Philanthropic Funding Realities in the New Economy

An assessment of funding opportunities and challenges in 2010.
Commissioned by the Connecticut Humanities Council

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Executive Summary

In the summer of 2009 the Connecticut Humanities Council commissioned an assessment of the philanthropic funding environment in Connecticut and nationally for itself, and additionally for the humanities organizations it funds. The Council had grown to one of the largest humanities councils in America but, concerned about the global recession and its effect on funding opportunities, the Humanities Council commissioned this report to explore its funding options. After the report was submitted in March 2010, CHC chose to share it with its grantee community. This report has been updated as of June 2010 and adapted for that larger audience.

The report presents a sobering assessment of the national and local economy, the philanthropic landscape and funding options for the near term. The Humanities Council realized that the same forces affecting its funding will impact grant recipient agencies too. Equally important to know from a planning perspective is that the decrease in philanthropic and governmental funding is likely to last for as long as five to eight years. In addition to dramatic decreases in funding, the philanthropic community will face further changes in demographics, technology, communications and the very fabric of how the nonprofit sector operates.

On the other hand, the economy *will* rebound, or at least stabilize, over time, even if it does not return to recent levels for many years to come. Change brings possibility along with challenge, and today's not-for-profits have the opportunity to confront these new economic and cultural realities and to restructure their business models and expectations for them. Those that do are likely to survive, and even thrive, into the future.

Global and National Trends

Even before the global recession began in 2008, trends were emerging that presaged change for the nonprofit sector.[1] They included:

- demographic shifts (to a more diverse population);
- technological advances (changing the way people communicate and work);
- the trend toward organizing work in networks (allowing or even demanding new organizational structures and lines of authority);
- a reported increase in interest in civic engagement and volunteerism by the younger generation (including a generational preference for hands-on philanthropy)--this is an interesting development as it follows a period of reduced civic engagement by busy families, isolated by long commutes, packed schedules, and television[2];
- a blurring of sector boundaries between philanthropic, private and governmental sectors (enabling unusual collaborations and/or providing competition from heretofore unanticipated sources).

An entire essay could be written on the implications of each of these factors for not-for-profits and their programming, but for now I recommend to readers a report from La Piana Consulting, *Convergence: How Five Trends Will Reshape the Social Sector,*[3] as one of the more cohesive of many reports in recent years warning of approaching change on a major scale.

We turn now to the more immediate, and urgent, impact of the global recession. The stock market provided the general population with the most obvious indicator of economic trouble in 2008. After an almost catastrophic drop in 2008, the stock market rebounded significantly in 2009 and early 2010, lulling some into complacency that the worst was over. But while the Dow Jones Industrial Average exceeded 11,000 in April for the first time since September of 2008, it dropped steadily from then on, closing at 10,043 on May 25.[4] Both the U.S. and international markets are showing further volatility as the growing debt crisis is recognized in weakening European economies, and security issues persist in North Korea, Afghanistan, Iraq and the Middle East. While periodic upswings in the stock market may result temporarily in individual donors feeling better about making gifts, that trend (if it develops) will help only those not-for-profits that already have a strong and loyal individual donor pool. (Interestingly, in 2009 many not-for-profits locally and across the country reported only a minor dip in individual giving from long-term, loyal donors, confirming the adage that individual donors will stick with a favored charity in recognition of special challenges.)

However, not only is the stock market not on a reliable upswing, it is *not* even the relevant benchmark for measuring the severity and longevity of the financial challenges for not-for-profits. The more predictive measurement of not-for-profit fiscal health is *state tax revenues*,[5] which are, across the nation, the lowest in over four decades, according to the Nelson A. Rockefeller Institute of Government[6]. As of December 2009, state tax revenues (from all sources, across all states) had declined for a record fifth consecutive quarter; put another way, after adjusting for inflation, state tax revenues were at the same level as ten years ago, although the nation's population has increased ten percent in the intervening years.[7] The Institute expects that when all figures are in, they will report a record *sixth* quarter of decline as well.[8] State governors, the Rockefeller Institute and others predict at least 5-8 years for state tax revenues to recover to pre-recession levels. Further impeding recovery is the fact that state spending is not generally cut at the same rate as income, producing structural budget gaps for the future. [9]

The National Governors' Association predicts a "lost decade" due to this recession's severity, the projected slow recovery, and future demands to meet neglected needs.[10] As of December 2009, more than 40 states already had reduced spending on important human services for the current fiscal year, with many (including Connecticut) facing further cuts to close current year shortfalls. More than 80 percent of both counties and cities also expect funding shortfalls in the next fiscal year.[11]

