Daring to Lead 2011

A National Study of Nonprofit Executive Leadership

BRIEF 1

Leading Through a Recession

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KEY FINDINGS

The vast majority of nonprofits, 84%, were negatively impacted by the recession. Negative financial impact however, is not the same thing as planned downsizing. A minority of nonprofits, 26%, reported a smaller budget this year than last; 40% maintained their budget size; and 34% budgeted for growth compared with the prior year.

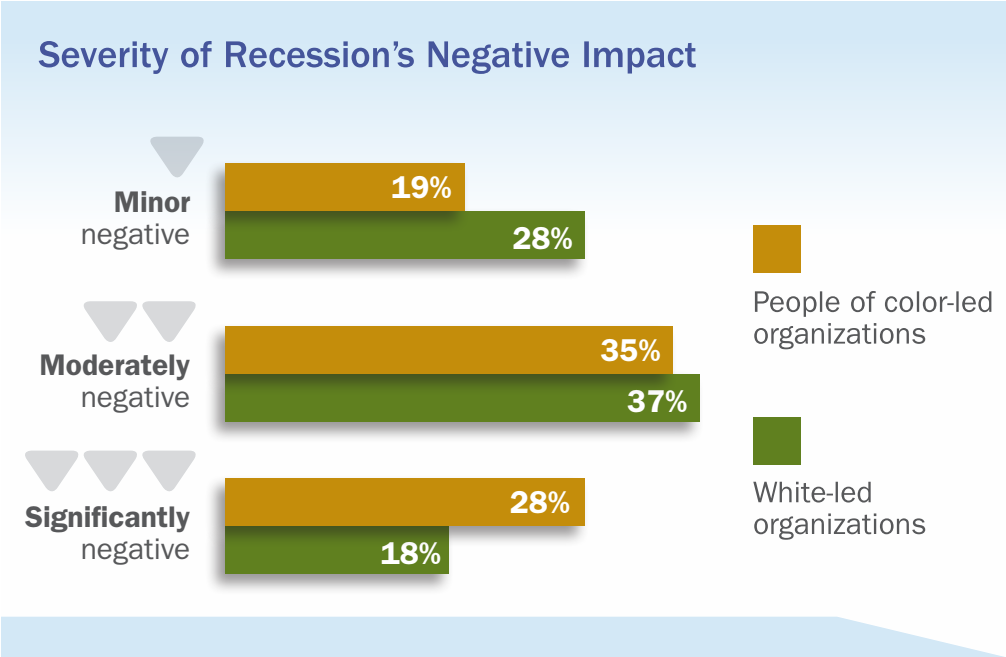
Organizations led by people of color are more likely to have experienced significant negative impact from the recession. Twenty-eight percent (28%) of minority-led organizations were severely impacted compared with 18% of white-led nonprofits.

The recession amplified pre-existing economic challenges for the sector, including inadequate government funding, insufficient cash reserves, and low levels of executive financial literacy.

Daring to Lead 2011 found that a large majority of community based organizations and their leaders were negatively impacted by the recession. The negative effects on organizations include both diminished financial health and downsizing of organizations. Eighty-four percent (84%) of nonprofits experienced a weakening of their financial position—though not necessarily a reduction in their annual budgeted expenses—due to the recession. Twenty-six percent (26%) decreased their annual operating budgets in the face of reduced funding. For leaders, the negative effects included recession-related anxiety and burnout, as well as delayed executive transition. Overall, the recession has underscored the endemic weaknesses in many nonprofit business models. This research captures profound executive frustration with business model challenges, including inadequate government funding at a time of increased demand for services.

