National Assembly of State Arts Agencies
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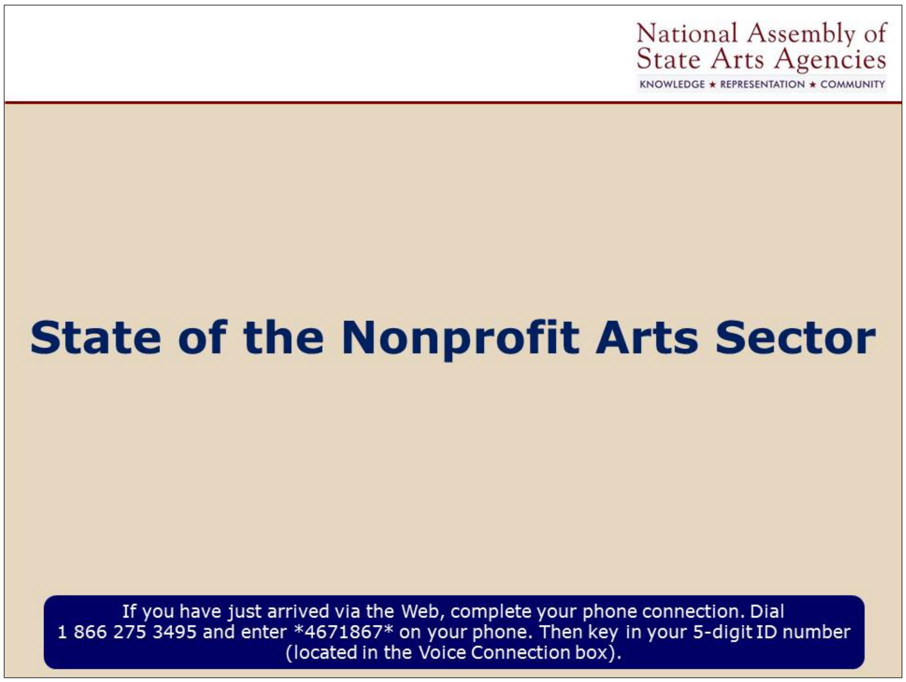
State of the Nonprofit Arts Sector

September 12, 2012
Web Seminar
Abridged Transcript



Introduction

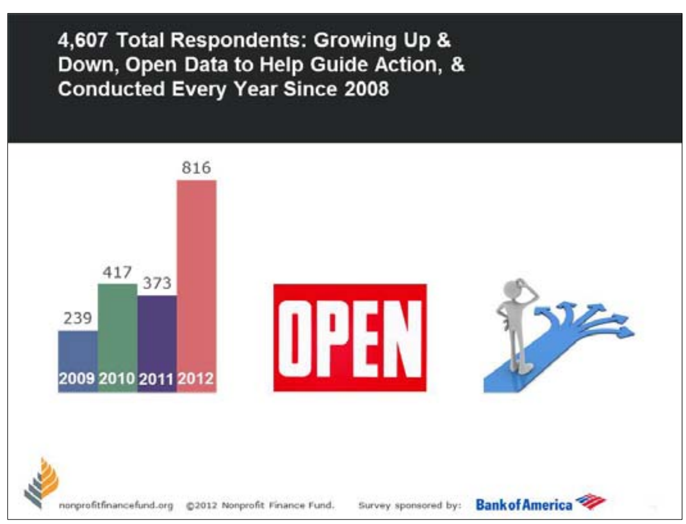
Kelly Barsdate: State arts agencies work very closely with all kinds of entities—public agencies, schools, individual artists and commercial groups—but we have a special relationship with nonprofit organizations. Fifty-three percent of SAA grants are awarded to arts nonprofits, and they play an important role in our arts ecosystem. Nonprofit groups make the arts accessible in unique ways: they incubate creative talent and are often the connectors that bring civic groups, private citizens, businesses and other folks together at the community level. We are really pleased that we get to spend some time today focusing on the condition of arts nonprofits and how they are adapting to tight economic times. The folks at the Nonprofit Finance Fund [NFF] are great people to do that with. Quite a few states have worked with NFF over the years, and NASAA has had them present at conferences and share research as well. Ryan Stubbs, NASAA's research director, is moderating things today, so I will pass the baton to him.

