Nonprofit Finance Fund

Dynamic Adaptability: Arts and Culture Puget Sound

Capitalization Tools and Strategies for Cultural Organizations in a Changing Economy

Presented by

Rebecca Thomas, Director, National Advisory Services
Paula Smith-Arrigoni, Manager, Western Region

Nonprofit Finance Fund

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Overview: Nonprofit Finance Fund (NFF)

NFF connects nonprofit finance to nonprofit success

Serving thousands of nonprofits and funders nationwide since 1980

- $175 million in loans; over $1 billion in capital leveraged for nonprofits
- Over 500 customized financial consultations
- Hundreds of strategic partnerships to advance the nonprofit sector
- Thought leadership to advance friendlier funding practices across the nonprofit sector

"We're in the business of helping nonprofits run better."

–Clara Miller, NFF President and CEO

Our Goals

Equip you to incorporate your organization's business dynamics and financial condition in planning and decision making

Provide you with financial tools & strategies to map out your resource needs and manage in a changing environment

Improve your understanding of the revenue and capital requirements for artistic success

Agenda

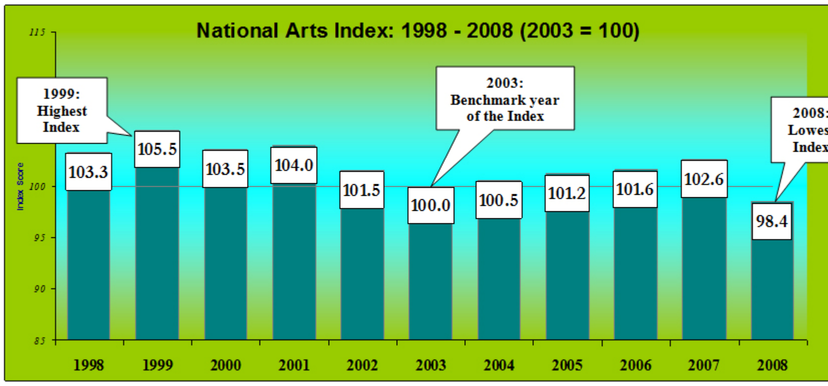
A Historical Perspective and Context
- Nonprofit and sector-specific risk

Assessing Risk: Evaluating your financial situation
- A look at area business models in the arts

Addressing Risk: Planning and managing in changing times
- Program profitability, scenario planning and other decision-making tools

Full-Enterprise Funding: Supporting long-term vibrancy and impact
- Capital is for change; revenue is for routine
- Interactive case study

How to Adapt?

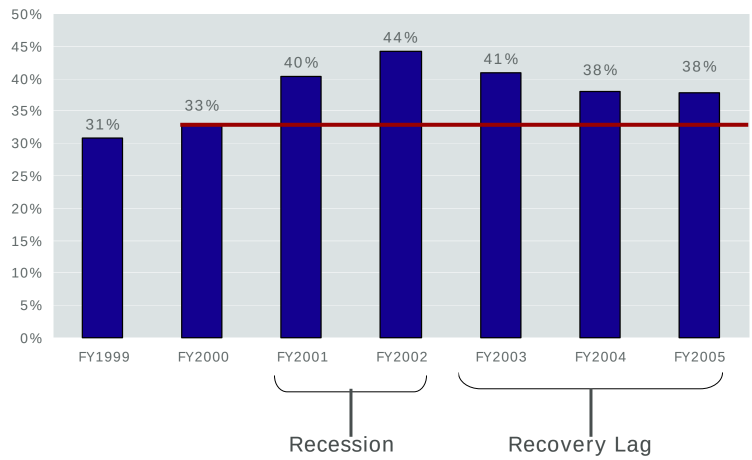


Managing Risk in the Arts

1. **Economic environment risk**
   - Funding shifts and cutbacks
   - Audiences' reduced ability to pay
2. **Field-wide risk**
   - Demographic shifts
   - Changes in audience engagement/participation
   - Technology advances and expectations
3. **Artistic risk**
   - Artistic success may not translate into profits
   - Commercial success may require artistic compromise

What Happens to Nonprofits in and After Recession?

Percentage of Agencies Reporting (post depreciation) Deficits



Operating Within A Flawed System

The Realities and Challenges of Nonprofit Finance

1. **The Subsidy Business:** Since nonprofits can rarely charge prices sufficient to cover the full costs of their core mission programs, they require a second, support business.

2. **Covering the Full Cost:** In the nonprofit world, overhead and profits are often seen as **unnecessary and unrelated** to achieving the mission.

3. **Fundraising Hierarchy:** Inflexible funding for program growth and bricks-and-mortar is the norm. Nonprofit leaders have become desensitized and trained to ‘accept what they can get’ rather than to ask for what they need.

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 to have to work with.

Where are the Opportunities?

Reconfirm your organization's alignment with core mission

Encourage and embrace creative thinking

Consider bold, internal changes

Implement and institutionalize good financial management practices now– to position your organization for a stronger tomorrow

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

-Rahm Emmanuel

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Assess Risk: Understanding Current Position

The urgency and type of action leadership should take depends on your organization's current financial position.

Are you operating *now* from a position of strength or weakness?

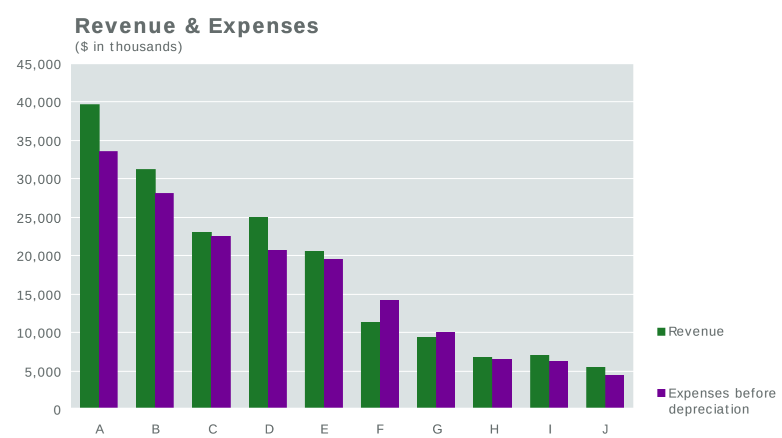
Can you afford a deficit and, if so, how large and for how long?

