Philanthropic Security

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This is the first in a two-part series focused on ways advisors can help their clients feel more secure about their philanthropic investments.

Imagine waking up and reading in the morning news that an organization you have been supporting for years is shutting its doors. You have given them a significant gift every year for the last decade, attended their fund-raising events and have even volunteered for them on occasion. While you knew that times were hard, you had no idea that such an integral part of your community was at risk of closing.

Sadly, this isn't a fantastical scenario. In the last few months, two prominent social service organizations-the Jane Addams Hull House Association of Chicago and the YWCA of the Greater Triangle in Raleigh, N.C.-discontinued operations. Both institutions had been serving their communities for over 100 years, providing vital youth, workforce development, counseling and senior services to tens of thousands of people each year. As demand for social services continues to rise and funding continues to dwindle, most in the nonprofit sector agree that these closings may be a harbinger of things to come.

By looking at the problems these institutions grappled with, and how they were handled, advisors can help clients identify signs that the recipients of their charitable dollars may be in trouble. Advisors who can ease clients' concerns about the viability of the organizations they support help give clients confidence that both their financial and philanthropic investments are being protected-something that can engender a great deal of client loyalty.

Warning Signs

The stories behind the Hull House and the YWCA implosions illustrate the challenges that community nonprofits across the country are facing. As a result of the recession, organizations that provide human services-such as housing, food and health care-are struggling to balance greater demand for their services with financial hardship driven in large part by cuts in both government and foundation grants. In fact, 90% of nonprofits surveyed by the Nonprofit Finance Fund earlier this year expect demand for their services to increase in 2012; only half of these organizations expect they will have the resources necessary to keep pace with these growing needs.

While some organizations have adeptly altered course to weather this storm, others have not. What follows are some indicators of distress that clients should look for when assessing whether the organizations they support are taking the steps necessary to ensure survival.

Overdependence on grants funding. Both the YWCA of the Greater Triangle and Hull House became so heavily reliant on government funds that they neglected to cultivate a base of individual donors in their local communities. While a heavy reliance on government grants may have been a successful strategy when the economy was thriving, keeping the same strategy during the recession became a recipe for disaster. Hull House, for example, relied on government grants for 85% of its revenues. In a climate where funding for human services is being slashed, nonprofits should be looking to diversify their sources of funding to make up for inevitable foundation and government grant losses.

Diminishing revenue, mounting expenses. Anyone reviewing the YWCA of the Greater Triangle's Form 990-which, like all 990s, is publicly available online via Guidestar and the Foundation Center-would have seen that between fiscal 2008 and 2010, overall revenue fell 25%, while expenses grew 35%, swelling the organization's deficit to nearly $850,000. A 990 can also be helpful in showing how organizations are coping with revenue shortfalls. For example, during the same period that revenue at the YWCA fell by 25%, salary and benefit expenses grew by over 50%. The YWCA had increased its staff by 20 employees. The failure to make the cuts necessary to accommodate diminished revenue indicated a disconnect between staffing, fiscal accountability and management oversight.

Refusal to cut expenses and explore creative solutions. Although staff and program cuts are painful, an organization's willingness to make responsible budgeting decisions during times of duress indicates a commitment to carrying out its mission. Donors should feel comfortable asking staff to describe the adjustments made as a result of decreased income. In some cases, donors can even make suggestions that might help an organization think about how to budget creatively. If an organization considers merging with a peer organization or looks at other solutions for achieving economies of scale, it shows they are being realistic about the severity of the situation. These organizations most likely deserve support.
If leaders are not willing to entertain such ideas, the organization might be putting itself at risk for permanent closure. Even though Hull House had eliminated programs that weren't generating enough revenue and consolidated service delivery centers to reduce operating costs, it didn't look for potential merger partners until its last two months. By then it was too late; Hull House was too buried in debt to be a viable partner.

Lack of leadership. A lack of strong organizational leadership, high executive staff turnover or friction among an organization's leaders can indicate troubled waters. For example, during its final nine months of operation, Hull House operated with no one at the helm. A complete absence of leadership can be indicative of myriad internal problems. In the case of Hull House, the organization simply didn't have enough money to hire a replacement when the CEO left.

Disengaged board members. Board member engagement-both in terms of expertise and monetary support-is one of the most important ingredients for organizational success. The people on a board matter. As a group, they need to have the right mix of knowledge and skills to guide an organization. As individuals, they should have networks with deep pockets that they can turn to for fund-raising. One of the problems that plagued the board of the YWCA was that members didn't have the resources to write big checks. In addition, board members should be well aware of an organization's financial situation; a functioning board will assist in developing the annual budget and ensure that proper financial controls are in place. It will also help the organization develop contingency plans in the face of both great success and hardship.

Examining the indicators outlined above can help your clients spot a potentially risky philanthropic investment. Advisors who understand how to evaluate recipient organizations not only provide better services to their clients, but also open up new opportunities within their own advisory practices.

In the next issue, we'll discuss how advisors can help their clients discern which organizations will make the most of their charitable dollars.

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