

on the money

The Key Financial Challenges Facing Nonprofits Today — and How Grantmakers Can Help

BY NANCY BURD

GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS



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with contributions from William H. Woodwell, Jr. and Molly Merriman

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Grantmakers for Effective Organizations is a coalition of more than 350 grantmaking organizations committed to building strong and effective nonprofit organizations. Understanding that grantmakers are successful only to the extent that their grantees achieve meaningful results, GEO promotes grantmaking practices that improve nonprofit results.

More information on GEO and a host of resources and links for grantmakers are available at www.geofunders.org.

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INTRODUCTION

About This Publication

This publication marks an attempt by Grantmakers for Effective Organizations (GEO) to better understand and communicate the financial challenges nonprofits face, the ways in which grantmakers are both improving the situation for nonprofits and perpetuating the problem, and the areas where knowledge and practice need further development.

The discussion in the following pages is broken into two main sections. The first, “Assessing the Problems,” looks at the key financial problems facing nonprofits today, and how grantmakers may inadvertently contribute to creating (or at least not resolving) some of these problems. The second section, “Meeting the Challenge: Ideas for Grantmakers,” catalogs some of the ways in which grantmakers can work to ease the financial burdens on nonprofits and ensure that philanthropy becomes a boon, not a barrier, to nonprofit success.

While the for-profit sector has developed best practices and shared knowledge around critical finance issues, the nonprofit sector has not. GEO hopes that this publication, while not providing all the answers, can at least start grantmakers down the path to better understanding problems and solutions. GEO intends to continue exploring this topic in the months and years ahead and will be providing additional examples, tools and strategies for grantmakers as they seek to respond to nonprofits’ financial needs. Working together, grantmakers must ensure that nonprofits have the resources and the flexibility they need to make a lasting difference on the issues that are the focus of their work.

The content of this publication is based on an assessment of the field by Nancy Burd. Contributing to this work were William H. Woodwell, Jr. and Molly Merriman who participated in gathering and synthesizing the research.

St. Louis’s **DEACONESS FOUNDATION** is providing significant, multiyear targeted operating support grants to eight child-focused agencies in the region as part of a major grants program known as the Deaconess Impact Partnership. Agencies are using funds to strengthen core internal operations, including governance and leadership, financial and strategic planning, fundraising, evaluation, professional development, marketing and information technology systems.

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At the **PHILANTHROPIC VENTURES FOUNDATION** in Oakland, California, staff and board have embraced a new model of “paperless giving” to try to reduce the costs (in money and time) that nonprofits must expend in applying for and reporting on foundation grants. The grantmaker explains on its Web site: “We knew the answer was not more — more paper, more procedures, more obstacles, more time. And we believed that if giving grants involved fewer, simpler processes, every dollar would work harder and do more.”

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When **THE F.B. HERON FOUNDATION** decided to expand its role beyond traditional grantmaking by embracing mission-related investing as a core strategy, the New York City grantmaker realized that its own grantees and partners offered an array of investment opportunities. Now, in addition to providing grants, the foundation invests in a range of market-rate and below-market mission-related investments to expand home ownership, spur enterprise development and provide access to capital in low-income communities.

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Three grantmakers, three approaches to the urgent financial and operating challenges facing many nonprofit organizations today. As the nonprofit sector struggles to meet escalating service demands while at the same time addressing the underlying causes of social problems from poverty to crime and violence, many grantmaker and nonprofit leaders continue to argue for grantmaking strategies that are more responsive to the needs of grantees. The goal is not just to enable nonprofits to meet today’s priorities but also to provide the kinds of support that will let them build strong organizations for tomorrow.

Advocates of general operating support and other strategies aimed at easing the money crunch facing nonprofits point to a strong, documented connection between how organizations are funded and their ability to deliver results. A core belief underlying this work is that nonprofits with financial reserves and flexible dollars are much better equipped to weather economic and other crises and adapt to a changing environment than those with highly restricted revenues.

“Financial Stress Is a Given”

All grantmakers work to support strong and successful nonprofits. At least that’s their intent. Yet many nonprofit organizations struggle financially, even those with excellent programs, and especially those seeking to grow. And, while there is an increased level of financial awareness, scrutiny and even new practices in the sector, financial stress is a given among nonprofits — and grantmaking practices are part of the reason.

Today’s nonprofits primarily depend on highly restricted grant support that does not cover general operations. They spend too much time trying to cobble together a patchwork of funding sources. They are subjected to complex and redundant paperwork in order to apply for and report on grants. And, last but not least, they plow most if not all of their grant monies into delivering services now, rather than investing in their organizations so they can get better at what they do and perhaps take a long-range approach to address some of the root causes of the problems they are working so hard to address.

All of this contributes to hollowed-out nonprofit organizations with high rates of personnel turnover and executive burnout — not to mention an inability to grow stronger over time. Adding to the challenge is a new emphasis by government on expanding successful

Working together, grantmakers must ensure that nonprofits have the resources and the flexibility they need to make a lasting difference on the issues that are the focus of their work.

community programs to scale — but without a concurring emphasis on building the capacity of nonprofits to manage their growth.¹

To address these problems, GEO has launched a program area focused on nonprofit finance called “The Money.” GEO’s focus: the ways in which many prevailing approaches and principles in philanthropy can unwittingly create problems for the nonprofit sector; and what grantmakers can do to remove barriers to nonprofit success. GEO’s vision is of a nonprofit sector that is more financially secure, where grantmakers are providing support that sustains nonprofits, and where nonprofit leaders can put their energy into leading strong, successful programs that have real impact on complex social issues.

GEO began its work on these issues by nurturing a dialogue in the sector about the importance of general operating support to nonprofits. However, we understood from the start that a lack of general operating support was not the only crack in the system of nonprofit finance. It was time, we felt, for a bigger conversation about the many financial challenges facing nonprofits today — and how grantmakers can best support nonprofit success.

Cynthia Gair of the venture philanthropy and intermediary organization REDF (formerly the Roberts Enterprise Development Fund) observes: “Foundation funding has fueled social sector innovation and filled critical emergency community needs. However, with some notable exceptions, the field has not developed an approach that supports long-term solutions to the long-term problems it seeks to address.”²

¹ Roob, Nancy & Jeffrey L. Bradach. “Scaling What Works: Implications for Philanthropists, Policymakers and Nonprofit Leaders,” Edna McConnell Clark Foundation, April 2009.

² Gair, Cynthia. “Out of Philanthropy’s Funding Maze, Roadmap #1: Strategic Co-Funding,” REDF, June 2008.

ASSESSING THE PROBLEMS

NONPROFIT ORGANIZATIONS in the state of Massachusetts generate \$87 billion in annual revenues, hold \$207 billion in assets and employ 14 percent of workers in the state. Yet, despite its size and its importance to the Massachusetts economy, not to mention its critical role in meeting social needs, the state's nonprofit sector faces an array of severe fiscal challenges, according to a 2008 Boston Foundation report.³

Growth in the sector has not been accompanied by investment in the organizational infrastructure needed to support this growth. Smaller and midsized nonprofits in particular lack access to reliable funding sources that would help them cover the full costs of providing services while at the same time building stronger organizations for the future. Grants often come with onerous restrictions on how the money can be spent. And access to credit is limited only to stronger, better-endowed organizations.

The Boston Foundation report included specific recommendations for nonprofits and their funders in areas such as consolidating organizations, improving financial management in the sector, ensuring that grants cover the complete costs of services, and lowering the transaction costs of applying for and receiving funds.

Geeta Pradhan of the Boston Foundation sums up the study results as follows: "There are too many nonprofits, too little money, too many restrictions on money, and too little focus on the future."

The situation in Massachusetts is repeated in other states and communities across the country. Despite a wave of interest in recent years in what it takes to build stronger, more effective nonprofits, the sector as a whole still suffers from a chronic case of financial stress that inhibits effectiveness.

The Boston Foundation report represented a call to action to all nonprofit funders in the state, including government and foundations alike, that traditional approaches to nonprofit finance are not delivering adequate results for the sector and the communities it serves. Grantmakers can play an important part in alerting government about its historical role in the undercapitalization of nonprofits, and about the importance of covering the full cost of nonprofit services (something that government grants largely have not done). But the biggest opportunity for grantmakers to make a difference on these issues will come from changing their own practices and assumptions with regard to nonprofit finance.

³ Boston Foundation, "Passion and Purpose: Raising the Fiscal Fitness Bar for Massachusetts Nonprofits," June 2008.

Disconnect Between Words and Action

Grantmakers often go to heroic lengths to support a remarkable array of nonprofit programs and services. They are passionate about their missions and are committed to seeing real progress on issues from the environment and public health to education, poverty reduction and social justice. Yet a growing chorus of people inside and outside of the nonprofit sector are saying that grantmakers themselves, despite the best intentions, may actually be contributing to the financial challenges facing nonprofits.

GEO's 2008 survey of philanthropic practice found a pronounced disconnect between the ways in which grantmakers are supporting nonprofits and what nonprofits say could contribute most to their success.⁴ For example, while 80 percent of grantmakers in the study said they devote some portion of their budgets to general operating support, respondents devoted a median of just 20 percent of their grant dollars to such support. The median grant size for all respondents was \$20,000 — a welcome sum for almost any organization but hardly enough to underwrite any kind of lasting change. Further, only 41 percent of respondents said their application requirements were proportionate to the size and type of the grant.

