

E X E C U T I V E S U M M A R Y

Passion & Purpose

Raising the Fiscal Fitness Bar for Massachusetts Nonprofits

The Boston Foundation



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Preface

This report is titled *Passion & Purpose* because almost all nonprofit organizations begin with a deeply felt sense of mission on the part of a group of people or, in some cases, an individual. After that initial spark, however, the rubber hits the road and the real work begins. And as nonprofits evolve over the years, a whole host of issues surface, many of them related to organizational growth and financial stability.

You will find a tremendous amount of detail about the Commonwealth's nonprofit sector in these pages—not only its finances, which are the primary focus, but its size, scope, workers and geographic reach. There are close to 37,000 nonprofit organizations in Massachusetts generating more than \$86 billion in revenues and holding some \$207 billion in assets. Almost 14 percent of the Massachusetts workforce is employed by nonprofits. The diversity within the sector is also striking—embracing everything from small theater troupes in the Berkshires to human services agencies in every part of the state—to one of the most richly endowed universities in the world.

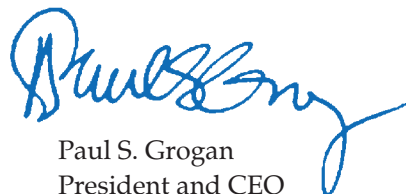
But this report is not only descriptive of the sector. It sounds a very serious alarm about how stressed and extremely vulnerable our state's nonprofit sector is in today's economy and issues a clarion call to nonprofit organizations, especially those that are small and mid-sized, to consider innovative, even bold strategies to buoy their chances of surviving in uncertain times. This call goes out not just to the staffs and boards of these organizations, but to all of their stakeholders and supporters, including government, foundations and individual donors.

One of the major challenges facing the nonprofit sector in Massachusetts today is its dramatic growth over the last two decades. In just 18 years, the number of public charities in this state has virtually doubled. In an expansive, booming economy, this kind of growth might be welcome or at least sustainable, but in an economy that is shrinking, it is cause for serious concern.

History tells us that when our economy goes flat, the government's instinct is to cut funds. It took years for the nonprofit sector to recover from the economic downturn that started in 2001 and was exacerbated by 9/11, when cuts in government support choked support for the kinds of basic human services that so many nonprofits provide.

The good news is that today the nonprofit sector in our state has more going for it than ever before. Until recently, Massachusetts was one of just a few states without an association to represent the interests of its nonprofit organizations. But in 2007, hundreds of nonprofits statewide began to find their voice and speak as one when the Massachusetts Nonprofit Network was created to strengthen the sector through advocacy, capacity-building and public awareness.

And now, with this detailed report, we have the power of information and a series of specific recommendations for shoring up this all important sector. So, in addition to providing a tremendous amount of data and analysis, we hope that this report will open a dialogue about how to strengthen the Commonwealth's nonprofit sector and help to prepare it for hard times, whenever they may come.



Paul S. Grogan
President and CEO
The Boston Foundation

Introduction

“The 21st century will be the century of the social sector organization. The more economy, money, and information become global, the more community will matter. And only the social sector nonprofit organization performs in the community, exploits its opportunities, mobilizes its local resources, solves its problems. The leadership, competence, and management of the social sector nonprofit organization will thus largely determine the values, the vision, the cohesion, and the performance of the 21st century society.”

—Peter Drucker, Leader to Leader Institute

The nonprofit sector plays a vital role in supporting the long-term needs and well-being of our state and our nation—from providing health care and social services, to offering a platform for arts and culture, to coping with everything from economic downturns to global warming. Strong financial health is essential to fulfilling these all-important roles, yet scholars and skeptics both express serious concerns about the sector’s weak financial health—with debates ranging from questions about the sector’s ability to sustain vital services to concerns about its inefficiencies and duplication of services. Some argue that the sector’s financial weakness is due to the rapid proliferation of organizations that are competing with each other for financial resources. Others view the shortage of funding as a serious threat to the fabric of the entire sector.

Notwithstanding these concerns, the Massachusetts nonprofit sector is an unmistakably major contributor to the Commonwealth and its economy. The economic importance of the nonprofit sector’s 36,748 nonprofit organizations is clearly evident from its earnings of \$86.7 billion in revenues and \$207.1 billion in total assets in 2007. With more than a quarter of these revenues spent annually on compensation, the nonprofit sector is also a solid source of employment in the state, employing well over 447,642 people or 13.8% of state’s workforce. Public charities comprise the majority of the sector (23,886 or 81%), generating \$70.4 billion in revenues with \$168.6 billion in total assets.