State of the Nonprofit Arts Sector

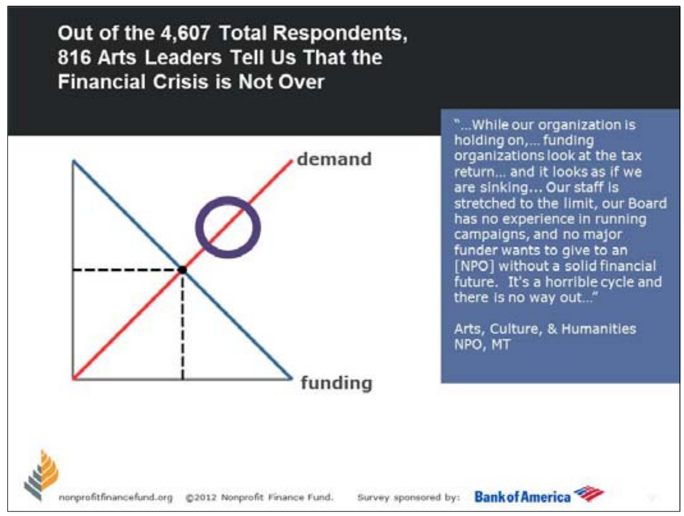
Ryan Stubbs: Today we will learn more about the state of the nonprofit arts sector from our colleagues at the Nonprofit Finance Fund, who will give us a detailed overview of what nonprofit arts organizations across the nation are saying about their financial health, their financial outlook and their funders. On the line with us from NFF is Associate Director of Knowledge & Communications Anjali Deshmukh, who joined NFF in 2008. Anjali is responsible for writing, editing and project management for NFF's public media, including research reports, articles, blogs and marketing documents. She also serves as lead graphic designer for NFF. Joining Anjali from NFF is Associate Director of National Services Emily Guthman. Emily directs NFF's strategic initiative development, design and implementation nationally. In this capacity, Emily designs innovative financing and funding programs, stewards stakeholder relationships, and actively grows NFF's business development efforts. And last but not least is NFF Manager of Consulting Services Jina Paik. Jina oversees the delivery of consulting services and the management of funder initiatives and relationship building across NFF's metropolitan New York market. Thanks to all three of you for joining us today.

Emily Guthman: Thank you. Our presentation today will be based on the results of our 2012 State of the Nonprofit Sector Survey. As a little background, the Nonprofit Finance Fund is a national nonprofit and community development financial institution. For over 30 years, we have been dedicated to improving the giving and using of money across the social sectors, and during that time period approximately 50% of our clients in both our lending and consulting practices have been part of the arts and culture community.

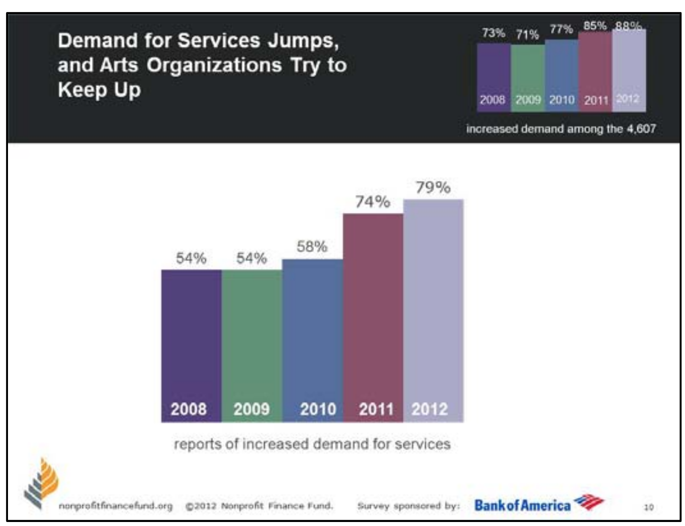
We are beginning to talk about our work in terms of the type of capital that we bring to bear within the complete capital framework. NFF is a lender and an underwriter, deploying capital to nonprofit organizations in loans and lines of credit for over 30 years. Our human capital is really our expertise that has fostered our consulting practice. NFF advises nonprofits and funders on the link between strategy and finance. We really help organizations answer important questions and plan around uncertainty. NFF works in partnership not only with funders and nonprofits, but increasingly with other stakeholders, like local governments and municipalities, to advance shared objectives for the sector. And finally, our intellectual capital is why we are here today: to share the results of our learning, surveys, research and reports, most of which can be found on our website. I'll turn things over to Anjali, who will talk a little bit more about the survey.