GEO's findings echoed other research that raises questions about many of the prevailing practices in philanthropy. For example, when asked to suggest improvements to their grantmakers, grantees responding to a 2006 Center for Effective Philanthropy (CEP) survey suggested not just more general operating support but larger grants and more multiyear support.⁵ Even general operating support grants don't help in many instances because they are too small or short-term to matter.

"Foundations should be making long-term, substantial investments that allow grantees to make long-term, substantial change in their communities," said one nonprofit representative who participated in a focus group for GEO's Change Agent Project.

Further, the Change Agent Project and other studies have surfaced complaints about arduous application and reporting processes and the lack of standardization among funders — problems that result in nonprofits spending more time and money on compliance and less on mission fulfillment.

Meanwhile, more and more nonprofits are being encouraged by their funders to seek alternative sources of capital to improve their financial health. But for many types of nonprofits working on issues such as reducing poverty, alternatives to government and foundation funding are few and far between. Adding to the challenge are charity watchdog groups that apply arbitrary rules about "efficiency ratios" that put a premium on low operating costs. This has led nonprofits to discount the importance of investing in the infrastructure they need to perform well over time.

The remainder of this section summarizes some of the key financial problems facing nonprofits today, and how grantmakers may inadvertently contribute to creating (or at least not resolving) some of these problems.

The problems are:

1. Restrictions on Funding
2. Misperceptions Around Sustainability and Growth
3. "Too Many Masters"
4. Onerous Grantmaking Practices
5. Knowledge Gaps

⁴ Grantmakers for Effective Organizations, *Is Grantmaking Getting Smarter? A National Study of Philanthropic Practice*, 2008. Available at www.geofunders.org.

⁵ Huang, Judy, Phil Buchanan & Ellie Buteau. "In Search of Impact: Practices and Perceptions in Foundations' Provision of Program and Operating Grants to Nonprofits," Center for Effective Philanthropy, 2006. The report also notes that grantee suggestions were largely related to aspects of their relationship with grantmakers beyond the type of support, such as the quality of interactions with program officers, the selection and evaluation processes, and the impact of grantmakers on the fields they support.

PROBLEM #1: Restrictions on Funding

Like any business, a nonprofit needs a well-managed, fully operational “infrastructure” in order to succeed. Infrastructure includes technology, facilities and human resources. Every successful business, nonprofit or for-profit, depends on it.

Despite the obvious importance of infrastructure to the success of nonprofits, grantmakers overwhelmingly prefer to support direct delivery of services or programs, often leaving out or paying a small percentage of the costs to deliver those services or operate the enterprise. Foundation CEOs surveyed by CEP indicated a preference for providing program support over operating support, with 49 percent favoring program support and 16 percent preferring operating support.⁶

The proportion of restricted versus unrestricted grants has changed very little in the last 10 years despite high-profile efforts on the part of philanthropic and nonprofit leaders, as well as groups such as GEO, National Committee for Responsive Philanthropy (NCRP) and Independent Sector, to change minds and dispel the myths that inhibit support for general operations.⁷

Making matters worse, even when grantmakers support programs, they rarely provide the funding needed to cover the full operating costs of those programs to the nonprofit organization. The same can be said for government funders, which provide insufficient resources for operating and “indirect” costs. The result is a continued and persistent “hollowing out” of organizational infrastructure in the nonprofit sector. Nonprofits lose the structural framework they need to stay strong in good times and bad.

According to the NCRP, the nonprofit sector is “choking on the highly restricted grant support it receives.”⁸ *Daring to Lead 2006*, a national survey of nearly 2,000 nonprofit executive directors conducted by CompassPoint Nonprofit Services, found a “deep dissatisfaction” with institutional grantmakers; many respondents specifically expressed dismay at the funding restrictions imposed on them.⁹

One nonprofit leader participating in GEO’s Change Agent Project said the perception among grantmakers is that “there is nothing compelling or sexy about operations.” Another said that funders want an “emotional return on investment, they say, ‘tell us a story that will make us cry.’”¹⁰

Because funds restricted to program expansion are the easiest for nonprofits to acquire, the whole sector is skewed toward a system of finance that undermines the operating capacity of these organizations.

When it comes to providing unrestricted support to nonprofits, many grantmakers face a “chicken and egg” problem. Before making a commitment to this type of support, they want confidence in the capacity of grantees to invest wisely and efficiently and to deliver improved results over time. But the lack of resources to build this kind of capacity means nonprofits are forever playing catch-up, and grantmakers are reluctant to take a leap of faith that grantees will be able to put unrestricted dollars to good and productive use.

⁶ Huang, Judy, Phil Buchanan & Ellie Buteau. “In Search of Impact: Practices and Perceptions in Foundations’ Provision of Program and Operating Grants to Nonprofits,” Center for Effective Philanthropy, 2006, pg. 4.

⁷ Wilhelm, Ian. “Nearly Half of Large Foundations Shun Unrestricted Grants, Study Finds,” *Chronicle of Philanthropy*, Dec. 8, 2007. Available at <http://philanthropy.com/premium/articles/v19/i06/06002802.htm>.

⁸ Wilhelm, Ian. “Foundations Urged to Help Charities Pay Operating Costs,” *Chronicle of Philanthropy*, March 22, 2007. Available at <http://philanthropy.com/premium/articles/v19/i11/11001201.htm>.

⁹ CompassPoint Nonprofit Services and The Meyer Foundation, “Daring to Lead: A National Study of Nonprofit Executive Leadership,” 2006.

¹⁰ See the GEO reports on the Change Agent Project, *Listen, Learn, Lead: Grantmaker Practices That Support Nonprofit Results*, 2006; and *Imagine, Involve, Implement: Transforming Grantmaker Practices for Improved Nonprofit Results*, 2008. Both are available at <http://www.geofunders.org>.

PROBLEM #2:

Misperception Around Sustainability and Growth

A major challenge facing every nonprofit is the goal of “sustainability.” Talk separately with grantmakers and grantees, however, and you might come away with two very different ideas about what “sustainability” means. To some grantmakers, sustainability means nonprofits will lessen their reliance on foundation funding and will learn how to pay their own operating costs. To many nonprofits, however, sustainability means implementing a funding strategy with sufficient capital to operate effectively year after year.

Nonprofit Finance Fund’s George Overholser has advanced a new framework for understanding philanthropic investments in nonprofits. He calls it “building versus buying.”¹¹ Building an enterprise, he says, requires growth capital and “a patient process of trial and error.” In contrast, buying from an enterprise puts a grantmaker in a position of asking that enterprise to “keep doing what it already knows how to do.”

Growth, or “build,” capital can provide an organization with the financial buffer it needs to learn from mistakes and grow over time. “Growth capital covers the deficits a firm incurs en route to sustainability,” Overholser writes.

For grantmakers, a key takeaway from Overholser’s work is the need to be absolutely clear about what type of capital you are providing to nonprofits, and to set your expectations accordingly. For example, if you are providing “buy” money, then you cannot expect

your grant to deliver any returns to the organization beyond its capacity to continue delivering the services you are funding. Similarly, when providing “build” capital, it’s important to understand the level of funding that an organization truly needs to achieve real and sustainable growth.

Clara Miller, president and CEO of Nonprofit Finance Fund, adds that while most grantmakers see themselves as providing growth capital to nonprofits, most foundation grants today are too small to function as “build capital.” As a result, the majority of grants are treated not as investments (build) but as revenues (buy) and get plowed into service delivery. This prevents the organization from developing capacities and strategies for the longer term that will reliably attract more revenue to help it address the underlying causes of social ills.

The lack of sufficient growth capital for nonprofits contributes to the “service model trap” described by Elizabeth Keating of the Carroll School of Management at Boston College, and formerly of the Hauser Center at Harvard University (see sidebar for more).¹² Keating believes that nonprofits face enormous pressure to max out on current services — not just from grantmakers but also from nonprofit leaders themselves who have been conditioned to show that they are devoting as much of their resources as possible to the goal of serving more and more people. This means organizations have little money or time left over to devote to building a sufficient infrastructure to address long-term solutions. Therefore, sustainability suffers.

¹¹ Overholser, George. “Nonprofit Growth Capital: Defining, Measuring and Managing Growth Capital in Nonprofit Enterprises. Part One: Building Is Not Buying.” Nonprofit Finance Fund. Available at <http://www.nonprofitfinancefund.org/>.

¹² Buechel, Kathleen, Elizabeth Keating & Clara Miller. “Capital Ideas: Moving from Short-Term Engagement to Long-Term Sustainability.” The Hauser Center for Nonprofit Organizations, John F. Kennedy School of Government, Harvard University, 2007. Available at <http://isites.harvard.edu/fs/docs/icb.topic171906.files/proceedings.web.pdf>.

Many grantmakers go so far as to *encourage* ill-planned growth by urging nonprofits to take their programs “to scale,” even when these organizations do not have the infrastructure or the planning capacity (not to mention the resources) to do so. The belief that nonprofits can learn from for-profits, while true in many circumstances, can lead to problems for the sector when grantmakers and grantees unquestioningly embrace business models such as going to scale and generating earned income through business ventures (aka “social enterprise”). While many organizations have succeeded in these types of efforts, private-sector models of growth and revenue diversification do not directly translate in the nonprofit world.

