



Briefing Paper No. 1

The Impact of Economic Recession on Nonprofit Organisations*

This paper is based on a presentation given to a workshop jointly hosted by DVA Navion and the Asia-Pacific Centre for Philanthropy and Social Investment at Swinburne University of Technology (a founding partner of CSI) on 28 April 2009 in Melbourne.

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The Centre for Social Impact (CSI) is a bold partnership between the business schools of the University of New South Wales, the University of Melbourne and the Swinburne University of Technology. It brings together the committed hearts and business heads of the philanthropic, not-for-profit, private and government sectors in pursuit of social innovation. It provides socially responsible business management education and research in the common cause of building a stronger civil society for Australia.

The CSI briefing papers are summary papers describing a topical issue and its impact on the third sector.

* This paper complements *The Challenge of Economic Recession for Nonprofit Strategy*, June 2009.

The distinctive nature of nonprofit enterprise

There are more than 40,000 economically significant nonprofit enterprises in Australia. A significant proportion are social welfare organisations, often defined by their 'charitable' status. Most operate as businesses and many of the larger ones have for many years operated commercial arms as a means of raising revenue that can be directed to community benefit.

Yet while they experience many similar challenges to small and medium enterprises in the private sector - such as how to raise and allocate capital, build organisational capacity, manage cost-effective performance and scale-up their operations – they share a number of distinguishing features. They are often dependent on volunteer effort and their paid employees tend to be comparatively lowly-paid and work within relatively flat structures of authority and remuneration. Their outcomes are defined in terms of their social mission. Although many closely monitor their costs of operation it is far harder to measure social returns on their investment than for listed companies which can report operational earnings, returns on equity, profits and shareholder value.

However, at a time of economic downturn, nonprofit businesses share one particular characteristic that presents the greatest challenge of all – their heavy dependence on third-party funding. In general they provide services to individuals irrespective of their ability to pay. Consequently a nonprofit's economic viability and financial security is not directly related to how good a job it is doing for its 'customers' or 'clients'. Rather a nonprofit's sustainability is significantly dependent on the generosity of third-parties: they look to the individuals, corporations and governments who support their community goals to subsidise the services that they provide.

This simple truth has major consequences. The fact that those who provide much of the income are not the direct beneficiaries of the services delivered means that nonprofit social welfare organisations are particularly susceptible to the revenue instability that accompanies economic recession. The donations they receive – whether from socially responsible businesses or philanthropically-disposed individuals - are discretionary. As personal incomes and assets fall, corporate profits decline and the accumulated corpuses of foundations shrink, so third-party support becomes less assured.

This is the particular challenge faced by nonprofit businesses at a time of global financial crisis and worldwide recession. Outcomes are uncertain. In Australia many will be hard hit; most will weather the storm; a small number will find opportunities to prosper and expand their activities but a greater number will struggle and some will not survive.

Doing it tough: an imaginary tale

In order to distinguish the diverse challenges of economic downturn, imagine a medium-sized, well-established nonprofit social welfare organisation. It operates mostly in Australia although it has recently expanded its activities to the Pacific. For many years it has successfully run commercial operations, directing the surpluses it receives into community benefit. With volunteer labour, it runs thrift shops. In the last few years it has sold branded items to supporters. Increasingly its commercial success has come from winning contracts for the delivery of government programs. Let us name this hypothetical venture *Social Impact*.

Social Impact is doing it tough. The extraordinary Board meeting just held, heard from the CEO that the organisation confronts no less than 10 separate but related challenges. She counted them out.

1. **Individual donations** are holding up fairly well, especially from those who have previously given to the organisation. A well-structured mix of face-to-face and online fundraising, including from direct mail, telemarketing and payroll giving, has been successful. Receipts indicate that donors are proving resilient. Early indications are that individual donations might be the same in 2009 as in 2008, although there is some concern that the public's generous response to the Victorian bushfires and Queensland floods might have a negative impact on future donations. Maintaining income level is not necessarily good news because *Social Impact* has been increasing its individual donations by an average of 5 percent over the last 7 years, a growth that has been built into the business plan.
2. It seems that larger **gifts** from a group of high net worth supporters are under threat. Although only two major benefactors have withdrawn funding this year others, apologetically, have foreshadowed the need to reduce their level of support. Unlike in the previous two years no new PPFs (**prescribed private funds**) have shown an interest in providing charitable assistance. **Bequests** are still being received, but as most come in the form of property or shares, their value has significantly reduced.
3. Many of the **corporate partners** who support *Social Impact* have significantly reduced their profit forecasts, their share prices have fallen and a number are laying off 10-15 percent of their staff. Belt-tightening is the order of the day. It's likely that one significant long-term contract, expected to have been rolled over mid-year, will now be terminated. Right now there's a palpable sense that businesses are more focussed on the financial bottom line.
4. *Social Impact* has done well to keep a relatively large share of its assets in **cash**. Unfortunately falling interest rates are significantly reducing the expected returns on these investments, which have traditionally been used to help defray the costs of service delivery.
5. *Social Impact's* **investment holdings**, carefully accumulated over the last decade in a portfolio of domestic and international shares, property trusts and unlisted property, has fallen in value by about 35-40 percent since mid-2008. This can't just be borne stoically as a 'paper loss'. Dividend and rental returns on the corpus are down 15 percent. It now looks likely that it will be necessary to call upon some part of the savings which, until now, had been treated in the business model as if they were a form of cumulating endowment.
6. The **trusts and foundations** who have provided assistance in the past have also seen their endowments, and the return on those endowments, fall markedly. Although normal review processes are still in place it is already clear that distributions are falling and the value of grants is declining. Rejection notices are becoming more frequent. Multi-year commitments have been impossible to secure.