What is your risk tolerance?

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

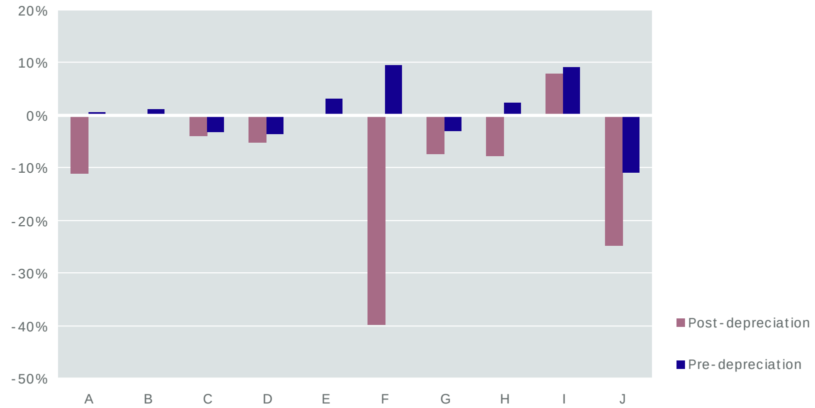
Understand Operating PERFORMANCE

Peer Analysis: Does Revenue Cover Expenses?



Peer Analysis:
Surplus and Deficits (%)

Unrestricted Surplus (Deficit) as a % of Expenses



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

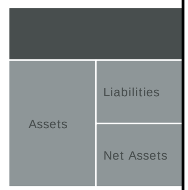
Understand Operating PERFORMANCE

Determine STRENGTH of Our Balance Sheet

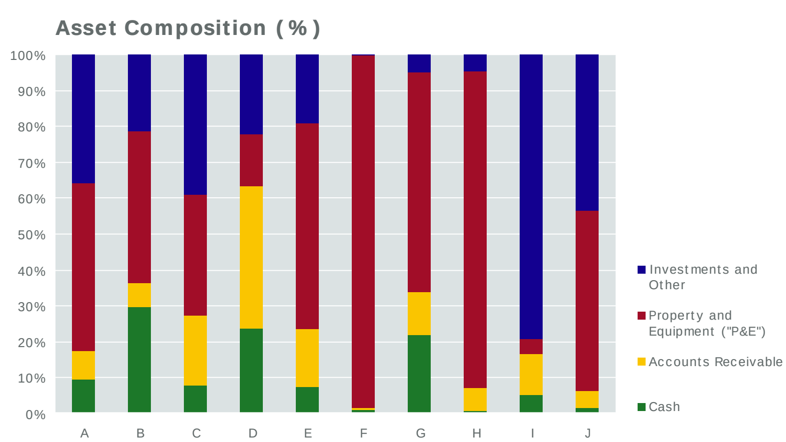
Assess Risk:
Know your Balance Sheet

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

ASSETS	**Cash** – How much? How "liquid?" **Receivables** – Are they slow to collect? Are any at risk for collection? **Fixed Assets** – How will you address repair and replacement issues?
LIABILITIES	**Line of Credit** – How do you manage cash flow? Are you using debt appropriately?
NET ASSETS & RESERVES	**Unrestricted Net Assets** – Do you own more than you owe? **Temporarily Restricted Net Assets** – Do they fully support your core programs? **Reserves** – Do you have them? Are they suitable to your needs? Agreement on use?



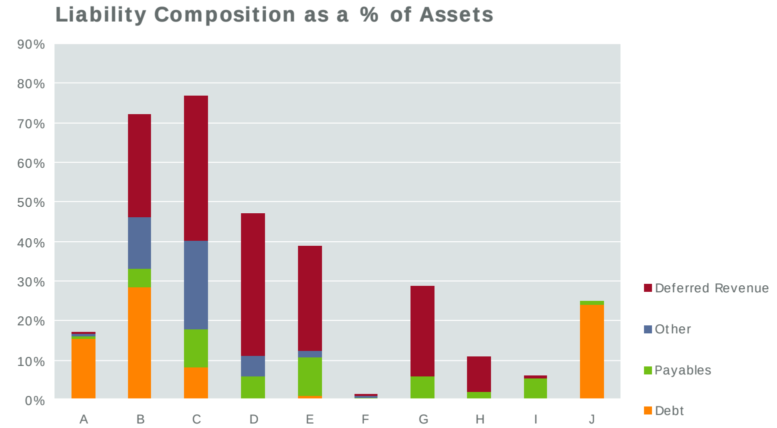
Peer Analysis: Asset Structure (%)



Receivables are funds owed to an organization, for goods and services it has provided or that have been committed as a grant or donation. The funds have been booked as revenue, but the cash has not yet been received.

Property & equipment (P&E), often called **fixed assets**, are physical items an organization owns (e.g., property, building, equipment, improvements), and cannot easily be converted to cash.

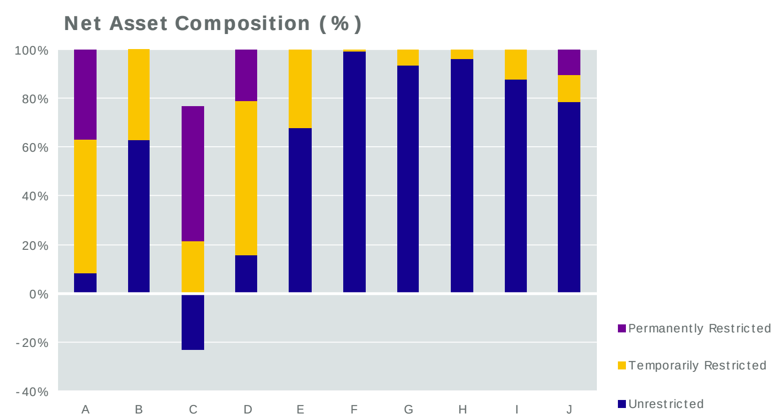
Peer Analysis: What Drives Liabilities?