The bottom line for nonprofits is that ambitious growth without adequate capital is risky, just as it is in private industry. And, while the for-profit world has financial instruments to minimize risk and promote full capitalization, nonprofits have nothing of the sort.

Another sustainability issue is the preference of many grantmakers for one-year grants. In GEO’s 2008 national survey, only 60 percent of grantmakers said they make multiyear grants of two years or more sometimes, often or always. However, the proportion declined among smaller foundations and community foundations. And, as the economy tanked in 2008, many grantmakers pulled back from multiyear commitments to grantees because of financial uncertainty.

The preference for one-year commitments to grantees ignores a basic fact about organizational sustainability. It is almost impossible for an organization to develop a long-term business plan or build financial stability without knowing the funds will be received on a year-after-year basis.

LITERATURE REVIEW:

The “Services Trap” Defined

“The current services trap is grounded in the urgency surrounding critical social problems. Because the problems are urgent, it often appears that they are best solved by expending all available resources with the aim of serving more and more people. The pressure to increase the volume of service delivery at all costs overwhelms the capacity and systems that might help the organization stay in the game over the longer time period required to really solve the problem. Money and effort are invested only in the ‘now,’ with little or no accrual of cash reserves or investment in the organization’s infrastructure. A telling sign of this ‘current services’ mentality is the fact that many nonprofits publicize that close to ‘one hundred percent’ of any dollar given is spent on delivery of current services, suggesting that to do otherwise is wasteful. Many nonprofits fall into that trap, and many funders — with the best of intentions — unwittingly lead them to it.”

CAPITAL IDEAS: MOVING FROM SHORT-TERM ENGAGEMENT TO LONG-TERM SUSTAINABILITY, SYMPOSIUM EXECUTIVE SUMMARY, MAY 15, 2007, HAUSER CENTER FOR NONPROFIT ORGANIZATIONS, HARVARD UNIVERSITY, AND THE NONPROFIT FINANCE FUND

PROBLEM #3: “Too Many Masters”

Revenue diversification is the rule of thumb in resource development for nonprofits. But a greater variety of resources comes with a corresponding increase in resource dependencies, management challenges and mission creep. Although the benefits of diversification may mitigate the risk of losing one or more grantmakers, the consequences of “too many masters” may create problems for the typical nonprofit.

Hilda Polanco, managing director of Fiscal Management Associates, a New York agency that works with nonprofits on finance issues, observes that many nonprofits underinvest in business planning during times of organizational growth. They raise money from one grantmaker at a time, developing a strategy that is customized for each funder’s program and grantmaking strategy. Considering the small size of most foundation grants, this piecemeal approach to raising money can lead to haphazard growth and can divert the organization from its core focus and mission as it tries to meet the varying demands and interests of an array of grantmakers. In their efforts to satisfy many masters, nonprofits often add heavy layers of infrastructure and new costs to their businesses.

A far better approach, Polanco suggests, is for nonprofits to step back and plan their growth in the larger context of how they can develop and apply long-term solutions to social problems.

In countering an argument for revenue diversification, William Foster and Gail Fine of the Bridgespan Group conducted a study of the revenue mix of more than 100 U.S. nonprofits that had grown to \$50 million or more in annual revenues between 1970 and 2003.¹³ (Hospitals and colleges were excluded.)

They discovered that most of the organizations that had achieved this level of growth had two things in common:

1. They raised most of their funds from one type of funding source (e.g., government, fees or corporate), debunking the belief that growth and sustainability could be achieved only through diversification.
2. They built the infrastructure of their organizations to maximize their capacity to get and manage the funds.

These organizations, in other words, became more focused on growth, and as they grew they invested heavily in their capacity to raise funds from the source they believed was most likely to support that growth.

One of the shared characteristics of the largest organizations in the study was having a well-organized and robust administrative infrastructure to support the funding operation. Foster and Fine’s article quotes Catherine D’Amato, CEO of Greater Boston Food Bank, who says, “We started as a charity and became a charitable business.”

Not every organization can or should aspire to extraordinary growth, but the lessons learned from organizations that did are important. The study suggests that nonprofits should not necessarily seek diversity of funding for diversity’s sake, but that they must become more intentional in determining their funding mix.

According to Clara Miller, Nonprofit Finance Fund’s (NFF) research shows that “more diversification isn’t necessarily better” when it comes to nonprofit revenue sources. NFF research shows that organizations with one or three major revenue sources are typically less profitable than those with two. In fact, in some cases profitability declines as organizations add other major sources of funding.

“This likely happens because a third line of business creates complexity and drives up internal costs, boosting the overall cost structure,” Miller explains.

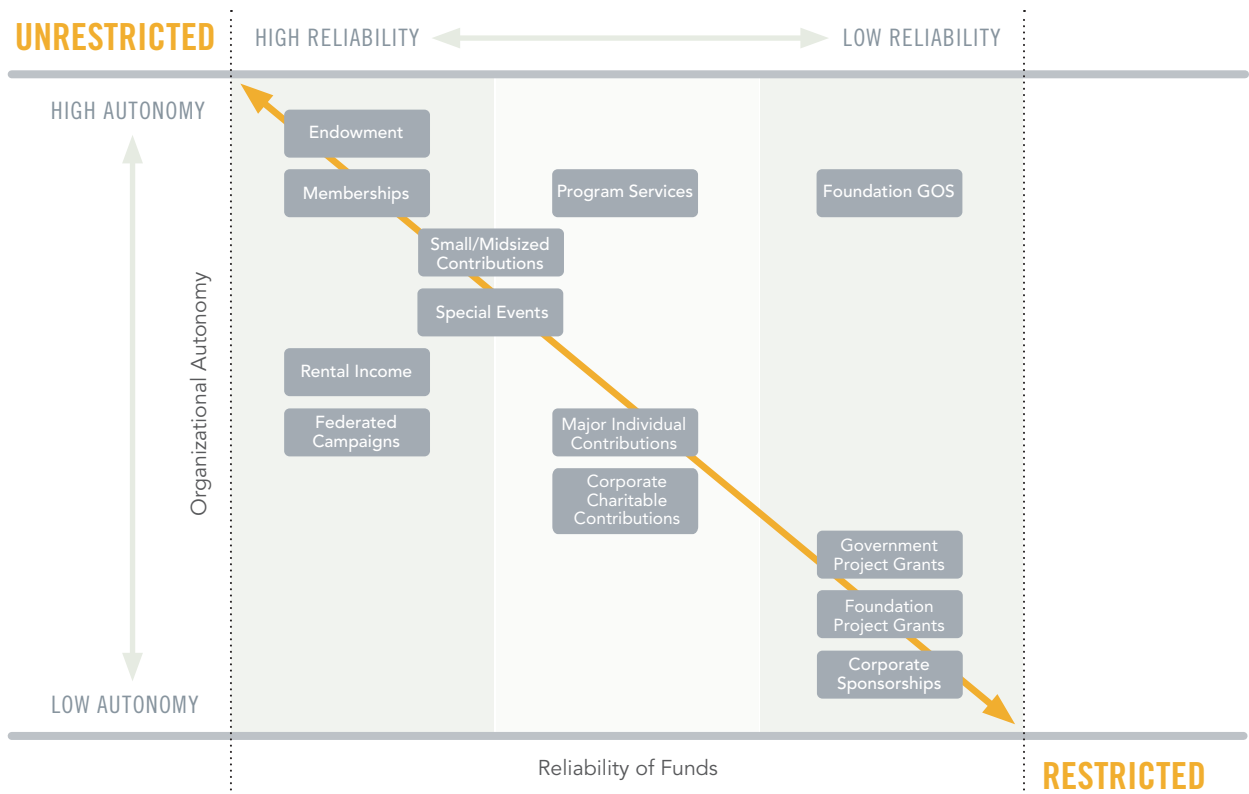
¹³ Foster, William & Gail Fine. “How Nonprofits Get Really Big,” *Stanford Social Innovation Review*, Spring 2007. Available at http://www.ssireview.org/images/articles/2007SP_feature_fosterfine.pdf.

She continues: “Mission-driven organizations don’t always appreciate the need for new skills, systems and capital that comes with starting another business line.”¹⁴

For grantmakers, the message is clear: Revenue diversification is not always the best measure of a healthy nonprofit. Equally important is the level of funding that the organization receives from various sources and the strings that are attached to that funding. Therefore, grantmakers that want to help nonprofits improve their funding streams should consider providing flexible funding that allows nonprofits to develop other reliable sources of revenue. Grantmakers also should consider covering the operating costs of nonprofits that rely to a large degree on government grants for program funding.

Jon Pratt, executive director of the Minnesota Council of Nonprofits, uses two principles of organizational sustainability — reliability of funds and organizational autonomy — to create a “reliability-autonomy” matrix, which provides a tool to aid nonprofits in making high-level strategic decisions. The matrix (shown below) divides eight common types of nonprofit funding into three levels of autonomy: high, medium and low. The less restricted the funding, the higher the autonomy. For grantmakers, the matrix underscores the importance of unrestricted funding in supporting nonprofit sustainability. This type of funding can give nonprofits the flexibility they need to develop more reliable sources of funding over time.

Reliability/Autonomy Matrix¹⁵



For grantmakers, the matrix underscores the importance of unrestricted funding in supporting nonprofit sustainability.

¹⁴ Miller, Clara. “Truth or Consequences: The Implications of Financial Decisions,” *The Nonprofit Quarterly*, Summer 2008. Available at <http://www.nonprofitquarterly.org/>.

