

Nonprofits and the Economic Recession

A Discussion Paper

Laurie E. Paarlberg, Assistant Professor
Master of Public Administration Program
Department of Public & International Affairs
University of North Carolina Wilmington
601 S. College Rd.
Wilmington, NC 28403-5607
(910) 962-2291 paarlbergl@uncw.edu

Since September 2008, we have all been bombarded with news about the economic crisis—declining home values, sinking retail sales, tightening of credit, record stock market losses, declining value of pension funds. Like many of you, I have been tempted to put my head down and ignore the current situation and “wait for it to end.” However, as a professional who studies nonprofit organizations and their management, I’ve been concerned about the conflicting information that we’ve received about what impact this crisis will have on nonprofit organizations. On the one hand, there is analysis of previous economic recessions that suggests that philanthropic giving is generally “recession proof.” In other words philanthropic giving generally holds up very well during economic downturns and does not experience as steep drops as the market—suggesting that nonprofits are recession proof. On the other hand, mounting anecdotal reports from a variety of sources suggests that by the fall of 2009, most nonprofit organizations were experiencing a perfect storm of increased demand for services, increased costs of operations and decreased revenues. More than one-third of organizations had made cuts to operations (National Council of Nonprofits). I’m generally an optimist—I wake up each morning believing that a wonderful day awaits me and it can only be better than the day before. However, the recent economic crisis and current economic recession, convince me that for many nonprofit leaders, the future does not look like yesterday.

In this discussion paper, I’d like to offer my perspectives on how why this downturn might be particularly damaging to philanthropic giving, especially at the individual level and some suggestions on how nonprofits and the broader nonprofit community might strategically approach this nonprofit world. I am not someone who has a special training in economics or other matters particularly relevant to the general economic conditions, nor do I have a crystal ball. Instead, I offer these observations as someone who tries to pay attention to what is happening in the nonprofit sector.

Part I: Our current economic downturn and its impact on philanthropic giving

Nonprofits have complex revenue structures, receiving revenue from a multitude of sources—including individuals, government, foundations, churches and other community groups, as well as corporations. In addition, this revenue takes many forms—donations, fees and other earned income, membership dues, investments, grants and contracts. The complexity of funding sources makes it difficult to predict with any certainty what this crisis means for the sector as a whole. Let’s take a moment to review what we know about private philanthropic donations and past economic downturns and then explore why giving during this current downturn may “not hold up”.

Nonprofits and the Economic Recession

What we know about previous downturns:

First, it is clear that trends in giving are related to the economy. People give more when the economy is up and vice versa. However, studies at the IU Center on Philanthropy suggest that swings in individual giving are generally not as severe as broader economic downturns. As the Center of Philanthropy at Indiana University reports, "During good economic times, giving tends to grow robustly. However, when the economy grows at a moderate or slow rate, philanthropy continues, although at a slower rate of growth". Melissa Brown, associate director for research at the Center of Philanthropy at Indiana University observes that donations to US charities have increased during thirty-nine of the past forty years. Most Americans tend to be "routine" givers even during downturns. A recent survey by World Vision suggest that some people may switch their spending, especially during holiday seasons, in order to continue to donate, giving to charity in lieu of a present exchange. Based upon declines in the stock market through November 2008, Patrick Rooney, interim executive director of Center of Philanthropy at Indiana University estimated a 4-5% decrease in individual giving. In general, philanthropic giving drops far less than the financial markets (Strom, 11/10/2008, Bracing for Lean Times Ahead. NY Times). As an example, professional fund raisers in the field of higher education believe that giving to higher education will only decline by about 1.7% in 2009 and that high wealth individuals maybe willing to respond more positively to appeals because they believe that their giving is "more important than ever." (<http://www.case.org/Content/PressRelease/Display.cfm?CONTENTITEMID=9109>).