Anjali Deshmukh: NFF has been conducting the state of the sector surveys for several years now, and each year we have seen an overall increase in respondents as well as a greater ability to filter and slice the data for subtlety. This year, we had a total of over 4,600 respondents, 816 of which identified as working in arts and culture. This is in great part due to organizations like NASAA, who have served as outreach partners to help disseminate the survey to their networks. We are very committed to providing open data to the sector, and every year we make the anonymous results of our survey available to anyone who wants them. To further support that effort, this year we created a survey analyzer that allows people to filter the results on their own by annual expense, state and sector. The purpose of the survey is to provide the sector with a tool for decision making. NFF is as much about learning and data as we are practice and experience, so we work with both organizations and funders to apply the data to the unique environmental context. That is why you will be hearing from Jina a little later on about what NFF has seen in the sector based on some on-the-ground experience.



What is the big message that the data has shown? At the highest level we have seen a continual increase in demand for services, while overall the availability and reliability of funding has been going down slowly over time. We know that nonprofits have always struggled to cover the full cost of doing business, and this is certainly not something specific to just arts organizations. In part this is really due to the difficulties in which money flows in the sector. There are indications that the gap is getting wider over time. In the middle of this tension are the organizations themselves, who are trying to stretch resources and stay sustainable. I want to call your attention to the quote on this slide because I believe it eloquently shows what NFF has been trying to work towards over the last several years, "[Our most recent audit shows a substantial deficit for the third year in a row.] While our organization is holding on, . . . funding organizations look at the tax return, [our lack of reserves and P&L] and it looks like we are sinking. . . . Our staff is stretched to the limit, our Board has no experience running campaigns, and no major funder wants to give to a nonprofit without a solid financial future. It's a horrible cycle and there is no way out. . . ." This pretty sad story from one of our survey respondents accurately shows what NFF has observed over the past several years: that our current system and ways of doing business have become more and more

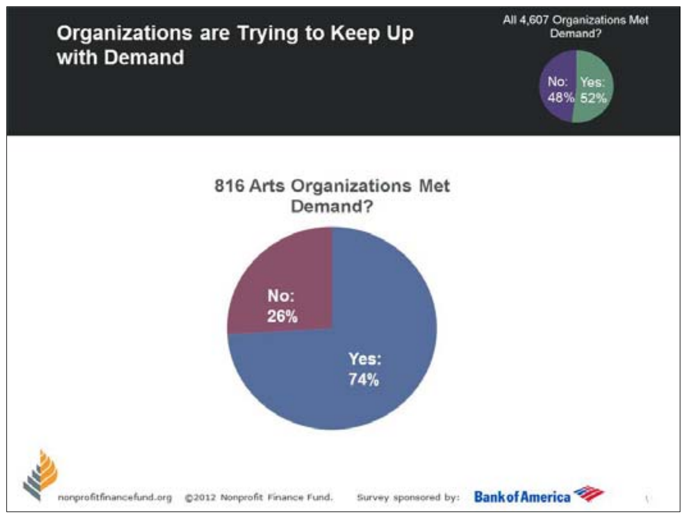


unsustainable, and as a sector we are facing an increasing urgency to develop new ways of doing business and explore new ways of achieving social impact.

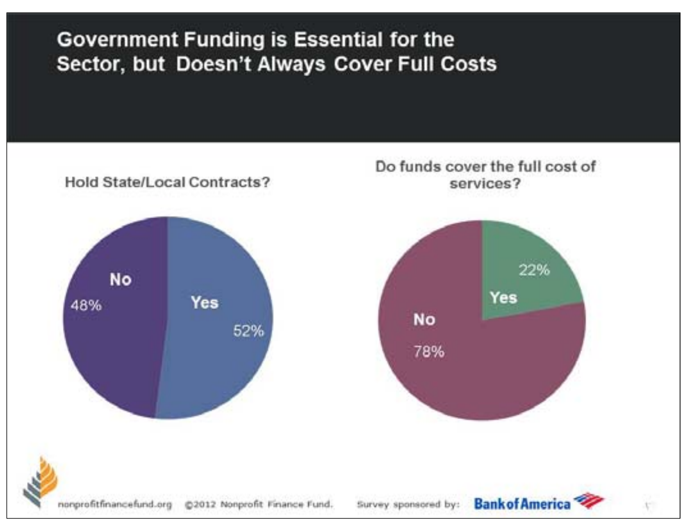
Emily: Demand outpacing funding has challenged all of us as we compete for scarce dollars each year. Not surprisingly, demand is expected to climb again in 2012. Some of us feel it already; some of us anticipate the increasing demand as we head towards the end of the calendar year. We will be sharing the results of the 816 arts and culture respondents and compare that to the full survey responses right on the slides themselves. That will give you all the ability to see how the arts sector compares to the sector as a whole on a number of key metrics and responses.

