DEVELOP STRONG FISCAL MUSCLES FOR HIGH PERFORMANCE

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Develop Strong Fiscal Muscles

It's no surprise that financial sustainability and full-cost funding are top concerns of nonprofit leaders, at least according to the 2018 State of the Nonprofit Sector Survey. In the best of times, an increase in funding can help maintain operations, grow programs, or create new incentives for nonprofit staff. And there's no doubt that economic downturns, like the 2009 Great Recession and government shutdowns, create challenging times that can lead to staff lay-offs, reductions in program offerings, or an organization's closing. But in good times and bad, there's one bottom-line: The greatest strategies and theories of change don't matter if they can't be funded or sustained. A high-performing organization needs strong fiscal muscles to take advantage of financial opportunities and be prepared for financial challenges. To encourage the sector to build its fiscal muscles, the Leap Ambassadors Community hosted two webinars on Pillar 4 of the Performance Imperative. The presenters included veteran leaders who are also Leap ambassadors: **Dominique Bernardo**, Variety – The Children's Charity (formerly of Congreso de Latinos Unidos); **Wendy Foster**, Big Brother Big Sisters of Eastern Massachusetts; **Ann Goggins Gregory**, MidPen Housing; and **Hilda Polanco**, Fiscal Management Associates, LLC. Their insights are shared in this article.

Scenario Planning and Financial Modeling Aren't 'One-and-Done'

Scenario planning and financial modeling are foundational exercises for building fiscal muscles. These key activities help leaders envision their work, understand the organization's financial state, and ensure they are on track to meet future demands by testing assumptions and the likelihood of achieving impact under plausible conditions. When done right, planning and modeling provide a framework of an organization's strategies to achieve and also inform how to handle the unpredictable, like cash flow issues or receiving a significant, financial donation.

It's not uncommon for an organization to get hit with news that forces it to decide whether it's the time to grow, remain steady, or shrink. "Sometimes you end up with a smaller organization based on the resources that are truly available," Goggins Gregory notes. Having a scenario developed before the news arrives means leaders have a more thoughtful process in place for decision making.

"Planning and modeling are not one-time efforts," Polanco says. She adds, "A strategy without a multiyear financial model is a set of good ideas but not necessarily an actionable plan." Planning and modeling require an organization to go through as many drafts as it takes to get to scenarios that match their fiscal reality.

Develop Strong Fiscal Muscles

Strategy Must Align With Budget

The iterative process of strategic planning and financial modeling—informed by conversations with board members, executive leaders, program staff, mission stakeholders, clients, and funders—can produce a robust strategy that leads to high performance and greater impact.

Polanco thinks that a well, thought-out strategy answers three questions:

- **What Will We Do?** – helps identify the specific programs and strategies that the nonprofit will use to achieve its goals. The process provides clarity and synergy among the organization's mission, vision, and goals.
- **How Will We Get There?** – forces the nonprofit to think about its plans to execute its strategy. How will we grow? How will we replicate? How will we track outcomes? How will we collect information? Do we need to hire additional staff? Do we need a new facility?
- **What Will It Cost?** – is the test that determines if the plan is actionable and whether you have the proper resources, staffing, and infrastructure to implement it.

Answers to the three questions must be a part of the organization's strategic plan and corresponding budget.

Your Budget Is Your Values Statement

"An organization's budget is its greatest expression of its values," Polanco observes. "It transparently exposes one's values to external audiences and shows choices and prioritization of one activity over another." These values are tested when questions arise around: increases (or not) in employee compensation, cost of living adjustments, and retirement contributions; financial incentives to clients; facility investments; depreciation for fixed assets replacement; allocation of dollars for evaluation activities and tracking outcomes; and, resources for professional development.

Webinar participant and Leap Ambassador **Cheryl Collins** shares a recent exchange she had with a nonprofit leader of an organization where she serves on the board: "If human capital is our most important asset, then perhaps it's ok (or more than ok) for it to be such a large percentage of [our] budget. After all, we need staff to do what they do with excellence to ensure that programs are growing and thriving."

Develop Strong Fiscal Muscles

Building the nonprofit's fiscal muscles require the leader to understand the budgeting process and present the organization's strategy in terms of revenues and expenses. By understanding the true costs of the work, the nonprofit board and executive leader can appropriately target their development efforts to private and public foundations, government sources, or individual givers. High-performing nonprofits budget for at least two years and, ideally, have a financial forecast and plan for five years. Additionally, they achieve a budget surplus or cushion that can be invested back into the organization.

Beyond Crisis Budgeting: Having a Surplus, Building a Reserve

While a balanced budget might work for some boards or funders, it begs the question of whether and how the organization is strategically thinking about its future: Is it prepared for a "rainy day" like the next recession? Budgeting with a surplus helps nonprofit organizations establish or maintain a financial cushion for economic downturns or other scenarios when an organization may need to use its reserve. "I worry about organizations that aren't operating at a surplus against their budget. It's a cause for concern," Polanco says. "It's impossible to create a reserve fund if you don't have a budget surplus."

If your budgeting strategy leads to a surplus, the board can create a board-designated fund and determine an amount that will go into the reserve as revenues are generated. This strategy is often referred to as an *annual surplus designation* and provides an ongoing partnership between executive leadership and board. A reserve policy can help determine what's realistic and manageable, or you can ask: What amount will it take for the executive director to sleep at night?