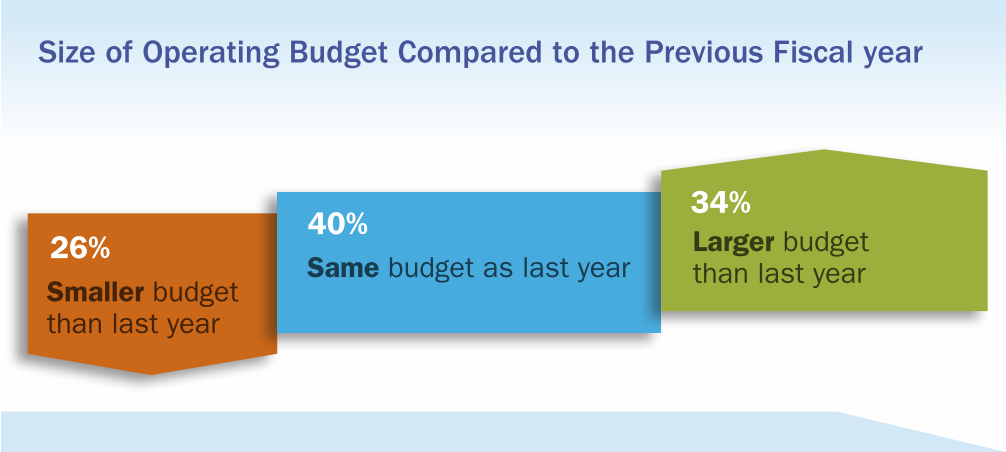
Daring to Lead is a joint project of CompassPoint and the Meyer Foundation. This is the first brief in the Daring to Lead 2011 series. To see all reports and findings from the Daring to Lead national research project, visit: ***www.daringtolead.org****.*

There is not a single story of the recession's toll on nonprofit organzations and on their leaders. The vast majority of executives reported a negative impact on their organzations, but the intensity of that negative impact varies widely. Notably, executives of color were more likely to report their organizations experiencing signficant negative impact.



The varied timing of funding changes across nonprofit revenue streams—individual giving, foundation grantmaking, and government contracting, for instance—inevitably effects how quickly organzations can anticipate these shifts and make commensurate budget decisions. By the fourth quarter of 2010 when these data were collected, 26% of organzations had downsized; that is, they were operating on a smaller budget than the previous year. The largest group of respondents, 40%, were operating with roughly the same budget as the prior year. More than one third of nonprofits (34%) were operating with a budget larger than the previous year's, indicating the opportunity that some executives found in higher demand for their programs, federal stimulus funding, increased donor commitment to safety-net services, and other counter-cyclical market forces.

However, we don't know how many of these organzations in fact met their own budget expectations in 2010 and 2011; the recession made budgeting revenue accurately challenging for many nonprofits. Further, organizations that experienced temporary growth with stimulus dollars will have to right-size as that funding ends. And finally, the shifts to funding strategies that some foundations have made recently—in part catalyzed by the recession's impact on their assets—may persist through the market's recovery causing commensurate shifts in many organizations' revenue mix.



"We have actually grown a lot during the recession because of stimulus funding and other opportunities. So on one hand, it's been harder in some areas, but we've had to be quicker, and more flexible, and really reactive."

"The complexity of the funding sector has evolved rapidly. The days of somebody knowing you, believing in you, and funding you based on that relationship are gone. The whole issue of return on investment and measurement makes it harder to stay true to our mission—as unimpacted by external forces as I would want to be."

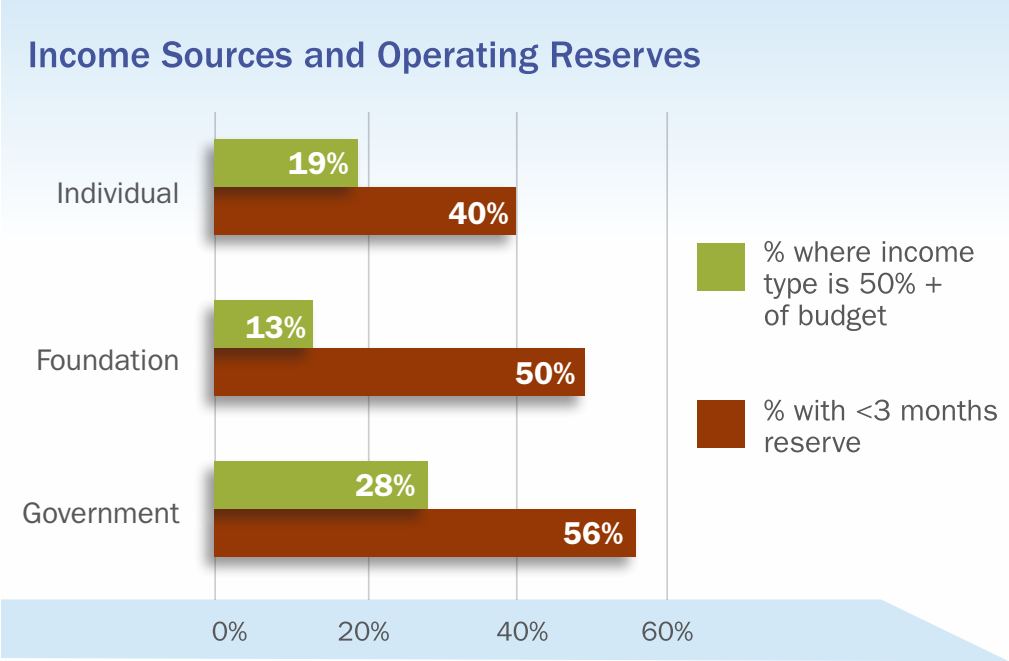
The survey went beyond recession-specific questions to better understand nonprofit business models, financial health, and executive and board attention to these aspects of leadership. Among three income sources—individual donations, foundation grants, and government contracts—government contracts were most likely to comprise 50% or more of an organization's budget. More than one in four organizations (28%) was majority government funded, and these groups tended to have smaller cash reserves. Fifty-six percent (56%) of nonprofits that are majority government funded—typically those providing direct human services—reported an operating reserve of less than three months, compared with 42% across all organizations.