What we see on [the above] slide is that 79% of survey respondents in the arts sector are reporting an increase in demand for services this year. This possibly links to signals of economic recovery, with arts organizations and the sector playing a critical role in driving economic growth.

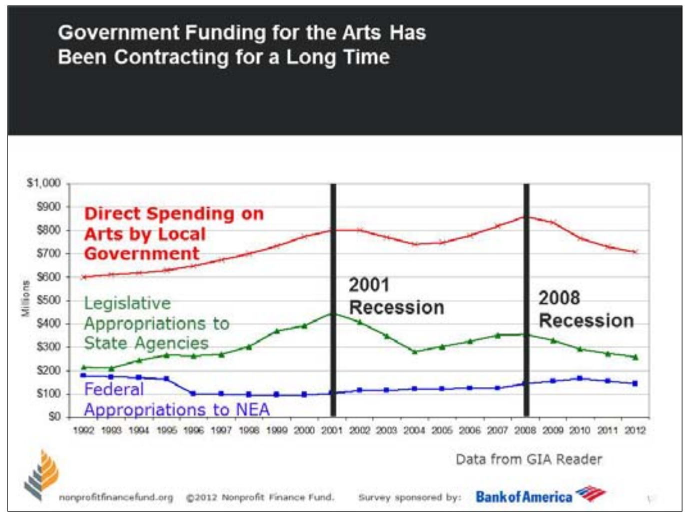
How well is the cultural sector and the sector as a whole keeping up with a fourth straight year of growing demand? For a lot of you in the arts sector, keeping up with demand can signal economic recovery. We are really excited to see that 74% of arts organizations surveyed met demand. But keeping up with demand can mean something else in other parts of the sector. Only 52% of the full sector could keep up with demand. This could be a signal, perhaps, of a stretched human service sector—only 58% of them could keep up with demand—and a sign of an unstable social safety net.



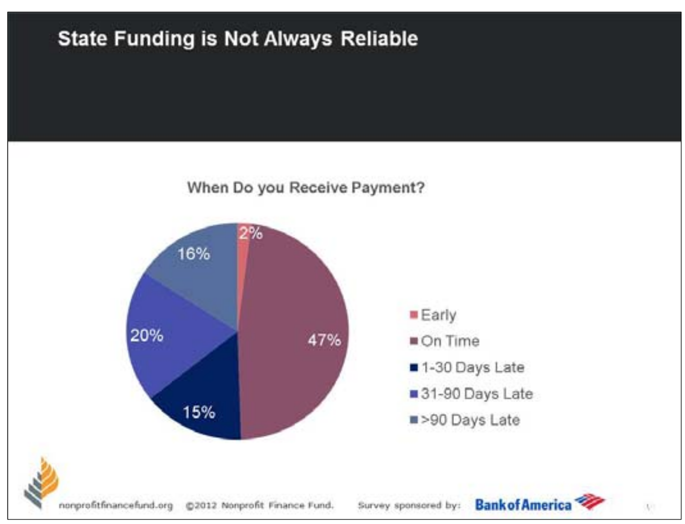
Anjali: This year's survey took a closer look at nonprofits' experiences with government funding. A smaller percentage of the arts sector, 37%, received federal funding or held contracts with the federal government. But just over half of respondents have held contracts from state or local governments, yet nearly 80% have said that those funds did not fully cover the costs for which they were intended. This is a chronic problem within the nonprofit



sector and certainly not specific to arts organizations. Unlike for-profits that raise broad based capital and then internally designate how it is used, nonprofits have to raise money for specific purposes or programs. As a result, they are continually filling funding gaps to make ends meet. A few ways we suggest to funders to help grantees better cover their cost is to consider providing more flexible funding and supporting surplus generation. Surplus capital is a critical missing key in the sector; it allows organizations to choose how they use funding based on their internal strategy and pivot more freely with greater flexibility as the environment deteriorates. In terms of surplus generation, NFF always says that nonprofits need profit; they need to more than just break even if they are going to grow, innovate or adapt to a changing environment. In difficult times, it typically is difficult for these organizations to carry reserves on their balance sheet.