However, the true value of the nonprofit sector lies in its ‘public purpose’. From reducing health disparities, to counseling families facing home foreclosures, to providing higher education, to training immigrants for jobs in the new economy, Massachusetts nonprofits *provide critical services*. They *advocate for change* on important community issues from civil rights to the environment, and *express community values* and *invigorate life* into our communities through arts and cultural activities. They engage thousands of volunteers and workers and bring personal passion and commitment to serving the public good. They *build the community’s social capital*, *foster innovation* and *spur social change*.

Abolition. Suffrage. The great cultural institutions constructed at the end of the 19th century, such as Symphony Hall and the Museum of Fine Arts. The affordable housing movement. The most extensive network of Community Health Centers in the country. The creation of First Night. The founding of City Year. Stories of the nonprofit sector’s impact illuminate the history of the Commonwealth, reminding us of the numerous times that collective civic action gave rise to the civic institutions and social movements which have shaped our country, enriched our society, and improved the quality of all of our lives. Most of all, nonprofit organizations offer numerous benefits that are neither the purpose nor the purview of the private and public sectors.

A deep look at the nonprofit sector uncovers three primary value propositions: 1) *the creation of a civil society through grassroots action and volunteerism*; 2) *the provision of societal benefit and a 'safety net' through the delivery of services and quality of life contributions*; and 3) *large-scale services and contributions to the state's economic health and competitiveness*. These three value propositions are represented by three different segments of the sector. Distinguished in this report as "Grassroots" organizations, "Safety Net" organizations and "Economic Engine" organizations, these three segments typically exist in a variety of business environments and exhibit differing financial health indicators. They encompass the broad diversity of the sector and urge us to look at practices of running and funding nonprofits with a more nuanced view of the value of the sector, as we make hard decisions about how best to enhance the entire sector's capacity to meet its stated purposes.

This report examines the overall health of the nonprofit sector, with a particular focus on financial health. What types of organizations exhibit strong or weak financial attributes? Does financial health vary by budget size? Do organizations in certain sub-sectors exhibit greater financial strength? What factors are associated with better financial health? The answers to these questions form the basis for a series of recommendations related to restructuring and consolidation, as well as changes to the funding strategies and policy implications necessary for the sector's future sustainability. This report represents not the end but the beginning of a dialogue that ultimately will strengthen the entire sector—building on the powerful combination of passion and purpose that drives nonprofit organizations to innovate, to excel, and, always, to serve the interests and concerns of the people of Massachusetts.

Executive Summary

The State Of The Massachusetts Nonprofit Sector & A Call To Action

Passion & Purpose: Raising the Fiscal Fitness Bar for Massachusetts Nonprofits is both a primer on the state's nonprofit organizations and a call to action. It aims to further the understanding of Massachusetts nonprofits and the value they provide, as well as take a hard look at the sector to underscore the importance of financial health as a necessary and critical condition to meeting its public purpose. The report calls upon all stakeholders—government, foundations, investors and nonprofits themselves—to raise the fiscal fitness bar by looking at strategies, practices and policies to strengthen the Massachusetts nonprofit sector so that it can continue to serve as a powerful 'glue' for our communities, an expression of our values, and an important contributor to our state's competitive edge.

A Snapshot of the Massachusetts Nonprofit Sector

Doubling in size over the last two decades, today's Massachusetts Nonprofit Sector has evolved into a principal provider of services, a major employer and a formidable economic player in the Commonwealth. In late 2007, the nonprofit sector in Massachusetts was estimated to include almost 36,748 nonprofit organizations that earned \$86.7 billion in revenues and held \$207.1 billion in total assets.¹ Of this total, public charities—the principal focus of this report at 29,766 organizations—made up 81% of the sector, generated \$70.4 billion in revenues and held \$168.6 billion in total assets. As an employer, the Massachusetts nonprofit sector as a whole accounted for 13.8% of the Massachusetts working population in 2007 with 447,642 workers² whose total wages amounted to \$20.8 billion. Massachusetts has the fourth highest percentage of total nonprofit workers with Washington, DC leading with 16.2% of its working population.³

The Massachusetts nonprofit sector's importance was evident in its vital role during the economic downturn that followed the technology bust of 2000 and post 9-11. During the 2001–2004 period, Massachusetts

Principal Sources for 2007 Snapshot Data

There is no single source of current data on nonprofits. This study therefore uses a combination of data from the Internal Revenue Service (IRS), the National Center for Charitable Statistics, the American Community Survey of the US Census, and the Massachusetts Department of Unemployment Assistance to provide a current snapshot of the Massachusetts Nonprofit Sector.

