
The Financial Health
of Minnesota's Nonprofits

A report conducted on behalf of the
Minnesota Nonprofits Assistance Fund

by
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Introduction

Up to one-third of Minnesota nonprofits report strong indications of financial health. These nonprofits have not carried deficits from year to year, they have consistent surpluses, and they report reasonable access to funding. The report findings also indicate that at least 10% of the sector is on shaky ground and struggling day to day with the possibility of closing.

This report studies financial health by assessing organizational access to financial resources, the existence of internal cash for handling shortfalls, the consistency of surpluses and positive fund balances, and the financial attitudes and practices of management.

Up to 60% of nonprofits have not achieved the financial status their managers desire and need for programming stability. The report findings show a majority of nonprofits experience threatening cash shortfalls without the internal resources to handle the problem. Deficits are commonplace. As a whole, the industry in Minnesota spends at least \$2.5 million more per year than it earns, while the expenses of nonprofit organizations are rising 11% faster than income.

Nonprofit managers report high levels of confidence in their ability to manage their agency's finances. More than 95% agree that financial health is essential to the continuation of their organization's mission. The report indicates, however, that a wide gap exists between the financial goals of managers and the financial health of nonprofit organizations.

The report concludes that the cause of financial instability is a combination of external funding realities, beyond the control of the nonprofit industry, and internal factors which are within a nonprofit's control to change.

This report recommends a shift to budgeting based on available income, rather than projected expenses. It also recommends more technical assistance with budgeting, creating internal cash reserves, and cash flow analysis for boards and staff.

The financial health of Minnesota's nonprofit organizations is an increasingly urgent topic among nonprofit executives, foundation staff, government contract officers and others concerned about the ongoing survival of this important sector.

It was just ten years ago that the industry experienced a major belt-tightening. Decreased federal and state spending caused nonprofits to look at financial resources in a different way. Borrowing from the entrepreneurial wave of the '80's, many nonprofits sought to control their own financial destiny through earned income projects.

Now in 1990, while few will argue that there is a growing demand for our state's human service, economic development, cultural or education services, there is renewed anxiety over future funding for these important services.

The increasingly evident slow down in the economy is being felt on a national and local level. Within the last year, Hennepin County shed millions of contract dollars from its traditionally funded human service agencies; at the same time nonmetro counties and United Ways report inability to increase funding levels because of their own lack of resources.

We see more nonprofits merging services with other groups in hopes that consolidating costs will increase financial security. Arts organizations, ever vulnerable, seek out new ways to justify the *essential* nature of their services.

Foundations and individuals have also sharpened their priorities, possibly excluding some types of organizations from funding consideration.

Nonprofits are not the only victims of economic change. Long host to many locally-owned Fortune 500 companies, our state's business community has experienced its own mergers, acquisitions and cutbacks, giving nonprofits another cause to worry. Minnesota's banking community, too, has undergone significant change. Nonprofits report a tightening of credit policies from many metro and nonmetro banking institutions which once were more eager for nonprofits' business.

Money, tight as it once was, is now getting tighter.

The last ten years have been difficult ones for nonprofits. Yet, ever adaptable, the nonprofit industry has more than just weathered the storm; it has also broadened its financial and management know-how. *The changes of the last ten years have made nonprofit managers more aware than ever that the organization's mission, no matter how important, cannot exist without solid financial support and management.*

The goal of this study, conducted during the summer of 1990, was to measure the financial health of Minnesota nonprofit organizations; to discover some of the factors that lead to financial health; and to suggest conclusions and implications for the Minnesota Nonprofits Assistance Fund and the funding community.

The study was conducted by The Stevens Group under contract with The Minneapolis Foundation to manage the Minnesota Nonprofits Assistance Fund (MNAF). MNAF comes into contact with hundreds of nonprofits each year through its loan and technical assistance programs. The survey was developed with four basic assumptions:

- * Financial health is essential for the effective delivery of a nonprofit's mission.
- * External changes in the funding community and financial environment have increased the financial stress on nonprofits.
- * Nonprofit service demand appears to be increasing just at a time when funding supplies and access are decreasing.
- * Financial health is a product of balancing external pressures and income against internal financial management practices and strategies.

Grateful thanks is extended to the Northwest Area and the Otto Bremer Foundations for funding this study. We also wish to acknowledge Mary Ellen Specter who conducted the data analysis and case study interviews; MNAF's Advisory Committee, as well as Thomas Berg, Bobbie Henrie and Sarah Lutman provided helpful input and review of the survey instrument. Special thanks to the two hundred sixty-three nonprofits who took the time to complete the questionnaire; and the six nonprofits whose specific experiences add a real-world quality to our statistical findings: Equity Services, Inc., St. Paul; Illusion Theater, Minneapolis; Occupational Development Center, Thief River Falls; Northern Community Radio, Grand Rapids; Northside Residents Redevelopment Council, Minneapolis; and Theater 65, St. Paul.

Financial Status of Minnesota Nonprofits

Methodology

The study's sample is drawn from a roster of nonprofits registered with the state of Minnesota. After specifically excluding private foundations, civic organizations, hospitals, development funds, sports and wildlife associations and the like, we arrived at a universe of 1,090, from which we sampled 491 nonprofits with 501(c)3 status, 60% located in the seven county metropolitan area of the Twin Cities, and 40% located in greater Minnesota.

Two hundred sixty-three responses were returned from nonprofits geographically proportionate to the state's nonprofit population. 61% of the study's respondents are from the seven county metropolitan area and 39% are located in nonmetro Minnesota.

The high response rate and universe parallel give a 90% confidence level to the data presented in this report.

The survey was designed as a self-report. Its thirty-six questions asked for objective financial information, as well as perceptions about the organization's financial health. Thus we have a measure of the *perceived* financial health of an organization to compare against more *objective* financial information such as audits, financial statements, budgets and other matters of fact.

Organizational Profile

Most of Minnesota's nonprofits (49%) are health and human service agencies. Approximately 13% are arts groups, another 23% engage in advocacy, community/economic development and education, and the remaining 15% provide multiple services, housing and other services.

This study found that in 1989 the median nonprofit budget was approximately \$450,000. The average budget for the same year was \$1,000,000. The sizable difference between the

median and the average can be attributed to large budgets which skew the average.

Revenue Mix

The nonprofit sector as a whole received 34% of its revenue from federal, state or local government. Earned income is the second largest source of income, on the average comprising 22% of the nonprofit sector's revenue base.

- * Nonmetro nonprofits are more likely than metropolitan nonprofits to receive 50% or more of their revenue from the government.
- * Nonmetro organizations rely less on foundations and United Ways to support their budget.
- * The nonprofits in this study rely least on charitable gambling as a revenue source. (Since the study sample eliminated civic and sports organizations, this finding may not be true of the whole industry.) Gambling proceeds for 1989 were the smallest revenue source reported and they are expected to stay small.
- * Thirty-eight percent of nonprofit managers report they expect their current revenue mix to change by 1992. In aggregate they expect to receive at least 10% less money from the government, more from earned income, and to make up the difference with individual contributions, United Ways, special events, and foundations.

As a group, managers do not expect foundations to substantially replace losses in government revenues.

Perceptions of Financial Health

Nonprofit managers report surprisingly optimistic views of their organizations' financial health.

- * Twenty-one percent (21%) of nonprofit executives and/or financial officers believe their organizations are "financially healthy and not presently vulnerable."
- * Forty-three percent (43%) say they "have been financially healthy to date, but feel vulnerable in the future."
- * Thirty-three percent (33%) say they "have some financial problems, but expect to survive."
- * Only three percent (3%) "don't know how they will survive this year."

Financial Information and Decision Making

Nonprofit managers report in large majority that financial information is integral to their decision making.

- * 99% report that they use financial information when making organizational decisions.
- * 98% believe that strong financial management will enhance the mission of their organization.
- * 97% agreed that a balanced budget is essential to the successful operation of their organization.
- * 81% report that understanding and managing the financial operations of the organization is one of their greatest managerial strengths.
- * 89% are comfortable with the skills of their financial staff.

The Relationship between Financial Status and Agency Type

Survey response showed several differences between arts organizations and human service organizations. (We use the generic term "human services organizations" throughout this report to include human services, health services, advocacy, economic development services, and education.)

When compared to human service organizations:

- * Arts groups tend to be concentrated in the metropolitan area.
- * Most are less than ten years old.
- * Arts groups as a whole report more problems with cash shortages than human service organizations.
- * Arts groups are less likely to have an operating reserve than human services.
- * Financial management of arts organizations is more often the responsibility of the business manager, rather than the executive director.
- * Arts organizations receive a smaller proportion of their budgets from the government than human services.
- * Arts groups spend more of their staff and board meeting time discussing cash shortages.
- * Arts groups feel less inclined to serve their clients regardless of cost.

The Relationship between Financial Status and Location

Another set of significant differences is apparent between metropolitan and nonmetro organizations.

Nonmetro organizations are more likely to be funded by the federal, state or local government than those organizations located in the Twin Cities seven county metropolitan area.

- * Government funding is more likely to account for 50% or more of the collective budgets of organizations located in greater Minnesota.
- * Nonmetro nonprofits are less likely to be funded by foundations, corporations, and United Ways than are metropolitan organizations.

- * Delays in government payments or reimbursements are more likely to be the cause of cash flow shortages for outstate organizations than for metro organizations.
- * More nonmetro organizations cite poor timing of fundraising activities as a cause for cash flow problems than nonprofits located in the Twin Cities.
- * Nonmetro organizations are more likely to feel they do not have sufficient access to funding sources.
- * They also are more likely to feel they should serve their clients regardless of the cost or the cash available.