¹⁵ Pratt, Jon. “The Dynamics of Funding: Considering Reliability and Autonomy,” *The Nonprofit Quarterly*, Fall 2002. Available at <http://www.nonprofitquarterly.org/>.

PROBLEM #4:

Onerous Grantmaking Practices

The oft-used, tongue-in-cheek phrase, “If you’ve seen one foundation, you’ve seen one foundation,” points to a major management challenge facing many nonprofit organizations today. Nonprofits — and many grantmakers themselves — often lament the varying and sometimes onerous requirements that organizations must follow in applying for and reporting on grants. From duplicative grant applications to demands for arbitrary impact indicators, many grantmakers place enormous burdens on their grantees — even those that receive relatively small amounts of money or that may receive funding from the same grantmakers every year. In addition, grantmakers typically ask for the same data from repeat grantees year after year, which is time-consuming and expensive.

“There is an overemphasis in this sector on the written word,” says Ami Dar, founder and executive director of Idealist.org. “People have to go through ‘the process,’ and everyone has to go on ‘the docket’ when we could accomplish so much more by simply empowering program officers to meet with people, prepare a summary of their conversations and then send a check.”

The 2008 Project Streamline study, “Drowning in Paperwork, Distracted from Purpose,” concluded that many common grantmaking practices — such as “one-size-fits-all” application requirements — can actually interfere with the ultimate effectiveness of grants. Among the other findings in the study: nonprofits continually reinvent their programs — at least on paper — in response to grantmaker preferences; and grantmakers’ due diligence procedures tend to require redundant documentation from grantseekers.¹⁶

Project Streamline also found that the cost of applying for many foundation grants often is too great in comparison to the award. Other research has affirmed that there is little relationship between the size or type of grants that organizations seek from foundations and the application process they are asked to follow. In some cases, nonprofits report that the costs in staff time or in direct expense to hire a grantwriter who will compile documents and fill out forms can be greater than the size of the grant.

“Complying with the conditions attached to funding — and coping with fluctuations in revenue — imposes direct and indirect costs and occupies the attention of managers and directors,” says Jon Pratt, executive director of the Minnesota Council of Nonprofits.

In GEO’s national study of philanthropic practice, only 41 percent of respondents said their application requirements were proportionate to the size and type of grant (for example, fewer requirements for small grants or event sponsorships). Large foundations in the GEO study (those with a median grant of \$50,000) estimated that grantees spend a median of 10 hours on the proposal and application process for a typical grant. In reality, according to the Center for Effective Philanthropy, grantees of large foundations spend a median of 20 hours per grant.¹⁷

It’s not surprising that grantmakers aren’t always aware of the amount of time grantees spend meeting their requirements. GEO’s national study found that only 12 percent of respondents collected information about how long it takes grantees to meet their organizations’ administrative requirements.

¹⁶ Bearman, Jessica. “Drowning in Paperwork, Distracted from Purpose: Challenges and Opportunities in Grant Application and Reporting,” Grants Managers Network, 2008.

¹⁷ Center for Effective Philanthropy, “Analysis of Key Predictors of Grantee Ratings of Process Helpfulness and Time Spent,” prepared for Project Streamline, 2007.

“There is an overemphasis in this sector on the written word. People have to go through ‘the process,’ and everyone has to go on ‘the docket’ when we could accomplish so much more by simply empowering program officers to meet with people, prepare a summary of their conversations and then send a check.”

AMI DAR, FOUNDER AND EXECUTIVE DIRECTOR
IDEALIST.ORG

PROBLEM #5: **Knowledge Gaps**

Perhaps the biggest financial problem facing nonprofits and their funders — and a problem that underlies all the others — is a misunderstanding on both sides of the nature of money in the nonprofit sector. According to Miles Wilson, director of The Grantmaking School, a program of the Dorothy A. Johnson Center for Philanthropy and Nonprofit Leadership at Grand Valley State University, foundation staff generally are hired for their expertise in specific program areas rather than their knowledge of nonprofit finance. This creates a problem for both grantmakers and grantees because the effectiveness of programs is so closely tied to their underlying finances.

“Understanding the cash flow of the organizations you are granting to will tell you a lot about the degree of capacity they have to deliver on the results they are promising,” Wilson says.

William P. Ryan, in a 2001 paper prepared for The Rockefeller Foundation and the Fannie Mae Foundation, identified the three types of capital that nonprofits need.

1. Facilities capital — funds for building or acquisition of real estate to house nonprofit offices and programs.
2. Working capital — funds for routine expenses during times of low cash flow, or for more strategic investments in an organization’s capacity to grow or improve its services.
3. Permanent capital — funds granted for an organization’s endowment, or to the capital reserves that community development organizations use to invest in housing and business development.

Not surprisingly, Ryan's scan of the field identified working capital — and, in particular, working capital that allows nonprofits to make strategic investments in improving organizational capacity — as the most sought-after form of capital among nonprofits, and the hardest to obtain.¹⁸ The lines Ryan draws to divide different forms of nonprofit capital are similar to the “build versus buy” distinction explored on page 6. And a major problem facing the sector is a lack of shared understanding and consensus about the types of capital that nonprofits need most.

“The idea that different nonprofits need different types of capital for different purposes is almost self-evident. Yet the general discourse among both nonprofit managers and grantmakers seems to make few of these distinctions,” Ryan writes.

Adding to the knowledge gap that keeps grantmakers from providing nonprofits with the right kind of support at the right levels is a lack of understanding of what it actually costs nonprofits to deliver services or to achieve their goals for growth. “Nonprofits may not ask for what they truly need because they don't always understand full costs,” says Nonprofit Finance Fund's Kristin Giantris.

Further complicating the problem is the common (and flawed) perception that nonprofit overhead costs should be low no matter what. This contributes to a lack of transparency among nonprofits about the true costs of running their programs and sustaining their organizations.

The Nonprofit Overhead Cost Project found substantial inconsistency among nonprofits in how they report functional expenses.¹⁹ For example, personnel costs constitute a majority of administrative expenses across the field, yet tracking personnel time remains a low priority among nonprofits. The failure to track or effectively allocate staff time to different functions may, in turn, contribute to underreporting of fundraising costs, which nonprofits and donors have come to view in a negative light even though nonprofits rely on contributions to succeed.

In the end, the lack of knowledge and transparency about administrative costs becomes a self-fulfilling prophecy as nonprofits are denied the resources they need to maintain an adequate organizational infrastructure. Nonprofit executives who lack accurate financial information end up making important resource-related decisions on the basis of intangibles such as intuition, the skills and knowledge of the program staff, or the preferences of the organization's funders or board members. And grantmakers who lack knowledge about the true costs of running nonprofits often end up providing bare-bones support that does little to ensure that grantees can build strong and healthy organizations.

A study of 650 health and human service providers in Massachusetts that derived at least five percent of their revenues from state government found that 60 percent had cumulative deficits on their state-funded activities since 1993. The same is true of countless nonprofits that receive funding from other grantmakers, suggesting a profound mismatch between what organizations

¹⁸ Ryan, William P. “Nonprofit Capital: A Review of Problems and Strategies,” Fannie Mae Foundation and The Rockefeller Foundation, 2001. Available at http://www.community-wealth.org/_pdfs/articles-publications/pris/paper-ryan.pdf.

¹⁹ Nonprofit Overhead Cost Project, “Getting What We Pay For: Low Overhead Limits Nonprofit Effectiveness,” Center on Nonprofits and Philanthropy, Urban Institute, and Center on Philanthropy, Indiana University, August 2004.

are receiving and what they actually need.²⁰ In response to the Massachusetts study, state lawmakers approved a number of changes, including more leverage for human services providers in setting the rates for their work and opportunities for regular reviews and cost-of-living adjustments.

Not only do nonprofits and their funders need to develop a better understanding of the nature of money in the sector, they also need to engage in more advocacy to change assumptions and misperceptions that make these problems worse. To the extent that foundations, government, nonprofits and others in the sector can come to consensus on what a healthy nonprofit looks like in terms of its balance sheet and spending patterns, then organizations will be more likely to get the kind of support they need to stay healthy and succeed. An example of this kind of consensus building and advocacy is the work of the Association of Chief Executives of Voluntary Organisations (ACEVO), which advanced the concept of “full cost recovery” among its 2,000 members in the UK’s nonprofit sector (see page 19 for more).

LITERATURE REVIEW:

**Spending More, Not Less,
on Operations**

“No organization in our study was an extravagant spender on fundraising and administration. Yet contrary to the popular idea that spending less in these areas is a virtue, our cases suggest that nonprofits that spend too little on infrastructure have more limited effectiveness than those that spend more reasonably. Thus, in addition to the ceilings on these cost ratios that many watchdogs set, floors should perhaps be introduced as well.”

NONPROFIT OVERHEAD COST PROJECT, “GETTING WHAT WE PAY FOR: LOW OVERHEAD LIMITS NONPROFIT EFFECTIVENESS,” CENTER ON NONPROFITS AND PHILANTHROPY, URBAN INSTITUTE, AND CENTER ON PHILANTHROPY, INDIANA UNIVERSITY, AUGUST 2004.

²⁰ DMA Health Strategies, “Financial Health of the Providers in the Massachusetts Human Services System,” October 2007. Available at <http://www.doughertymanagement.com/>.

