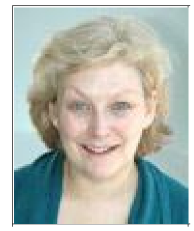
# Member Area

## Perspectives

### January 2008

### Real Progress on the Nonprofit Capital Market?!



*Clara Miller is president and CEO of the* ***Nonprofit Finance Fund****, a national leader in helping nonprofits strengthen their financial health and improve their capacity to serve their communities. This column is part of a series that has appeared in the past few months in which leaders from our community examine the current social finance system. This month, Clara describes three developments that may help nonprofits find more stable financial footing.*

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I was going to entitle this column, "Let's Talk about the Money," but when I reflected on 2007, I easily thought of a dozen examples of experienced folks in the sector who are not only talking about the money, but doing something truly promising, too! So I have tempered my exhortations about "enterprise-friendly" improvements for 2008 with notes to cheer them on. Here's the short list:

- **Support the Front Lines with Enterprise-Friendly Pricing** . If the major (or the only) "paying" customers (funders) insist on paying below cost for services from nonprofits, our enterprises won't be able to deliver very long. Investment and risk capital will vanish, effectiveness will decline, and vulnerable people will suffer. While all recognize the benefits of thrift, most also acknowledge the consequences of starvation. Especially among nonprofits serving low wealth populations, conditions have become exploitative to the point of starvation, with few voices demanding improvement. In the words of a former New York City official, "*I managed competitive bids for tens of millions of dollars of ... shelter contracts with nonprofit service providers ... [M]y sole job was to get the lowest price and to make sure I got more than I was paying for. Although I constantly worried about the sustainability of the nonprofits I was contracting with ... I was buying their services, pure and simple, and I was not about to pay the full freight. For their part, they had to suck it up and be nice to me because I was, in their words, "the customer ... "* NFF's nationwide base of borrowers and advisees tell us that over the past several years, income from government contracts, which used to pay around seventy cents on a dollar of cost, has declined to more like fifty. And that ratio is falling!

  The for-profit sector, on the other hand, walks away when the government's pricing is too low. We can't afford that dispassion, however sensible it is in business terms. Our mission urgency means that everyone -- funders, board members, managers, and government contractors alike -- routinely overexploit the enterprise through tactics ranging from heroics *("We all work 18 hours a day to keep homeless people safe."*) to bullying negotiating postures ("*Since you aren't going to walk away from these vulnerable souls, we expect you to serve 100 more this year."*). Destructive conditions like these (deeply sub-marginal cost recovery is only one of the many) undermine promising programs, most profoundly in low-wealth markets.

One idea for improvement on the “buyers” side: If you are a “buyer” of charitable or philanthropic services -- government, foundation, or donor -- support the front lines. Pay full cost for what you’re buying, or if you can’t (or won’t), avoid draconian tactics -- cutting overhead arbitrarily, paying less and less against a dollar of cost, reflexively restricting cash, adding work without adding compensation, refusing changes in line items given shifts in cost, nit-picking through small contracts, and requiring the reduction of cash reserves to pay for current services to mention just a few.

There are a few 2007 exemplars of enterprise-friendly “buyers” and advocates, including Paul Shoemaker of Social Venture Partners, who continues to “stir the pot” on general support in Grantmakers for Effective Organizations’ listserv, and a variety of foundation heads (Paul Brest of the Hewlett Foundation, most prominently) continuing to push for more general support as the standard practice. Going beyond general support, there’s Gregg Behr, head of Pittsburgh’s Grable Foundation, who is adopting the “net grants” approach. A net grant equals the face amount of the grant minus the cost to provide it -- writing the proposal, reporting, telephone conversations, meetings, etc, and the foundation tries to maximize the net amount of its grants.

- **Enterprise-Friendliness Means Capital Structure Neutrality!** Any change in the balance sheet -- taking a loan, restricting a grant, decreasing cash, buying a building or raising an endowment -- is simply a means to an end, achieving mission. Loans alone do not constitute “access to capital,” owning a building may or may not be good for mission, mergers may or may not work well. Individual organizations may be taking on too much debt or be overly averse to it, they may acquire real estate but underinvest in information technology. Some cling to the idea of building endowments or side businesses when they should build development capacity. And that’s the point. Dispassion about the “means,” and avoidance of outmoded rules of thumb about restricting cash or acquiring particular assets, positions us all to consider a much more important question: how will money -- and assets in general -- help accomplish a particular mission? Instead of asking, “how do we get that building,” the enterprise-friendly manager, board member or funder asks, “what should the entire balance sheet look like in five years, and why?”

  In 2007, I saw the beginning of a real paradigm shift among some major foundation funders. More are now willing to make “enterprise-friendly” and purpose neutral grants both as “builders” (to expand or improve organizations) and as buyers (to pay for ongoing operations). Among those entering the ranks of asset-neutral builders is The Kresge Foundation, internationally known for bricks and mortar funding, which has stepped boldly beyond those boundaries to take a holistic approach to “capital.” The Doris Duke Charitable Foundation, The Ford Foundation, The MacArthur Foundation, and The Rockefeller Foundation are also among those who are making or enabling “growth capital” -- equity-like grants structured to finance change in an organization without assuming any particular asset choice (building, technology, endowment, etc.). These investors acknowledge the extraordinarily high cash needs of growing nonprofits. And their practices are promising adoptions of a new set of financial habits that can nourish nimble, healthy, effective enterprises sector-wide.

- **Serious about Self-Sufficiency? Sustainability? Effectiveness? Engage in Group Behavior.** While charitable passions and beliefs vary, the way money does (and doesn’t) work is more predictable. Ambitious growth without adequate capital is risky in any sector. Nonprofit growth requires more “equity” proportional to revenue than most for-profits, more than virtually any single funder of any type can comfortably give to one organization. Funders who understand this know that if their best and fastest-growing grantees are going to succeed, they need scalable business models, holistic financial plans -- AND they need to enlist other funders to amass the capital to get these grantees up the growth curve unscathed. This problem is most evident among organizations serving low-wealth communities, because “growth capital” from individual donor campaigns is much less accessible to them.

  Here, again, are truly transformative developments from leaders in the field. The Edna

McConnell Clark Foundation recently announced that it, The Bill & Melinda Gates Foundation, The Robert Wood Johnson Foundation, The Picower Foundation, and Andrew Balson (of Bain Capital) are building a fund of $120 million of equity-like growth capital focused on three high-performing organizations serving young people. And the Surdna Foundation continues to organize syndicates to finance public media organizations -- most recently with Public Radio Capital -- using a range of providers of both debt and equity like growth capital to do so. Possibly most promising on the group behavior front is the growth of the Program-Related Investment (PRI) Makers Network, where a seasoned group of foundations -- Heron Foundation among the leaders -- are encouraging an expanding group of interested parties to learn and, hopefully, invest together. They are using foundation funds to provide loans and other kinds of investments beyond grants, and also tapping the range of potential investments in equity, debt, and deposits available via foundations' investment portfolios, all to support missions.

We hope these promising beginnings will gain momentum this year. Improvement to our business environment is a threshold requirement for an effective social sector. Without it, all other capacity building work (including our own financing and advising here at NFF) will fail. With it, we'll all win.

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