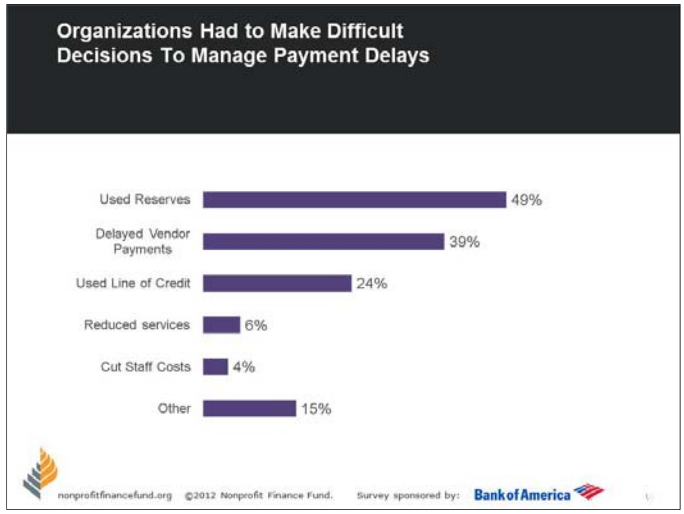


To complete that picture, nonprofit sustainability is as much about effective practices as it is about what money is available. We took a look at government funding right now. This slide shows Grantmakers in the Arts data tracking the amount of funding available from three main sources of government revenue: direct expenditure by local government, legislative appropriations to SAAs and federal appropriations to the NEA. You can see that, since the 2008 recession, funding has decreased overall, with federal resources staying the steadiest over time. The most striking picture is that there are indications of an even longer term trend of decline. Overall, funding has not recovered to the levels where they were over a decade ago in 2001. This returns to the overall themes we discussed earlier. Nonprofits have varying revenue models and don't necessarily count on government funding as their primary source of revenue, but we need to ensure that arts organizations are prepared to fill potential revenue losses with more long-term solutions. Long-term solutions may mean more enterprise level changes to their business model and thinking about new ways to do business.

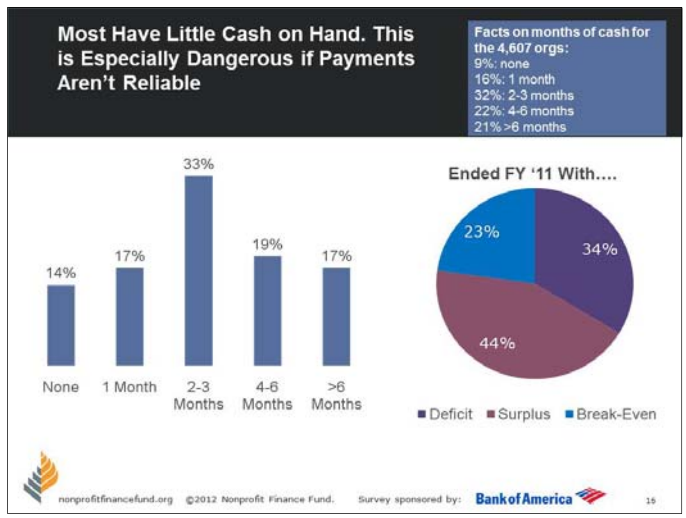


Emily: Not only is government funding declining, but organizations are facing the implications of an uncertain and unreliable reimbursement cycle from these core funders. Of the arts organizations with state contracts who responded to our survey, half experienced payment delays. As you can see on this chart, 16% of the respondents' delays were over three months.

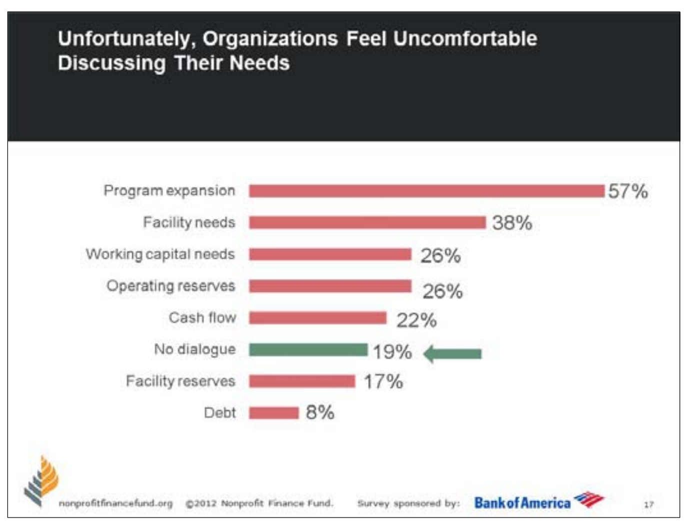
How do organizations manage these delays, plan for the uncertainty and deliver their services without having the funding in advance? Close to half of the organizations are dipping into their reserves to support activity now and then repaying into them once payment is received. Almost 40% delay paying their bills until their funding has arrived. And other organizations have had to manage in ways that directly affect their clients and staff. The have had to reduce services and staff. Let's look at some additional effects of delayed payments, especially in a tight financial environment.