Barriers to Smarter Grantmaking

Grantmakers want to provide the best support they can to help nonprofits succeed. But there are a number of barriers that can stand in the way. Understanding these barriers will help grantmakers chart a course for change.

UNCERTAINTY ABOUT ACCOUNTING RULES

Many grantmakers are held back from exploring new ways to support grantees by the simple fact that they don't know how to handle accounting for activities in flexible ways. How does a grantmaker keep track of payout if it moves to multiyear funding? How does it move beyond assessing individual programs to a fuller understanding of whole enterprise finance — for example, true costs of services, cash flow management and financial and business planning? As this report shows, many grantmakers are developing answers to these questions, and numerous intermediary organizations exist to help build the knowledge of nonprofits and grantmakers alike. Grantmakers seeking a better understanding of these issues should look to their colleagues and others for help and ideas, and GEO intends to continue exploring and disseminating new models and examples in our work ahead.

PERPETUITY CONCERNS

Many grantmakers feel a tension between their desire to help grantees to the greatest extent possible and the need to protect foundation assets for the future. If we provide more funding for organizational infrastructure and operations, they say, we either will have to increase payout or reduce our overall grants budget, or do both. The recent economic crisis brought these concerns into even sharper relief, as many grantmakers were examining their perpetuity assumptions for the first time. Yet another perpetuity-related concern that keeps grantmakers from trying new approaches to nonprofit finance is the perception that program-related investments delivering modest to minimal returns won't grow the corpus to the same degree that stocks historically have done — even despite the crisis in the markets in recent years. But the fact is that many grantmakers, such as The F.B. Heron Foundation, have seen their program-related investments hold up better than other investments in sharply declined markets. Others, such as the Bill & Melinda Gates Foundation, increased giving and payout rates in the face of the recent economic downturn. Still other grantmakers, such as Girl's Best Friend Foundation, have embraced strategies for spending down their assets (i.e., "sunsetting") so they can have the maximum possible impact on grantee success.

CONCERNS ABOUT MEASUREMENT

Many grantmakers view program grants as easier to track when compared with general operating support and other forms of infrastructure support. But as GEO has shown in the publication *General Operating Support, Vol. 2: Assessing the Impact*, measurement of more flexible forms of funding is not as much of a challenge as it's made out to be. The key is to work with grantees to identify organization-level rather than program-level indicators of success. Many grantmakers have developed ways of doing this. Grantmakers also should keep in mind that an overemphasis on evaluation and reporting, especially for grants that represent a relatively small share of overall nonprofit budgets, can reduce "net grant" for both program funding and general operating support.

DEPENDENCY ISSUES

Avoiding grantee dependency on a foundation's support is an oft-cited reason for grantmakers' preference for restricted program support, one-year grants and smaller grants.²¹ But sustainability is not possible without dependable sources of revenue and without sufficient resources to build the infrastructure that will help organizations plan for the future. In addition, many foundations repeatedly make grants to the same group of nonprofits year after year; these organizations already depend on grantmakers to deliver a significant share of their funding. For grantmakers interested in seeing nonprofits develop additional funding streams, one answer is to provide more operating capital so they can try new things; it is hard for an organization to develop new sources of funding if all of its current funds are restricted to programs. In addition, many nonprofit and foundation leaders say grantmakers should be worried more about sustainability among the nonprofits they fund than about dependency. Fulfilling your mission as a grantmaker often requires long-term partnerships with grantees that share your priorities.

PRESSURE TO SAY "YES"

Grantmakers feel constant pressure to provide support to a broad range of nonprofits. The desire to say "yes" can contribute to smaller grants to more organizations, which ultimately will have a smaller impact on nonprofit success. In an influential *Harvard Business Review* article in 1999, Michael E. Porter and Mark R. Kramer argued that grantmakers need to work more strategically in their selection of grantees so that they can deliver more effectively on their missions. "Strategy demands focus, yet foundations generally spread their resources — money and people — too thin," they write.²² A better approach: providing a smaller group of nonprofits with more resources to make a real difference.

LACK OF TRUST

The lack of a sense of true partnership and transparency between grantmakers and grantees contributes to grantmakers' aversion to providing long-term, unrestricted funding. Fixing the relationship between grantmakers and grantees is therefore an important first step in providing the kinds of support that will contribute most to nonprofit success. Coming out of the Change Agent Project, GEO identified a number of ways in which grantmakers are working to improve the grantmaker-grantee relationship. These include actively soliciting the opinions and input of grantees in surveys, focus groups and enhanced outreach; bringing a "customer service" mindset to grantmaking; bringing more people with nonprofit experience onto the boards and staffs of grantmaking organizations; and facilitating shared learning with and among grantees.

²¹ See, for example, Huang, Judy, Phil Buchanan & Ellie Buteau. "In Search of Impact: Practices and Perceptions in Foundations' Provision of Program and Operating Grants to Nonprofits," Center for Effective Philanthropy, 2006; and GEO, *Is Grantmaking Getting Smarter? A National Study of Philanthropic Practice*, 2008.

²² Porter, Michael E. & Mark R. Kramer. "Philanthropy's New Agenda: Creating Value," *Harvard Business Review*, November-December 1999.

MEETING THE CHALLENGE: IDEAS FOR GRANTMAKERS

OBVIOUSLY, GRANTMAKERS cannot solve all of the financial challenges facing nonprofits today. But grantmakers can take a number of steps to ensure that the support they provide to grantees, and the policies and procedures connected to that support, allow nonprofits to fulfill their missions as effectively and efficiently as possible.

As the field of philanthropy considers how best to support nonprofit success, grantmakers need to think differently about the capital and infrastructure needs of their grantees, while weighing new strategies for investing in and supporting their work.

Clara Miller says that grantmakers — and, indeed, the entire nonprofit sector — need to start thinking in terms of “whole enterprise finance.” The goal, she says, should be to “create an enterprise that can reliably attract revenue and deliver quality programs over the long term.”

Nonprofits should have the revenue they need not just to cover current operating expenses but also to create and maintain a healthy balance sheet. Looking through the “whole enterprise finance” lens allows grantmakers to sharpen their understanding of the full cost of nonprofit operations, including the need for savings, the cost of debt, and outflows related to property, plant and equipment.

The following is a summary of some of the important ways in which grantmakers can work to ease the financial burdens on nonprofits and ensure that philanthropy becomes a boon, not a barrier, to nonprofit success. Grantmakers should start with an assessment of the key financial challenges facing their grantees and other nonprofits in their communities or mission areas. They then should select the strategies or activities that will help ensure that they are providing the best kinds of support to help grantees succeed.

Listen to Grantees

Shortly after Rip Rapson became president and CEO of the Kresge Foundation in Troy, Michigan, he organized a series of meetings with grantees. “We wanted to talk to folks about how our grants affected them,” he says. Rapson was somewhat surprised by the complaints he heard.

“We heard we were too rigid, and that it took too long to apply for grants,” Rapson says. Even more important was what grantees had to say about the grantmaker’s “Capital Challenge” grants — historically, Kresge had supported fundraising campaigns to build libraries, schools and other capital projects. Organizations told Rapson and his colleagues that, while the challenge grant was a useful tool in a particular circumstance, what they really needed was more flexible forms of capital support. Based on what they were hearing, the grantmaker’s board and staff initiated a major change in strategic direction — supporting not just buildings but everything from business planning to nonprofits’ working capital needs.

The Kresge story is proof that grantmakers can learn a lot about the financial needs of grantees by taking an obvious yet often overlooked step: listening to grantees. In GEO’s 2008 national survey of philanthropic practice, less than four out of 10 respondents (36 percent) reported that they solicited feedback of any kind (anonymous or attributed) from grantees through surveys, interviews or focus groups.

Because they are not actively engaged in ongoing conversations with grantees, many grantmakers are unaware of the serious fiscal bind that many nonprofits find themselves in, and they lack a complete understanding of how their current grantmaking practices may or may not be supporting nonprofit success.

Without listening to grantees, grantmakers also do not know how to improve their grantmaking so that it meets grantees’ real, day-to-day needs. A more open and transparent relationship with grantees will help grantmakers achieve a more complete understanding of nonprofits’ underlying capital structures and of the types of money that will help them most.

Questions for Grantmakers

- ▷ To what extent do your grantmaking strategies and the types of support you provide reflect the perspectives of grantees?
- ▷ How does your organization engage with grantees outside of the application and reporting process to better understand their daily financial and operational challenges and needs?
- ▷ What more can you do to make sure you are getting honest feedback from grantees about the kinds of financial support that will help them most?

Provide the Types of Support Nonprofits Need Most

Since 1997, REDF (formerly The Roberts Enterprise Development Fund) has provided both financial and strategic support for a portfolio of employment-focused social enterprises run by San Francisco Bay area nonprofits. In these multiyear, highly-engaged partnerships, REDF provides general operating support grants together with organizational development support, access to additional funds for capital expenses, strategic business assistance, social outcome measurement, and technological tools and training.

Cynthia Gair, REDF's managing director of programs, said that an evaluation of 10 years of the grantmaker's work shows the potential impact of larger, general operating grants on nonprofit results. "The significant size and consistency of REDF's primarily unrestricted financial support, over numerous years, enabled grantees to develop and be prepared to weather the tough times that small businesses often face," Gair says of the evaluation results.