Surpluses, Deficits and Operating Reserves

The survey asked a number of questions about nonprofits' experiences with surplus, deficits and operating reserves.

- * A full 84% of nonprofit managers believe that surpluses are essential for stable financial management. However, 25% say that surpluses are impossible to obtain and 16% of nonprofit managers do not think that surpluses are important.
- * 86% of Minnesota nonprofits have had surpluses in at least one of the past five years; and 14% had surpluses for all five years of the survey.
- * Two-thirds of Minnesota nonprofits did not have a current surplus at the end of 1989.

- * Almost three-quarters (73%) of the organizations reported having deficits in at least one of the past five years; and 11% have had deficits in at least four of the last five years.
- * A comparison of those respondents submitting both income and expense for 1988 and 1989 shows that expenses (21%) are increasing at a faster rate than income (10%).

Cash Shortfalls

Almost two-thirds (62%) of nonprofits have had a cash shortfall in at least one of the past three years. Nonprofits report that, on the average, shortfalls affect financial performance four months of each year; although some organizations reported cash shortfalls which affected more than twelve months.

- * The top three reasons given for cash shortfalls are: delays in government funding (26%); timing problems with fundraising (14%); and a prior deficit (12%).
- * When confronted with cash shortfalls, 27% have sought a solution to the problem by applying for a loan; 25% transferred money from other funds; 18% attempted to speed the collection of awarded grants; 16% approached foundations; and 7% of nonprofits solved their cash shortages by holding salaries.

| Nonprofits Most Significant Financial Problems |
|---|
| <ul style="list-style-type: none"> * Chronic lack of cash; * Severe cuts in funding; * Significant growth that has resulted in outmoded financial systems. |

| Nonprofits Most Significant Ongoing Problems |
|--|
| <ul style="list-style-type: none"> * Growing demand for service without the resources to support program growth; * Shortage of income to meet expenses; * Shrinking public money to support programs. |

Discussion

The data presented above shows a wide discrepancy between nonprofit managers' goals, perceptions and intentions, and the objective reality of their situations. For example, although 84% of nonprofit managers say that surpluses are important; the reality is that only 33% of nonprofits had a surplus last year. Worse yet, although the majority of the industry values surpluses, 98% of nonprofits cite chronic cash shortages as their most significant financial problem; with 25% of the industry giving up on the possibility of ever obtaining a surplus.

Two-thirds of the industry reports they are now or have been financially healthy to date. Relatively speaking, this may be true. A full discussion of financial status needs to consider both objective and perceived judgements.

This study, however, was conducted to determine more than just the relative financial status of the sector. We mean to determine its *financial health*. In a sense, this study is an industry "check up". Since the nonprofit sector does not have its own standards of financial well-being, we developed the following seven-pronged definition to assess the financial health of Minnesota's nonprofit sector.

Definition of Financial Health

- * Financially healthy nonprofits have sufficient financial resources to ensure stable programming.
- * Financially healthy organizations have a ready source of internal cash, or access to cash, available in times of shortfalls.
- * Financially healthy organizations are committed to income based spending.
- * Financially healthy organizations retain, at the end of each year, a positive cash fund balance.
- * If there has been a deficit for the year, financially healthy organizations have accumulated surpluses which are greater than the current year's deficit.
- * Financially healthy organizations have established, or have specific plans to establish, an operating reserve to finance cash shortfalls and program growth.
- * The boards and management of financially healthy nonprofits hold themselves responsible for the financial stability of the organization.

Financial Health of Minnesota's Nonprofit Sector

The study is predicated on seven factors which collectively form a definition of financial health. The study's results demonstrate the presence of all of these factors in at least some of the state's nonprofit community. Although the majority of nonprofits believe these factors are essential to financial health, the data indicates that many of these determinants are absent from a majority of responding organizations.

These seven factors are described in detail in this chapter and followed by supporting data from respondents.

#1: The financially healthy organization has sufficient income to ensure stable programming.

The two adjectives, sufficient and stable, are the key components to this definition. Nonprofits, like any service business, need adequate income to meet program demands. Healthy nonprofits understand the importance of continuity of service as well. *A vibrant organization needs a stable source of income, well matched to its expenses to continue its programming, as well as its credibility with clients, board and outside funders.*

Although income sufficiency is derived from several means, two specific factors, *stability of revenue* and *revenue diversity*, were analyzed for their role in income sufficiency.

- * Nearly two-fifths (38%) of nonprofit managers expect their revenue mix to substantially shift in the next two years; they expect it to tilt away from government revenues to more earned income.

But those organizations who already receive a smaller proportion of revenue from government (21%) were more likely to have run three or more deficits in the past five years.

The proportions of revenues currently received from foundations, individuals, United Ways, special events, and charitable

gambling are expected to remain about the same.

- * Forty-seven percent (47%) of nonprofits are dependent on one predominant source of revenue, with government funding listed as the most predominant income source. Twenty-nine percent (29%) claim foundations as their single predominant income source.
- * Fifty-three percent (53%) of nonprofits have two or more significant sources of revenue. Among these organizations, foundations are the most common element in the mix, followed by government, fees, and individual donations.

#2: The financially healthy nonprofit has an internal source of cash or ready access to cash in time of shortfall.

Like any business, nonprofits must have cash to survive. Without cash, payrolls cannot be met, taxes cannot be paid, and services must be put on hold.

Cash shortfalls happen in even the best managed organizations. Grants and contract payments are delayed, receivables are slow to pay, and expected donations are postponed.

The ability to handle the ebb and flow of income is a critical step in stabilizing and gaining control over a nonprofit's financial condition. Some organizations have their own savings surplus or reserve to handle these inevitable income fluctuations. Other groups use borrowed money as a temporary solution. *Either way, quick access to cash spells the difference between stable uninterrupted services and crisis conditions.* 62% of nonprofits have had cash shortages in at least one of the last three years.

- * 27% of nonprofit organizations use borrowed funds, either from a bank or from MNAF, in times of cash shortfalls.

- * 25% have used an internal source of cash to even out negative cash flow.

#3: Financially healthy nonprofits engage in income based, rather than budget based spending.

Most nonprofits aspire to and value a balanced budget. Yet some have not yet learned the relationship between having a balanced budget and adjusting the organization's actual expenses to match the income it has received.

The spending patterns of financially healthy organizations are *income based*. *Financially healthy organizations do not overspend available income - whether it is budgeted or not.*

An analysis of survey respondents reporting income and expenses for both 1988 and 1989 revealed that these nonprofits overspent income by \$1,000,000 in 1988, and by \$600,000 in 1989. Although these figures represent a small proportion of the total income in this sector, they do indicate the industry's tendency, as a group, to spend more money than it has.

The analysis of expenses also revealed that over the past three years expenditures from nonprofits rose twenty-one percent (21%), while income rose only ten percent (10%).

Although 88% of nonprofit managers report making monthly comparisons between budgeted and actual income and expenses, we estimate that in any given year at least one-third of nonprofits have an annual deficit.

With such a strong commitment to responsible spending, how does this happen? There are many reasons. In our estimation the primary reason for overspending lies in the nonprofit's traditional dependence on the *budget* as its only financial management tool. The truth is that *when the budget alone is used without balance sheets and cash projections for financial management, spending will occur according to income goals, rather than income realities.*

#4: At the end of each year, the financially healthy organization retains a positive cash fund balance (surplus).

In the private sector, surplus (profit) measures business success. A nonprofit's success is not as easily measured. Still, even though surplus does not indicate a nonprofit's *success*, it is a strong indicator of organizational *health and stability*.

It is not that long ago that nonprofits expected to be "penalized" by funders if a surplus were to appear on their balance sheet. The study posed a variety of questions meant to elicit managers' experience and attitudes about surplus.

- * 84% of nonprofits believe surpluses are essential for financial stability; however 25% believe surpluses are impossible to obtain.
- * 86% of nonprofits have had a surplus in at least one of the last five years; but only 14% report a surplus in each of those years.
- * At least two-thirds of Minnesota nonprofits did not have a cash surplus for the year ending 1989.

Significant ambivalence toward surpluses appears to exist. Nonprofit managers want surpluses and believe they are important, but other factors come between the goal and its realization.

#5: In years where a deficit does occur, the financially healthy organization has accumulated surpluses sufficient to cover the current year's deficit.

In spite of solid financial practices, there will be years when a deficit occurs. Financially healthy organizations hold themselves accountable for developing strategies to handle deficits in years when financial resources are not as great as originally anticipated. They wisely find ways to make up for a current year's deficit by spending less in the following year(s) or supplementing the shortfall with accumulated surpluses.

Minnesota's nonprofits have a variety of ways to handle current year deficits.

- * 37% of those organizations who have had a deficit in the past five years report that the deficit was handled with a prior year's reserve. 14% report that they cut expenses to handle the deficit, 11% borrowed money,

and 9% cut expenses, including laying off personnel.

#6: The financially healthy organization has established (or has plans to establish) an operating reserve to finance growth and cash shortfalls.

An operating reserve is a designated savings fund established for a particular purpose, usually to meet ongoing fluctuations in income, or to internally finance the replacement of fixed assets.

Operating reserves are a planned strategy for financial performance. They anticipate financial shortcomings and are generally established with board participation to meet those shortcomings. Operating reserves are more definitive than a surplus. The surplus is a by-product of a year when income exceeds expense. Although surpluses are sometimes planned, they often just happen. An operating reserve never "just happens". It is a strategic, and often painful, tactic on the part of a nonprofit to develop its own solution to unpredictable income shortfalls.

Reserves can be developed through an internally funded savings plan or by funding depreciation; they can also be fundraised.

Last year, cash shortages threatened fifty-seven percent (57%) of organizations without reserve funds.