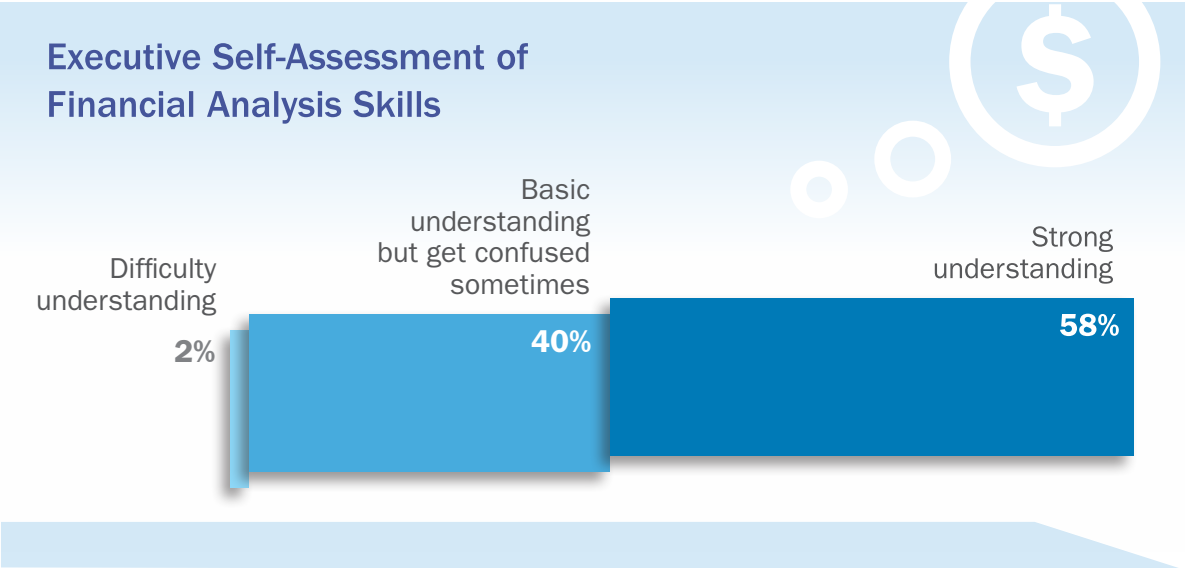
Further, executives struggling to meet an increased demand for services due to the economy's effect on their communities were frustrated by their partnership with government funders. In fact, 58% of executives reported government funding relationships as somewhat depleting or depleting, compared with 28% and 20% for foundations and individual donors respectively.

"Government is a nightmarishly bad partner that's trying to get worse."

"It's like our little version of Hal, but as opposed to a computer, it's the bureaucracy that has evolved with its own 'mind' to herd you in all sorts of different ways and it makes you wonder, 'Do I need to change what I am doing? Do I need to spend more time lobbying?' It's exhausting to think about, to worry about, and even to complain about."