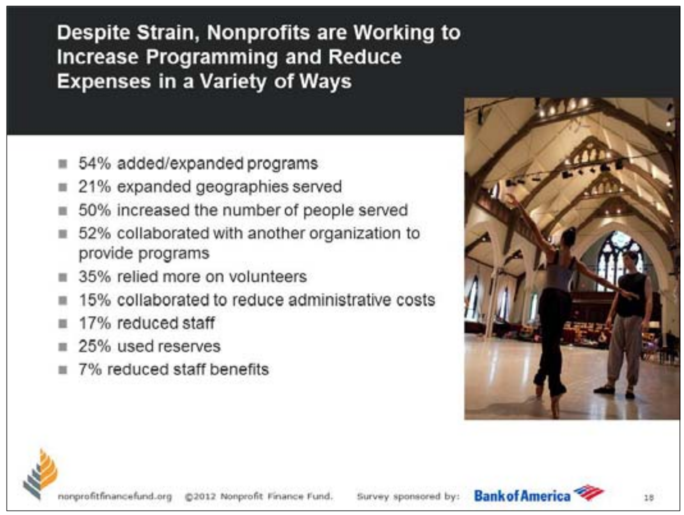
Anjali: This slide is a bird's-eye view of financial health. About two-thirds of organizations have three months of cash or less, and 34% ended fiscal year 2011 with deficits. Knowing the months of cash an organization has is a helpful indicator of how prepared an organization may be if their sources of revenue falter. For some organizations with reliable revenue, it may well be that three months of cash is enough to stay stable; but thinking about payment delays, these numbers have hidden pitfalls when revenue may be becoming more volatile than usual. Although these numbers don't seem as immediately dire as they could be given the economic situation, there may be an underlying strain on the business model that is taking its toll on the sector.



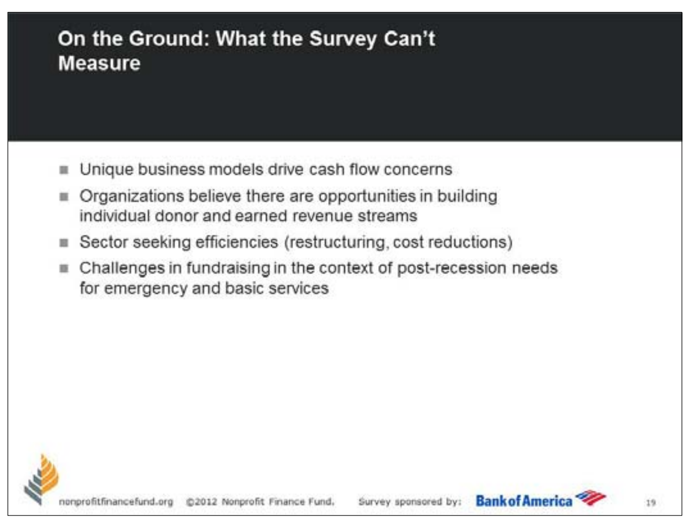
In this year's survey, we also asked organizations what they would feel comfortable discussing with their



funders. Program expansion takes the big lead. Unfortunately, most nonprofits feel uncomfortable discussing a lot of crucial financial issues with their funders. Only 22% felt comfortable discussing cash flow issues and only 8% felt like they could discuss debt burden. One of the more striking numbers is that 19% felt like they couldn't discuss anything with their funders. These results track very closely with our overall results, but there is one area that we thought was interesting: 29% of non-arts organizations felt that they could discuss facility needs with their funders, whereas 38% of arts related organizations were comfortable doing so. We thought this may suggest that arts funders may have a greater understanding of the importance of maintaining quality facilities in comparison to their peers. It also may reflect that arts organizations make a better case about the importance of facilities to carry out their missions.