#7: The board and management of financially healthy nonprofits hold themselves responsible for the financial stability of the organization.

Although the prevailing opinion is that the board of directors alone is ultimately responsible for the success or failure of a nonprofit organization, in practice, it is the executive director who most often *feels* and *takes* the responsibility.

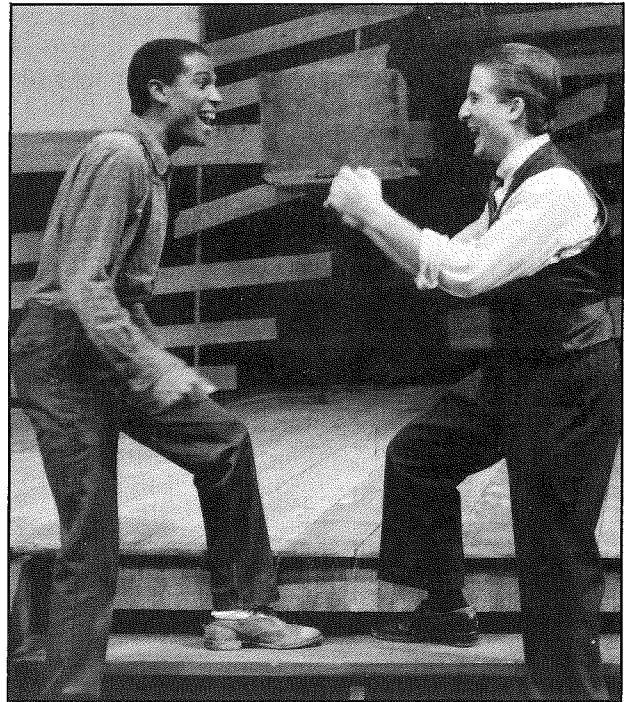
Our survey asked specifically, "Who is most responsible for the financial success or failure of your organization?" Seventy-three percent of the respondents report that the executive director is the one who is most responsible for the organization's financial success or failure. Only 14% stated the board is responsible. (The other

13% cited program or financial staff (6%); 8% stated "other"(!).

Arts organizations and all other organizations with budgets less than \$250,000 are more likely to have the board of directors or a business manager responsible for finances.

Although most respondents indicated that they currently use financial information and review it with their boards, the study's results show great interest in training board and staff to read financial statements and understand cash flow. This suggests a need for developing more financial skill for boards and managers. There is no doubt that technical assistance can play an important role in increasing the financial skill. *But skill does not take the place of responsibility.*

It is not our purpose to step into the debate over *who* is ultimately responsible for the financial well-being of the nonprofit organization. The important issue is that *someone is holding themselves responsible for the success or failure of the nonprofit they are there to govern or manage.*



The Illusion Theater uses its performances to teach people about important social issues.

Critical Paths to Financial Stability

The study isolated several variables which are now and will continue to be critical factors to the ongoing financial stability of Minnesota's nonprofits.

Financial Technical Assistance

The study found that most nonprofit managers (95%) have sought some form of technical assistance in the last five years.

Ninety percent (90%) report that technical assistance has both changed their organization and made it more effective.

The study also found that most nonprofit managers are aware of sources of technical assistance in their communities and are comfortable diagnosing their own situations prior to seeking technical assistance.

Seventy-eight percent (78%) do not believe that foundations are providing adequate funding for technical assistance; and eighty-four percent (84%) report their willingness to pay for technical assistance themselves when funds are not available.

Though managers realize the need for financial technical assistance, few are receiving it. In fact, fewer nonprofits report receiving financial technical assistance than any other type of assistance.

- * Of all nonprofits which had received some form of technical assistance, only 15% had received technical assistance for a financial matter. Of those, 4% received assistance in cash flow projection; 6% had received training in overall financial management; and 5% received training in budgeting.

Nonprofits have used a wide variety of technical assistance to improve management. But when asked what additional areas of technical assistance would be most useful for the future, the most frequent responses were: cash flow

projections; establishing fee structures to cover costs; and board development.

There was also significant interest in teaching board and staff members how to read financial statements.

Learning to Deal With Cash Shortfalls

Sixty-five percent (65%) of nonprofits say chronic lack of cash is their number one financial problem. It is one of the top three financial problems cited by almost all (98%) of the study's respondents.

Because cash shortages are so commonplace in the industry, it is essential that Minnesota nonprofits have cash available to handle those short falls.

The consistency of the cash shortfall problem throughout the nonprofit sector sharpens the need for cash flow statements as the essential tool in financial management. No other source of information anticipates when shortfalls will occur with enough accuracy to enable positive action.

Although cash flow statements are the first step in learning to deal with cash shortages, the next step can take one of two forms, an internal operating reserve or access to a cash flow loan. Either or both of these vehicles may be appropriate solutions for the cash-short nonprofit.

Income Based Budgets

There are many ways in which a nonprofit's business differs from its commercial counterparts. Yet nonprofits experiencing tough financial times might borrow a lesson in budgeting from the private sector, which considers income first in its budgeting process. For too long nonprofits have focused their budgets first on the expense side, considering the income which pays for these expenses almost as an after thought. This is a recipe for deficits and shortfalls.

Program based budgeting and functional cost analysis, too, are additional tools for understanding program costs.

Sixty-five percent (65%) of the study's respondents understand that their commitment to mission does not require spending more money than they have. And yet, the rate of deficit and lack of reserve funds indicate that in day-to-day practice expenditures are not balanced against income.

Strict adherence to income based budgets will go a long way toward correcting this disparity between understanding and reality.

Financial Flexibility

Forty-seven (47%) percent of Minnesota nonprofits rely on one funder as their sole source of income. The fact that in most cases this predominate funding source is the federal, local or state government has implications which, in light of recent cutbacks, should give the sector considerable pause.

Nonprofit organizations need both service flexibility and funding flexibility as they maneuver through the tides of change.

Diversifying the organization's income, described in detail in Equity Services' Case Study, is the easier of the two tasks. Income diversity lessens the nonprofit's dependency on one revenue source, giving it more flexibility if that source is ever jeopardized.

Flexibility in service commitment is a much more difficult problem. Society expects nonprofits to meet unmet community needs, often without regard to cost. Although many nonprofits would have great difficulty turning away potential clients because of lack of funds, all nonprofits have an obligation to be fiscally responsible, ensuring the stable continuation of mission for today and tomorrow's clients. This stability cannot be achieved when service is reimbursed or priced at below breakeven levels.

Financially healthy nonprofits stay flexible and responsive to community needs. Although committed to mission, they have built enough flexibility into the agency's budget, programs and management practices to weather difficult times. No longer content to be totally dependent on one

income source for one service, where appropriate, financially flexible nonprofits diversify their funding and approach to programs.

Updating Financial Systems

When asked to cite the three most significant financial problems faced by the organization in the last year, significant growth which resulted in outmoded financial systems was near the top of the list.

A nonprofit agency relies on its financial systems to provide up-to-date financial information. Ninety-nine percent (99%) of Minnesota nonprofit managers report that they routinely use financial information for decision making. Outmoded financial systems that cannot deliver timely and adequate information for board and management will hold an agency back in its quest for financial health and stability.

As funding declines or takes fundamental shifts, nonprofits will need to become more astute with managerial and board use of financial information. There will be a need for up-to-date financial systems that can deliver information about actual income and expenses, costs per unit of service, receivables collection, and cash shortfalls in a timely way. Without this information, management and boards cannot make responsible decisions related to the organization's mission, programming and finances.



Leo Keskinen, a volunteer programmer for Northern Community Radio, has been doing his show "Finnish Americana" for twelve years.

Minnesota Nonprofits Assistance Fund's Role in the Financial Health of Nonprofits

The Minnesota Nonprofits Assistance Fund (MNAF) was established in 1980 as the funding community's direct response for nonprofits experiencing delays in government contract payments.

In its nine subsequent years, MNAF has made nearly 500 loans totalling over \$9 million dollars to nonprofits throughout the state.

Conducted ten years after MNAF's inception, this study reports that a full twenty-six percent (26%) of nonprofits still cite delays in government payments as the number one reason for their cash flow problems.

The survey asked several questions about MNAF's contribution to nonprofits' financial health, as well as the overall effect of the loan on the agency. The results below are reported from a subset of 70 survey respondents which had borrowed money from MNAF and the rich anecdotal information provided by the case studies.

MNAF Provides an Immediate Solution to Cash Shortfalls

Of the seventy respondents that had received a loan from MNAF, 89% report stabilization of cash flow as the loan's most valuable effect.

Most of the case subjects and a majority of MNAF borrowers explained that prior to coming to MNAF, they had been turned down for a bank loan. MNAF provided these organizations with a quick source of cash badly needed to stabilize operations. The case studies emphasize the critical importance of having access to cash: The Illusion Theater was unable to proceed with its productions until an infusion of MNAF dollars; Northern Community Radio was in danger of not meeting payroll and having its bank loan called; Equity Services was unable to fulfill its commitments to its community to start a new program; Northside Residence Redevelopment Council was finding it difficult to operate all its

programs because of uneven cash flow; Theater 65 needed cash for a crucial production; and Occupational Development Center could not finance necessary expansion.

MNAF's role as a source of cash to meet temporary shortfalls, stabilize finances, and allow organizations to carry on with their missions has been, and continues to be, a dominant function. The study's results suggest that the demand for this will continue to grow.

MNAF Helps Nonprofits Become More Self-Reliant and Achieve Financial Goals

In addition to meeting cash needs, MNAF also helps organizations become more self reliant. MNAF gives nonprofits the tools and information to gain control of their operations, which then leads to achieving financial and programmatic goals. The overwhelming majority of MNAF loan recipients (84%) say that the MNAF experience contributed to their self reliance.