There are some signs of good news in the first quarter of 2010, on both the national and state level. Unemployment appears to have leveled and retail sales are beginning to improve on a month-to-month basis, both of which drive state tax revenues. Indeed several states have reported quarterly increases in tax collection over the same period a year before, although some of that is the result of tax increases. Local tax collections have not been hit as hard as states', primarily because property taxes have remained more stable, but those collections are also showing modest improvement, although there is wide variation from city to city[12]. Unfortunately, these slight positive indicators do not reverse the poor prognosis for overall fiscal recovery for the states. Even a rapid recovery would take several years to bring state income back to prior levels; at the same time, all of the states are finding it extremely difficult, and so far impossible, to cut spending to sufficient levels to balance with the reduced income. Economists predict the slowest recovery since the Great Depression, and thus a prolonged period of struggle for the states.

This deeper understanding of the states' budget picture and state tax revenues in particular, are relevant to nonprofits for several reasons. The first and obvious one is that states provide a major portion of nonprofit revenues either as grants or contracts for services. The Urban Institute calculated in 2005 the charitable sector's income sources as follows:

Earned income from private sources	50%
Government fees for service	21%
Government grants	9%
Private contributions	12%
Investment income	5%
Other income	3%

In addition, the states' budgets reflect the same economic factors that directly affect not-for-profits in their non-governmental revenues. When individuals and businesses cannot pay income, corporate and sales taxes, they are unlikely to make significant charitable contributions, and earned income tends to drop as well.

Connecticut's economy and the impact on nonprofits

- We have all heard the litany of factors in this country that differentiates the current recession from recent ones, making recovery an elusive challenge. A simplistic list includes: depressed housing markets and mortgage foreclosures, leading to declining consumption and therefore sales tax revenues, and to depressed property tax revenue leading to reductions in local town and education and other services (and employment); high unemployment leading to depressed income tax revenue, further reducing consumption and services. The downward spiral is proving exceptionally difficult to reverse.

- In this "perfect storm," the Connecticut Legislature and Governor struggled until May of 2010 before achieving an agreement on the *current* year's state budget. Despite taking a number of extraordinary steps to close a staggering budget gap, including substantial borrowing, allocating all federal stimulus funding, depleting the rainy day fund, reclaiming many state and quasi-state agency fund balances, postponing funding the state's pension obligations, delaying contracted payments, raising taxes on high earners, and rescinding $32 million in budgeted expenditures in November 2009, the state still faced a projected deficit of more than $513 million as of January for the fiscal year that was already half over.

- The picture looks no better for next year. The current draft 2011 budget assumes an incipient economic recovery, but as the Center on Budget Policy and Priorities put it: "Historical experience and current economic projections suggest 2011 will be worse than 2010." [13] In April of 2010, the Connecticut Legislature approved a budget for FY2011 of $19 billion. It increases spending by 0.9 percent and borrows nearly $1 billion, while raising no taxes. It eliminates a previously projected deficit of $726 million with a $366 million extension of federal stimulus funding, sweeping state agency funds, further borrowing, and $177 million in cuts, including cuts to human services, arts and culture.[14] It also defers a state pension payment of $100 million, which is permitted if revenues are under-target by $300 million; however, at the same time the budget assumes that the $300 million in revenue *will* be received. [15]

- The University of Connecticut's Center for Economic Analysis predicts that, since the national growth rate for the third quarter of 2009 was recently revised downward to 2.2 percent, "a national recovery will trail off, falling from 2.9 percent in the [third] quarter to just 0.9 percent in the last quarter of 2011." [16] Given that national context, "There is broad agreement, including [from] the Governor's Council of Economic Advisers, that Connecticut will continue to lose jobs at least until July [2010], and any recovery will be anemic. Global Insight [an economic and financial analysis firm] does not see the Hartford region recovering lost jobs until after 2015, and anticipates the New York region recovering only in 2012."[17] Equally important, this latest analysis projects state output will grow modestly through the first half of 2010 but decline slowly thereafter, never recovering to the level achieved in the last quarter of 2007."[18]
    - The state's budget crisis can itself exacerbate the economic decline, as every $1 billion cut in state spending can lead to 18,000 jobs lost.[19]
    - Furthermore, in the last twenty years most of Connecticut's job growth (perhaps the lowest of all the states) has been in low-wage sectors.[20]

It is important to note here that, as noted in the Urban Institute chart above, earned income plays a very significant role in the financial health of many organizations. In some sectors, earned income can fund up to half of an operating budget; obvious examples are schools, colleges, hospitals and performing arts organizations, but even museums and historical houses charge admissions and rental fees and operate stores to earn revenue. The recession has pressured these sources of income as well.