Payables are funds owed by an organization to its vendors for goods or services purchased.

Deferred revenue refers to payment received from a client for a transaction that has not yet occurred (e.g., subscription purchase for performances held on future dates). This situation creates an obligation, and thus a liability, for the organization to provide goods or services in the future.

Peer Analysis: Net Asset Composition (%)



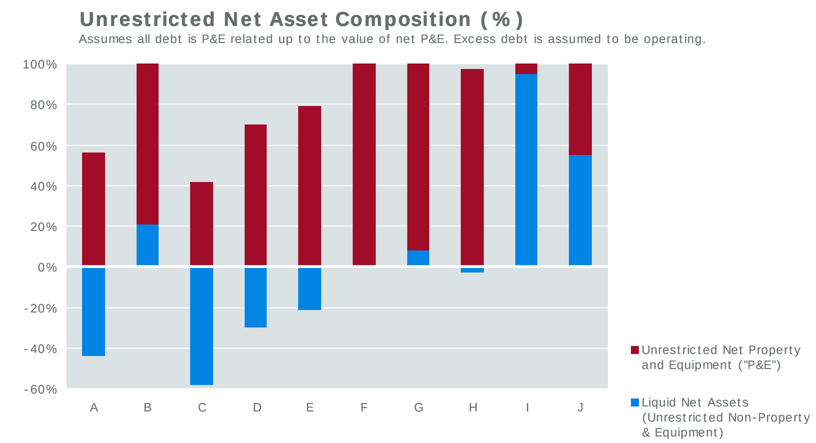
Net assets represent the difference between total assets and total liabilities, effectively net worth. Net assets are categorized as unrestricted, temporarily restricted, or permanently restricted.

Unrestricted net assets have no external restriction as to use or purpose.

Temporarily restricted net assets have a donor-imposed time or purpose restriction that, once satisfied, are released.

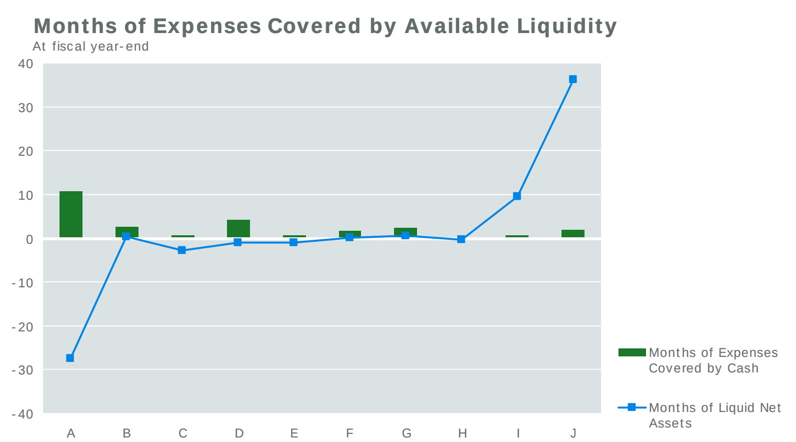
Permanently restricted net assets e.g., traditional endowments, refer typically to funds with donor-imposed stipulations that the principal not be spent; some or all of the earnings are available for specific or general operations.

Peer Analysis: Unrestricted Net Asset Composition (%)



"**Liquid Net Assets**" represents NFF's estimated amount of unrestricted net assets NOT invested in property and equipment. The formula is unrestricted net assets less the net result of property and equipment minus debt. Theoretically this is the liquid amount of available. If "P&E" is negative, suggests more debt than P&E- neither good nor bad.

Peer Analysis: How Much Cash and Liquid Net Assets Are Available to Support Operations?



Months of expenses covered by cash and investments is a measurement of how long the organization could operate at current expense levels using current cash reserves or investments.

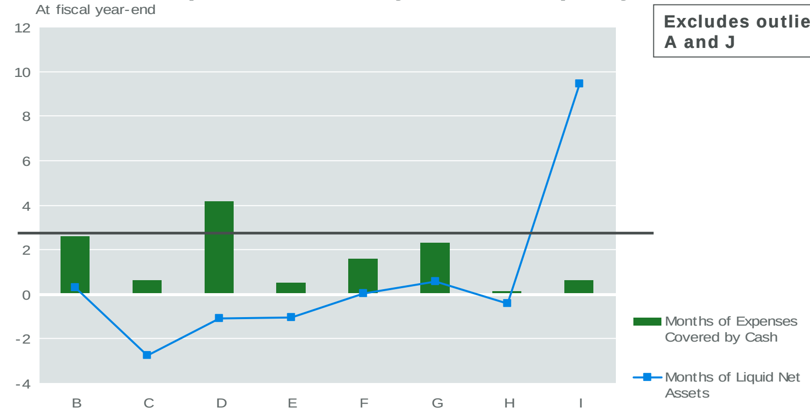
Months of liquid net assets refers to the number of months the organization could operate at current expense levels using liquid net assets.

Peer Analysis: How Much Cash and Liquid Net Assets Are Available to Support Operations?

Months of Expenses Covered by Available Liquidity

At fiscal year-end

Excludes outliers A and J



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Months of liquid net assets refers to the number of months the organization could operate at current expense levels using liquid net assets.

KEYS TO SURVIVAL: ACCESS TO CAPITAL

An organization's adaptive capacity is directly tied to its capital structure

If your organization has…

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

…It has very little ability to respond or adapt in challenging times

- Borrowing to replace lost income is rarely appropriate

Risk – Cash = Crisis

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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Knowing-Doing Gap: Where are You?

Information Gap: Do you develop transparent, accurate and timely financial planning and management reports that give you the information you need?