Second, looking at foundation giving, a recent report by the Foundation Center concludes that during each of three most recent recessionary U.S. foundation giving in inflation-adjusted dollars remained stable (to read the rest of the report: http://foundationcenter.org/gainknowledge/research/econ_outlook.html). For example, in 2003, despite an average 16% drop in foundation assets between 2000-02, foundation giving dropped only 0.6 percent (4.4 percent after inflation). Several factors help to lessen the impact of reductions on foundation assets on giving levels. First, during the last two decades a generally strong economy resulted in increased gift to existing foundations (as evidence by Warren Buffet's gift to the Bill and Melinda Gates Foundation) and the establishment of new foundations. New money reduced the impact of declines in existing foundation assets. Finally foundations determine their level of grant making for any given year based on a rolling average of their asset values over the prior two-to-five years. The use of rolling averages helps to ensure more stable levels of giving.

Why giving during this economic downturn may be different?

Despite the generally positive outlook that I've describe with respect to historical trends in individual and foundation giving during previous economic downturns, the unique characteristics of this economic lead many nonprofit leaders believe that nonprofits will face unprecedented challenges during this crisis. Without reviewing the economic background of our current situation, it's important to note that this crisis is unprecedented in recent history in terms of its scale and scope. First, the 00-02 downturn had some geographical and industry bounds. For example, while the tech industry was declining in 00-

Nonprofits and the Economic Recession

02, retail, banking and financial services, and the real estate sectors were growing rapidly. In 2008, all industries in all parts of the country have experienced dramatic declines. As a result, while foundations on average lost 16% of their assets in the 00-02 recessionary downturn, foundation leaders estimated that foundations had lost an average of 30% of their assets during this fall's stock market decline. While sharp decline in asset values may not result in reduced giving in 2009, due to the use of rolling averages we can certainly expect that foundation giving in 2010 will reflect the drastic market drops of 2008.

Second, our current economic crisis has fundamentally shaken the average American's sense of long term economic security and may severely limit individuals' short term and long term ability to donate to nonprofits. Not only are unemployment rates rising rapidly, but individuals have experienced large reductions in assets, as a result of declining home values and investment portfolios. In addition, over the last two decades, growing consumer debt has meant that many Americans have used debt to fuel rising lifestyle spending, as opposed to increases in income. For example, increased access to consumer and home equity borrowing has meant that individuals could purchase a new car or other consumables on stagnant incomes, and still give to nonprofits, if they so chose. Individual donors face increasingly difficult lifestyle choices, but ultimately individuals can't donate what they no longer have.

Recent surveys of donors and professionals working in the fund development show how quickly the financial crisis has influenced giving patterns. As an example, the Council for the Advancement and Support of Education polled its membership of fund raising professionals in July 2008 and then again in January. In early July, these professional fundraisers on average expected to see a 5.3 increase in giving. In January 2009 they reported on average .3 percent increase, a significant drop from the 7% increase recorded in 2007 and significantly lower than predictions in July (CASE). Giving rates dropped immediately and dramatically.

In a random nationwide survey of 1000 adults, the Barna Group, a company that specializes in providing information to religious institutions, found that 68% of the respondents reported that they had been "noticeably affected" by the economic crisis. 22% had been affected in a "major way." During the last three months of 2008, almost 1/3 of all respondents reported reducing their gifts to nonprofits. A particularly ominous signal is reduced giving to churches. 20% of the households reported decreased giving to churches, and of those who reported reduced decreased giving, 17% reported reduced giving by up to 50%, while a full 22% reported that they had stopped giving to churches all together. (See the Barna Group for further details.

<http://www.barna.org/FlexPage.aspx?Page=BarnaUpdateNarrow&BarnaUpdateID=322>).

While declines in wealth and access to credit and their implications for giving in the short term are sobering, what may be most significant barrier to long-term contributions to nonprofits, is the loss of assets and retirement savings. Over the last three decades, individuals have increasingly assumed greater risks for their future through self-refunded market based retirement funds, and the number of individuals with guaranteed pensions has dropped. The loss of long term assets—home values and market based retirement funds-- that baby boomers had counted on for retirement may severely limit their ability to make larger gifts in the future. This may be a particularly important factor for giving levels in the Cape Fear region, which has witnessed an influx of retirees into the area in recent years.

