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Best Practices for Financial Success in the Nonprofit Sector

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Best Practices for Financial Success in the Nonprofit Sector



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Abstract

With the recent upturn in economic success over the past year, United States citizens are poised to contribute to nonprofits and philanthropic causes. This project attempts to establish the best practices for financial success in the nonprofit sector as nonprofits look for an increase of funding from this philanthropic surge.

Research Question

In the Nonprofit sector, what practices and methods are most successful for reaching financial sustainability and resiliency?

Competencies addressed:

- Financial Resource Development and Management
- Future of the Nonprofit Sector

Methodology

In order to effectively compare nonprofits financially, we decided to focus on nonprofits that all performed similar functions and that were located in similar environments. This led to us comparing four well-known museums in similar United States metropolitan areas: Los Angeles, California and Phoenix, Arizona. By nature, these nonprofits exist and serve similar communities of interest, and they all file similar financial records. After establishing which organizations to target, we performed the same financial and managerial analysis for each group and drew conclusions about which practices were successful and which practices were not. We also consulted five pieces of scholarly research to draw other conclusions about our subject matter.

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Literature Review

Bowman, Woods:

- Financial capacity is sustainable in the long-term if the rate of change is enough to maintain assets at replacement cost
- The principle in which managers are given a short-term budget surplus in order to achieve long-term sustainability
- Long term equals sustainability, Short term equals resiliency

Weerawardena, Jay, Robert E. McDonald, and Gillian Sullivan Mort:

- Because the environment is increasingly more competitive, nonprofits need to adopt a focus of organizational sustainability in the areas of strategic and operational management
- The organization has to maintain fiscal responsibility in order to fulfill and develop their mission
- The organization needs to be more proactive in operational decisions
- A nonprofit must be profitable
- Innovation is an area where nonprofits can gain an advantage which will develop new ways of bringing higher quality to customers

Kaplan, Robert S:

- Introduces the method of the balanced scorecard to measure performance and manage the organization more effectively
- The scorecard includes the financial, internal, and customer perspectives as well as a section focused on both learning and growth, with each portion looking at objectives, measures, targets, and initiatives.

Ben-Ner, Avner:

- Operational efficiency needs to improve for nonprofits to remain competitive
- This can be aided by audits that are more strict and through management having more control placed upon them by stakeholders in regards to budgetary and operational information

Herman, Robert D:

- An organization's overall effectiveness is linked to board effectiveness and to good management practices
- These management practices are likely not universally applicable as there will be distinguishing factors between types of nonprofits
- To determine best practices, look at organizational responsiveness

Overall, the literature emphasizes the importance of organizational and managerial effectiveness. These two principles are critical to financial sustainability in the nonprofit sector. They are also important factors in helping the nonprofit sector stay relevant in an increasingly competitive market. This can be accomplished through implementing policies and measures like the balanced scorecard or through practices such as greater control over management on the part of nonprofit stakeholders.

Findings

Financial ratio analysis was applied to each of the four museums. Data concerning their asset structure and income and expense makeup for the past three years was taken from their Forms 990. These were used to calculate ratios that examined profitability, efficiency, solvency, and leverage, allowing us to compare the four nonprofits more effectively.

Results

Our ratio analysis found that financially sustainable organizations did the following:

- Maintained a proper amount of debt; neither so large that interest is unbearable nor so small that capital is restricted (found by using leverage rates).
- Utilized fundraising professionals and other resources to maximize effectiveness (found through correlations between overhead and income).
- Considered their unique circumstances to decide whether the appropriate route to sustainability was cutting expenses or maximizing revenue (found through profitability and efficiency ratios).

Analysis

- Smaller museum establishments have employed various techniques to avoid closure due to a lack of funding and mismanagement. Techniques used to increase overall visitor enjoyment include technologically advanced exhibits and interactive exhibits.
- Although advancements are generally improving program attendance, the costs of such programs has increased.
- By understanding what is needed for a nonprofit to be financially stable (particularly museums), these institutions can better prepare themselves for their financial future.
- A thorough self-examination of practices and strategies can ensure that these programs have sound strategies in place for developing revenue and fundraising opportunities, securing donations, investment and asset management, and how to manage a decrease in these funds.

Implications for Research

Our research suggests that our results would be accurate and applicable across many nonprofit markets and industries regardless of size, and that our process could be used to effectively analyze best practices as determined per market or specific needs.



Phoenix Art Museum