Form 990 Filing Public Charities as the Empirical Focus of the Study

The report's quantitative analysis is focused on the subset of federally registered public charities that filed an annual Form 990 return with the IRS in 2003, the most recent year for which digitized Form 990 data is available. The sample includes 8,312 public charities that receive more than \$25,000 in revenue and are required to file a return, and excludes most churches. Some charities that voluntarily file are also included in this analysis.

experienced a 5.5% decline in employment overall, yet educational services and health care/social assistance programs experienced employment growth of 5.8% and 5.5%, respectively.⁴ Using these large classifications, health care and social assistance programs added more employees than any other sector (22,205) with educational services coming in second at 6,404 additional employees. In the 2004 to 2006 period, these two sectors grew in terms of employment faster than the state rate of 1.8%, posting gains of 4.1% (health care) and 3.1% (education). Again health care provided the largest number of new jobs with 17,492 and the education sector adding 3,699 new jobs.

Spread across a wide variety of industries, nonprofits touch all aspects of our lives and our communities. Offering a wide range of services, the highest concentration of nonprofits can be found in areas that

essentially define the image and competitive edge of Massachusetts as the “Education and Health Care Mecca,” with a rich and vibrant Arts and Cultural environment, and a community that cares deeply about its most vulnerable members. Of the 10 industry sectors defined further in this report, Massachusetts nonprofits are most densely concentrated in the areas of: Education, Science, Technology & Social Sciences, at 19% of the total; followed by Arts, Culture & Humanities organizations, at 14% of the total; and three other areas—Youth Development, Human Services, and Health Care—each accounting for 10% of the total.

The sector’s 36,748 nonprofits include 17,900 organizations that are non-filers and are under \$25,000 in budget size, 5,647 organizations that have budgets under \$25,000 but file the Form 990 with the IRS, and 7,655 organizations with budget sizes that range between \$25,000 and \$250,000. The total also includes 5,380 organizations with budgets between \$250,000 and \$50 Million, and 166 organizations whose budgets exceed \$50 million.

Found in every community across the Commonwealth, on a strictly numeric basis, nonprofit organizations are concentrated in the eastern half of the state, with the highest concentration in Suffolk, Middlesex, Norfolk and Essex Counties. As data show, nonprofits are more heavily concentrated in urbanized areas. Greater Boston, Worcester, Springfield, Holyoke, Pittsfield, New Bedford, and Fall River form distinct clusters.

Three Value Propositions

A thoughtful analysis of the breadth and depth of the entire Massachusetts nonprofit sector reveals three fundamental value propositions that capture its full range of activities and services:

- Creation of civil society through grassroots action and volunteerism;

- Provision of societal benefit and a “safety net” provision through the delivery of services and quality of life contributions; and
- Large-scale services and contributions to the state’s economic health and competitiveness.

Organizations can benefit the community through a combination of these value propositions, but most organizations exhibit one more fully than the others. For the purposes of this report, budget size was combined with these value propositions to create three categories of nonprofits: “Grassroots” organizations are those with \$250,000 or less in total expenses; “Safety Net” nonprofits range from \$250,000 to \$50 million in total expenses; and “Economic Engine” nonprofits report \$50 million or more in total expenses. These three segments typically exist in a variety of business environments and exhibit differing financial health indicators. Five major business models based on financial characteristics and revenue streams are found across the spectrum of these public charities. They include: *Support Organizations, Membership Organizations, Expressive Voice Organizations, Service Providers, and Large Institutions* (See page 27 for descriptions). These business models can also be found across different sub-sectors in the 10 industry sectors defined by the mission focus of organizations.

As the analysis illustrates, the financial health outcomes of nonprofit organizations tend to vary most significantly by budget size, which is closely related to value propositions. And while this classification by budget size may seem over-simplified, it helps us grapple with the complexity, breadth and depth of nonprofit activities. It also enables us to look at practices of running, funding, and supporting nonprofits with a deeper view of the value of nonprofits as we make choices about how best to enhance the sector’s capacity to meet its stated public purpose.

Number of Organizations	Non Filers	< \$25K	\$25K to \$250K	\$250K-\$50M	>\$50M	Total
Year 1995	15,144	1,504	5,975	4,214	116	26,953
Year 2003 (Analysis Year)	16,572	5,560	7,134	4,825	138	34,229
Year 2007	17,900	5,647	7,655	5,380	166	36,748

What Constitutes Nonprofit Financial Health?

A consensus does not exist about what does or should constitute financial health for a nonprofit organization. The use of the term ‘nonprofit’ to define the sector has resulted in a view held by many nonprofit boards, executives, and funders that nonprofits should operate with zero annual profit. This view maintains that holding valuable resources in anticipation of future needs or potential funding disruptions means foregoing provision of much needed services today. Under this current services view, nonprofits are not created to generate profits, but rather to serve the public. Hence many nonprofits feel compelled to devote the bulk of their income toward current program services, operate with breakeven budgets, and invest little in support services, such as organizational capacity, administration and fundraising.