The case studies demonstrate how self reliance is an effect of the loan process. Those interviewed reported that the requirements of the application, completing cash flow projections, and the process of income and expense analysis lead the applicant to recognize funding and expense patterns that caused cash shortages.

This understanding was then translated into strategies which addressed the pattern or cause.

All six case participants stated that the loan was far more to them than a source of cash. It was a tool to achieve financial goals.

MNAF Improves Nonprofits' Financial Systems

Three-fourths (76%) of MNAF loan recipients reported that the loan process resulted in an improvement in their financial systems.

All of the case studies show an improvement in financial systems after working with MNAF. This improvement comes about through a Socratic method of questions and answers. Through the application process, organizations learn what information they need for clear financial understanding and successful planning. Some managers report that the process taught them to "think financially."

Often financial system changes are not complicated and are well within the organization's present capabilities. The Illusion Theater simply had to use its existing computer program to start producing monthly cash flow projections. Theater 65 had to more accurately anticipate the costs of productions and the possibilities of marketing. Northern Radio was able to immediately identify a cause for chronic cash shortfalls and implement a simple solution.

The most complicated enhancement of financial systems recorded through the case studies is the case of Northside Residence's Redevelopment Council. Here MNAF helped NRRC's new bookkeeping staff develop an internal, computerized system that could produce monthly reports for their multiple income structure.

MNAF Increases the Agency's Financial Discipline

By providing a place to learn how to think financially, MNAF also contributes to the organization's financial discipline. Financial discipline refers to the regular review of financial information that enables organizations to be more responsible for their future, better informed, and better planned.

Seventy-six percent (76%) of nonprofits who received MNAF loans reported an improvement in their financial discipline. An excellent example is The Illusion Theater. Here MNAF staff, in addition to providing a line of credit, encouraged the staff and board to develop its own operating reserve fund. The Illusion Theater is a model for the discipline required to build an operating reserve. Combined with strong management, its board's control and

oversight have created an atmosphere of strong financial responsibility and discipline for the theater.

MNAF Allows Organizations to Take Advantage of Opportunities

MNAF loans enabled Illusion Theater, Equity Services, and Occupational Development Center to take advantage of opportunities for growth. Thirteen (13%) percent of loan recipients state-wide also report using their loan for this purpose. Most nonprofits are reluctant to self-finance growth. The Occupational Development Center in Thief River Falls is a wonderful example of borrowing for growth. This case is a model too of how a good business plan contributes to a positive loan decision.

MNAF Increases Credit-worthiness, Confidence, and Community Reputation

Five of the six case studies report that MNAF's loan improved their credit status at banks and with funders. It also inspired greater confidence among the executive staff, and built a stronger community reputation. These borrowers' success with MNAF has given many the confidence to re-approach banks and to begin a banking relationship.

Financial forecasting and strategies developed during the loan process also contributed greatly to the sense of control executives have over their present and future financial condition. More often than not nonprofit managers feel they do not have control over their financial destiny. The loan process provides organizations a setting in which questions and answers can be discussed without judgement. The process points out the areas where information would be most useful and needed for producing a clear and insightful picture of the organization.

Organizations also report that a more positive overall community reputation was begun as a result of the MNAF loan. Not only do loans stave off crises, they give the organization the status, among funders and in general, of a well run, going concern.

Implications for the Minnesota Nonprofits Assistance Fund

MNAF's role as a solution to cash shortfalls remains primary for a growing number of nonprofits. It is expected that the demand for both short term cash flow loans and longer, larger, more complex loans will increase. Beyond lending, the MNAF loan process provides a setting for free inquiry into the status and financial needs of an organization. MNAF staff help managers realize and address their need for better financial systems, better cash flow projections, and improved financial discipline.

Nonprofits sense that they lack control of their own financial destiny is the most fundamental problem MNAF has seen over the last nine years. Coupling the data in this report with our strong belief that effective financial management requires some ability to anticipate and control internal and external pressures, the Advisory Committee of MNAF sees the following specific program implications for the Minnesota Nonprofits Assistance Fund.

Continue to Meet Nonprofits' Temporary Cash Flow Needs

The survey data indicates that the majority of nonprofits have experienced cash shortages in the past, and fully two-thirds of Minnesota nonprofits expect to encounter a cash shortfall within the next two years.

Although there are many reasons for cash shortfalls, the most common reason cited is still delays in government disbursements.

Likewise, nonprofits that have been recipients of start-up grant funding, may need stabilizing income to bridge the gap between the start-up phase of their project and ongoing programmatic revenues.

Nonprofits providing contractual services will continue to need lines of credit or quick cash access to stabilize cash flow between billing and collection.

Based on the findings in this report, we anticipate the areas for most loan growth will be in greater Minnesota and in arts organizations.

Increase Financial Technical Assistance to Borrowers and Potential Borrowers

Historically, MNAF's technical assistance has been limited only to nonprofits presenting themselves for a loan. Although assistance was provided even when a loan was denied, the entree to technical advice was through the loan application.

The study indicates that there are clearly a substantial number of organizations that could use financial assistance whether or not they are appropriate loan candidates. This is a subject MNAF's Advisors will study over the next several months.

Encourage Lending from Local Banks

The banking industry is undergoing major shifts in how it does business, making it difficult to speculate about the industry's general interest in lending money to nonprofits.

It is safe to say, however, that the savings and loan crisis of the late 1980's has renewed regulators' interest in encouraging and protecting the solvency of our country's financial institutions. This may mean that individual banks which in the past have welcomed nonprofit borrowers may now have to abide by stricter criteria in analyzing a nonprofit loan application.

Through the years MNAF has worked with local banks to jointly participate in financing and to move organizations toward commercial credit.

Many organizations receive the first loan in their history from MNAF. For them that is the crucial beginning of a credit record and a history that banks will acknowledge. It indicates the need for MNAF to formalize its role as an introductory

lending institution that can help organizations set goals for a banking relationship.

And yet, during this difficult time in the banking industry, MNAF may become, for some nonprofits historically bankable, the lender of choice.

Provide for the Working Capital Needs of Nonprofits

In 1992, nonprofit managers project an average six percent increase in earned income to compensate for reductions in government spending.

Nonprofits, adding more earned income to their revenue mix, will need financing for start-up costs and then working capital to meet the ups and downs of billing and collection. A line of credit is often the right tool for nonprofits with significant earned income.

MNAF's Advisory Committee is now considering extending current loan guidelines to include more routine lines of credit to appropriate organizations.

Provide Lease Financing

MNAF currently makes loans for the acquisition of fixed assets such as computers, photocopiers, phone systems and the like. Many nonprofits though do not think of MNAF before signing an agreement to finance equipment at 18+ %.

MNAF needs to develop a way to communicate the availability of funds for this purpose so that, where appropriate, nonprofits have a more reasonable financing vehicle for their capital purchases.

Outreach to the Nonprofit Entrepreneur

Three of the case studies illustrate the positive role MNAF played with the nonprofit entre-

preneur. Managers from these organizations expressed their appreciation for MNAF as a setting for discussing new ideas and approaches. They explained that before the MNAF loan process, they could not get a hearing at other lending institutions. They also felt there were precious few opportunities in the nonprofit world for such discussions.

MNAF hopes to continue in this role. We value the importance of frank discussion and constructive feedback to the realization of an idea's full potential.



Equity Services is a St. Paul nonprofit providing homecare services to elderly, disabled, and mentally or physically handicapped people.

Implications for the Philanthropic Community

In the preparatory stages of this study, several foundation staff were asked for questionnaire input. All were interested in what the nonprofit sector believes the role and programing priorities of the foundation community should be. The survey asked two specific questions related to funders' role in the financial health of nonprofit organizations. Our findings are presented here at face value for the benefit of individual foundation analysis and conclusions.

What do you believe is the role of philanthropic support?

Respondents were asked to circle one answer.

| | |
|-------------------------------|-----|
| Respond to nonprofit requests | 40% |
| Develop its own initiatives | 14% |
| Supplement government funding | 13% |
| Provide seed capital | 12% |
| Replace government funding | 2% |
| Other | 19% |

Indicate the categories you would encourage foundations to fund.

| | Agree | Disagree |
|-----------------------------|-------|----------|
| General Operating Support | 88% | 12% |
| Program Grants | 96% | 4% |
| Challenge Grants | 85% | 15% |
| Program Related Investments | 79% | 21% |
| Technical Assistance | 88% | 12% |
| Its Own Initiatives | 68% | 32% |
| Endowments | 79% | 21% |
| Capital/Buildings | 88% | 12% |
| Operating Reserves | 57% | 43% |
| Replace Government Funding | 66% | 34% |

These responses suggest a variety of roles for the philanthropic community. Coupling these responses with the purpose of this study, we suggest the following implications for foundations interested in advancing the financial stability of the nonprofit sector.

Increase Funding Opportunities for Nonprofits in Greater Minnesota

Throughout the study, organizations located outside the Twin Cities consistently noted their lack of access to sufficient foundation funds. This study does not establish whether these perceptions are factual. Even so, feelings of inaccessibility may hinder a nonprofit from making application for funds that are available to them.

Fund General Operating Support

One-third of respondents stated *general operating support* as their greatest unmet funding need. Although this is an expected answer, it does not mitigate the critical role general operating support can play in the financial stability of an organization. Although the study's data was not conclusive, it appears that an additional 10% of income for many nonprofits (particularly smaller groups without revenue flexibility) if coupled with prudent management practices, might spell the difference between breaking even and running a deficit.

Foundations have moved away from general support for a variety of reasons. There are ways, however, to structure general operating grants so that they are more than an unspecific contribution to a nonprofit. Linking general operating grants to a targeted program of increasing nonprofit financial stability is one idea to consider.