With respect to financial leadership among executives and their boards, the findings indicate some areas of concern. First, a significant minority of executives are not deeply financially literate. When asked how comfortable they are with financial analysis, 40% assessed themselves as having only moderate literacy. Similarly, when asked whether their role in finance energizes or depletes them, a significant minority described their role in finance as depleting (7%) or somewhat depleting (32%).





At the board level, executives reported relatively high levels of financial oversight compared with other potential aspects of board engagement such as fundraising or public policy; 73% of executives said they had someone on the board providing significant effort to support the organization in financial oversight compared with 47% in fundraising and 32% in public policy by comparison. But given the common refrain among respondents about the challenges of getting a board of directors to fully understand the organization it is governing—and the fact that 39% of leaders reported that they do not have board engagement in strategic decision-making—the degree to which board leaders are partnering with staff on fundamental questions of business model and sustainability remains in question.

"I've been trying to diversify my board into business people because I need members who know how to run a business and understand budgeting. Can you read the financial statements? Do you know what these mean? They have no idea."

Calls to **Action**

1

Increase Financial Literacy of Executives and Board Members

With small margins for error and an unpredictable economy, the pressure on nonprofit leaders to make good business decisions is high. Good decision-making requires competency and confidence in financial analysis.

- Executives should prioritize closing their own financial literacy gaps by taking classes, working with a finance coach or mentor, and tending to a strong partnership with their finance staff/contractors and board finance committee members.
- Board orientations need to include a thorough explanation of the organization's business model and walk-through of the monthly financial statements. Further, all board members benefit from an annual refresher—perhaps as part of the annual retreat—on how to review the monthly statements and what the key business drivers are to monitor for a given budget year.

2

Expand the Board's Role Beyond Financial Oversight

The recession has brought into relief endemic challenges in many organizations' business models and added new challenges to the mix. The work of shifting in fundamental ways what an organization does and how it finances its work requires a different set of conversations than traditional financial oversight.

- Executives and management teams can support the board's deeper engagement in questions of sustainability by creating a visual presentation of the organization's current business model—what is does, how it finances the work, and what differentiates it from other players in the market—in a concise, digestible format.
- Executives and boards can partner in identifying key sustainability questions and exploring intentional shifts in business model that may be necessary or advantageous. Consider expanding the functional emphasis of the board finance committee beyond review of past performance to exploration of business model strengths and weaknesses.
- Consider use of organizational dashboards or other visual reporting methods to present boards of directors with metrics around program, finance, and fundraising such that the interdependent elements of an organization's business model are regularly reinforced.

3

Advance the Conversation Among Funders about Sustainable Nonprofit Business Models

These data suggest particular challenges for executives relying on government funding for a majority of their organizational revenue, but continued dialogue among all funder types about nonprofit sustainability—and how specific funding practices may contribute to or undermine it—will benefit the sector generally.

- Program officers should prioritize closing their own financial literacy gaps; those with business or public administration training will benefit from developing nonprofit-specific literacy.
- Whether their funding is technically restricted or not, funders can advance the dialogue about nonprofit sustainability by engaging with nonprofit grantees in ways that:
    - demonstrate concern and support for organizational health, including the accumulation by grantees of adequate cash reserves;
    - encourage and pay for best practices directly associated with good program delivery such as evaluation, adequate compensation, and staff professional development; and,
    - regularly examining the administrative requirements of their own funding practices to reduce the transaction costs for nonprofits of their grantmaking.

Daring to Lead 2011 has multiple components:

- *Daring to Lead 2011: A National Study of Nonprofit Executive Leadership*
- Three topical briefs: *Leading Through a Recession, Inside the Executive Director Job,* and *The Board Paradox*
- The interactive *Daring to Lead* website (daringtolead.org), where you will find report downloads, additional data and findings, downloadable charts and graphs, community comments, research methodology, and information about the project team and regional partners.

Please visit daringtolead.org frequently to hear what sector leaders are saying about the findings and to engage in the ongoing dialogue about their implications for nonprofit executives and boards, philanthropy, and capacity builders.

Note on terminology: We use the term executive and leader interchangeably in this report to mean both Executive Director and CEO.

For reference purposes, please use the following citation:
Bell, Jeanne, *Daring to Lead 2011 Brief 1: Leading Through a Recession* (San Francisco, CA: CompassPoint Nonprofit Services and the Meyer Foundation, 2011).
All charts are available to download at daringtolead.org.

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