Video Transcript

ENTREPRENEURSHIP IN NONPROFITS

Financial management in nonprofits: challenges

[Georg von Schnurbein] Let's start this video with an example. A social initiative in an emerging country wants to improve the nutrition of young families where the parents are unemployed. These families do not have enough money. But the way they spend their money on food is neither efficient nor healthy.
Your idea is to offer food baskets for a healthy meal and provide information about healthy but affordable meals. Now, what are the potential financial challenges that your social initiative faces?

First of all, there are too many options. It sounds weird, but business companies know exactly that they make their money through prices. But in a nonprofit context, do you apply for state funding? Do you ask for donations? Should you seek grants from foundations, sponsoring from companies, legacies, loans, crowdfunding, or earn your own revenues? The list is endless.
Take a look at this overview once published by Susan Raymond. It looks more like a piece of art than a strategic advice. So the first challenge is to develop a mix of financial resources that suits your mission, your organization, and your financial needs.

Let's have a look at the second challenge. There is a lack of numbers. Assume that you get food sponsored to fill your baskets. Still, you need to know how much it will cost to provide one family with a food basket. But you also have the aim to provide information. What are the costs for this even more important part of your activity?
Usually you will have difficulties in finding benchmark or baseline data, or the right set of key indicators. But financial planning without a reference is difficult. So you need to build a dashboard with the right numbers.

The third challenge is the lack of knowledge. In a typical social initiative, there are many great people involved with great skills to realize the organization's mission. To provide food baskets, you need cooks, food consultants, or retail experts to manage the logistics. At first sight, financial analysis or accountants are not necessary, because the primary mission is not about financials.
But financials are an important means to an end. As a consequence, financial management is kept simple. No cash flow planning, no capital budgeting, no capital cost control. Most organizations work with simple cash-in, cash-out statements. Especially if you need to decide on expansion of future projects, the lack of financial knowledge is a threat to the organization's survival.

Fourth challenge, the danger of mission drift. As I said, financials are only a means to an end. If your social initiative is able to raise enough funds, develop a dashboard with the relevant key indicators, and it has the financial knowledge, it might become very successful. Perhaps we start selling the food baskets at a low price. Or we start our own restaurants where the families can eat. We also start a fancy top line so donors can support us by buying the food baskets.

Suddenly, someone stands up and claims that our initiative has lost its social compass, because we are running after the money. True? True, but! Where's the red line between mission and market? This trade-off challenges every nonprofit organization or social initiative. The answer to this has to be decided by each organization itself. The only clear red line is if the tax authorities decide that your organization is not charitable anymore and will be handled like a business.

The final challenge is the year-to-year fixation. Because social initiatives have difficulties in measuring their success, people tend to focus on the input. Thus, administration costs and fundraising costs become indicators of success, although they tell nothing about it. To make it even more problematic, expenses are always bound to one year. But if you want to invest, it is clear that costs are higher before returns will be realized.
Let's say our initiative has a five-year growth plan to increase fundraising return by 50%. We won't reach this goal if we keep our fundraising efficiency stable, that means the ratio between input and return. We will need to invest in the first years to receive higher donations in the later years.
In a year-to-year perspective, we are not doing fine in terms of fundraising expenses, but over the total period, it is working. The challenges I just mentioned provoke constant discussions and uncertainty. You will realize that these questions are never entirely answered.