Interpretation Gap: Do management and board collectively have the ability to understand, interpret and discuss the implications of financial information?

Decision making Gap: Do you have a culture of making and following through on tough decisions?

Do You Have the "Right" Financial Information?

Do your current financial planning and management documents give you the information you need?

- Balance sheet
- Monthly cash flow projections
- Revenue and expense by program
- Multiple scenario budgets and projections

Who is involved in preparing the reports?

How frequently?

Who receives them?

When and how does the Board get involved?

Do You Use What You Have?

To provide **visibility** into the sustainability of program and enterprise level plans

To develop and adjust **strategy** in response to shifts in your internal or external environment

To facilitate **communication** of resource needs to supporters, funders, and board

To make better (and often difficult) **decisions** in a timely fashion

What May Be Hindering Action?

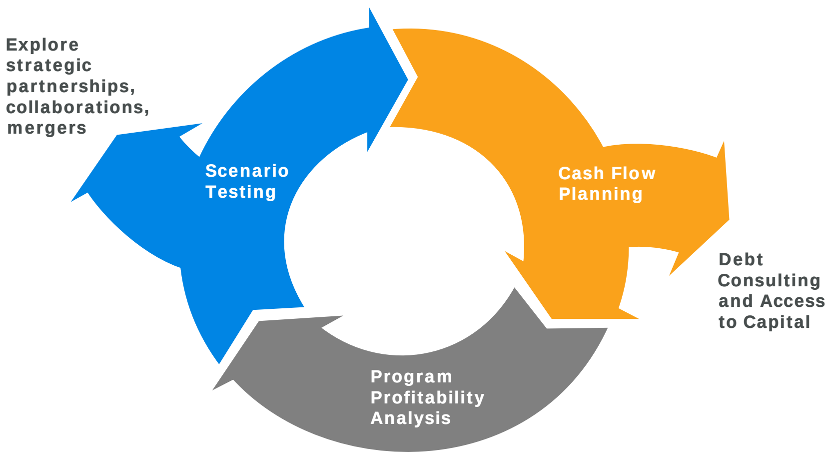
How well does your management team do with making data-driven decisions?

How well do you think the board does?

What holds you back from making changes?

What do you think can be done to improve your decision-making processes?

A Planning Continuum



Quantifying the Challenge: Cash Flow Management

Developing a visual landscape of cash in and cash out ensures more visibility into the timing and reliability of liquidity

Cash flow projections enable nonprofit managers to estimate how much cash they should keep on hand and, if appropriate, how much short-term debt they need for tough months

- Distinguish between "cash flow" issues (timing of receipts) and "cash" issues (shortage of cash overall)

Cash flow planning is an iterative process, requiring constant monitoring and adjustment

Cash Flow Management

Operating Cash Flow
ABC Center
Fiscal 2008, ending 07/31/08

Numbers in 000s	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	2008	2009	2010
Beginning Total Cash	35	38	12	14	-	26	14	8	8	5	4	10	18	1	1
Operating Cash															
Unrestricted Operating Cash Receipts															
Earned Income	31	24	30	25	22	32	27	32	44	45	52	54	418	-	-
Unrest. Contributions	15	0	2	0	35	0	3	0	0	0	0	0	55	-	-
Total Op. Cash Receipts	46	24	32	25	57	32	30	32	44	45	52	54	473	-	-
Operating Cash Spent															
Personnel	28	17	19	22	19	28	24	21	28	30	30	30	296	-	-
Professional Fees	0	0	0	0	0	0	0	0	0	0	0	0	-	-	-
Occupancy	3	3	3	7	3	3	3	3	3	3	3	3	40	-	-
Interest on debt	0	0	0	0	0	0	0	0	0	0	0	0	-	-	-
Support (Program)	12	30	8	10	9	13	9	8	16	13	13	13	154	-	-
Total Op. Cash Spent	43	50	30	39	31	44	36	32	47	46	46	46	490	-	-
Net Cash from Operations	3	(26)	2	(14)	26	(12)	(6)	-	(3)	(1)	6	8	(17)	-	-
Ending Cash	38	12	14	0	26	14	8	8	5	4	10	18	1	1	1

Debt and Access to Capital

Lines of Credit

- Address periodic or recurring CASH FLOW issues
- A bridge for timing gaps between disbursements and receipts of cash

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

Quantifying the Challenge: Program Profitability Analysis

Assessing the underlying economics of programs informs decisions about:

- Whether and how to cut costs
- Whether and how to re-allocate resources among competing priorities
- Whether to sustain, grow or change programs
- Where to focus fundraising efforts

Nonprofits often make decisions to maintain deficit programs critical to their mission. The key is to identify the source of subsidy needed to cover these deficits.

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:

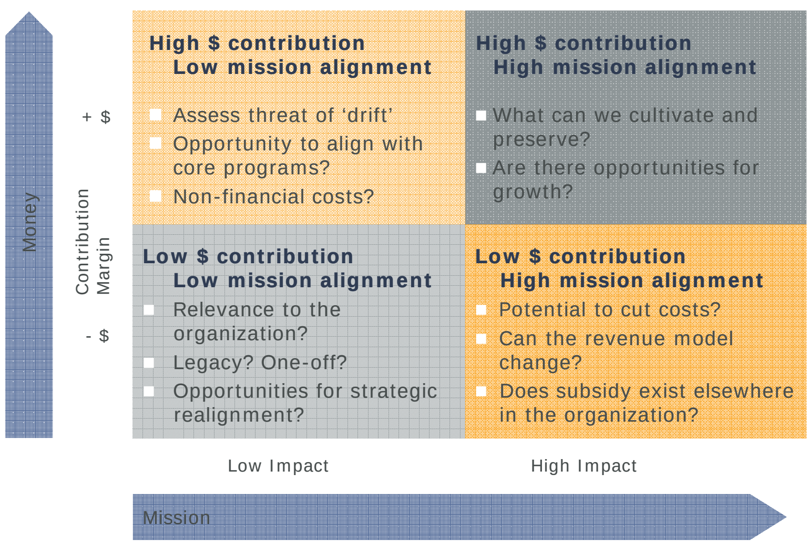
- What we **MUST** do
- What we **SHOULD** do
- What we **WANT** to do