Nonprofits and the Economic Recession

More importantly this crisis may have shaken individuals' confidence in the security of their future and their perception of their ability to be "philanthropists."

There is still a great deal that we do not know about how individuals and foundations and even government will act in the coming months. On one hand, we can hope that those who have the ability will realize that their gift is even more important now and increase their level of giving. We might also hope that as individuals seek to simplify their lifestyles that they consider increasing their participation and volunteering in nonprofit activities in response to growing community needs. There has also the possibility that foundations may trim administrative costs in order to shift additional resources to grant making. And then of course, we have little indication of how federal government stimulus programs will impact government funding of nonprofits.

However, while evidence from previous economic downturns presents a fairly optimistic picture of the impact of this economic crisis on nonprofits, the unique nature of this crisis suggests that 2009 and 2010 will present very difficult years for most nonprofits, particularly those that are heavily reliant upon individual giving and foundation giving and those that were already experiencing financial stress.

Part II: Local Implications: What this crisis might mean for the sector in our region

To bring the national economic crisis to home, it's important to consider the potential consequences that decreased levels of philanthropic may have on the nonprofits in our region. While I don't have a crystal ball or any special forecasting powers, we might have a better understanding of what the current economic conditions mean for the sector in our region if we first take a look at the "growing philanthropic divide" --a national trend--and the characteristics of the nonprofit sector in our region.

Philanthropic Divide

As a nation, our nonprofit sector entered, the economic crisis of 2008 with a resource divide between "elite nonprofit organizations" and community based nonprofit nonprofits. In a very illuminating article in the Chronicle of Philanthropy (1/8/08), Holly Hall descried a growing charitable divide that mirrors the growing income divide in the United States. Historically, nonprofits that provide social services, particularly community based nonprofits not affiliated with a national organization, have lagged behind the elite nonprofits, such as colleges, hospitals and cultural institutions in fund raising achievements. However, during past economic downturns, for example the downturn in 2000, charities of all kinds experienced declining donations. However, reporting in 2008, Hall notes that in the years leading up to 2008 that giving to social service agencies was flat or declining, while donations to "elite" nonprofits increased dramatically. On the one hand, increased giving to elite institutions is explained by the income divide in the generally population. High income individuals who on average experienced a doubling of income between 1979 and 2005 generally give to elite institutions. More than 44% of the donations from the wealthiest givers are given to colleges and universities. Not surprising since individuals often give to those causes or institutions that they have some personal connection to. As a result, elite institutions have built endowments and reserves that not only allow them to buffer themselves from economic downturns, but they have also had the resources to expand their fund raising staffs.

Nonprofits and the Economic Recession

In contrast, those families who earn less than \$100,000 per year have experienced less rapid growth in income in recent years, and these individuals account for 49% of all contributions to social service organizations. Hall posits that slowing rates of income growth through the end of 2007, resulted in slowing of contributions to the types of nonprofits middle income individuals usually contribute to: social service organizations. Job loss, decreased access to debt, and rising anxiety of middle class donors will likely hit social service organizations, particularly those without the brand recognition of a national name, the hardest.

The State of the Nonprofit Sector in Southeastern North Carolina.

In order to understand the implications for decreased philanthropic giving on nonprofit organizations, it's also important to understand something about the state of the nonprofit sector in any particular region. I did some preliminary analysis of the 501c(3) organizations in my local geographic region using data from their 990 tax reports collected by the National Center for Charitable Statistics. Analysis of that data suggests that the sector in our region is young and small and operating at the "edge".

Young and Small: First, New Hanover County has experienced rapid increase in the number of new nonprofit organizations. While there were 417 registered nonprofits in 2000, by 2006 that number had risen to 656. However, during that same time period while 161 of those organizations reported over \$25,000 in total revenue, by 2006 that number had only increased slightly to 205. Across the nation, the number of nonprofits had increased by 27% between 1995-2005.

From a positive perspective this indicates a tremendous explosion in civic engagement and an interesting in responding to community needs. However, with respect to the current economic crisis this suggests that a significant number of organizations may not have yet have the organizational history or the reputation in the community to survive during a sustained downturn.