Continue to Fund Technical Assistance

Technical assistance is valuable to the nonprofit community. Almost all nonprofits believe their organizations have changed as a result of technical assistance. Strategic planning, bookkeeping and computer assistance outdistance the other types of technical assistance nonprofits purchase. However, board training, fundraising and personnel management are also frequently used.

Technical assistance for cash flow, financial management and budgeting, though, account for only 14% of the nonprofits' use of technical assistance. Fundraising assistance alone (11%) almost equaled that percentage.

Sufficient income to meet program demands is certainly part of the nonprofit's financial health equation. The rest of the equation though, is financial skill and responsibility.

Stronger encouragement of nonprofits to understand their current financial circumstances is a role foundations may want to assume. In some cases, technical assistance may be the right method for obtaining this understanding.

Encourage Nonprofits to Practice Financial Skills

The study asks respondents to judge their own financial skills. Almost all (91%) report sufficient knowledge and skill to manage the finances of their organizations. 81% go on to say that "financial management is one of their real strengths." Most (89%) are also comfortable with the skills and adequacy of their financial staff.

It is clear that nonprofit managers believe their financial skills are strong. Yet, the objective financial data reported throughout the study does not correspond to the high level of financial confidence reported by managers.

It is possible that the financial skills of the nonprofit manager do not dictate the financial condition of the organization. It is also possible that directors perceive their skills to be greater than they really are. One other possibility exists though. Sometimes nonprofits find themselves trapped in a captive funding or spending

situation which requires a combination of skill and action to change.

The grant review process can be a source of encouragement for nonprofits to take the actions necessary for financial stability. A one-year grant for a new counselor will not help an organization whose county per diem is \$25 a day less than needed to break even. We are not suggesting that foundations become advocates or consultants to grantees. We do believe, though, that foundation officers can play a supportive role for nonprofit managers and boards needing the franchise to convert their financial skills into responsible and difficult decisions.

Help Nonprofits Establish Operating Reserve Funds

Operating reserves, a nonprofit's own equity, can spell the difference between stability and vulnerability for some organizations. Although all the nonprofits in this study could *use* a reserve, only a smaller proportion would benefit from one. Reserve funds are meant for organizations without deficits. They are most beneficial for organizations that know how to project cash flow and can, to some degree, predict future growth. In a sense these are life cycle issues. Reserves require a certain level of organizational maturity and an ability to control, to some degree, your own destiny.

Foundations do not need to be the sole provider of reserves. There are several ways nonprofits can, and possibly should, first contribute to their own reserve fund. When the first dollars into the reserve are the nonprofit's own, there is a much greater likelihood that the reserve will remain intact. Still, most nonprofits cannot squeeze enough from their operating budgets to develop an adequate reserve. This is where the funding community enters the picture.

There are several nonprofits that could right now adequately sustain a reserve; with growing financial management skills there will be more candidates for a reserve fund in the future. If managed correctly, operating reserves have the potential to significantly increase the financial stability of many nonprofit organizations.

Conclusions

Up to one-third of Minnesota nonprofits have strong indicators of financial health. These nonprofits have not carried deficits from year to year; they have had surpluses to finance temporary cash shortages and they report reasonable access to funding.

Further analysis though reveals that up to 60% of nonprofits studied experience circumstances that block their journey to financial health. We estimate that at least 10% of the sector is on shaky ground and struggling day to day with the probability of closing.

There are many troubling signs:

- * The majority of Minnesota's nonprofits experience cash shortfalls without the internal or external resources to handle the shortage.
- * Deficits are common place. The industry consistently spends more than the income it receives. Furthermore, the expenses of nonprofits are increasing at a higher rate than income.
- * Nonprofit managers report high levels of confidence in their ability to manage the agency's finances, yet, in many cases, this skill does not improve the bottom line.

Some types of organizations are more unstable than others. This study shows that the particular characteristics of arts organizations and outstate nonprofits make them more financially vulnerable than their counterparts.

Arts organizations often have conflicting cycles of revenue and expense that create large swings in cash flow. These patterns perpetuate instability and can quickly result in deficits if not remedied by quick action and/or an infusion of cash.

Likewise, the strong reliance on government funding makes outstate nonprofits also financially vulnerable. If government funding declines as the majority of nonprofits expect, organizations in greater Minnesota will be disproportionately hurt; nonprofits in greater Minnesota have little revenue flexibility. They, more than their urban colleagues, feel they must provide service to clients at all costs. Solutions are not easy for outstate nonprofits who also feel

they have insufficient access to funding to support or enhance their programs.

The study finds differences between perceptions about financial health and reality. Executive directors judge their organizations' financial positions more favorably than the objective data supports. There is a subtle thread throughout the data that indicates nonprofit directors use financial *instability* as a norm. *Survival has become the measure of stability* - and for many directors, survival is synonymous with health.

We conclude that the cause of financial instability is a two-fold combination of *external* funding realities, beyond the control of the nonprofit industry, and *internal* factors which are within a nonprofit's control when skill, responsibility and decisive action are present.

Most nonprofits see the handwriting on the wall. There is only so much money to go around. Competition is getting tighter for government, foundation and private dollars. Competition cannot be controlled but the ability to manage the organization within the confines of its real income can. There are financial skills that make this job easier. The real challenge in the face of changing funding patterns, though, is to manage the organization within realistic income expectations. Too little income weakens the nonprofit sector's ability to perform its mission. The major *barrier* to the *financial health* of the nonprofit sector is not too little income, *it is spending more money than it has*.

A nonprofit's money is a precious and powerful tool for accomplishing mission. The ability to understand and use money effectively will be a fundamental part of surviving and maintaining a healthy organization in the slowed-down economy of the 1990's.

Certainly financial health is only one way a nonprofit remains viable. The mission of the organization and its service to the community is every nonprofit's primary focus. Still, when the stability of the sector is in jeopardy, it causes us all to take a closer look at finance.

We look forward to the day when the financial health of the nonprofit sector will no longer be a goal, it will be a given.

Case Study: Equity Services of St. Paul, Inc.

Equity Services of St. Paul, Inc.
615 South Chatsworth
St. Paul, Minnesota
Bruce Larson, President and CEO

Agency Description

Equity Services is a St. Paul nonprofit providing home care services to elderly, disabled, and mentally or physically handicapped people. Founded in 1985 by its current Executive Director, Equity Services provides the following services: personal care, including grooming, bathing, exercise or assistance with medical treatment; housekeeping and meal preparation; home health plan management.

During its initial years, Equity Services trained and employed disabled and minority workers to dismantle computers to be sold for parts. This project, although helpful in providing work experience for its clientele, ended after three years when all the computers were dismantled.

In 1987, Equity Services assumed the operation of the St. Paul District 7 Planning Council's neighborhood-based home health care project. With Ramsey County Public Health as its primary referral source, Equity provided service to 300 people in 1989, the majority residing in Equity's own Frogtown neighborhood.

Equity Services employs 60 people, 55 of whom are home health care workers. The agency's neighborhood commitment is reinforced by its hiring practices -- almost half of Equity's employees are Frogtown residents.

In 1989, Equity Services' budget was \$521,632, a substantial growth from its first budget of \$500 four years ago. The majority of its expenses are salaries, payroll taxes and insurance. The agency's rent is less than one percent of its annual budget. There has been a surplus in each of its five years of operation; the cash balance at the end of 1989 was \$24,508.

The Executive Director states the agency "has achieved modest financial stability." Even though payments for services are received

upwards of 45 days from the date of billing, the agency is able to use its internal surpluses to handle operating expenses in a timely manner. The Executive Director, however, would like the agency to be able to cover up to 90 days of operating costs and secure a \$100,000 line of credit.

MNAF Loan Procedure

Equity Services first approached MNAF in April, 1987 for a \$10,000 loan to launch the home health care service project. A loan was a last resort option after several grant requests were rejected by local foundations. Foundations declined funding because Equity was a new organization and did not have a proven track record. Prior to coming to MNAF, Equity had applied for a bank loan. That application was denied because of Equity's short financial history and lack of sufficient collateral. In addition, the bank had a minimum loan amount of \$50,000. Equity Services neither needed nor could they afford the loan payments on a \$50,000 loan. The loan bank's officer referred Equity Services to MNAF.

Equity Services secured the MNAF loan in three weeks, after an initial interview and completion of a written loan application. The Executive Director considered the paper work to be "modest and reasonable" and similar in content to that required by the bank. The application process, though, differed significantly from the bank's in that the Executive Director could complete the paperwork himself. The bank's process would have required hiring an outside accountant to complete the bank's forms. MNAF's staff assisted in completing the loan application and offered advice on preparing the necessary financial projections.

A loan of \$10,000 at 10% simple interest repayable in two years was subsequently made. As part of the application process, MNAF staff advised the Executive Director that a loan combined with grants would produce a more favorable financial condition to successfully launch the home health care services. With

MNAF's advice on how to proceed for funding, Equity Services successfully raised \$18,000 in foundation support within 90 days of its first MNAF loan.

Equity Services returned to MNAF nine months after receiving its first loan for an additional \$10,000 loan to stabilize cash flow. It too was made.

In 1988, when Ramsey County asked the agency to expand its services beyond their immediate neighborhood, Equity Services returned to MNAF for a third loan. This loan of \$25,000 consolidated all existing loans.

In total, Equity Services borrowed \$45,000 from MNAF with full balance repaid by December, 1989.

Loan Effect on Agency

Diversified income.

Equity Services' Executive Director reports that he learned the importance of diversifying income sources during the first loan application process. The financial forecasting clearly showed that Equity needed a mix of grants, loans and multiple contracts for home health care services.

