

THE NONPROFIT TIMES™

The Leading Business Publication For Nonprofit Management • www.nptimes.com • \$6.00 U.S. January 1, 2009

STREETSMART NONPROFIT MANAGER

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What To Expect

The sector is recession resistant, not recession proof

The 'R' word has now been confirmed and it's officially time to consider the implications.

Start with this truism: The nonprofit sector is recession resistant, not recession proof. To understand why this is the case, consider the differences between nonprofits and for-profits.

The for-profit set-up is based on a simple transactional model involving a buyer and a seller exchanging value directly with each other. The virtue of this model is its elegant simplicity. Its downfall is that it can quickly be disrupted if either the buyer or the seller decides not to participate in future transactions.

By contrast, the bulk of nonprofit activity is a three-way relationship between the funder of the services, the consumer of the services, and the supplier of the services. On the face of it, this would seem to be just as fragile a relationship as the two-way commercial one. But it is actually a more stable model because the single most important source of funding has to be from the general public in the form of donations or government contracts or grants. (For more on this idea, see *Three Corners* in the June 2008 issue of *The NonProfit Times*).

COMMERCIAL ACTIVITY REACTS FIRST

One of the characteristics of the standard commercial transaction is usually its immediateness. The buyer and seller both have parallel interests in carrying things out in more or less the same time frame. Buyers want to use the product or service quickly, and sellers want to get paid quickly. During a recession, that immediateness gets amplified because either buyers or sellers pull out of deals faster and in greater quantity than in normal times.

In the nonprofit world, the "public support test" that charities must pass requires

them to get a significant portion of revenue from the general public in the form of donations and grants, or as government funds of some kind. Donations and grants, as any development person knows, represent the hopes of the givers. Their expectations are for future social benefits from the activities their funds support. The key is that the expected use of the funds – and definitely the social benefits – are months in the future, perhaps even years. Unlike in a commercial transaction, the average donor does not expect immediate results. Large institutional donors, such as foundations, are encouraged by tax law and the realities of giving to maintain predictably smooth giving cycles.

Government funders might expect immediate results for their dollars, but stability and predictability are one of the supreme achievements of any governmental system. Changes, whether positive or negative, tend to come slowly because government's role is to set the tone for the larger economy. This all adds up to a prescription for delay.

PHILANTHROPY REACTS LATER

This effect last was observed at the beginning of this decade. The tech bubble of the late 1990's officially burst in March of 2000. Here is what happened back then. Donors had already donated a good portion of the funds to be used by many charities during the previous fall, always the peak giving time for tax and cultural reasons. So those funds had already been taken up by the receiving charities and slotted for use in 2000 by the time the bubble burst.

The glide path down from the burst took several months to get established. Nonprofits with fiscal years ending in June were probably minimally affected. Those with fiscal years ending in September were similarly spared, especially because organi-

zations with September year-ends typically get a large part of their funding from the federal government.

But by the time giving season rolled around again in the fall of 2000, the downturn was firmly established. It became rooted during 2001, and fiscal years ending during that period (and later) typically registered massive red ink.

Individual donors hold back from giving during the front end of a recession. Private foundations don't necessarily feel a recession the same way, but the money available for grants declines because the value of portfolios drop along with the general economy. Foundations interested in perpetuity will follow formulas that begin ratcheting down total funds available for gifts. But none of this affects nonprofits with the immediacy characteristic of commercial transactions.

This is the essence of why the nonprofit sector is recession resistant, not recession proof. Bad news unfolding in the larger economy takes a while to reach nonprofits the way a severe thunderstorm is seen well before it rattles the eardrums.

The reverse is true too. Donors, burned by the recent downturn, might hold back a bit until the good news is confirmed. Foundations might see the good news in the value of their portfolios, but the same cautious grantmaking that was slow to accept the downturn will be slow to embrace the up-tick. Once reduced, government funding typically takes a while to return to previous levels, if it ever does.

There is every reason to expect that this recession will act like previous ones. In many ways, it already has. State governments, major funders of large swaths of the nonprofit sector since Ronald Reagan bent the revenue streams in their direction away from the federal government, starting making serious cuts during the last several months of calendar year 2008. The biggest

effect of those cuts won't really start showing up in nonprofits' revenue lines until right about now.

Private foundations started pulling back during the second half of last year. The grants they would have made in 2009 will leave budget holes in nonprofits that managers will be scrambling to fill in the early months of 2009. They will conclude that immediate action is necessary (if they haven't already), and the cuts that ensue will spread throughout the rest of that calendar year.

Red ink will flow in abundance next year, as virtually all endowed organizations will take unrealized losses. Many foundations will cut back and/or slow their pace of grantmaking. These losses are already locked into place at the time of this writing, barring a record-setting Wall Street comeback. Next year's recession resistance will decline dramatically as operating revenues decline due to short term givers' reflexive reaction to the economic pinch.

What the market loses, it usually regains. Eventually, stable economics will return. Short-term givers will rebound first, and the big money from endowments and Wall Street-driven activity will start coming back next. Street-smart managers will be anticipating the signals of the rebound, having taken whatever advantage they can while things were going downhill. (See "Opportunity is Knocking" in the January 2008 issue of *The NonProfit Times* for how to do this). They'll be ready to do the same as the upswing gains momentum. This route is already charted. It needs only dates and timelines to be complete. This too shall pass. *NPT*

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