Using Program Profitability
A Case Study

$ in thousands

Rock City PPM FY2010	Programs: Original Productions	Programs: Arts-in-Education	Programs: Community Events	Program Subtotal	Capacity: Gen Ops	Capacity: Development	Capacity Subtotal	Total Budget
Revenue								
(A) Earned								
Admissions	$14	$73	$10	$97				$97
Fees	$58	$29	$402	$489				$489
Merchandise Revenue	$4	$3		$7				$7
Subtotal	$76	$105	$412	$593				$593
(B) Contributed								
Government					$49		$49	$49
Individuals	$75			$75	$88	$138	$225	$300
Corporate	$18			$18				$18
Foundations					$44		$44	$44
Net Assets Released	$312	$682	$205	$1,199	$340		$340	$1,539
Subtotal	$405	$682	$205	$1,292	$520	$138	$658	$1,950
Total Revenue	$481	$787	$617	$1,885	$520	$138	$658	$2,543
Expenses								
Personnel	($152)	($401)	($157)	($710)	($181)	($137)	($318)	($1,028)
Artist fees	($128)	($132)	($306)	($565)	($148)	($4)	($152)	($717)
Facilites	($70)	($57)	($3)	($129)	($57)	($7)	($64)	($194)
Office / Misc	($43)	($9)	($14)	($65)	($46)	($14)	($60)	($125)
Advertising / Marketing	($33)	($41)	($4)	($78)	($4)	($20)	($23)	($101)
Program	($184)	($45)	($110)	($338)	($5)	($35)	($40)	($378)
Total Expenses	($609)	($684)	($592)	($1,885)	($440)	($217)	($657)	($2,543)
Surplus / Deficit	($128)	$103	$24	($0)	$80	($80)	$1	$0

Program Profitability Analysis:
A Visual Tool



Planning Your Response: Scenario Testing

Building a financial model with alternate case scenarios enables you to project and communicate in financial terms a range of possible outcomes

- Take the long view
- Engage in “outside-in” thinking
- Involve multiple perspectives

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

- Consider 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 (CAUTION: Avoid over-diversification - new business lines can increase risk)
- Ensure new revenue opportunities are “net” positive

Planning Your Response: Scenario Testing

Determine 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

Plan for a worst-case scenario

- Easier to add back later than to be forced to take drastic action without a thoughtful plan

Can be as complex or as simple as needed:

- What would we do differently if budgeted revenue dropped 10%? 20%? 30%?
- What is the likelihood of receipt for each revenue source within each program? What adjustments will we make within these programs and to our supporting capacity?

Communicate Early and Often

Engage staff in conversations about options

- Valuable source of creative ideas and solutions

Bring alternatives to the Board for decision making

- Board has fiduciary duty to safeguard organization's assets

Stay in front of donors—don't pull back

- Be candid about the impact of the economic climate on your programs and organization
- Communicate your strategy and plan to adjust
- Emphasize your commitment to mission and the urgency of your needs
- Articulate your case for full cost, full enterprise funding

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Nonprofit Commerce Is Different

In the for-profit sector, investors and buyers have explicit, well understood roles:

- Buyers pay full cost for value
- Investors provide capital for financial return
- Equity investors serve to protect the organization from being exploited or overextended

In the nonprofit sector, these roles are murkier:

- Core business loses money (there's a reason we have a nonprofit sector)
- Thus, there is always a 'mission support' or 'subsidy' business (usually fundraising)

Because sources of buy money rarely pay prices that cover full costs, nonprofits will always rely on subsidy → required "dependency"

Nonprofit Commerce Is Different

Further, there is no explicit mechanism for obtaining the funds required to manage risk or pursue opportunity

- There are limited incentives to ensure that the "enterprise" is properly capitalized to deliver on mission

When program growth and change occur, one of two things happens:

- more fundraising (larger deficit, esp. with growth)
- financial chaos

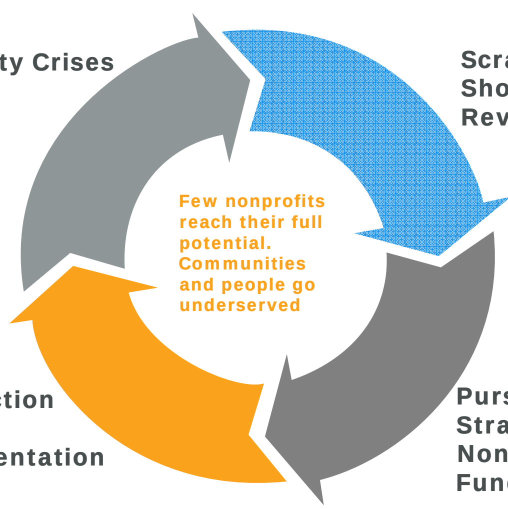
Delivering on mission successfully requires subsidy, both for upfront and recurring costs

Equity Ethic Challenge

No equity ethic → fragile “enterprise”:

- Nonprofits scramble to raise the difference between the cost of service and the market price
- Nonprofits can’t invest in long-term horizon projects
- Nonprofits lack “no” and “uh-oh” money: $ to say no to sub-optimal funder requests and $ to make mistakes
- A multitude of small funder relationships can dilute focus
- Funders write small checks, fearing dependency
- Funders have difficulty accepting that exit strategies may not exist

Reality: The “Doom Loop”



A New Concept for the Field

Buy Money (Revenue)

Funds to do what you already do

Money received in exchange for or to support regular operations: Ticket sales, annual giving, and memberships are examples

Pays for full costs of business through a combination of:

- Earned income
- Project support
- General operating support (GOS)

A New Concept for the Field

Build Money (Capital)

Funds to change what you do

- Growth
- Buying/renovating space
- Significant investment in IT, HR, fiscal, etc.
- Improving the subsidy business
- Retrenchment/downsizing/merger

Sizeable periodic investments that can pay for:

- Non-recurring expenditures
- Temporary support of general expenses
- Relief of temporary revenue shortfalls
- Unaddressed existing capital needs
- Future perceived capital needs

A New Concept for the Field

True capital can be used for any purpose (really!)