Emily: Despite all the hardship and what might appear as doom and gloom, we are excited to see a bit of silver lining, and are excited to see the sector working in creative ways to maintain and increase programming while simultaneously reducing expenses. In our on-the-ground work with organizations in our lending and consulting businesses, we have seen a lot of arts organizations that rely heavily on earned income successfully adding or expanding programs over the last year. We have seen increases in the number served, so there are more performances, after-school arts programs and people accessing our cultural assets. We are also seeing increased collaborations, and we are seeing those in two different buckets. We are seeing organizations partnering with other organizations to deliver programs and we are seeing a lot of back-office collaboration. Unfortunately, we are not out of the woods yet. For the fourth consecutive year, we are also seeing organizations with staff and benefits reductions in a sector that is not yet at equilibrium.

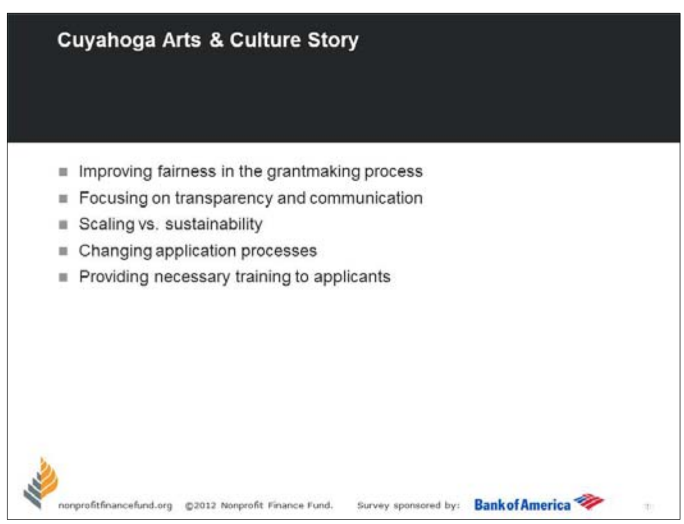


I will now turn things over to Jina Paik. She will be sharing things that are outside of our survey results, informed by her day-to-day work on the ground with clients.

Jina Paik: It is always helpful to get a big picture of what is happening in our sector, especially when talking about finances. A lot of the information that we get from the survey we cannot always get from annual reports. I think it is also really interesting to look at the arts world from the ground up. We are encountering clients who have seen a drop in foundation giving and corporate support and government giving. Anecdotally we are hearing that our clients are experiencing greater reluctance from funders and donors to support arts organizations in this environment of widespread human need, basic services and emergency services. What we are seeing is that arts organizations are coping by turning to their closest supporters. They are also focusing more on their revenue streams: performance fees, admissions, educational fees and even retail opportunities.

The other strategy that we see more today than in the past is that organizations are seeking efficiencies. This can take many forms. The ever-present one is cost reductions. We are seeing more drastic cost reductions, often including staff, but we are also seeing more restructuring to meet their needs. Strategic partnerships are also a strategy that we hear a lot about. They can be partnerships that are temporary or ongoing to not only to share costs but also serve their populations better. We are also seeing more mergers.

Ultimately, it all comes down to cash flow. It is still a really big issue and an ongoing focus for a lot of managers. The survey spoke some about the various strategies that folks are using to manage their cash, but what is really interesting is how arts business models can often drive these cash flow swings. For example, if you are a small dance company, your cash flow has everything to do with whether or not you are busy creating a new piece of work or in the period of performing. When in the creating phase you may need cash, whereas in the performance stage you are getting cash. So in this way, your business model drives your need for cash and your uses for cash. This is something that is particularly relevant to the arts sector because we have organizations that are selling tickets for performances and tuition for classes, and the need for facilities also drives the need for cash more. A lot of what we are seeing on the ground confirms the survey results, but also provides nuances specific to what arts organizations need to complete their missions.



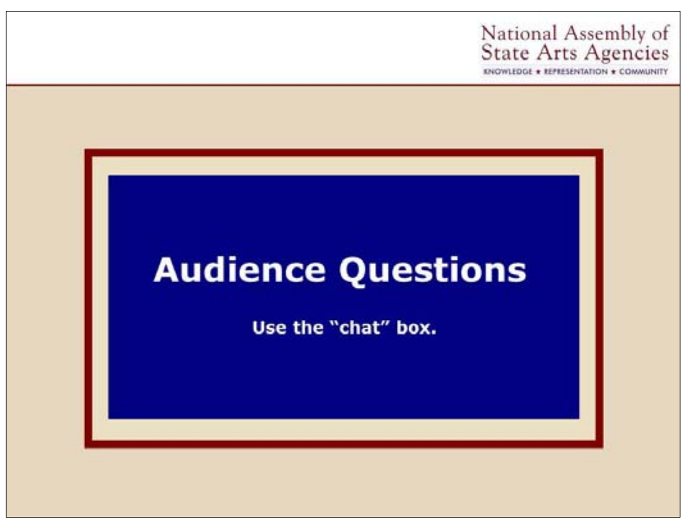
We know from our work with arts funders that they are facing a host of challenges. Allocations for the grant pool can be difficult to predict year to year because they may be contingent on tax revenue of one sort or another. The big challenge that we hear in this era of having less money is how to make the best decisions around allocating those scarce resources, especially when you have existing programs and processes that you need to maintain. I wanted to showcase the work we are doing with