So if government funding is unpromising, can we turn to the philanthropic sector to rebalance the revenue stream for our state's not-for-profit organizations? Not surprisingly, the prospects there are sobering too. The next section explores how the not-for-profit funding sector overall is responding to this confluence of generational and economic changes.

Philanthropic Funders' Responses

While private philanthropy in this country (defined here as contributions from individuals, foundations and corporations, or non-governmental and non-earned income) is critically important in many ways, it does not "drive the bus" in the arena of social benefit. Contrary to common perception, private philanthropy funds a relatively small percentage of services provided by the nonprofit sector – the overwhelming portion is funded by state and federal government.[21]

In the 18th and 19th centuries, the role of private philanthropy in America was to provide social benefit that individuals could not provide for themselves. Education (in both schools and libraries), arts, culture, and basic human needs for those affected by poverty, natural or economic disaster all received support because of individuals' motivation to provide for their neighbors and strengthen their own communities. Through the 20th century, many of these philanthropic endeavors became institutionalized and funded by private foundations and corporate giving programs, and many migrated to government services (a limited reflection of the European model that evolved from a feudal system where all services were provided by the lord of the manor.) In the 1960s, the philanthropic sector took on a new role—to educate and influence government about social issues and to experiment with solutions; the concept was that government would then pick up the successful ones and take them to scale across the nation. In a democratic society committed to separation of church and state, private philanthropy also continued to support quality-of-life endeavors and religious pursuits outside of the responsibility of government. This clear expectation for the role of philanthropy has been breaking down since the federal government began to shed itself of entire programs in the 1980s, but the fundamental reality remains that private philanthropy cannot replace government funding to supply basic human services or other social benefits.

To put philanthropic funding in context, the following chart shows the source of non-governmental charitable giving in the U.S. for 2008 (percentages vary by less than a decimal point each year):

Individuals	75%
Foundations	13%
Bequests	7%
Corporations	5%[22]

Non-governmental giving in the United States has consistently been directed by donors (individuals, corporations, and family and institutional foundations) in the following proportions across the following sectors (numbers rounded)[23]:

Religion:	35%	Arts, culture and humanities:	4.5%
Education:	13%	International affairs:	4.3%
Human Services:	9%	Environment and animals:	2%
Health:	7%	Foundations (family, etc.):	11%
Public-society benefit:	8%	Unallocated:	6%

The distribution of funds supplied by individuals, foundations and corporations varies significantly from one sector to the next.

Foundations and Corporations in Connecticut

How do funders see the current situation? One spokesperson, who reflects the views of many interviewed foundations and corporations, summed it up: some individuals still have some money to give (if they are still employed or wealthy); corporations are cutting their giving staffs and their budgets; foundations are starting to drop staff and their grant budgets; new foundations are still forming but they are not connecting to organized philanthropy. All in all, there is not much new money being dedicated to philanthropy except for food and energy. This comment was made before the earthquakes in Haiti and Chile, which has diverted money at least for 2010.

Some interesting comments from a sampling of funder interviews (comments not attributed to preserve anonymity):

- "The state is doing exactly what we don't want the nonprofit sector to do – slashing without visionary thinking."

- "All foundations' assets are down at least 30 percent and not yet back." (This said as of December 2009). For example: one large funder has reduced its projected funding by 20 percent, cut all non-core grants, all discretionary or opportunistic funds, and is making no long-term commitments.

- "Funders are all focusing on basic human needs" (said by multiple foundation leaders). "We do want to preserve 'essential' arts and culture," but the definition of "essential" varies by funder. One of the major community foundations noted that its grants for arts and culture remain a steady percentage of its overall grants, but the needs of those agencies are elevated so the grants are focusing more on organizational needs than new programming.

- Many interviewees commented that, "No funder is taking on new grantees/relationships."

- Several funders commented that, "'Nice but not essential' programming is getting squeezed out." An example they often used was that literacy ("How to read") may be essential for economic recovery, programs on "why read" or "loving to read" are not.