Since then Equity Services has successfully achieved its income goals. Its income is a mix of several grants, loans, contracts and a small number of fee paying clients. It will continue to diversify by becoming certified for Medicaid and Medicare direct reimbursement. This will allow the agency to aggressively market its services to HMO providers and insurance companies.

Enhanced reputation with foundations.

The MNAF loan proved to foundations that Equity Services was credit-worthy. The Executive Director reports that MNAF's staff were called by funders as a reference for their grant requests. MNAF's knowledge of the agency's financial condition and needs provided the extra validity Equity Services needed to qualify for a grant.

Equity Services subsequently has been awarded \$88,880 from several local foundations.

Enhanced the Executive Director's financial forecasting techniques allowing accurate planning for future development.

Prior to negotiating a loan with MNAF, the Executive Director felt he had a good sense about his organization's financial needs. He projected future costs, made judgments about his income requirements and prepared budgets. However, he had never completed cash flow projections, a skill learned during the MNAF loan process.

Since 1987, the Executive Director completes cash flow projections quarterly. At the end of the past three years Equity's actual budget was within 5% of his original projections -- a fact he credits to cash flow forecasting.

Acquired the financial skills that allowed the organization to develop continued financial stability.

Although MNAF's assistance taught the Executive Director financial principles and various approaches for future stability, the Executive Director reports that MNAF's staff never made decisions for him. MNAF did not give opinions about what his agency should do or do the work for him. Although this was the most difficult part of his experience with MNAF, this experience allowed him to "learn faster, gain more confidence in [his] own abilities and continue to apply new found skills to new situations."

Developed an understanding of how to use money as a tool.

Through MNAF, the Executive Director developed a greater understanding and appreciation for the variety of ways money could be used as a tool to achieve agency goals. He views the agency's surplus reserve and its initial success with foundations as the development tools which leveraged both the prototype for new services and \$400,000 in agency growth. He believes the agency is now further ahead than if they invested their surplus in a savings plan.

The Executive Director summarizes his experience with MNAF as "an environment for discussing and exploring options that was non-judgmental for the novice nonprofit entrepreneur." MNAF was also willing to look at the smallest track record and make judgments about an agency's potential.

Case Study: Illusion Theater

Illusion Theater
528 Hennepin Avenue, #704
Minneapolis, Minnesota
John Montilino, Managing Director

Agency Description

Illusion Theater is a professional theater dedicated to creating and producing new plays. It also uses its plays to educate and to prevent sexual abuse, interpersonal violence and HIV/AIDS.

The Illusion Theater began in 1974. During its sixteen years, the Theater has created over 60 new plays in collaboration with many playwrights, directors, composers and designers. In 1978, the theater directors joined with a human service professional and created the play, TOUCH, which addressed the prevention of sexual abuse of children. TOUCH's success led to a prevention program that now includes five plays, workshops, educational materials and other training. In the last twelve years, the prevention workshops and plays have toured in 44 states and reached over 650,000 people.

In 1985 Illusion moved from a theater with space for 60 people to the Hennepin Center for the Arts, which has seating capacity for 320. There has been steady increases in audiences over the last several years, with an audience level of 30,000 expected for 1990.

Illusion employs twelve full time employees year round. The senior management team includes two producing/artistic directors, one managing director and one director of prevention programs, who is also a practicing therapist. During the six month performance season, the Theater hires as many as 75 part-time artists.

Illusion's 1990 budget is set at \$882,800. The largest percent (73%) of the budget is salaries, payroll taxes and employee benefits, with occupancy related expenses approximating 4% of overall expenses.

The Theater's income sources are diverse. The largest percent (54%) comes from foundations and corporations, and another 31% comes from ticket sales, sales of video products, licensing fees and touring. The Theater has managed to retain a small surplus at the close of the past six financial periods. In 1990 the surplus is expected to be \$2,000.

The managing director describes Illusion's financial health as very strong, but still vulnerable. The Theater has a six year record of small surpluses, but also recognizes that if one sizable grant is lost, the organization would be financially vulnerable.

MNAF Loan Procedure

The Theater's performance cycle results in yearly cash shortages. Its expenses are always greatest between February and July, during the new performance season. However, the majority of the Theater's income is raised or earned during the late summer and fall when expenses are lowest. The managing director explains that even the most perfectly balanced budget would not provide the cash reserves necessary to cover the costs during cash poor months. Further, these cash poor cycles, which occur regularly each year, limit program expansion.

Illusion first handled its cash shortages by running a deficit. In its first thirteen years, the Theater incurred a deficit in four separate years. Those deficits created a financial burden which threatened to jeopardize operations.

The first opportunity to correct the situation came through a trial "Cash Reserve for the Arts" project initiated by the Dayton Hudson Foundation and administered through The Minneapolis Foundation. Although Illusion Theater met the cash reserve requirement and was awarded a \$25,000 cash reserve grant, growth and income timing problems during the two year grant period rendered the amount insufficient to remedy the Theater's cash flow problems.

Next Illusion went to a bank to borrow money. The bank made a loan against a United Way grant, but the bank would not lend enough to cover Illusion's spring 1987 cash crisis.

The Illusion staff then went to the Minnesota Nonprofits Assistance Fund for financing. Illusion's first MNAF loan of \$30,000 was made in 1987, within one week of application, at an interest rate of 11%.

Using some of the knowledge gained from participation in the Cash Reserve for the Arts project, Illusion staff prepared the loan application with minimum assistance from MNAF staff.

The managing director remembers that applying for their first loan seemed "daunting". He believed it would be very difficult to get a loan and was worried they would not get the needed money. He reports being relieved when the loan was approved and believes that the loan never put the Theater at risk since it had predetermined how it would repay the debt.

Illusion has borrowed money from MNAF every year since 1987 to even out that year's operating income. Although in the past, Illusion has completed a new application each year, this year their application changed and the paperwork was reduced.

In 1987, Illusion also reapplied for a bank loan and received a \$70,000 bank loan using their United Way grant as collateral. In each of the past three years they have received a loan. The managing director explains that Illusion was uncertain if MNAF would meet all their needs and they also wanted a second source of potential credit. At this time cash flow loans are central to the Theater's successful operation.

Now the MNAF loan operates like a line of credit with maximum credit approval set for \$160,000. They can draw on that amount in increments determined by Illusion up to the predetermined amount. They must sign a note at the time of each draw-down, but do not have to repeat the approval process. It differs from a bank's line of credit in that it cannot be accessed by a telephone call and a note must be signed for each withdrawal. According to the managing director it would be easier if MNAF would change its procedures to allow for just one

document signing and telephone access to the funds.

Loan Effect on Agency

Increased community respect and agency confidence.

The managing director explains that they have learned how to financially manage a million dollar theater. That recognition increases their own confidence for growth. In addition, their successful track record increases community respect particularly from funders. The community views the Theater as financially strong. He believes that the enhanced community respect has been very valuable and an intangible asset in its fundraising.

Allowed the Theater to grow.

The Theater wanted to grow with each new season but did not have the cash reserves to fund the growth. In a sense, the loan provided that reserve.

Built internal financial reporting systems to a more sophisticated level.

The Theater's financial systems now have the capacity to project cash shortages and time lines for repayment. This allows the Theater to borrow the stabilizing amount and plan for the prompt discharge of the debt.

Learned how to protect a cash reserve and developed a strong conviction in the importance of protecting that reserve.

The Illusion Theater board of directors is clearly involved in the financial oversight of their theater and actively involved in its borrowing and cash reserve management. The board serves as a control on the Theater's cash reserve and protects it from disappearing into the general operating budget. The managing director explains that establishing the control and board oversight was the most valuable assistance MNAF gave them.

The managing director comments that MNAF meets the unique financial needs of nonprofit organizations. It lends without the traditional collateral requirements and could be a useful tool for any nonprofit with a revenue stream which allows repayment.

Case Study: Northside Residents Redevelopment Council

Northside Residents Redevelopment Council
1014 Plymouth Avenue North
Minneapolis, Minnesota
Matthew Ramadan, Executive Director

Agency Description

Northside Residents Redevelopment Council (NRRC) is a neighborhood organization that represents the near northside of Minneapolis. With a census of 35,000 in 1980, this is one of Minneapolis' largest and lowest income neighborhoods.

NRRC began in 1971 as the vehicle for northside residents' involvement in federal housing development initiatives. In the past 19 years, NRRC has significantly expanded its service to residents. In addition to new crime prevention programs, NRRC began in 1980 its own low-income housing development agency which has developed 25 single family homes and 120 rental units in the near northside. With the assistance of other housing developers, NRRC also manages their own properties.

NRRC has also been responsible for recruiting approximately 25 companies to locate in its neighborhood, adding 500 new jobs. Some of those jobs were filled by neighborhood residents. In 1985, NRRC began an employment agency to encourage those companies to hire more neighborhood residents. It now works with neighborhood employers to recruit residents for training programs and/or jobs.

NRRC employs five and one-half staff, most of whom are neighborhood residents.

NRRC's budget is \$190,000. Its income comes from a variety of sources with the largest source (35%) being earned income. Approximately one-fourth of its income is government contracts and another fourth is foundation/corporate grants. The remainder is from the United Way and individual contributions and memberships.

The Executive Director describes NRRC's financial health as "somewhat unstable, but getting stronger all the time". He reports that each day there are improvements.

MNAF Loan Procedure

In 1989 staff and administrative changes significantly altered the financial condition of NRRC. These staff changes resulted in a six month period where there was no additional fundraising. During that same time, expenses increased due to the higher cost of temporary employees. By October, 1989, NRRC needed \$17,000 to pay its bills.