GEO's *General Operating Support Action Guide* describes the commitment of REDF and numerous other funders to providing unrestricted operating funds to nonprofits, while making the case for such grants as "one of the most effective changes grantmakers could make to improve nonprofit results."

"General operating support is the 'working capital' nonprofits need to sustain their day-to-day operations," according to the *Action Guide*. "The nonprofit can spend [the unrestricted funds] on an array of expenses, including program costs, salaries, administration, office expenses, technology, personnel training, fundraising and marketing."²³

But simply allocating a certain portion of grants to general operating support is not enough. Grantmakers also need to make sure that their grants — for general operating support or program support — are large enough to make a difference for grantees. As grants get larger and are offered over a longer period of time, CEP's research shows that grants for general operating support have a more positive impact on the organization than grants for program support. CEP concludes; "It is not operating support alone that generates higher ratings of impact on the grantee organization, but rather operating support of sufficient size and duration."²⁴

Grantmakers around the country are providing general operating support in ways that are as different from one another as they are the same — that is, each foundation's program is aligned to its individual mission and strategies and the perceived needs of its grantees. Some foundations provide purely unrestricted funds while others hew to a highly negotiated approach where the operating funds are linked to specific outcomes for the grantee organization. What all of these efforts have in common is the premise that a strong infrastructure and the capacity to fully cover overhead costs are key drivers of high-performing organizations.

These same principles apply whether a grantmaker is providing general operating support or making restricted program grants. When providing program support and other types of restricted funding, grantmakers should cover the full costs of services. This may mean engaging with grantees in an open and honest conversation about the true costs of their operations, from fundraising and personnel to technology and other infrastructure. Without a better understanding of these overhead costs and how they affect nonprofit bottom lines, grantmakers cannot know if they are providing a sufficient level of support to ensure the success of the programs and the organizations they are funding.

²³ Grantmakers for Effective Organizations, *General Operating Support Action Guide*, 2007. Available at <http://www.geofunders.org>.

²⁴ Huang, Judy, Phil Buchanan & Ellie Buteau. "In Search of Impact: Practices and Perceptions in Foundations' Provision of Program and Operating Grants to Nonprofits," Center for Effective Philanthropy, 2006.

The Association of Chief Executives of Voluntary Organisations (ACEVO) has advanced the concept of “full cost recovery” among its 2,000 members in the UK’s nonprofit sector. Under full cost recovery, ACEVO states, “organizations and their funders ensure that the price of contracts and grants reflects the full costs of delivery, including the legitimate portion of overhead costs.” In a recent survey, ACEVO found that 75 percent of its members had instituted a full cost recovery model in their organizations, using the ACEVO template or a model based on ACEVO principles.²⁵ Now ACEVO is engaged in a wide-ranging advocacy and education campaign on full cost recovery, with more than 15,000 individuals reached by training, and has released a “Full Cost Business Planner” for nonprofits. The British government and the Big Lottery Fund, the UK’s largest private funder, have agreed to pay nonprofits following the principles of full cost recovery.

An important consideration for grantmakers considering what types and levels of support different nonprofits need most is where the organizations are in their development and growth. According to Susan Kenny Stevens, author of *Nonprofit Lifecycles: Stage-based Wisdom for Nonprofit Capacity*, nonprofits can be found at any one of seven lifecycle development stages, from “idea” and “start-up” through “growth” and “terminal.”²⁶ At each stage, an organization can face different program, management and resource challenges that will respond best to different strategies and approaches on the part of their funders.

Yet another change that grantmakers can embrace to help make sure grantees have the resources they need is to provide more multiyear support. Making multiyear commitments would, in fact, not be a major change for many grantmakers. While most grantmakers prefer to make grantmaking decisions every year, they also

tend to fund the same nonprofits year after year. Multiyear commitments with adequate safeguards can give nonprofits the tools they need to ensure that service demands can be met over time. For grantmakers and nonprofits alike, multiyear commitments have an added bonus: removing or truncating some of the underwriting burden from program officers’ and development officers’ workloads.

Questions for Grantmakers

- ▷ What portion of your organization’s grantmaking is in the form of unrestricted general operating support? What about multiyear support? What is stopping you from providing more of these types of funds?
- ▷ What is the size of your average grant for either general operating support or program support? Is this enough to make a real difference vis-à-vis grantee capacity to achieve their goals and mission?
- ▷ Do your organization’s program grants cover the full costs of the program to the organization? If you are partially funding a program, do you know what the full costs are?
- ▷ Do grantees provide “full-cost” information to help guide your grantmaking decisions?

²⁵ ACEVO and the Big Lottery Fund, “Mind the Gap: A Funder’s Guide to Full Cost Recovery,” September 2006. Available at <http://www.fullcostrecovery.org.uk/main/>.

²⁶ For more information, see <http://www.stagewiseenterprises.com>.

Relieving the Burden: Suggestions for Grantmakers from Project Streamline

- ▷ Stop outsourcing basic administration. Eliminate requirements such as multiple copies of application and reporting documents. Phase out forms that can't be completed on a computer.
- ▷ Take advantage of technology. Accept applications and reports electronically. Make sure online grantmaking systems work smoothly.
- ▷ Use an alternate source (such as GuideStar or IRS Publication 78) to verify the public charity status of potential grantees instead of requiring a copy of the IRS Letter of Determination.
- ▷ When possible, accept common applications and reports as well as grantees' existing materials, particularly budgets.
- ▷ Streamline processes for seeking project timeline extensions and budget modifications so grantees aren't spending a lot of time on requests that are almost always granted.
- ▷ Consider a two-part grantmaking process that includes a short letter of inquiry or concept paper, submitted in advance of a full proposal.
- ▷ Pay for specific evaluation measures if you require them so you are not outsourcing the foundation's evaluation function to grantees.

Bearman, Jessica, "Drowning in Paperwork, Distracted from Purpose," Grants Managers Network, 2008, p. 35. Available at www.projectstreamline.org.

Reduce the Burden on Grantees

Bill Somerville, president and founder of the Philanthropic Ventures Foundation (PVF) and author of *Grassroots Grantmaking: Field Notes of a Maverick Grantmaker*, has some simple advice for his colleagues in philanthropy: Go easy on your grantees.

Somerville's foundation has embraced a model of "paperless giving" that eschews formal application and reporting processes. Somerville explains, "I meet with you and you have a good idea and I trust you to implement that idea, so I send you a check" (along with a simple letter of transmittal). PVF, which has no application deadlines that grantees need to adhere to, offers an array of "immediate response" grant programs in areas from health and social welfare to education and the arts.²⁷

While many grantmakers might feel nervous about following the PVF approach in its entirety, the fact is that every grantmaker can take steps to make the grantmaking process easier on grantees. The Project Streamline study recommended that grantmakers conduct a rigorous assessment of the type of information that is really needed to make grantmaking decisions. Grantmaker actions proposed by Project Streamline: streamlining the application and reporting process for small grants, aligning reporting requirements with grant type, and developing online databases to collect and store basic information from repeat applicants in order to avoid duplication of effort year after year. In addition, the Project Streamline study recommended that grantmakers communicate processes and strategies clearly so grantseekers don't waste their time applying for grants they have little chance of getting.

²⁷ For more information, see www.venturesfoundation.org.

Grantmakers have approached the challenge of reducing administrative burdens on grantees in a variety of ways. Within two weeks of Hurricane Katrina in 2005, for example, the W.K. Kellogg Foundation put more than \$12 million into the region through investments in community organizations that previously had been grantees. “The foundation took a calculated risk to allow these known partners with local knowledge to solve problems quickly and effectively — even without a ‘foolproof’ overarching plan in place,” according to a Kellogg Foundation report.²⁸

The Coleman Foundation and the John E. and Jeanne T. Hughes Foundation in Illinois have advanced the concept of the “elevator grant” as a way to streamline grantmaking procedures. To get an elevator grant for their programs in entrepreneurship education, educators submit two-page project overviews and give three-minute, in-person “pitches” to foundation representatives before an audience at the annual meeting of the National Association for Community College Entrepreneurship.

“This program provides a quick, low-intensity opportunity for educators to pitch their ideas in a way that is proportionate to the grant award and that provides a venue for the sharing of ideas with a broad group of colleagues,” says Clark McCain, program manager with the foundation, who adds that each elevator grant is typically between \$5,000 and \$7,500.²⁹

Nonprofit Finance Fund has advanced the concept of the “net grant” as a guidepost for the sector as nonprofits and grantmakers seek to streamline

application and reporting processes. “How much did it cost your grantee to acquire and report on the grant from you?” Clara Miller asks. “Subtract it from the grant, and that’s the ‘net grant.’” If the net grant is too small to make a difference to the grantee (or if the requirements associated with the grant are too large as a percentage of the total grant), then the grantmaker is asking for too much.

Questions for Grantmakers

- ▷ Are your organization’s application and reporting requirements proportionate to the size of your grants? Do you have fewer hoops for smaller grants?
- ▷ Have you tried to calculate the costs to grantees of working with you as a grantmaker? Do you know the value of your “net grant”?
- ▷ To what extent can you streamline grantmaking procedures while still getting the information you need from grantees?

²⁸ W.K. Kellogg Foundation, “Intentional Innovation: Getting More Systematic About Innovation Could Improve Philanthropy and Increase Social Capital,” August 2008.

²⁹ For more information, see www.nacce.com/?ElevatorGrants.