Staffing is kept to a minimum, and volunteers and modest wages are encouraged. This approach results in relatively small organizations that generally grow opportunistically when funding prospects arise, with few investments or cash reserves either to sustain operations—during economic downturns or funding disruptions—or to expand to meet increased demand for services. Increasingly, the nonprofit sector and its stakeholders are questioning this approach as it creates a plethora of small organizations that are financially fragile, and run the risk of being unable to sustain their mission and provide program services at current levels into the future.

An alternative view is that the financial health of nonprofits should be measured using modified financial ratios commonly employed in the for-profit sector. The financial statement view suggests a focus on a few key ratios to assess a nonprofit’s health in comparison to some standards of financial health, such as holding three months of cash on hand, operating with modest surpluses or maintaining low levels of debt. This approach, however, does not take into consideration the heterogeneity of the sector, in terms of size, mission or business model. It also assumes organizations with lower levels of debt are financially healthier; however, in the nonprofit sector, organizations are often impaired because they lack sufficient access to credit.

This study presents a broader analytic framework called ‘Financial Stewardship’—an approach rooted in the belief that strong financial health and accountability

are critical for mission fulfillment now and into the future. An organization that exhibits strong financial stewardship can answer affirmatively to the following four questions posed by Regina Herzlinger in her 1996 *Harvard Business Review* article “Can Public Trust in Nonprofits and Governments be Restored?:”

1. Are the organization’s goals consistent with its financial resources?
2. Is the organization practicing intergenerational equity?
3. Are the sources and uses of funds appropriately matched?
4. Is the organization sustainable?

As the analysis in this report will show, there is no single set of financial indicators and ratios to which the entire sector can be held. The financial health of nonprofits must, therefore, be seen in context—of similarly sized organizations with similar business models and similar mission and organizational activities.

The financial analysis on which this report’s recommendations are based will focus on indicators of short- and long-term financial health that relate to these questions: *Liquidity, Profitability and Sustainability*. For an explanation of technical terms, see **Appendix B**.

1. Liquidity

Does the organization have sufficient cash resources to deliver its mission and pay its obligations on a timely basis?

Several different measures can help to assess liquidity. *Cash on hand*, which compares the cash balance to operating expenses (total expenses less depreciation), indicates how many days or months of expenses an organization can cover out of current cash holdings without liquidating investments or relying on new revenues. A rule of thumb that is often used asserts that nonprofits should have three months of cash on hand as a liquidity buffer. The study also looks at other liquidity measures, such as *net operating cycle*, which compares net working capital⁵ to operating expenses, and the *inverse current ratio*,⁶ which is current liabilities divided by current assets or the resources needed to be paid in cash or delivered in services in the next 12 months against liabilities over the 12-month period.

2. Profitability

Has the organization earned new economic revenues sufficient to cover current expenses and allow for appropriate growth and a margin for error?

Profitability in the nonprofit sector is generally measured by net income (annual deficit or surplus) as a percent of total revenues. This measure is known as the *surplus margin*. Many organizations operate based on annual budgets that call for breakeven operations, i.e. a surplus margin of 0%. This goal, however, does not ensure that current resources are sufficient to meet current needs, while also providing adequate resources to allow for intergenerational equity and organizational sustainability. Specifically, it does not take into consideration four issues: current financial health, economic growth, contingencies, and projected future service needs.

Most organizations do not budget for positive surplus margins sufficient to build their existing financial resources to the target level that is desirable for their industry sector and business model. As nonprofits cannot issue stock, running surpluses (either in operations or in capital gifts) or reinvesting endowment income are the only methods to grow the organization's resource base. To be sustainable, organizations need to keep pace with inflation or real economic growth. Breakeven budgets also fail to recognize that budgets are estimates and that unexpected events often have an adverse effect on earnings. The final factor to consider in setting a budget target is the level of expected future service needs.

Combined, these factors suggest that many nonprofits should budget and operate regularly with positive surplus margins in the 2% to 5% range.

3. Sustainability

Does the organization have enough of its own resources to continue operations into the future?

This concept is the hardest to assess well, since a business outlook is not offered with the financial statements. As forward-looking information is not readily attainable, sustainability in this study will be measured using *leverage*. This measure is defined as total liabilities divided by total assets, and it measures the degree to which an organization relies on debt rather than its own resources—known as *net assets*⁷—to fund its assets.

While higher leverage is considered a risk factor in the corporate sector, a lack of leverage may be problematic for many nonprofits. A for-profit is encouraged to borrow to fund long-lived assets (e.g., buildings and land) and overcome short-term liquidity needs when necessary. As borrowing allows firms to grow internally, deal with cash flow fluctuations, or acquire others and interest is tax-deductible, leverage is encouraged up to the point that a firm may no longer be able to service its debts in a timely fashion.