NRRC was referred to MNAF by MNSHIP, one of its major funders. In October, 1989, NRRC applied for a \$17,000 MNAF loan. MNAF denied the loan citing lack of permanent management as the primary reason. In the next few months NRRC hired a permanent executive director, continued to receive grants and contracts that had been awarded earlier, and began to reestablish its financial routine. Although all the right things were being done to put the agency back on its feet again, the agency was operating with a deficit and unable to pay bills which had accumulated during the interim transitional period.

Five months after its first rejection, NRRC reapplied for a \$7,000 MNAF loan. The loan terms included 10% interest with repayment in two months. NRRC repaid the full loan in the required time period.

The loan application process took two weeks. The Executive Director met three times with MNAF staff, bringing the application to the first meeting in which NRRC's financial situation was discussed. At the second meeting, the agency's financial statements were reviewed. The third meeting provided technical assistance to help NRRC's new accountant structure a payoff schedule for accounts payable, including the pending loan. At that time MNAF suggested

NRRC set up its own internal accounting system to learn more about the organization's finances. Previously, NRRC had relied upon an outside accounting service to keep their books and prepare financial reports. NRRC consequently had little understanding of its own financial situation or cash flows.

Although NRRC continued to receive grants and loans, income remained less than expenses, adding to its earlier debt. By June, 1990, NRRC was again short of cash.

In mid-June NRRC went to its local bank to apply for another loan. The bank said they qualified for a loan because of their strong history as a customer and housing developer, but denied the loan because NRRC did not have a current financial statement. When asked why NRRC did not come to MNAF for another cash flow loan, the Executive Director explained he did not return out of embarrassment over not following through with the recommended internal financial system as suggested by MNAF during technical assistance. He explained that the organizational strain of fundraising with new staff made the development of a financial system a lower priority.

Loan Effect on the Agency

Recognized the need and value of operating own internal accounting system.

The cost of hiring an outside firm was high and resulted in the organization not having enough information to control their financial condition.

Reestablished its credit-worthiness.

The loan reassured the community NRRC was still operating and credit-worthy even with the major staff changes.

Helped the agency identify areas they needed to improve to become a stronger organization.

The NRRC staff quickly learned that their accounting skills needed to be updated. Multiple services, property management and development made their finances complex. Financial systems needed to be computerized to enable effective management of their operations.

Contributed to an unrealistic attitude that their financial problems were resolved.

The organization believed it could relax after they received their loan or raised additional money. It did not understand that fundraising and financial management were on-going activities requiring constant attention.

The Executive Director explained that MNAF was very helpful in showing its organization that it needed to set up an internal financial system and develop a strong management overview. NRRC was responsible to implement the system and ask for help if needed. According to the Executive Director, it would have been more helpful to NRRC if MNAF staff would have followed up to see if NRRC had stabilized.

The Executive Director sees MNAF not just as a loan agency but a place to assist nonprofits in any way to make them financially solvent. Technical assistance should be MNAF's primary function.

Case Study: Northern Community Radio

Northern Community Radio
KAXE 91.7 FM
1841 East Highway 169
Grand Rapids, Minnesota
Sharon McKeever, Business Manager

Agency Description

Northern Community Radio, started in 1976, is a publicly owned radio station that provides a wide variety of programs to six counties in Northern Minnesota and Southern Canada. The broadcast area covers a 100 mile radius from the Grand Rapids station and has a potential audience of 170,000 people.

The station is noted for its extensive regional programming, close to half of which is locally produced, primarily by volunteers. Northern Community Radio has between 50 to 100 active volunteers a year. Northern Radio employs six full time employees and four part-time programmers.

The 1990 budget for Northern Radio is \$300,000. The largest percent (34%) of its revenues is from government grants. It also receives about 32% of its income from foundation and corporate grants, with the remaining third of its income earned through memberships, ticket sales and other fundraising events. Northern Radio has 2,000 members.

The station's business manager described its financial condition as "stable and getting stronger." In 1989 it retired a long standing debt and expects to generate a small surplus in 1990. The business manager explained the station is still troubled by cash shortages because of erratic revenue patterns, but its overall financial health looks good, particularly in comparison to its past.

MNAF Loan Procedure

From 1980 to 1985 Northern Community Radio encountered several financial problems. The

local economy worsened reducing the radio station's revenues. When its radio tower was struck by lightning, the station's insurance only partially covered the replacement cost. There were also major staff changes every few years, disrupting any plan to bring financial stability to the station. By 1985, these factors had produced a deficit of over \$100,000. That same year, its largest creditor placed a judgment against the station forcing impending closure if its debt could not be restructured.

At that time the station manager approached MNAF for a \$50,000 loan. The loan was to reorganize the current debt and pay half of the long-standing debt. The loan was denied. At the time MNAF had a policy of not making loans to restructure debt. In addition, MNAF staff believed that the station could not sufficiently guarantee repayment of the loan.

After being rejected by MNAF, the station applied for a loan with its local bank. The bank loaned the station \$38,000 for five years. That money was used as lump sum payment to the large creditor. A payment schedule was agreed to and the judgment was lifted. The bank loan was paid before its term in September, 1989.

The restructuring of the debt started to rebuild the station's financial health, but the station still suffered from periodic cash shortages. In 1987, Northern Community Radio had been awarded a major state grant, but would not received it in time to meet cash needs. The station went again to MNAF to apply for a loan. This time MNAF approved its request and the station received a \$18,000 loan at 10% interest for 90 days. When the state grant was received, the station repaid MNAF in full.

The loan application process took less than four weeks. The former station director completed the application himself in about five hours. He already knew how to project the station's income and expenses since it was part of the

documentation required for the bank loan. Prior to the first MNAF application, cash flow projections were not a regular part of the station's financial practices. The former station manager reports that cash flow projections became an important tool in developing a subsequent plan to restructure its debt.

The former station manager described the MNAF loan process as positive. The staff was helpful and the interest rate favorable. He explained that the MNAF process was more rigorous than the local bank. The local bank also considered the station personnel's reputation and was willing to loan more money than MNAF.

The business manager described MNAF as "an organization that helps you through rough times." She would recommend MNAF to any nonprofit organization.

Loan Impact on the Agency

Contributed to the financial turnaround of the station.

It provided the short term cash needed to pay employee salaries and also helped the station stay current with the debt repayment.

Increased the station's credit-worthiness.

The business manager believes that MNAF's willingness to loan the station money combined with its ability to repay the loan increases the station credit status. This resulted in securing a \$15,000 line of credit with the local bank.

Changed the timing of their fundraising campaign to address the on-going cash flow problems.

The MNAF loan process helped the station realize their cash shortages were a reoccurring pattern. The majority of its fundraising occurred in the fall, resulting in shortages in the following summer. To help address the summer shortage, their main fundraising campaign was moved ahead from October to August. In addition, the August campaign appealed to summer residents vacationing in Northern Minnesota - a new market for members. Memberships and revenues both increased.

Case Study: Occupational Development Center, Inc.

Occupational Development Center, Inc.
Highway 32 South, P.O. Box 730,
Thief River Falls, Minnesota
Peter Lavalier, Executive Director

Agency Description

The Occupational Development Center (ODC) trains and employs disabled adults living in a fourteen county area of northwestern Minnesota. ODC began in 1971 in Thief River Falls. In subsequent years it added sites in Crookston, Bemidji, and most recently in Roseau.

ODC serves approximately 270 disabled adults each year. These adults receive the support, training, and work experiences they need to become successfully employed in the community. The client gains work skills by building snowmobile crates and other products used for

recreational vehicles. A small percent of the ODC's work is recycling.

ODC has a staff of 120 people. Approximately 25% are full time employees and work year round. The remainder work eleven months of the year alongside clients to model work skills and behaviors.

In 1990, ODC's budget is approximately \$4,000,000. The budget has increased substantially since 1982, when ODC made the decision to retain a solid manufacturing base, keeping operations closely tied to the recreational vehicle industry, Thief River Fall's primary industry.

The majority of ODC's expenses go toward raw materials. Approximately 30% of its expenses are wages and benefits and 10% overhead costs.

The majority (76%) of ODC revenues are earned from product sales to Arctic Cat and Polaris. Another 22% of its income is from government purchases of service contracts and the United Way. For the past six or seven years, ODC has had a yearly operating surplus, averaging 1% of income. Their surplus has ranged from \$10,000 to \$103,000.

The Executive Director describes the agency's financial health as "good." Its debt-to-fund balance ratio is very low and its level of cash-on-hand is fair.

MNAF Loan Procedure

In 1988, ODC wanted to expand its operations by contracting with its second recreational vehicle manufacturer, Polaris Snowmobiles. It needed approximately \$90,000 in increased capital to finance the raw materials and labor costs associated with this new start-up venture. The Executive Director first discussed a loan with the Crookston Revolving Loan Fund where he had previously borrowed. However, the Loan Fund was unable to lend the money because ODC's maximum had already been extended.

ODC's director next went to a regional economic development agency, Jobs Inc., hoping they would invest in ODC's new operations. However, no government money was available there. Jobs Inc. recommended MNAF and local banks as possible alternatives. Jobs Inc. contacted a local bank for ODC, resulting in a loan of \$30,000 at 11 1/2% interest. MNAF loaned ODC the additional \$60,000 at 8% interest for 12 months.

The MNAF loan process took two months to complete. The Executive Director described it as a "simple" process. He completed the application with assistance from MNAF staff. He visited the MNAF office once. He explains the paperwork was more complicated and time consuming than that required by the bank. The bank did not require a business plan or cash flow projections.