Work with Other Grantmakers to Reduce Red Tape, Pool Resources

Grantmakers, of course, do not have to work entirely on their own to reduce the burden of grantmaking procedures on nonprofits. In fact, in many cases grantmakers can have a greater impact by working together to streamline the process.

The Pennsylvania Cultural Data Project, for example, unites 15 funders and the State Arts Council in Pennsylvania in the use of a common form to collect organizational data from potential grantees in the arts. With seed funding from a smaller group of grantmakers, the project was launched in 2004 after three years of testing and development. It is now housed in the offices of The Pew Charitable Trusts, providing a standardized, online tool for grantees to fill out as part of the application process to any of the participating grantmakers.

The Pennsylvania model has been replicated in Maryland, California, Illinois, Massachusetts and New York, with several other states interested in joining the project. In addition to making things easier for grantees, grantmakers have found that the system allows them to capture sector-wide statistics that can be used as an important analytical tool.

Beyond common application and reporting processes, many grantmakers also are exploring how to pool their resources more effectively. These efforts have the dual purpose of simplifying the grantseeking process for nonprofits (instead of applying separately to two or more grantmakers, they can apply just once) and delivering larger, higher-impact grants.

REDF uses the term “strategic co-funding” to refer to grantmaker collaborations such as these. As Cynthia Gair, managing director of programs, explains, “Strategic co-funding supports solutions to social problems in much the same way that venture capital-style money aggregation supports the development of a new company. Unlike much of current nonprofit funding, it is solution-focused, rather than project-focused, and it is driven by the long-term strategy and overall needs of an initiative. More than a casual ‘contribute-if-you-want-to’ pooling of dollars, it requires drive, strategic focus and long-term commitment.”³⁰

REDF argues that the two primary benefits of strategic co-funding are that it brings nonprofits more money and more efficient money.

- ▷ More money: “Money attracts money, and philanthropists are best positioned to expand donor pools because people like to put their money into pots that have already been ‘vetted’ by others. Just as venture capital investors seek their peers’ vetting of specific investments, philanthropists can influence each others’ funding choices.”
- ▷ More efficient money: “When money is aggregated via a co-funding group, fundraising and reporting can be reduced dramatically for ... grantees. Philanthropists, too, can be more efficient by decreasing due diligence and monitoring duplication while more effectively aligning funding, policy, and practice.”³¹

³⁰ Gair, Cynthia. “Out of Philanthropy’s Funding Maze, Roadmap #1: Strategic Co-Funding,” REDF, June 2008, pg. 3.

³¹ Gair, Cynthia. “Out of Philanthropy’s Funding Maze, Roadmap #1: Strategic Co-Funding,” REDF, June 2008, pg. 10.

Perhaps one of the most well known examples of strategic co-funding is The Edna McConnell Clark Foundation's Growth Capital Aggregation Pilot (GCAP). Recognizing that some of its highest-performing grantees struggled with raising the funds they needed to expand and achieve sustainability, the foundation launched a pilot program in June 2007 to raise, with co-investors, \$120 million in up-front growth capital for three of its grantees.

In less than a year, the foundation reached its funding goal: It contributed \$39 million and the grantee organizations and 19 co-investors made commitments of \$81 million. Grantee organizations will implement their ambitious growth plans over the next few years, and the foundation will play a coordinating role to engage grantees and co-investors in an investment management strategy and an extensive learning agenda.

The three grantee organizations participating in the pilot serve a combined total of 27,000 youth. The pilot's goal is "to help them extend their combined reach to more than 65,000 youth by 2012, while leveraging approximately \$700 million in public funding. If the GCAP succeeds, it will achieve the kind of scale, sustainability, and impact that the foundation has aspired to realize for nearly a decade, in the belief that building larger, stronger, national youth-development organizations is the most effective, efficient and expeditious way to change the destinies of low-income Americans."³² In addition, the foundation hopes that the pilot's success will encourage more funders to embrace strategic co-funding as a way to support large-scale social change.

Aggregation or syndication efforts such as GCAP are founded on the realization that working on a one-on-one basis with a number of grantmakers at

once can be counterproductive for nonprofits. For grantmakers seeking to achieve more bang for their grantmaking bucks, collaborating with other funders on issues of shared concern may be just the ticket to broader impact.

Questions for Grantmakers

- ▷ Is there potential to work with other grantmakers to institute common grant application and reporting processes among your grantees?
- ▷ Are you funding in issue areas or geographic communities where it would make sense to pool resources in "strategic co-funding" or "syndication" arrangements?

³²The Edna McConnell Clark Foundation, "An Experiment in Coordinated Investment: A Progress Report on the Edna McConnell Clark Foundation's Growth Capital Aggregation Pilot," 2008, p.3. Available at http://www.emcf.org/pdf/gcap_progressreportOct08.pdf.

Consider Alternative Financial Tools

One thing that many grantmakers are learning from their grantees these days is that grants aren't everything. Increasingly, grantees are appealing to grantmakers for different types of investments that will meet their capital needs.

For example, after the Marion I. and Henry J. Knott Foundation began hearing from grantees that they were facing serious cash-flow issues, it convened a focus group of nonprofits to explore the problem and potential solutions. Before long, the foundation established a revolving pool of funds that are available in the form of cash-flow loans for nonprofits. The program was modeled after a similar program administered by The Eugene and Agnes E. Meyer Foundation in Washington, D.C.

"A lot of these organizations were facing serious timing issues with reimbursements from government and other foundations, and the loan program is our effort to help bridge the gap," says Greg Cantori, executive director of the Knott Foundation.

Debt is a form of capital that isn't an obvious choice for many in the nonprofit sector, but current research indicates that debt levels in the sector approximate those in the for-profit sector for organizations of similar size and development stage. Shari Berenbach, president and CEO of the Calvert Foundation, which provides an array of loans to nonprofits around the country, says that bridge financing like that provided by the

Knott and Meyer Foundations is only one form of loan capital that grantmakers can provide to nonprofits. Others include mortgages that offer more favorable terms than a commercial lender, pre-development financing for new projects, and loans to community development banks and other intermediary lending institutions.

An important decision for grantmakers who are interested in providing loan capital to nonprofits is whether to offer direct loans or work through an intermediary, Berenbach says. Calvert Foundation's flagship product, Community Investment Notes, provides a means for grantmakers and other private donors to pool their loan funds in a managed portfolio of loans to nonprofits. But even small grantmakers can develop their own in-house loan programs if they are willing to develop the in-house capacity to evaluate and manage the loans, according to Berenbach.

Direct loans to nonprofits fall into the category of "program-related investments" (PRIs) that grantmakers increasingly are turning to as an alternative, or supplement to, traditional grants to nonprofits. PRIs are a non-grant means of fulfilling the five percent payout goal of foundations and until recently were the only lending instrument available to nonprofits by foundations. PRIs are structured primarily as loans and are often made at very low interest rates to nonprofits. Once the loan is repaid, the foundation can reuse the funds for other PRIs or grants. PRIs can help a foundation make a larger and longer-term commitment to a nonprofit, which is particularly important at the start-up stage. For instance, The Annie E. Casey Foundation's average grant is \$75,000 while its typical PRI is \$500,000 to \$1 million.³³

³³ Kelly, John. "A Push for Investments Instead of Grants," *Youth Today*, Sept. 1, 2008. Available at http://www.youthtoday.org/publication/article.cfm?article_id=2220.

The F.B. Heron Foundation made its first PRI in 1997; it was a loan to New Jersey Community Capital to expand and improve its child-care facilities. As its PRI portfolio has grown, the foundation has pursued an array of investment opportunities, including insured deposits at fledgling, rural credit unions at below-market rates; senior loans to small business loan funds, such as North Carolina-based Self-Help Ventures Fund; subordinated loans to provide credit enhancement for affordable housing development; and private-equity venture funds. At \$22 million, Heron's PRI portfolio offers a steady return, measured against a benchmark of the long-term inflation rate plus one percent, without any losses to date.³⁴

While PRIs help circulate money within the nonprofit sector, they can be cumbersome and costly to set up, especially for smaller grantmakers. An alternative to launching your own PRI program is to invest in intermediary organizations that make PRI-type investments. These can include organizations ranging from narrowly focused community development financial institutions (CDFIs) such as Nonprofit Finance Fund in New York, to broader ones that provide investment capital for housing, small business and other community projects. CDFIs also include community development banks, credit unions, microenterprise loan funds, nonprofit facilities funds and venture capital funds. Calvert Foundation is a CDFI intermediary that operates like a fund of funds.

Yet another alternative for grantmakers seeking to make non-grant investments in for-profits is a new legal structure currently being discussed called a low profit liability company, or L3C.

The L3C is a new form of limited liability company (LLC) that combines the best features of the LLC with the social conscience of a nonprofit. It uses PRI rules to bring together foundations, businesses and private investors to make important investments that otherwise would not occur. Vermont is the first state to enact this new type of company and legislative efforts are currently underway in Georgia, Michigan and North Carolina.

The L3C model is designed to attract both private and philanthropic investments to ventures designed to have a social benefit. To the extent that it is embraced by more states, it could provide grantmakers with yet another way to direct new capital to innovative for-profits and nonprofits while sharing the risk with other investors.

