Is Running a Nonprofit with a For-Profit Vision the New Normal?

By Adam B. Cole, CPA

Alleviating homelessness. Providing healthcare. Advancing educational and economic opportunities.

While nonprofit organizations may have a social purpose, they are, by definition, businesses that need to focus on profitability to further their mission. Like their for-profit brethren, they must have sound governance and financial practices, including a way to measure outcomes and return on investment (ROI), that can support their growth and help them maximize funding, mitigate risks and better serve their constituents. Without strategic operational investments, nonprofits risk failing to build up the foundation they need for sustainable success.

Here are three key lessons from the for-profit world that can strengthen nonprofits' long-term growth:

Lesson #1: Don't Starve Operations to Feed Programming

Roughly 1 in 5 nonprofits surveyed in *Nonprofit Standards*, BDO's 2018 nonprofit benchmarking survey, report spending between 90 to 99 percent on program-related expenses. Charity rating sites have put additional pressure on organizations to minimize their overhead spending. The unfortunate consequence is that many donors now assume, incorrectly, that low overhead costs are a good measure of a nonprofit's performance — what is commonly referred to as the "overhead myth." Low overhead may serve as a nice, short-term talking point for donors, but it's an unsustainable strategy.

In reality, high programmatic spending could mean the organization is underfunding critical areas necessary for long-term growth — a phenomenon known as the "starvation cycle" that creates an unhealthy environment for the business. Failing to invest in infrastructure such as new technology (including cybersecurity), employee training and fundraising expenses can be detrimental to organizational growth. Nonprofits must look at their operations with a more critical business mindset to find the appropriate balance between programmatic spending and the investments required for future growth. Key questions to explore include:

- Is the current level of programmatic spending sustainable in the long run?
- Should we invest more in expanding programming, or improving existing programs?
- Why are some programs having less of an impact than we hoped? What improvements would enable us to have a greater impact with constituents?
- What is the primary thing that could help advance the organization's mission the most? What would that require?

Lesson #2: Make Strategic Investments in Future Growth

Healthy organizations always have an eye on the future. Planning for mission-driven growth can take many forms. In some cases, growth opportunities take the shape of a strategic partnership with a similar nonprofit or acquiring another organization that can help advance the mission.

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In other cases, growth might require new resources that can help the organization address emerging challenges. For example, many nonprofits are re-evaluating donor outreach strategies as millennials and younger generations become a more powerful philanthropic force. Growing up in the age of social media and other technologies, millennials expect greater transparency from nonprofits about their impact. Financial reports must better reflect the information they desire. Fundraising campaigns may also need to change to reach this more tech-savvy generation, requiring organizations to experiment with new giving models and to diversify fundraising tactics. (See related article, "Survival Tips for the New Era of Fundraising" in the Spring 2018 *Nonprofit Standard.*). Growth-focused organizations are continuously assessing changing constituent needs and donor behaviors to adjust course appropriately.

Lesson #3: Prioritize Sound Leadership

Successful organizations have strong leaders at the helm, but they also plan ahead for the inevitable day when a change in leadership must occur. Unfortunately, leadership succession planning is often neglected in the nonprofit world, where devoted leaders often stay for long tenures and/or are hesitant to pass the reins to a new leader. As such, succession planning is one of the top concerns for nonprofit boards, according to BDO's *Nonprofit Standards* survey. (See related article, "Compensation Committee Wake-Up Call – the 'Other Obstacle' to Leadership Transition" in the Fall 2018 Nonprofit Standard.)

A standard business practice for large corporations, succession planning is critical to ensuring an organization's mission doesn't falter when a new leader takes over. This process includes multiple steps, from getting board and employee buy-in, to drafting a reasonable timeline, to communicating to key stakeholders about the change. As part of this process, it's also critical to examine what leadership qualities will help the organization achieve its future goals. Keep in mind that the best solution isn't always what works well now. As nonprofits embrace a more business-oriented mindset, for-profit business leaders and private equity investors are increasingly popping up on the board of nonprofits.

Assessing the Impact

Adopting a business mindset won't fix problems overnight, but it will start to push a nonprofit to ask more critical questions about its future growth and where to make the right investments.

One study by Stanford University Professor Walter W. Powell and a team of graduate students examined the managerial practices of 200 nonprofit organizations over a decade. Powell observed, "In the early part of the study, we saw the growing adoption of managerial processes commonly associated with business. For example, using auditors to perform internal financial reviews." His team found that nonprofits that were early adopters of managerial practices gave more attention to strategic planning, pursuing operational efficiencies and measuring progress. Ultimately, those organizations were more transparent, and less insular, actively collaborating with other organizations.

Strong nonprofit leaders must connect their passion for their organization's mission with a more critical, business-savvy mindset. Borrowing for-profit business strategies won't cloud the mission; instead, it can help organizations better clarify how to navigate new challenges and opportunities to reach its desired vision.

Adapted from the Nonprofit Standard blog.

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