In addition, 88% of the nonprofits in our region report total annual revenues less than \$250,000 per year, slightly higher than the national average of 85%. This suggests that many nonprofits in our region may not have the organizational capacity --particularly professional staff-- to compete with larger organizations in a turbulent environment.

Operating on the Edge: While some organizations may have accumulated reserves to tide them over during lean times, many nonprofits in our region are operating "on the edge." In 2006, median net income, for nonprofit organizations in our community was \$ 5,501! That means that half of the organizations in our region recorded net income, the income left after their expenses are met, of less than \$5,501. While nonprofits are not legally able to distribute their profits, net income or surpluses at the end of the year, are valuable. They allow nonprofits to build reserves for future lean times (such as 2008 & 2009). They allow nonprofits to prepare for unexpected expenses in the future, such as facilities repair. They also allow nonprofits room to develop in infrastructure--improved facilities, more sophisticated administrative support systems, and the professionalization of staff.

In conclusion, while social services across the country have entered this current economic crisis facing a growing divide between resources donated to elite institutions and those donated to meet local social

Nonprofits and the Economic Recession

service needs, the nonprofits in our region may face particular challenges responding to the current economic crisis. Nonprofits in our region are young and may have weak histories of support from local donors and foundations. Nonprofits in our region are small and already on the edge, lacking the ability to weather financial storms and decreasing their ability to invest in organizational infrastructure--such as professional fund raising or marketing systems--which might help them promote their cause. Finally, our nonprofits already have fewer resources to support community needs than do their peers in other parts of the state. We can only guess, but it would seem that the current economic crisis will have the most serious impact on those nonprofits that are young, small, and already have fewer resources to fall back on.

Part III: Strategizing under the Current Conditions

One of the most important questions that nonprofits are facing today is “how do we survive and continue to provide quality services to the community” under the current economic conditions? During difficult times, people are often likely to retreat, bury their head, reduce communication, and limit their interactions with others. I’d like to propose some very basic responses consistent with management theory that encourage organizations to be proactive, open and strategic. In addition, I’d also like to address the question of why the larger community should care about this issue.

What can organizations do?

1. **Consider multiple scenarios or possible futures**--While it may be natural and tempting for organizations to respond to the current crisis by saying, “we don’t know what is happening, we don’t have a clue as to what the financial stimulus package will mean for nonprofits...”, this approach puts nonprofits in a reactive mode. Instead organizational leaders can begin to think about multiple scenarios. At the most basic levels, leaders can begin to think about possible conditions that can have both negative and positive impact on their organization. For example a basic question might be, “How might we respond if higher unemployment rates lead to increased rates of volunteerism?” This question might lead the Board of Directors to consider if their organization is ready to handle such a possibility or would they even want to consider that as an option given their mission and model of service delivery. A more sophisticated use of scenarios might include projecting budgets at various levels--what if donations drop 10% or 20%, what would our budget look like?
2. **Pay attention to the “environment”**--During difficult times it is tempting to focus on the organization and all of the troubles that you are experiencing. However, this is also the most important time to pay attention to trends, even small trends in the environment. Producing scenarios and understanding the assumptions that underlie your current operations and the plans for the future are very important. For example if 2009 plans depend upon your organization receiving funding from a used clothing social enterprise, news articles that report drastic drops in retail sales may have important implications for your organization--both in terms of sales and future donations. The task of sifting through all of the information that we are constantly bombarded with can be lessened by expecting Board members to be involved in the process. This is a great opportunity to make sure that board members are aware of the strategic assumptions of the long term plans for your organization, they are aware of the “signs” that may indicate that these plans are under pressure and encouraged to use their diverse

Nonprofits and the Economic Recession

sources of information to be on the lookout for these signs, and are involved in on-going strategic discussions at board members.