Questions for Grantmakers

- ▷ To what extent would your grantees benefit from non-grant forms of support such as cash-flow loans and other kinds of program-related investments?
- ▷ How would the addition of PRIs and similar investments to your organization's portfolio affect its overall risk profile and return?
- ▷ Is your organization equipped with the staff and the capacity to manage loan programs, or would it be smarter to work through intermediaries to provide these funds to nonprofits?

³⁴ For more on PRIs, go to the Web site of the PRI Makers Network, <http://www.primakers.net>.

Bridge the Knowledge Gap

In addition to streamlining procedures and providing nonprofits with the types of support they need to be effective, grantmakers also can play an important part in ensuring that nonprofits (and colleagues in philanthropy) have a better understanding of key financial issues and how to sustain organizations over time.

Denver's Rose Community Foundation combines capacity-building support (including support for business and financial planning) with general operating support to selected grantees as part of its three-year BOOST program. "BOOST is based on the premise that financial health and good business planning are key to a nonprofit organization's performance, effectiveness and sustainability," according to the Rose Community Foundation Web site.³⁵

In total, the foundation invested \$2 million in the 10 organizations that made up the BOOST program's inaugural 2003-2006 class. Now the foundation is working with a second cohort of organizations. Participating organizations work with consultants to develop business plans and are awarded major grants for "operational upgrades" and for activities to carry out their plans. Among the results, according to an assessment of the inaugural class, was a new focus among the nonprofits on how to sustain strong programs over time. The most common use of the BOOST grants, according to the foundation, was to hire additional specialists on staff — particularly in the areas of development, marketing, finance and accounting.

"While many grantees made significant improvements in their financial resources, the most successful organizations experienced a fundamental shift in thinking and began to take a long-term perspective on both financial management and resource development," according to the foundation.³⁶

Grantmakers that do not want to take on the responsibility of managing a capacity-building initiative like the Rose Community Foundation example have other options for upgrading nonprofits' understanding of key finance issues. One option is to provide strategic guidance and advice to grantees on finance issues.

In a 2008 study, the Center for Effective Philanthropy (CEP) looked at the levels and types of "assistance beyond the grant" that grantmakers typically provide. Among the findings: The majority of grantees of a typical large foundation report receiving no assistance beyond the grant, a category that included everything from strategic planning advice to help with financial planning and staff and management training. The CEP study suggested that this type of "beyond the grant" support can be of enormous value to nonprofits, but that grantmakers should be wary of spreading this sort of help too thin. A better approach: "going in depth with grantees and addressing a range of needs rather than just one or two."³⁷

³⁵ See http://www.rcfdenver.org/initiatives_BOOST.htm

³⁶ Rose Community Foundation, "BOOST: Building Organizational Strength Together: Rose Community Foundation's Three-Year Capacity-Building Initiative," 2007. Available at http://rcfdenver.org/initiatives_BOOST.htm

³⁷ Buteau, Ellie, Phil Buchanan, Cassie Bolanos, Andrea Brock & Kelly Chang. "More Than Money: Making a Difference with Assistance Beyond the Grant," Center for Effective Philanthropy, 2008.

For grantmakers that may not have the wherewithal or the inclination to initiate their own finance-related capacity-building programs for grantees, another option is to work with other grantmakers to convene nonprofits for workshops on financial topics. In addition, grantmakers can work with management support organizations and other intermediaries to offer capacity-building support to nonprofits.

The Forbes Funds in Pittsburgh is an example of an intermediary that provides high-level capacity-building advice and technical assistance to nonprofits in partnership with regional funders. The Forbes Funds was formed in 1982 to support the work of the Pittsburgh Foundation. A leader in forging a regional approach to management support efforts, Forbes has been a central player in identifying needs in the nonprofit sector and in mobilizing resources to meet those needs.

Since the 1980s, and especially recently, Forbes has provided the catalyst for many of the most significant capacity-building efforts in Pittsburgh. Forbes started as an emergency financial-assistance fund for organizations that were affected by cutbacks in the Reagan Administration. It provided short-term loans, loan guarantees and capacity-building grants to nonprofits; built connections to the private capital markets in Pittsburgh; and educated nonprofits in capacity building. Today, Forbes is the only grant-making organization in Pittsburgh devoted solely to building nonprofit organizations' management capacity for human service and community development agencies. The Forbes strategy is regional and system-wide, in contrast to traditional management support agencies that tend to work with one organization at a time.

Other intermediary organizations providing similar services to nonprofits include Community Wealth Ventures, Nonprofit Finance Fund and the Fieldstone Alliance.

Questions for Grantmakers

- ▷ What can your organization do to strengthen grantee understanding of key finance and business planning topics — for example, through enhanced capacity-building support or grantee workshops and other convenings?
- ▷ To what extent does your organization's program staff have a grasp of key money issues in the nonprofit sector? What can you do to enhance their capacity to help grantees in these areas?
- ▷ Are there intermediaries that can help your grantees strengthen their capacity in these areas, and what can you do to support their work?

CONCLUSION

KNOWLEDGE, it is often said, is power. In the nonprofit sector, gaps in knowledge and understanding about key finance issues pose a substantial barrier to effectiveness and sustainability (and increased power to shape solutions) for nonprofits and grantmakers alike.

Grantmakers need a better understanding of what types of support can best help nonprofits succeed, and how to streamline the grantmaking process so that nonprofits can devote more time and money to mission fulfillment and less to completing applications and reports. And nonprofits (along with grantmakers) need to know more about topics such as business planning, financial management and resource development so they can move their organizations from a mode of month-to-month survival to actually building the infrastructure they need to sustain and grow their programs over time.

With this report, GEO has identified many of the systemic fiscal problems facing the sector, as well as an initial set of activities that grantmakers can undertake to ensure that nonprofits have the resources they need to succeed. Looking ahead, GEO hopes to initiate a wider and deeper conversation among grantmakers and nonprofit leaders about changes that are needed to make the world of nonprofit finance a saner, more reasonable place.

Many grantmakers are doing remarkable and commendable work to support nonprofits as they struggle to meet current service demands while planning and building for the future. GEO intends to continue sharing their stories, and to draw lessons from them that can benefit the field as a whole. The more knowledge that we can share on these issues, the more powerful our sector will be in addressing the crucial sustainability challenges facing nonprofits today.

Glossary

BUILD vs. BUY

Two different categories of nonprofit financing as described by Nonprofit Finance Fund's George Overholser. "Build" capital supports the growth and infrastructure of the organization, while "buy" capital supports current services.

CAPITAL STRUCTURE

The distribution, nature and magnitude of an organization's assets and liabilities. A nonprofit's capital structure is linked directly to the organization's underlying businesses.

DIRECT vs. INDIRECT COSTS

Direct costs are the costs directly incurred by a nonprofit in providing services or running a program; indirect or administrative costs (also "overhead") account for other costs to the organization of running that program, such as technology and facilities.

"FULL COST" ACCOUNTING

Accounting that measures the full costs of a given program or activity to a nonprofit organization, including direct and indirect costs (see above).

GENERAL OPERATING SUPPORT (GOS)

Grants in support of a nonprofit organization's mission and available for all operational costs rather than for specific projects or programs. As defined by GEO, general operating support is the "working capital" nonprofits need to sustain their day-to-day operations.

INFRASTRUCTURE

Technology, facilities, personnel and "back office" systems that allow nonprofits to sustain their organizations over time.

L3C (LOW PROFIT, LIMITED LIABILITY COMPANY)

A variation on the traditional LLC that brings together foundations, businesses and private investors to make investments in nonprofits and social causes.

MISSION-RELATED INVESTING

As defined by FSG Social Impact Advisors, mission investments are "financial investments made with the intention of (1) furthering a foundation's mission and (2) recovering the principal invested or earning financial return. Mission investing is a more specific type of social investing — the broader approach of considering social and environmental factors, whether or not related to mission, in investment decisions."

MULTIYEAR SUPPORT

Grants provided to nonprofits covering a period of two or more years.

NET GRANT

A calculation of the net costs to a nonprofit of a foundation's grant that accounts for the time and resources expended in applying for and reporting on the grant.

NEGOTIATED GENERAL OPERATING SUPPORT

A form of general operating support in which the grantmaker and grantee agree on certain organizational outcomes associated with the grant.

OVERHEAD

The indirect costs associated with running a specific nonprofit program or activity. (See also "Direct vs. Indirect Costs.")

PROGRAM-RELATED INVESTMENTS

A program-related investment (PRI), as defined by the PRI Makers Network, is "a tool foundations can use to leverage their philanthropic dollars. Unlike with grants, however, foundations get a return on their investment, through either repayment or return on equity." PRIs can include loans and lines of credit offered to nonprofits, as well as equity investments and other tools.

RESTRICTED vs. UNRESTRICTED FUNDS

Restricted grants are generally provided for a specific program or activity, but unrestricted funds can be used at the nonprofit's discretion to support operations, program, growth or other priorities.

SCALE

The growth of a nonprofit to deliver an optimum level of services to as many people or communities as it can serve effectively.

STRATEGIC CO-FUNDING

A partnership between two or more grantmakers to support one nonprofit or a group of nonprofits that are working toward a goal shared by the grantmakers.

SYNDICATION (OR AGGREGATION)

A funding model where a grantmaker aggregates the capital for a nonprofit and provides the grants management services on behalf of partner investors. In return, the nonprofit can carry out its business plan without spending countless hours cobbling together small grants and report to one entity that has agreed to mutual outcomes.

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