In a nonprofit setting, most forms of debt (excluding publicly issued bonds) do not benefit from tax exemption-related subsidies, making it less attractive. In addition, many nonprofits are not offered the ability to borrow from a lender, vendor or even a funder. These factors combined cause nonprofits to rely relatively little on credit or debt financing. Therefore, a high percentage of nonprofits in this study (44%) report no current liabilities and one-third report no liabilities at all. The Grassroots and Economic Engine organizations (with some exceptions) tend to fall neatly into the extremes of financial distress and health. In between the two extremes are the Safety Net organizations that are working to develop sufficient financial resources to escape the constant financial pressures associated with meeting payroll and remaining open to shift their eventual focus to being professionally run, financially stable institutions.

State of the Massachusetts Nonprofit Sector

The report's quantitative analysis is focused on the subset of federally registered public charities that filed an annual Form 990 return with the IRS in 2003, the most recent year for which digitized Form 990 data is available. The sample includes 8,312 public charities that filed a return, which includes most nonprofits with more than \$25,000 in revenue, and some charities (mainly churches) that voluntarily filed. The quantitative analysis (discussed in detail later in this report) forms the basis of the recommendations in this report. It looks at financial characteristics and financial health of nonprofits across budget size or industry sector. It also compares the regional distribution of nonprofits against socioeconomic indicators to see how the distribution compares to need. The following is a synthesis of the analysis:

Grassroots Organizations

The fastest growing segment of the three types of nonprofits identified for this report is Grassroots organizations with budgets of under \$250,000. In 2003, 4,574 such organizations filed Form 990s, accounting for 55% of the filing entities in Massachusetts. They are concentrated in industry sectors or program areas related to: Youth Development and Recreation (75%); Philanthropy (74%); Arts, Culture & Humanities (70%); Environment (67%); and Education (57%). Some examples of sub-sectors within these industries where small organizations are concentrated include: *Performing Arts Organizations*—representing the ‘Expressive Voice’ business model that are typically founder-led and hire actors and performers on an as needed or contractual basis; or *Amateur and Professional Sports Organizations*—representing the ‘Membership’ business model that are typically volunteer driven organizations that depend upon annual membership drives and contributions.

These organizations are cash driven with little or no opportunity or means for investment with more than 40% of organizations having 10% or less of their assets financed by debt. They are largely volunteer and shrink or grow over time in relation to their cash resources. Just over a quarter have cash on hand of 30 days or less, while almost half of them report annual deficits.

In addition to being the fastest growing of the three nonprofit types, Grassroots organizations are an incubator for new ideas and start-up organizations. A number of them have a niche focus and, therefore,

have less need to grow in size or in mission scope. For niche organizations to thrive, they must be able to sustain a positive surplus margin, have no outstanding payables/bills, and maintain two to three months of cash on hand.

Given the growing competition, these nonprofits can be well served by consolidation of operations such as back office support functions, space, staff and infrastructure or by mergers with more stable entities particularly for organizations that are neighborhood based or mission aligned.

Safety Net Organizations

Often characterized by staffed organizations, the sector’s 3,601 Safety Net organizations were those with budgets ranging between \$250,000 to \$50 million. This represents a broad spread, which in the quantitative analysis has been further broken down into four budget-size groupings: \$ 250,000 to \$1 million; \$1–5 million; \$5–10 million; and \$10–50 million. These organizations are typically concentrated in the program areas of Housing (62%), followed by Human Services (60%), Health & Medical (60%), and Community Capacity (46%)—industry sectors that provide a bulk of the safety net and quality of life services for communities. Business models that define most of the organizations in this classification are the ‘service provider’ and ‘large institution’ model.

Safety Net organizations offer both critical human services and quality of life enhancing services. Some examples of sub-sectors where these organizations

Grassroots Organizations

Financial Characteristics		Financial Condition of Median Organization		Recommended range
Organization Budget Size	\$0 to \$250,000	<i>Liquidity:</i> Days Cash on Hand	55 days	60–90 days
Percent with Employees	30.5%	<i>Liquidity:</i> Inverse Current Ratio	0.0*	Over 0 and under 1
Dominant Asset	Cash	<i>Profitability:</i> Surplus Margin	5.0%	2–5% minimum
Dominant Revenue	Contributions	<i>Sustainability:</i> Leverage	0.0*	Over 0 and under 1
Dominant Expense	None			

* indicating no current liabilities

are concentrated include: *Residential Care, Adult Day Care & Independence Services, Children & Youth, Housing Development, and Mental Health Services*. They represent the ‘service provider’ business model that is often heavily funded by federal, state and local government resources and generally paid in arrears (such as through cost-reimbursement). These funders often do not cover or cover fully important costs, and discourage profitability. As a result, many of these organizations see their cost of services not fully funded and have to raise additional funds for operations and to cover the gap in funds.