A second common strategy identifies a budgetary line item called an *annual contribution to reserve*. It provides a longer-term view of how many dollars you would like in your reserves, also referred to as an organization's *liquid unrestricted net assets*. Polanco says, "If an organization determines that it takes $1 million to maintain three months of operating costs, then they must decide how much to set aside each year to get to that amount." Some organizations even prioritize the annual contribution to reserve line item over other expenditures. Polanco notes, "The line item is a priority that you include as a part of a balanced budget."

A *targeted foundation investment* is a third approach that requires an organization to explore deeper partnerships with long-term funders and stakeholders. In this strategy, a foundation provides a grant earmarked to create a reserve account. The grant may be restricted initially while the board develops a savings framework that includes its reserve and other investment policies.

Develop Strong Fiscal Muscles

You're Never Too Small to Start

Bernardo and Polanco stress that budget surpluses and reserves are necessary for organizations of all sizes and types. Bernardo, who has worked at small and large nonprofits, found that a reserve was essential for sustainability and growth. Her former organization, Congreso de Latinos Unidos, achieved a budget surplus and decided to invest it with a new investment advisor. Expanding relationships with financial stakeholders was a noteworthy step in strengthening their fiscal muscles. For Bernardo, the investment represented a monumental step forward for Congreso. "It made a huge difference in the way we thought about reserves. Establishing and investing it was good," she says

Polanco says, "For organizations with a lot of government funding, a reserve may feel like a luxury, but it is a critical necessity to handle cash-flow issues and the unpredictable nature of reimbursements from governmental [and other] funding sources."

Fundraising Takes Upfront Investment

"When an organization is serious about financial growth or diversifying its financial resources, it will likely need to invest in its fundraising capacity," Foster observes. This may include training or hiring staff, adopting new tracking systems, developing different types of relationships, and talking about the organization in new ways. The adoption of new behaviors can help ensure that the board and leadership are confident in their development roles and can fully participate in fundraising strategies.

When Big Brothers Big Sisters of Eastern Massachusetts started its five-year growth campaign in 2013, consultants helped them develop a plan that outlined their investment requirements and provided a timeline for transitioning or hiring development staff and making necessary changes to the board. By identifying the organization's capacity gaps, it was clear that they needed to adopt new behaviors and incorporate new systems to cultivate donors and track donations.

Key to their plan was identifying a change agent fundraiser with the proven capacity to raise substantial gifts from individuals and teach the organization's leaders to fundraise in a new way. The consultants showed them the breadth of available talent and helped them get comfortable with paying a lot more money than they had paid to development officers in the past. Foster notes, "We all had to get our heads around the notion that the Chief Development Officer would likely be the highest paid person in the organization."

Other steps in the process included getting existing donors on board, cultivating new donor relationships, and shifting the board's thinking and fundraising behaviors. "We no longer just invite people to come to a gala or golf tournament. When [board members] reach out, they speak about the organization's mission and why they find it so compelling," Foster says. "The composition of our board changed quite a bit. It was important to have people willing to fundraise in this way."

As the organization grew its revenue, they recognized that they couldn't put all the money into program growth. Some would need to go to building infrastructure and organizational strength. During the first year, they made 80 donor cultivation visits. In the last year of the plan, they made 800 visits. They grew revenue by 62% and annual services to children by 54%. Learn more about their story in Four Bold Moves.

Developing Your Fiscal Muscles: Essential to Growth and Impact

High-performing nonprofit organizations stay prepared for the next Great Recession and other financial hits by developing their fiscal muscles. Leaders develop scenarios and financial models to take full advantage of opportunities and challenges that have the potential to shift the organization into a growth, stable, or reduction mode. They have multi-year plans in place that allow them to budget with a surplus and create and grow a reserve. They think comprehensively about the kinds of revenues that they will go after and ensure that the revenues fit their mission, business model, organizational capacity and fundraising approaches. Successful organizations and leaders can describe the business case for why their supporters should fund their reserve or make other financial contributions. Strengthening an organization's fiscal muscles help its leader have the resources to achieve its mission on behalf of the people and causes they serve.

Additional resources:

- Keeping It in Reserve: Grantmaking for a Rainy Day
- Reserve Fund Policy Template and Guide
- Resources for Nonprofit Financial Management: How to Strengthen Financial Management

Pillar 4
Financial Health and Sustainability

- The board and senior management **take charge of their organization's financial destiny.** They articulate the value they deliver and develop overall strategies, tightly aligned with their mission, to support and sustain the organization.
- The board and senior management **nurture the external financing relationships** required to support their organization's operations.
- The board and senior management establish **strong systems for financial stewardship** and accountability throughout their organization.
- The board, management, and staff build and participate in **budget processes that are oriented toward achieving results** and not just conducting activities. This means allocating adequate resources for monitoring and evaluation. And it means making hard choices, especially in tough financial times, to direct money where it needs to go to drive the intended results.
- Senior management **uses financial modeling to make clear and transparent the organization's financial condition** and, at any given point, predict how it will end the year (and what will make the prediction more or less reliable).
- The board and senior management **share financial results transparently** with key stakeholders at regular intervals.
- The board and senior management **treat fundraising/fund development as a strategic function that requires focus, management, capital, and specialized skill sets.** They craft clearly defined roles and goals for the board and staff.
- The board and senior management **operate their organization at a surplus** that allows them to build a strong balance sheet with appropriate reserves.
- The board, management, and key staff **understand their organization's cost structure**, which aspects of it are required to produce high-quality programs and/or services, and how it aligns with reliable revenue sources for funding it year in and year out. They are relentless in making necessary investments with an eye to costs and benefits while being equally relentless in reducing unnecessary costs.
- Senior management instills an organization-wide discipline of **compliance with all regulatory requirements.**

To see all the pillars of the Performance Imperative, visit our website.