- What the money is spent on specifically is not a primary concern
- What the money *achieves*—planned efforts to become more relevant, efficient, and capable—is the focal point

A proposed plan for change should be in the context of establishing or maintaining a healthy organization capable of obtaining *sufficient recurring revenue*.

- GOS is often buy money dressed up in build clothing. Sizable amounts can be used for build purposes but rarely are structured to lead to a viable revenue platform

Builders and Buyers are Different

	Buyer	Builder
Role	I'm buying arts education programs in the public schools.	I'm providing the capital you need to develop and support an arts education curriculum.
Exchange	Here's $20,000. How many school programs will that buy this year?	Here's $3 million. How long until your revenue will consistently support the new activity?
Success	That was a good deal. I'd like to buy more now.	Congratulations. You don't need my money again for a while.

A Rational Approach to Financing Mission Success

All nonprofits require revenue and capital to survive and thrive

As cultural nonprofits, you would fully articulate your capital and revenue needs

Funders would be clear about what they are willing to provide

You would base your decision on whether / how to move forward on the availability of capital and revenue

- Buyers would understand that they have fewer information rights than builders
- Individual investors would not decide *how* you spend your money

A Case for Build Capital and Buy Revenue

The mission of City Dance is to:

- create new ballets of excellence
- create an innovative approach to ballet training
- create inclusive and engaging outreach programs
- expand the role of dance in the enrichment of community locally and beyond

After signing a 99-year lease on a new facility, City Dance started a multi-phase renovation project.

The organization is also embarking on a significant expansion of its community programming, an effort to make dance more accessible and contribute to growth in non-traditional ticket buyers.

Your Assessment

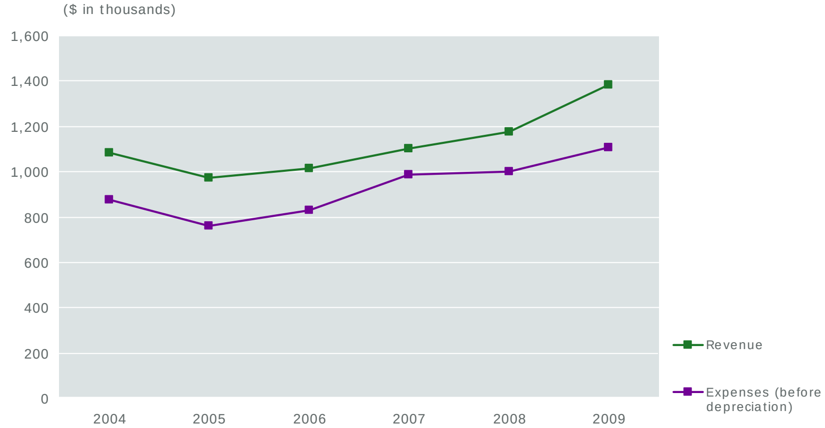
How would you characterize the organization's financial health? What story do the numbers tell?

What do you see as the top revenue and capital (buy and build) priorities for this organization?

If you were leader of this organization, how would you make a case for support?

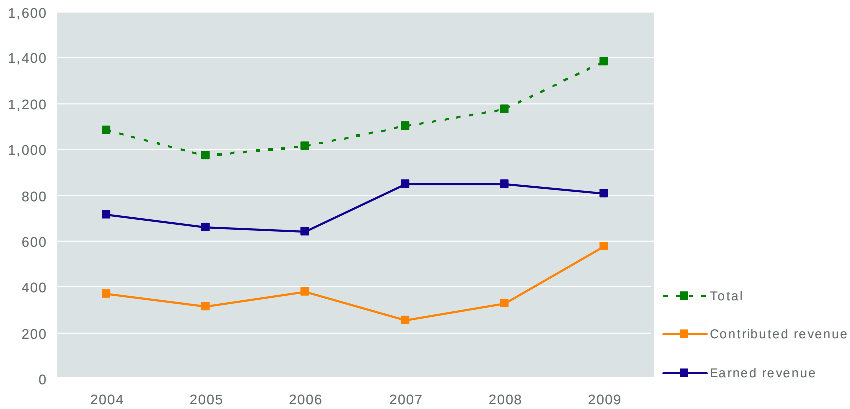
Operating Revenue & Expenses

($ in thousands)



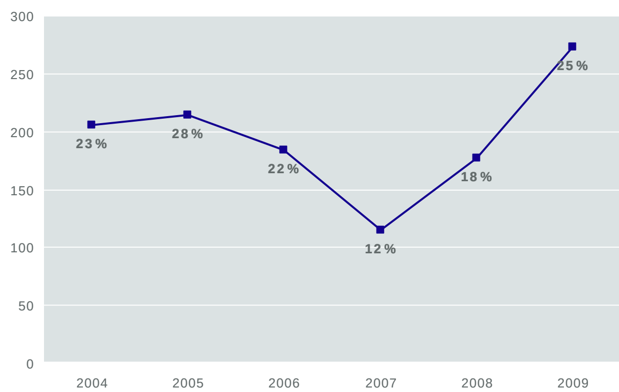
Earned & Contributed Operating Revenue

($ in thousands)