As Service Providers, these organizations depend upon stable staff, which creates a recurring fixed cost structure. A recent study conducted by the Massachusetts Executive Office of Health and Human Services found that one-third of them report annual deficits, with a total of 60% reporting surplus margins at 2% or lower. Almost half of the providers have liabilities in excess of net assets and 4% have negative net assets. Cash on hand is quite low, with 60% of providers holding under 30 days of cash on hand.

Other Safety Net organizations are spread across the Arts, Education and Environment program areas, and, by virtue of their size and financial characteristics, fit the ‘Large Institution’ business model. In the Arts, these organizations are found in the *Museums, Historical Societies, Performing Arts and Media and Communications* sub-sectors. Their revenues depend on contributions and also ticket sales and memberships. With the exception of Media and Communications, these entities have extensive investments (45%–56% of assets) and

fixed assets (23%–30% of assets). Surplus margins fall heavily in the 2–5% range. Median cash levels are on average quite high for the sector ranging from 83 to 177 days of operating expenses. This category, similar to the Economic Engine organizations category has more access to instruments of bond and mortgage financing than organizations in many other sectors.

Safety Net organizations make up the heart and soul of the nonprofit sector and solutions for this critical group lie largely in the approach funders take to covering the full cost of services they are purchasing with a sufficient cushion to enable stability and growth. In addition, this segment of the nonprofit sector, particularly those of the ‘Service Provider’ business model will be strengthened by strategic alliances and mergers aimed at creating efficiencies of scale and operating cost efficiencies as well as reducing duplication of services. Financially healthier organizations will have increased clout and competitiveness.

Economic Engine Organizations

In 2003, the 137 Massachusetts public charities with \$50 million or more in annual budgets represented 2% of organizations but 80% of assets and 72% of spending. These organizations are crucial to the state’s economy and are concentrated in the Education and Health Care & Medical program areas. Hospitals and Universities account for 60% of these organizations with others scattered across the nonprofit sector. Sub-sectors in Education where these organizations dominate include *Universities and Secondary Schools*. In the *Health Care &*

Safety Net Organizations

Financial Characteristics		Financial Condition of Median Organization		Recommended range
Organization budget size	\$250,000 to \$50 Million	<i>Liquidity:</i> Days Cash on Hand	60.2 days	90–180 days
Percent with employees	89.3%	<i>Liquidity:</i> Inverse Current Ratio	0.26	Over 0 and under 1
Dominant Asset	Fixed Assets	<i>Profitability:</i> Surplus Margin	0.7%	2–5% minimum
Dominant Revenue	Program Service Revenue	<i>Sustainability:</i> Leverage	0.27%	Over 0 and under 1
Dominant Expense	Compensation			

Medical program area, they include *Hospitals and Nursing and Mental Health facilities*. They typically conform to the 'Large Institution' business model.

These organizations have a complex revenue mix. They rely heavily on program service revenue but also have endowments, debt, and consistent contributors that allow them to invest in their human capital and in systems to be more effective and sustain their operations. As a result, their organizational and financial characteristics, in general, are quite healthy.

In Education, program service revenue is the dominant form of income for colleges and independent schools. Educational institutions have extensive investments (medians in 48%–79% of total assets), and fixed assets are the next most dominant form of asset. Similar to Arts institutions, Educational institutions have days of cash on hand that are relatively high, in the 40–140 days of operating expense range, and have surplus margins in the 2% to 5% range.

In 2003, Health sector institutes were the least financially healthy in the Economic Engine category. They were heavily reliant on program service revenue (63% to 74% of total revenues) and have the lowest cash levels in the 30 to 40 day range with receivables and inventory levels matching or exceeding payables in the 30 to 45 day range. Surplus margins fall in the 0% to 2% range. The financial health of this subsector has strengthened considerably in the past five years due to mergers and substantial restructurings designed to lower costs and increase revenues.

In general, these organizations are in pretty sound financial condition and because of their large economic impact have access to many of the infrastructure assets that the private sector enjoys.

Regional Distribution of Nonprofits Across Massachusetts Nonprofit Network⁸ regions:

While nonprofits are found in practically all communities across Massachusetts, their distribution is not always commensurate with socioeconomic need. Their concentration is sometimes driven by capturing economic opportunity, as in the Berkshires where there is a higher percentage of Arts nonprofits. And sometimes they express the values that a community holds dear, as in the Cape & Islands which have a concentration of Environmental groups. At other times, nonprofit intensity is driven by access to policy and power structures, as indicated by the many large and small institutions located in the Boston area, which is the seat of government and the setting for policy makers.