3. **Establish open communication** –During difficult times individuals often shut down communications. Leaders don't want to share information with staff and are even more reluctant to share bad news with their community stakeholders. However, it is important to open communication during difficult times in order to both lessen fears that your diverse stakeholders may have and to make your stakeholders and the community aware of your organization's needs. Open communication allows board members and staff to be effective contributors to long decision making. In addition, staff who work in the field have important firsthand experience with many of the leading indicators for your organization's future and may offer important perspectives on options. Finally, providing donors and potential donors with evidence that your organization is a good steward of community resources and that your organization produces valuable outcomes for the community may help to develop donors.
4. **Resist the temptation to do "across the board cuts"** --One of the easiest ways to respond to a 10% decline in revenue is to administer 10% cuts across the board. However, such across the board cuts may further endanger programs and administrative capacities that are already "lean." An alternative approach is to prioritize activities and programs based upon performance, existence of alternatives, and ability to leverage other resources. Now is the time to critically examine expenditures relative to the value that they create. For example if one of the programs that you operate is a program that is an "average" performer and there are other organizations in the community that also provide this service, this might be a program that you might consider scaling back or closing. Such a shift in resources may allow you to pump existing resources into programs that you excel at and/or that fill a much needed gap in the community. Difficult times are great times to conduct a thorough portfolio analysis of your existing organizations.
5. **Seek out cooperative partnerships**--For the last five years, nonprofit organizations have heard the endless mantra that they need to work better together and collaborate more, breeding a "cult of collaboration." True collaboration is difficult and costly and in today's environment, few organizations may have the resources to invest in collaborative efforts that have not received external funding. However, during our current economic conditions, all organizations would greatly benefit from seeking out simple cooperative arrangements with other organizations. Such cooperative arrangements may range from administrative partnerships to share back office operations that reduce overhead costs to increased coordinated service delivery.
6. **Invest in productive activities**-During lean times, many nonprofit organizations cut administrative functions to the bone in order to continue to respond to community need. While laudable, such cost cutting measures often put the organization's ability to effectively manage and coordinate service and account for their resources at jeopardy. While nonprofits have to be particularly careful stewards of the community's resources during difficult economic times, lean times are an important time to invest in administrative functions that will have a long term impact on the ability of the organization to provide services. For example, returning to the possible scenario that this economic crisis might lead to an increase in volunteerism rates, for those nonprofits that rely heavily upon volunteers or might want to use more volunteers, now is a great time to design and implement a system to manage volunteers. Such an investment

Nonprofits and the Economic Recession

might yield an important low cost strategy for surviving the current downturn and pay important dividends in the long term. Today's volunteers often become tomorrow's donors.

For more information about nonprofits and the economic crisis and to see examples of how other non profits are responding, check out:

Bridgespan: <http://www.bridgespan.org/LearningCenter/ResourceDetail.aspx?id=2638>

The Chronicle of Philanthropy's Special Report at http://philanthropy.com/financial_crisis/.

What about just letting nature take its course?

On several occasions I've heard the comment "There are far too many nonprofits in our region. We have too much competition in the sector and duplication of service. Now is a great time for some of them to go out of business." This current economic crisis certainly raises the potential that some nonprofits will indeed drastically curtail operations or close shop. From a community perspective, there are several important dangers of allowing "nature to take its course."

1. Nonprofits are important contributors to our economy--providing jobs and bringing resources from outside foundations and state and federal government to our community.
2. Nonprofits provide many instrumental services that government and business cannot and do not provide. There is probably no question in any one's mind that the social needs of our community far exceed the services currently provided by the nonprofits in our community.
3. Nonprofits provide an opportunity space for individuals to join together to address common concerns and express their values through volunteering, donating, and serving as board members. Would we want to imagine a community without the potential for such a high level of civic engagement?
4. Who is to decide which nonprofits will seek to exist? And how will that be done? If some nonprofits in our community close during this economic downturn, we have no assurance that the "right" organizations will close. It is very possible that some of those organizations that close will be good stewards of the community's resources and provide valuable benefit to the community. Forced closure due to hard economic times may certainly exacerbate existing gaps in the service delivery system.

The current economic crisis makes it very important that nonprofit leaders, staff and board members, strategically prioritize activities and engage their stakeholders in their future. However, the current conditions also require that the community fully understand the significance of the nonprofit sector, and become involved in efforts to strengthen our sector during these difficult times.