

Transactional Analysis, Nonprofit Style

An Interview with Richard Brewster

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NONPROFIT QUARTERLY RECENTLY interviewed Richard Brewster, Executive Director of the National Center for Nonprofit Enterprise (NCNE), to garner his thoughts about some of the economic models that nonprofit managers and their advisors work with in developing their organizations.

NPQ: Many funders are pushing nonprofits to “go to scale,” but what does that mean and does it make sense as an organizational approach to the development of responses to social problems?

Brewster: I don’t think that many small to mid-sized programs think too much about “getting to scale” if that means increasing impact by growing the single organization and increasing delivery of services. This willingness to stay smaller is probably based on realism and a concern about outcomes. Of course, organizations can and do grow within their geographic area to increase the numbers of people helped, but they can rarely get close to helping everyone in that area who may need the service they provide. Many times there is a ceiling on the availability of funding. Thus, it very rarely happens that an organization can permeate a population in need with its model of service even if that model is very effective—so the growth of a single organization may not be the avenue to a strong, consistent response to a social problem.

One archetypal response to this ceiling can be to grow through geographically dispersed affiliates. But another response is for organizations to try to bring work to scale through collaborating with organizations to try to act as more than the sum of their parts.

Costs and Benefits of Fund Diversity

NPQ: Do you think there is a “U-shaped pattern” in the way organizations are funded over time? Can you describe it?

Brewster: As William Foster’s article on page 26 in this issue indicates, most nonprofits start out with one to three sources of funding. From there many tend to diversify. The reason for this, of course, is to increase the money the organization has to work with and to decrease its risk.

Eventually the same groups that sought to diversify seem to cross another threshold and begin to concentrate on one type of funding which may provide up to 85% of their income. Some believe that this re-concentration is driven, at least in part, by transaction costs.

NPQ: What do you mean by transaction costs?

Brewster: Transaction costs include those costs that are over and above the directly attributable costs of fundraising: the costs of administering a particular type of funding (meeting reporting requirements, for example); the costs of developing systems to support fundraising and administration; the time spent by the executive director and key staff in building relation-

ships with potential funders; and the time and attention of program managers, who may be forced to act differently as a result of a particular funding stream.

It is important to take these transaction costs into account even if some of them seem qualitative.

Bob Herman and Dick Heimovics of the University of Missouri-Kansas City have produced some good evidence that one of the transaction costs critical to the effectiveness of a nonprofit is the time the executive director spends securing support, such as networking with politicians or maintaining relationships with foundation or United Way staff and large donors. But what about the opportunity costs of this activity? What other work is not performed because of the effort devoted to this activity? There are only so many hours in the executive director's day: in effect, he or she can become a bottleneck that *checks* growth in revenues. One response to this may be to concentrate on one or two sources of funds.

In organizations largely funded by grants and contracts, managing the interplay of restrictions that come with certain sources of funding is also time consuming and can back the organization into a corner.

NPQ: So are you suggesting that for diversification to be positive, you have to consider the source?

Brewster: Absolutely. The best source of funds for a nonprofit has three key characteristics. First, it yields a lot of dollars (of course!). Second, it is unrestricted. This is important partly because a nonprofit can shift this money to cover the loss of other funding. This is rarely possible. A good example is government money: a mental health organization that I know has recently diversified successfully by winning new government contracts to add to its principal contract with the county. If any of these contracts has cuts imposed, however, none of the income from the others can be used to cover the loss. The only thing that can be said is that at least the organization is still helping *somebody*. The other reason unrestricted funds are important is that they can give a nonprofit the financial capacity to respond nimbly (as described in "Goldilocks and the Three Budgets" on page 16). The final, crucial characteristic is that the

source is "internally diversified." That is, it comprises in itself a number of individual sources that are not correlated—so if one disappears or goes down in value, the others aren't affected.

This kind of diversification is sometimes mentioned in the literature but is, in general, seriously undervalued. If you can find the dollars you need, the ability to do with the money what you want, and the spread of risk, you don't need to diversify into a different category of funds, and you can avoid the transaction costs that are involved in establishing and managing new people, systems, and relationships.

NPQ: What are these quality sources?

Brewster: The sources that offer these advantages are essentially private contributions and profits on earned-income activities.

There are a number of types of nonprofit that actually benefit from these advantages. Organizations that supply guide dogs for blind people in the US and around the world all have high reserves—a lot of organizational "slack." On average, 60% to 70% of their revenues come from one specific source—bequests. Most of the people who leave bequests are friends and relatives of the people who benefit directly from a guide dog, the amounts are usually relatively large and unrestricted, and a decision by one particular person to leave money doesn't affect the decision by another.

Another, more ordinary example might be a small organization that provided support and residential services to women with mental health concerns and their children in one neighborhood in Boston. They were innovative and their story rang true at an emotional and intellectual level and they were able to build quite a large base of individual donors to supplement government contracts and foundation grants. This allowed them to remain the adaptive and independent program they were despite pressures to conform. Thus, if at the very least a nonprofit can find enough unrestricted, relatively low-risk support to provide the financial capacity to adapt to changes in the environment and innovate, it is in a much stronger position to exploit the restricted but often very substantial resources that government funds, for example, provide.

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