From a socioeconomic perspective, the distribution of nonprofits geographically does not always stack up against need. This is particularly evident in a region like the Pioneer Valley which is both economically distressed and has relatively few nonprofits serving populations in need, or the Boston Urban Core which has an abundance of nonprofits, but its highly diverse demographics are not matched with an equitable distribution of services, as well as the vibrant Metro-west region which has an unbalanced mix of nonprofits.

Economic Engine Organizations

Financial Characteristics		Financial Condition of Median Organization		Recommended range
Organization Budget Size	\$50 million and above	<i>Liquidity:</i> Days Cash on Hand	19.6 days	90–180 days
Percent with Employees	96.4%	<i>Liquidity:</i> Inverse Current Ratio	0.56	Over 0 and under 1
Dominant Asset	Fixed Assets	<i>Profitability:</i> Surplus Margin	15.0%	2–5% minimum
Dominant Revenue	Program Service Revenue	<i>Sustainability:</i> Leverage	0.33%	Over 0 and under 1
Dominant Expense	Compensation			

So, How Financially Healthy is the Sector?

In a nutshell, the results are not positive. The Massachusetts nonprofit sector's growth in revenue is not keeping pace with the numeric growth of organizations. This is exacerbated by the fact that inflation and cost of business factors are causing expenses to exceed revenue growth. These trends can be seen across organizational budget size and across industry sectors.

To ensure the sector's robust health and its continued ability to meet its public purpose, the Massachusetts nonprofit sector has to pause and reposition itself in view of its growth, its immense economic impact and its increasingly professional outlook.

The steady growth of the sector locally and nationally has not been accompanied by an investment in the infrastructure needed to support this growth. While the larger organizations and institutions can access banks and other private sector institutions to obtain working and growth capital, the smaller and mid-sized organizations have no systems of support and must rely on their perseverance and persistence to survive.

Massachusetts nonprofit organizations must look at restructuring for cost efficiencies and consolidation for strengthening programs and services—and must focus on the financial health of their organizations. To secure a high quality of services now and into the future, the nonprofit sector's stakeholders—government, foundations and individual donors—must look at more efficient ways of funding to cover the full cost of services and encourage financially healthy organizations. To sustain the very public purpose for which this sector was created, policymakers must look at policies to protect nonprofits and raise the bar for a high level of accountability from these valuable institutions.

As this report shows, the nonprofit sector is large and complex, with a wide variety of missions and a broad diversity of organization budget sizes. These organizations operate in business and financial environments that make it difficult to talk about the entire 'nonprofit sector's' financial well being as a whole.

The private sector operates on a single bottom line—the profit motive. It functions within a well established financial market place where costs of products and services are fully covered and profitability is the key to success or failure. Rules of the game for the nonprofit sector, however, are different. Costs

of services are rarely fully covered, money comes with a plethora of restrictions, investments in infrastructure and overhead costs are difficult to fund, and access to credit is limited to the better endowed nonprofits. Therefore, the nonprofits whose industry focus and operations most closely resemble the business sector, are the ones that are the most likely to succeed financially.

An in-depth look at public charities (the focus of this report) across six budget size categories, 46 industry sub-sectors, and eight regional groupings analyzed in this report indicates that there is no single set of financial indicators and ratios to which the entire sector can be held. The financial health of nonprofits must therefore be seen in the context of similarly-sized organizations with similar business models, missions and purposes.

Raising the Fiscal Fitness Bar for Massachusetts Nonprofits

A Call To Action

A stable financial condition is critical for nonprofits to meet their public purpose. Simply put, the three fundamental threats to nonprofit financial health are: 1) too many nonprofits; 2) too few resources; and 3) too little focus on future services and sustainability.

The rapid increase in the number of Massachusetts nonprofits, in contrast to the sector's overall slow revenue growth and rising expenses, begs two serious questions. First, can the sector support this proliferation in small and very small nonprofits? Second, can our nonprofit organizations sustain their public purpose responsibility with their current financial practices? The slow revenue growth also speaks to the serious funding constraints currently facing the sector. An important reason for the poor financial health of so many Massachusetts nonprofits is their focus on expanding current service and program delivery to the detriment of financial and organizational health and future services. Even greater funding is needed if these organizations are to expand investments and savings without serious disruptions in current services.

The 'call to action' recommendations that follow capture the ideas that have emerged from this analysis and through conversations with various stakeholders over the course of this investigation. They are aimed at improving nonprofit financial health and the alignment of money and mission for greater social impact. They are structured around three powerful concepts—restructuring, repositioning and reinvention.

Restructuring and Consolidation

While a simple solution to the problem could lie in consolidating the sector, the wide range of values, services and benefits that nonprofits provide can easily be lost during a restructuring. Appropriate measures must be taken by a nonprofit based on its budget size, business model, industry sub-sector, and stage of organizational development. Well thought-out restructuring strategies⁹ that range from back office support collaborations to mergers however, are clearly required.