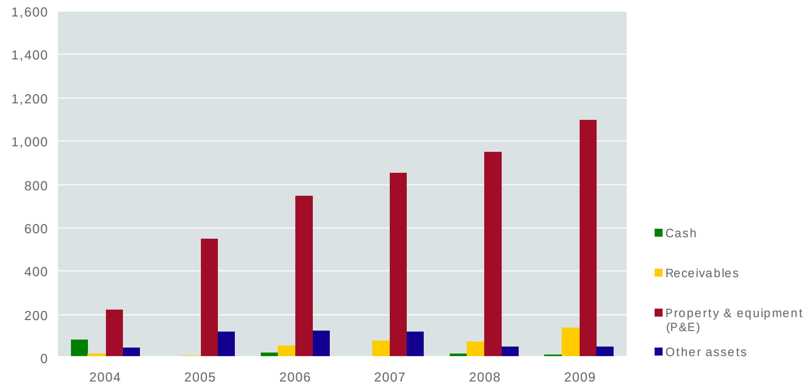
Operating Surplus (Deficit) Before Depreciation

Surplus/deficit as a % of expenses ($ in thousands)

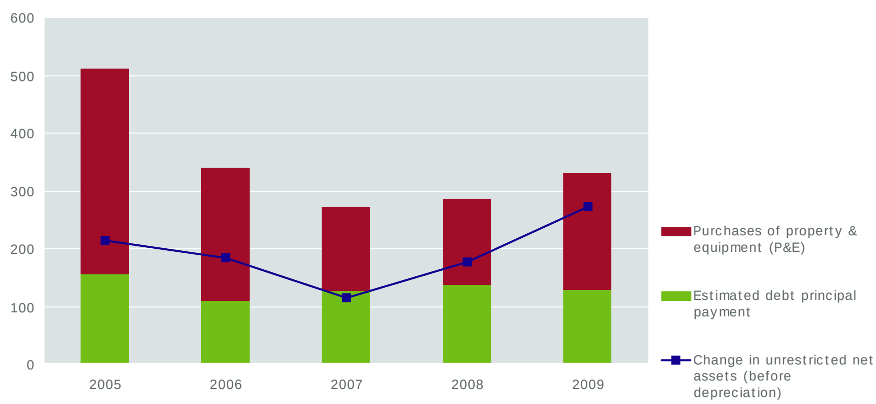


Total Assets

($ in thousands)

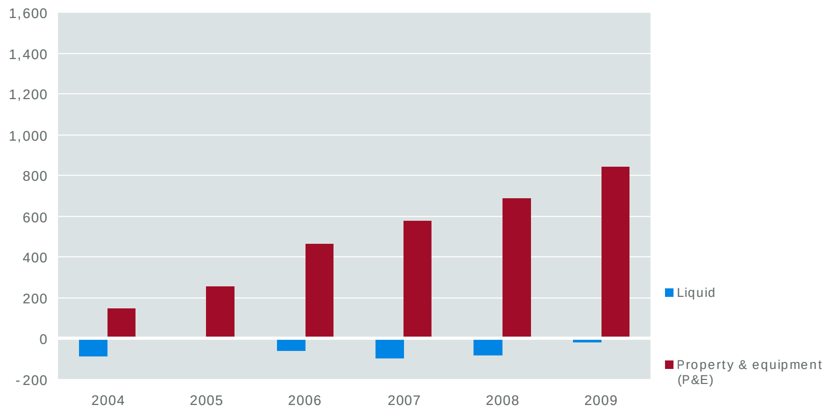


Surplus (Deficit) vs. Balance Sheet Needs ($ in thousands)

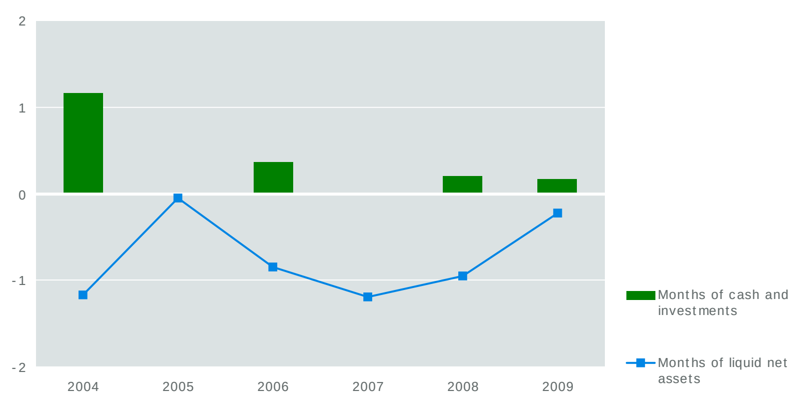


Unrestricted Net Assets

($ in thousands)



Months of Cash and Investments vs. Liquid Net Assets



Our Assessment

Growth has been accompanied by consistent annual operating surpluses.

Surpluses were spent on building improvements (build function) and have not covered the full cost of operations.

Short and long-term debt has financed leasehold improvements and been used to plug cash shortfalls.

Balance sheet is constrained in a number of ways:

- Less than one month of cash
- Negative liquid net assets
- Large investments in fixed assets (primarily leasehold)

Your Assessment

How would you characterize the organization's financial health? What story do the numbers tell?

What do you see as the top revenue and capital (buy and build) priorities for this organization?

If you were leader of this organization, how would you make a case for support?

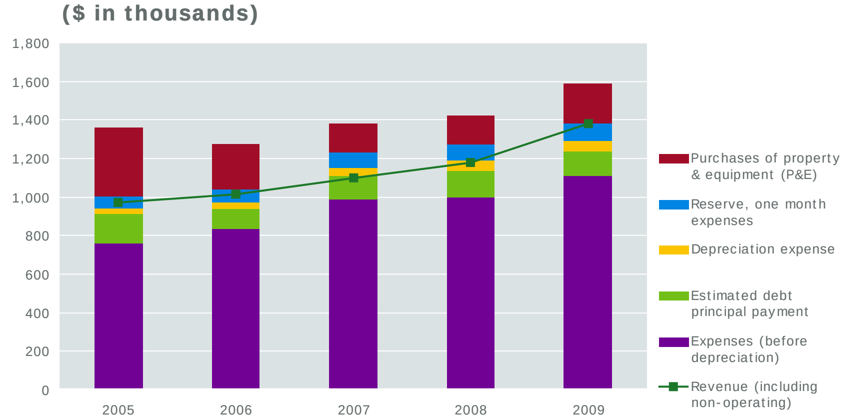
Defining the Need

A revenue, capital and expense strategy will need to address the following distinct but complementary issues:

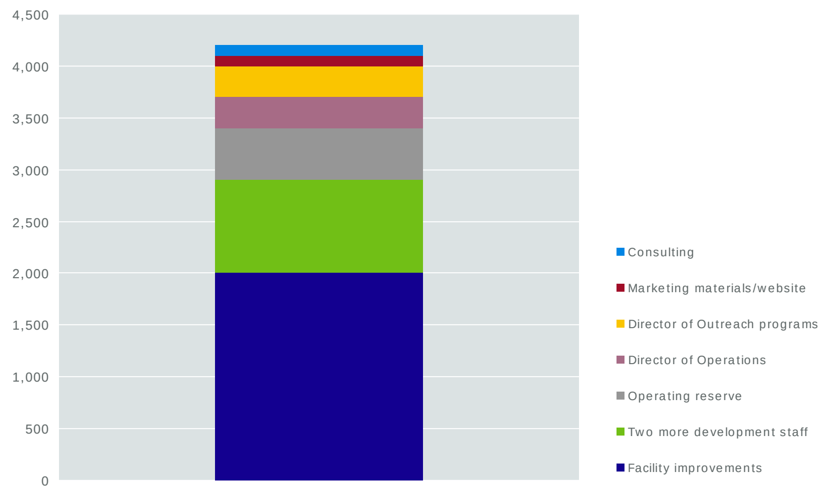
- covering the full cost of business every year — Buy
- recapitalizing the balance sheet — Build
- addressing additional building improvements — Build
- building infrastructure for future growth — Build

What are the Annual Full Costs?

Total Cost of All Business Activity ($ in thousands)



What are the Episodic Build Costs? (A $4.2M Proposition)



Your Assessment

How would you characterize the organization’s financial health? What story do the numbers tell?

What do you see as the top revenue and capital (buy and build) priorities for this organization?

If you were leader of this organization, how would you make a case for support?

What is our "Portrait of Sustainability?"

Operating Platform $600 in expense

Community Engagement: $450K in expense

Network of community-based orgs., resulting in tripling # of scholarships and 200% growth in non-traditional ticket buyers.

Fundraising	Producing	Education	Facilities
200 donors @ $2,500 avg. gift foundations & govt. @ $400K	60 performances @ $50 avg. ticket @ 85% capacity	400 slots with representation from 25 communities	Ongoing preservation
R: $900 **Dir. E: $0** **S/(D): $900**	**R: $450** **Dir. E: $400** **S/(D): $50**	**R: $850** **Dir. E: $500** **S/(D): $350**	**R: $0** **Dir. E: $150** **S/(D): $(150)**

Total annual revenue: $2.2M
Operating expense: $1.95M
Capital expense (annual): $0.15M

Making the Case for Capital Support

How will you define success?

How will your business need to change to realize success?

What will it cost your organization to get from here to there—to deliver on future goals consistently?

How will you establish or maintain your ability to generate sufficient recurring revenue?

What financial and programmatic metrics will you track to monitor your progress against plan?

Wrap Up

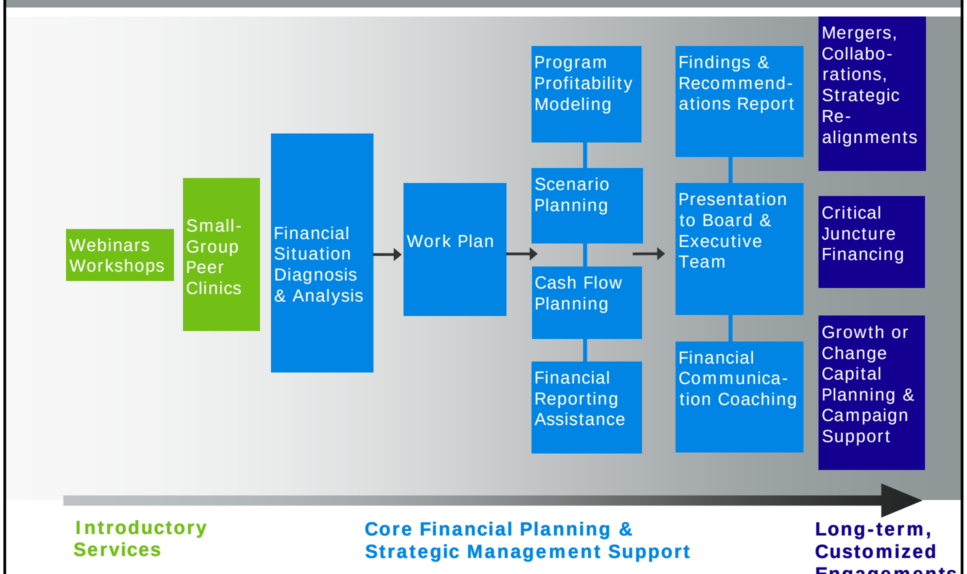
Making sound business choices requires reliable, accurate and timely financial information. Use financial planning tools to guide decision making:

- Assess your exposure and risk
- Plan your response
- Communicate early and often

A healthy capital structure is critical to long term artistic vibrancy and financial viability.

- Seek funding opportunities that cover full costs (revenue) and meet full enterprise needs (capital)
- Accept that not all revenue and capital opportunities are worthy of pursuit
- Manage costs in the context of revenue and capital realities

NFF Consulting Services
Tough Times Service Continuum



NFF Loans

Working Capital Loans

- Provide funds to manage your cash flow needs

Facilities Loans

- Provide financing for your facility projects such as acquisition, construction, and leasehold improvements

Equipment Loans

- Provide financing for your equipment purchases

NONPROFIT FINANCE FUND

Thank you

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

Rebecca Thomas
Director, National Advisory Services
Rebeccca.thomas@nffusa.org

Paula Smith-Arrigoni
Manager, Western Region
415.255.4849 ext 10
paula.smith-arrigoni@nffusa.org