In November 1989, ODC repaid its MNAF loan. It continues to have cash flow shortages but does

not reapply. The Executive Director explains that MNAF raised their interest to 10%, making it comparable to the bank's rate. ODC secured a \$200,000 line of credit with its local bank with a 10 1/2 percent interest rate and the convenience of local and accessible borrowing. In addition, its cash flow needs have now stabilized.

The Executive Director describes MNAF as an excellent source of training on how to operate a nonprofit agency. It is also an additional source of financial assistance appropriate for all nonprofits.

Loan Effect on the Agency

Increased growth in the operations created more viability and recognition in local and professional communities.

ODC is asked to speak at various conferences and recognized for its non-traditional and successful approach to employment and training for disabled adults.

Created new opportunities for ODC to operate as a business resulting in benefits for staff, clients and community.

The agency now provides a stable, on-going work base for staff and clients. Production has grown from nine months of the year to twelve. The new Roseau site provides employment and training for disabled adults where no services previously existed.

Training on modern equipment increases the clients' employability in the community. The new contract required remodeling and upgrading of equipment which provided up-to-date training for clients. Placement in community jobs increased 30 percent.

Increased the Executive Director's confidence.

During the loan process he learned more about borrowing and cash flow projections. He believes this resulted in becoming a "hard-nosed" negotiator and viewed by the banking community as part of the business community.

Case Study: Theater 65

Theater 65
2115 Summit Avenue
St. Paul, Minnesota
Tom Gilshannon, President

Agency Description

Theater 65 is a professional theater company utilizing the talents of older artists. Its plays are dedicated to developing pride and self worth in older people.

Theater 65 is a young organization. It began in 1985 by a group of older actors and actresses who were not being hired for local theater performances. Most American plays do not focus on older people and when they do, younger actors and actresses are cast and made-up to look older. The founding group recognized the wasted talent of older local artists and formed the Theater.

In its short history it has staged four major productions, each running in Minneapolis and St. Paul. All four received excellent reviews from theater critics. It also co-produced an original musical for Landmark Center in St. Paul. An outreach program was also created to take small plays to other communities. Two of the seven small plays are adaptations of major productions and the others are original creations for the Outreach Program. Theater 65 has formed a curriculum for older people who want to increase their acting skills or want to try acting for the first time.

Theater 65 has three staff people: a part-time accountant, a part-time marketing person and the president. Only the marketing person is paid. The treasure and president volunteer their services and are reimbursed for expenses only; actors, musicians, stage managers, and lighting technicians are paid in full for their services at professional rates.

The Theater's 1989 budget was \$23,395 with a deficit of approximately \$35,000. The largest

expense is production costs associated with the performers, musicians, designers, producers and set construction. Overhead is minimal (15%) because the College of St. Thomas donates a portion of the rent at below market rates.

In the past two years, the Theater has earned the largest percent of its income from the Outreach Program. It also receives contributions from individuals and has held several fundraising events. In 1989, the Theater received only one foundation grant.

MNAF Loan Procedure

The five year financial history of Theater 65 has been a shaky one. There are many circumstances which have contributed to the current deficit.

The Theater's first four plays were each very expensive. Although the reviews were wonderful, there was little promotion and the audiences were small. The costs were significantly greater than generated income and no money had been raised up front to cover performance expenses. The deficit at the end of the second production was approximately \$32,000.

A fifth and sixth production were planned for early 1987. The fifth production was cancelled because underwriting was not realized. The Theater raised some money for the performance and with a new marketing strategy expected to generate enough income from the performance to cover costs. However, it still did not have the up front cash to pay expenses. One of the Theater's board members knew about MNAF and recommended that the Theater request a loan. In March, 1987, the Theater staff met with MNAF staff to discuss the possibility of a loan.

The loan process took a little longer than a month. The president completed the loan application without assistance from MNAF staff. MNAF staff met several times with the Theater staff, board members and performers. The Theater had to assure MNAF they had the

financial capability and business background to repay the loan. MNAF loaned \$10,000 to the Theater for two years at 10% interest.

The loan was used to improve cash flow during the fifth production. The income covered basic costs, allowing Theater 65 to repay the first \$1,000 of its loan.

The Theater's financial condition, however, worsened with major staff and board changes. In May, 1987, one of its founders and strong board leaders was killed in an accident. She had provided the organization with much of its vision and enthusiasm. In August, a second board member, the treasurer, responsible for financial reports also resigned due to severe health problems. These changes left the organization with a need to reorganize and without the records needed to manage.

A sixth production had been scheduled, but had to be canceled when funds were not raised to cover costs. Theater 65 had applied to several local foundations with partial success. Most grants were small and the majority of its proposals were not funded. Foundations explained that the Theater was not financially strong enough to be considered.

In July, 1988, Theater 65 returned to MNAF for assistance. MNAF staff met weekly with the Theater president to develop a plan for recovery. Early in the meetings, MNAF suggested the Theater consider bankruptcy. But the Theater's board and staff believed that the Theater's strong professional performing reputation, combined with the success of the Outreach Program could turn the Theater around.

The plan for recovery included using Wilder Foundation staff to develop a bookkeeping system and to finish the 1987-88 books. The president worked out a payment arrangement with Wilder. It also set a goal to increase grant applications and create a working board of six. The first board committee created was charged with fundraising. At the same time a marketing person was hired on a commission basis to promote and sell the outreach programs.

Creative ways have also been used to reduce the deficit. The Theater has provided in-kind services to some of its creditors to work off

portions of its debt. In December, 1988, the Theater reduced its debt with the Landmark Center by producing a play for their fundraising events. The debt was forgiven. In addition the Landmark Center asked the Theater to continue performing and the Theater has continued to use this opportunity to earn income.

During the past three years, Theater 65 continues to pay MNAF. Its loan was refinanced to extend beyond its original two year term. Currently, the loan has been reduced to approximately \$5,000.

The Theater looks upon MNAF as an advising banker that provides sound information without the judgment. The president states that MNAF has definitely helped to keep the Theater in existence and that it understands nonprofits and knows the foundation community.

Loan Effect on the Agency

Provided the cash to produce the one play that was financially successful.

It was particularly important to Theater 65 to break even on its third production because they could not go further in debt. But it also tested its marketing strategy. The marketing was successful and the Theater was encouraged that with proper promotion they could break even and possibly make money. This meant that major productions were still possible for Theater 65.

Developed a plan to help the Theater recover its financial health.

With MNAF's technical assistance, Theater 65 developed a marketing strategy for the outreach program, set goals for grant applications and developed a plan for continued debt repayment. Slowly revenues are being raised and debts paid.

Provided the professional advice needed to handle difficult financial times.

The president reports it was important to have MNAF personnel to talk with frankly about the complete status of the Theater as an arts organization and a business. According to the president, MNAF understands that nonprofits are vulnerable.

About the Research

Study Universe

This study uses the State of Minnesota listing of registered charitable nonprofits as its universe. All charitable nonprofits are required to annually register with the Minnesota Attorney General's office. A charitable organization is defined by the state as one that receives or solicits more than \$25,000 in total contributions in a year or has hired a professional fund raiser to solicit funds for them. Government grants are excluded from the \$25,000 amount. This list is the most comprehensive and current listing of Minnesota charitable nonprofits.

The study uses a similar definition of charitable organizations but differs slightly. For this study, a charitable organization is defined as one that is eligible to receive a grant. The state listing is broader in that it includes organizations that might receive no grants but only individual contributions or received no grants and just hired a professional fund raiser. The listing was reviewed and organizations that did not meet the narrower definition were removed.

The original universe, thus revised, was reduced to 1,090 organizations. Zip codes were used to identify agencies located in the seven county metropolitan area. Organizations with zip codes outside the metropolitan area are classified as outstate organizations. The zip codes indicate that 691 or 63% of the organizations are located in the metropolitan area and 399 or 37% of the organizations are located in outstate Minnesota.

Sample

From the universe of 1,090 a random sample of 491 was selected. The universe of nonprofits is over sampled to ensure the number of returned surveys would be close to that needed without costly and time-consuming follow-up. The location of the agencies in the sample was also compared to the proportions in the universe. The sample proportions are consistent to the universe. 292 or 60% of the sample are located in the metropolitan area and 199 or 40% of the sample are located in outstate Minnesota.

Survey Response

263 surveys were returned. Of those 159 or 61% of the returned surveys were from organizations

located in the metropolitan area and 104 or 40% of the returned surveys were from outstate Minnesota. Based on this response rate the data has a 90% confidence level. The sampling error for the overall data is + or - 5 percentage points. When the data is analyzed separately for metro and nonmetro, the sampling error is + or - 7 percentage points.

The response rate for individual questions was also analyzed. The questions in this survey have reasonable rates of no response and none were excluded.

Case Studies

Six case studies are completed to supplement the survey findings. The case studies provide a human element to the data. This in-depth look at these agencies enhances the understanding of the conditions that brought these agencies to MNAF, their experiences with MNAF and the effect the MNAF loan had on their organization.

Three factors were used to select these six participants for the case studies: agency type, location and loan size. Several types of organizations are represented by these cases. Three arts organizations are included, two performing and one non-performing. Two social service organizations were selected and one neighborhood developer.

Two of these case participants are from outstate Minnesota: Grand Rapids and Thief River Falls. Four are located in the metropolitan area, two in St. Paul and two in Minneapolis. The third factor used to select the participants was loan size. To understand the full range of experiences it was important to include agencies with both small and large loan needs. The average MNAF loan size is \$20,000 to \$24,000. This average is the base used to select equal numbers of small, medium and large loans.

Every effort was made to include a cross section of agencies with differing degrees of financial health. The case studies included more than just those that could successfully repay the loan. However, agencies that were no longer in existence were not used.

The case study findings are integrated into the report.

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If you would like additional copies of this report, please write and send \$2.50 for each copy to:

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