>
<th>Success</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (Buyer)</td>
<td>I'm supporting a program that seeks to improve high school graduation rates in the inner city.</td>
<td>Here's $25,000. How many after-school sessions will that support next year?</td>
</tr>
<tr>
<td>Capital (Builder)</td>
<td>I'm providing the funds you need to replicate your program in two more schools.</td>
<td>Here's $2 million. How long until your revenue is more sustainable?</td>
</tr>
</tbody>
</table>
Addressing Grantees’ Financial Needs

- Begin with an understanding of the organization’s financial health and resource needs
- Responding to those needs can still align with the foundation’s or team’s strategic goals
- Consider ways that the amount and structure of your grant can directly support grantee needs and goals

**Does the grantee need** **Build** or **Buy** **dollars?**
Break-out Exercise: What Kind of Funder Are You?

On your own, then share in small groups...

- Consider the term, size, restrictions, and expectations of the grants you typically make (if there is a 'typical' grant!). Which grantee needs are you best suited to meet – do you provide Buy or Build money?

- Think of one particular grant that you have carried through it's life-cycle and "closed out"
  - What expectations did you have for the grant?
  - What information did you consider before making the grant?
  - Was this a Buy or Build grant?
  - How did you measure the success of the grant?

Common Ways Capital Grants Go Wrong... Not Enough Flexibility

Not Enough Time

- Deficits Incurred
- En Route to Sustainability
- Bridged with capital
- Surplus: Reinvested towards future growth and/or improvement

Common Ways Capital Grants Go Wrong... Not Enough Flexibility

- Start-Up
- Proof of Concept
- Expansion
- Sustainable Operations
- Business Model Revenue
- Expense

High Score!

Uh oh...

$
Common Ways Capital Grants Go Wrong…
Not Enough for the Full Cost of Change

We'll fund your new program for three years, but then you'll need to find new funders. We don't want our grantees to become dependent on our funding.

Here's a big grant to launch that new program. Hooray!

These funds are restricted to the new program, just as you laid it out.

Three years is plenty of time to find new funders. I know we can figure it out!

Franny, the ED

Can Grantees Come to You for Their Most Pressing Needs?

<table>
<thead>
<tr>
<th>Nonprofit Needs</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expanding programs</td>
<td>49%</td>
</tr>
<tr>
<td>Acquiring or improving a facility</td>
<td>14%</td>
</tr>
<tr>
<td>Developing reserves for operating needs</td>
<td>6%</td>
</tr>
<tr>
<td>Developing reserves for long-term needs</td>
<td>4%</td>
</tr>
<tr>
<td>Working capital (cash flow needs)</td>
<td>8%</td>
</tr>
<tr>
<td>Free flowing capital for organizational</td>
<td>6%</td>
</tr>
<tr>
<td>change (impact investing products)</td>
<td></td>
</tr>
<tr>
<td>Paying off loans</td>
<td>1%</td>
</tr>
<tr>
<td>General operating support</td>
<td>31%</td>
</tr>
<tr>
<td>Multi-year funding</td>
<td>14%</td>
</tr>
<tr>
<td>Organizational change or adaptation</td>
<td>17%</td>
</tr>
<tr>
<td>Measuring program outcomes</td>
<td>23%</td>
</tr>
<tr>
<td>Other financial or operational issues</td>
<td>5%</td>
</tr>
</tbody>
</table>

Nonprofits
- Know and ask for full costs
- Ask for the right kind of money (build v. buy)
- Don’t try to make up in volume what you lose on each unit
- Use change capital wisely – not to keep unsustainable activity going
- Test plans through market experiments, not just analysis

Funders
- Fund full costs
- Remember we need both builders and buyers – know which one you are
- Don’t confuse general operating support for change capital
- Allow for flexibility
- Talk about sustainability at the beginning of the grant – don’t wait until the end
Thank you
To learn more about NFF, visit us at nff.org

And stay connected: nff.org/socialmedia

Kristine Alvarez
Director
215-546-9426 ext. 208
kalvarez@nff.org

Thank you
To learn more about NFF, visit us at nff.org