7. *Social Impact's* recent tender for a major **government contract** secured 3 years ago has been only partially successful, with 30 percent of the business being lost. Although unrelated to the economic downturn, loss of revenue as an 'outsourced provider' of government services has further exposed the vulnerability of *Social Impact* to the financial crisis.
8. **Commercial sales** of goods is falling significantly, to the extent that operations this year may move into the red.
9. The 2009 **annual fundraising dinner** looks like it will have to be cancelled given that corporate tables have proven unexpectedly difficult to sell. Although the high profile event usually only raises around \$250,000 (net) it has provided a useful vehicle for publicising *Social Impact* and its achievements. This important marketing spin-off will now be lost.
10. *Social Impact's* **costs** are continuing to rise. It's now clear that the increased salary bill associated with the 3 year collective agreement struck with staff last February is going to present a funding challenge. At the same time the costs of operating overseas have been increased by the decline in the value of the Australian dollar.

Now let me reiterate that *Social Impact* doesn't exist. I am not aware of any nonprofit organisation that is facing all 10 challenges right now. Conversely I know of very few nonprofits that do not anticipate the prospect of facing many of them in the months ahead. To a large extent these financial problems bear testimony to the discretionary nature of nonprofit funding.

At the same time, of course, the demand for social services is increasing as a direct result of the economic downturn. Homelessness is rising, employment is falling, financial hardship is increasing and signs of community dysfunction are becoming more evident. Demand for support, advice and counselling is soaring. *Social Impact*, like most of its real-world counterparts, is being squeezed by the recession from all sides: it faces high fixed costs and depends on an uncertain revenue stream as the demand for its services increases.

Doing it tough: the real world

Imagining *Social Impact* is the easy part. In truth the real world is a far more complex place. The one certainty is that any overall assessment of the impact of economic recession on nonprofit organisations will reveal a very mixed picture. Some organisations will find it easier to maintain revenue and generate income than others, some will have greater assets to fall back on and some have a far stronger network of collaboration to lend support.

The likelihood is that a pattern will emerge beneath the variability. Generally smaller, newer and less well-known organisations will find the adverse economic circumstances more difficult unless they have strong support at the local community level. Social welfare and emergency relief organisations will find it easier to gain donations than nonprofits that support arts and culture. Faith-based organisations will generally be more successful in maintaining their support base.

There is a darker probability. Almost certainly the effect of global financial crisis on nonprofit viability is going to get worse in the next year. In general the decline in donations to social welfare

organisations follows the nadir of the economic cycle. There is a significant lag between the start of a recession and the time when the full force of its impact hits. A study of major charities in the UK suggests that it takes about 17 months for changes in GDP growth (or decline) to be reflected in charity income. Remember, too, that in a typical financial crisis it takes more than three years for sharemarkets to reach their trough and more than four years before unemployment peaks. The severity of the present downturn suggests that nonprofits will be 'fundraising in a cold climate' for some years ahead.

The extent of the decline in funds is harder to estimate. A 40-year study in the USA (1959-1999) suggests that, adjusted for inflation, philanthropic donations rose at an average of 3.0 percent annually but, in years in which there were at least 8 months of recession, giving fell 2.7 percent. The key message lies not in the exact percentages but in the need to compare declines in income not against zero but against the anticipated real annual growth that, most likely, has been incorporated into organisational planning.

More recent statistical evidence confirms these long-term trends in the US. The most up-to-date Index of National Fundraising Performance (which is based on the experience of 75 American nonprofits) indicates that revenue was down 3.3 percent in 2008 compared to an increase of 3.1 percent in 2007. Almost two-thirds of organisations are facing declines both in revenue and in donor numbers. A separate survey by the US Nonprofit Finance Fund found that whereas 40 percent of American charities had ended last financial year with an operating surplus, just 12 percent expected to do so this year.

There can be little doubt that, from the perspective of grantmaking foundations the crisis is continuing to worsen. A survey of American foundations found that their giving had actually increased 2.8 percent in 2008, but that the warning signs were already apparent. Of the 1,200 foundations who had responded a year ago only 29 percent had anticipated that they would reduce giving in 2008 – in fact, the figure turned out to be 47 percent. Greater pessimism now prevails. For 2009 slightly more than 67 percent expect to lower the total value of their grants.

The figures from Australia are less comprehensive but equally suggestive. Givewell has undertaken a survey of fundraising appeals, events and campaigns conducted since July 2008. Data from 196 respondents suggests an overall decline of 4.2 percent between 2007-08 and 2008-09.

The good news is that many Australian nonprofits are in a relatively healthy position to weather the coming storm. A decade of prosperity has seen gross revenue rise by an average of 9.4 percent per annum between 1998 and 2008. Even though the generation of stockpiles stalled in 2008, more than three-quarters of nonprofits surveyed are entering the recession with a surplus. The question is whether the resources will be sufficient to meet the rising demand for services and offset the decline in income.

References

The surveys referred to in the text can be found at Dennis O'Connor & Deidre Hatch, Fundraising in a Cold Climate. An Analysis by 2 into 3, 6 October 2008; Helen Flannery, Rob Harns & Carol Rhihe, Index of National Fundraising Performance: 2008 Fourth Quarter Results, April 2009; nfpSynergy, What Happens to Charities in a Downturn? June, 2008; Foundation Centre, Foundation Growth and Giving Forecasts, 2009 edition; and Givewell Research, Fundraising Appeals Survey 2009, March 2009 and 2008 Interim Charities Financial Analysis, March 2009.