Cuyahoga Arts and Culture because I think that this is a really great example of approaching this challenge effectively through some creative problem solving.

Cuyahoga Arts and Culture is a grant maker in Ohio that makes grants to cultural institutions within Cuyahoga County, roughly the Cleveland area. They fund organizations whose budgets can range anywhere from $100,000 to $50 million. One of the things they want to stress is that the award amounts that they give be meaningful to the organizations. Although that will depend on the organization, it also depends on the amount of funds available each year, which can be unpredictable.

Last year, Cuyahoga contacted NFF to help them mend their application process because they realized that their existing grant-making process had a bias towards organizations in growth. For instance, the way that they structured their grant-making formula essentially resulted in giving more money to organizations with a growth trajectory. They wanted us to help them think about how to offset the bias and move the grant making to support organizations that have healthy financial management. What that resulted in was a new section in their grants applications focused on financial health that added a certain amount of bonus points. The financial health section had three components. One focused on rewarding good operating performance, particularly organizations that could run a surplus. It rewarded organizations with risk tolerance, healthier liquidity ratios. And finally and most interesting, they rewarded organizations who could articulate their own financial trajectory, so they wanted to make sure that the organizations could speak to their own financial strategy and what they were doing to improve their future financial strategy.

They knew this last component was going to be difficult for some of their applicants, especially some of the smaller ones, so they held multiple workshops and webinars on the changes for the applications and provided opportunities for them to learn more about nonprofit concepts in general. Cuyahoga Arts and Culture also asked NFF to provide coaching for each applicant about how best to articulate their financial trajectory and use CDP [Cultural Data Project] data to support them. We have completed the coaching, and know from feedback that it was appreciated.



Q & A

Ryan: Great, thanks, everyone. We have time now for some questions. I wanted to start out with a question about demand. We saw a slide that showed that demand was increasing. How are you defining demand within this survey?

Anjali: In some ways, it really depends on the sector. In arts organizations, the demand has more to do with the participation in programs than with basic needs based demands for some human services organizations. That is one of the interesting divergent interpretations between sectors, simply based on the level of criticality of the sectors and how they are related to emergency services, as opposed to participation in theaters, for instance. So there is a divergence that tells different stories depending on the sector.

Ryan: Another definitional question: Could you explain how you define arts organizations in the survey a bit more?

Emily: Survey participants actually self-select when they take the survey. There are options of about 10 to 15 subsectors, arts and culture being one of them.

Ryan: We received an observation for which you may have a response. Speaking from the standpoint of a state arts agency, another reason that payments are late to arts organizations is that they neglect to send the state arts agency the appropriate paperwork. They agency holds payments until the arts organization sends them the report from the previous year, for instance.

Jina: That is interesting, because it is also a comment we hear a lot from the social services side of our work as well. This is an ever present complaint and it often seems to be a disconnect from the nonprofits as to what they actually need to do in order to fulfill their part of the compliance and reporting process. I don't know how we solve for that unless it is to be almost overly communicative about what the requirements for payments are.

Emily: Just as a follow-up, as was mentioned when we talked about the slide regarding what organizations are comfortable talking with their funders about, the funders may have a different perspective. It just points out that there is probably a communications gap between the two sides that needs to be bridged in some way.

Ryan: Another question: Does the sample size for the survey support state-by-state breakdowns?

Anjali: Yes. What you will find when you use the survey analyzer is that, with 816 respondents, some regions will have more information than others. Particularly in the areas where NFF is located, there are larger sample sizes—for instance, New York. In areas where we have less of a presence, we rely on our partners to help disseminate the survey to get those numbers up for an appropriate sample.

Ryan: Thank you once again, Anjali, Emily and Jina. And thank you to everyone out there for joining us today.