- The Massachusetts Nonprofit Sector needs to seriously consider mergers, strategic alliances and collaborations as a strategy to:

- Strengthen organizational balance sheets to enhance program offerings and ensure measurable impact and inter-generational delivery of mission;
 - Create economies of scale for greater impact—consolidating programs and associated support services; and
 - Create economies of efficiency for revenue sharing, eliminating duplicative costs and administrative/operational redundancies through the sharing of staff, space, back office consolidation, and group purchasing.
- The sector must look to utilizing the fiscal management services of umbrella organizations and other larger institutions, allowing new ideas to incubate and grow without the administrative burden of organizational structure and costs.
 - On the regulatory end, better tracking and regular public reporting of data on incorporation and dissolution of nonprofits is needed.
 - Funders need to support the cost of mergers and strategic alliances, acknowledging that effective collaboration takes time and resources.

Repositioning

Rooted in communities across the state, Massachusetts nonprofits are a powerful civic and economic force. With the recent creation of the *Massachusetts Nonprofit Network*—the first statewide association of nonprofits—and its longstanding and strong trade associations and regional networks, the sector is well positioned to maximize its potential and gain the efficiencies and effectiveness possible only through collective action.

- The Massachusetts nonprofit sector is an important economic force and needs to use its collective clout to reposition itself to:
 - Access and/or create instruments for growth, restructuring, capacity building and investment capital; and
 - Access vendor credit, group purchasing, and shared training and capacity offerings, particularly for

the small nonprofits through the Massachusetts Nonprofit Network.

- Nonprofits need to express their voice on key issues facing the sector—by joining the Massachusetts Nonprofit Network and other trade associations—and advocating for policies and practices to improve nonprofit financial health and mission accomplishment. Nonprofits must work together to:
 - Invest in the nonprofit workforce through better wages, fringe benefits and professional development, particularly in the areas of human services and early education;
 - Encourage investments in health, vitality and other ‘safety net’ issues for the families of those employed in the nonprofit sector through instruments of health insurance, retirement accounts and other benefits;
 - Work with the public sector to create a ‘Small Business Association’ type of publicly funded entity to support the healthy growth of the Massachusetts nonprofit sector; and
 - Reform the field’s overly complex and expensive accounting, regulatory, and contracting requirements.

Reinvention and Reinvestment

The Massachusetts nonprofit sector’s shift from a volunteer sector to one that is increasingly run by highly qualified professionals, its emergence as a principal provider of critical services, and its functioning in a competitive business environment require that we rethink and reinvent nonprofit operations and support systems commensurate with the 21st century environment.

- Nonprofit managers and trustees need to focus on improving financial management practices with a keen eye toward balancing and strengthening money, mission and organizational capacity.
- Nonprofit organizations need to resist the temptation to cover a higher level of services—and limit operations to those they can fully cover financially.
- Funders must be willing to pay fully to cover operating costs and support infrastructure and other strategies for efficiency and streamlining:
 - Seriously consider changes in government contracting policies to prepay and cover the true cost of services;

- Funders should pool resources to lower transaction costs for applying for and receiving funds and reporting on outcomes to reduce duplication;
 - Standardize and streamline grant/contract applications, operating requirements and reporting that is commensurate with grant size;
 - Where possible, raise substantially the average grant/contract size to lower transaction costs, achieve economies of scale in fundraising and programming and foster collaboration; and
 - Support fiscal sponsorship and other sector responses for brokering alliances.
- To ensure the strength and stability of the sector, the funding community must consider funding at both the organizational and the programmatic levels, even when the funder’s primary interest is in one program. Funders should:
 - Support and reward investments in organizational health and capacity;
 - Offer nonprofits access to working/growth/restructuring capital; and
 - Work with the banking community to enhance access to credit for nonprofits.
- Nonprofit managers and boards must bring financial management into close alignment with organization mission and purpose:
 - Regularly budget with a surplus margin and develop strategies to ensure sufficient liquidity and reserves to comfortably meet short-term obligations and/or unexpected funding disruptions or costs; and
 - Ensure strong financial stewardship through governance and sound internal controls, and institute regular finance and audit committee oversight and tracking of key metrics linking money and mission.
- Celebrate and reward excellence in nonprofit management and social innovation.

The past several years have shown the sector to be a critically important ingredient in everything Massachusetts represents. Its rapid growth, while concerning, is also an indicator of its success. And while practices, policies and strategies are needed to enhance its value and strengthen its outcomes, it is important to ensure that we are able to retain the passion, commitment and civic engagement of private individuals for public good. The nonprofit sector in Massachusetts has created, to a large extent, the structures and institutions needed to take it to the next level.

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