Corporate giving generally tracks corporate profits, which are more volatile, and currently down. It is thus very difficult to predict future corporate giving. Furthermore, corporations' funding priorities (usually blending with their marketing goals), currently favor basic human needs, presenting a challenge for all other fields.

While United Ways fund social services rather than arts and culture, their long and close relationship to corporate funders is instructive for grant seekers in other fields. No United Way operations, which raise the bulk of their dollars in the corporate community, are growing anywhere in the U.S.[24] Given static funding levels, United Ways are increasingly looking to fund systemic change in hopes of reducing safety net needs over time. These changes in part reflect the priorities of their corporate funders.

Individuals

Giving from individuals is valuable to an organization for several reasons, chief among them that individuals, once engaged and *if stewarded properly*, are loyal donors, while institutional funders almost always rotate funding after one, two or three years. Individuals are, naturally, the only source of bequests and other planned gifts, which provide the bulk of the country's endowment funds; and for many organizations individuals provide major lifetime gifts for capital and operating needs that are less likely to be funded by institutional funders.

The oft-cited statistic (noted above) is that individual donors provide close to 85 percent of overall *philanthropic* support in this country between lifetime gifts and bequests.[25] While that statistic is accurate, it includes religious giving, which alone consumes 35 percent of all philanthropic support (probably most of it from individuals). In contrast, arts, culture and humanities combined received just over 4 percent of all philanthropic (non-governmental) support.

A downward trend in major gifts across the country also indicates the severity of the recession and the inevitable increase of competition for shrinking charitable funds overall. Gifts of $1 million or more from individuals are decreasing dramatically, and many nonprofits with robust giving programs report smaller gifts from loyal donors trying to help as much as they can.[26] (The slight decreases, or even small increases, in annual giving result from the smaller, regular contributions from loyal donors.) A corollary of the sharp decline in major giving is that this becomes a very challenging time to launch a program to attract new individual donors who are already battling to support their long-time favorite organizations.

As funders struggle to make tough choices with diminishing resources, donors of all types are increasingly intent on ensuring that their dollars make a real difference. Explaining impact, educating donors about overhead costs, and providing realistic program evaluations have been a growing trend among, and challenge for, nonprofits, particularly for arts and humanities organizations. It is very difficult to *prove* some of the positive impacts of humanities programming in quantifiable terms. That difficulty, plus the challenge of competing with basic human needs in a time of great suffering, presents a real challenge for the humanities.

How Nonprofit Agencies Are Coping

On the battle-lines sit the not-for-profit agencies themselves, trying to deliver increasing services of all types with decreasing revenues.[27] The not-for-profit sector generally lags the general economy entering recessions, because of prior year grant commitments and because foundation funding is cushioned by spending policies, but they also lag coming out of recessions. So the direct impact of this recession is just now being felt across the sector.

Status across the Sector

The Nonprofit Finance Fund conducted a nationwide survey of more than 1,100 nonprofit leaders (88 in Connecticut) between February and April of 2009, with support from the Hartford Foundation for Public Giving. At that point, only 12 percent of Connecticut's responding nonprofits anticipated a surplus in their budget, and 41 percent anticipated a deficit. Only 16 percent anticipated being able to cover their expenses in both 2009 and 2010. Fifty eight percent anticipated funding decreases from governments, 66 percent from foundations, 52 percent from individuals, and 35 percent in earned revenue.[28]

The study asked what nonprofits were doing or considering in response to the challenging economy. The answers included:

- Develop a "worst-case scenario" contingency budget" (73%)
- Reduce staff or salaries (53%)
- Freeze all hiring and current salaries (51%)
- Reduce or eliminate programs (48%)
- Collaborate with another nonprofit to provide programs (42%)
- Reduce staff hours (32%)
- Merge with another organization (5%)

The Connecticut Association of Nonprofits conducted a survey of its statewide membership in January 2010[29]. Highlights of its findings include:

- Over 30% of the respondents reported a decrease of 10% or more from each of government grants or contracts, investment income and corporate donations
- 82% reported an increased demand for services
- 54% reported clients who had never sought services before
- 55% had reduced staff, despite increased demands

The United Way of Greater Hartford completed its annual study of nonprofit agencies in October, 2009. Its findings included:

- 50% expected revenue decreases from all sources
- 79% reported that gifts from individuals are less than 20% of revenue (i.e. they depend on the state, foundations and corporations)
- Many reported giving to be down by both dollars and numbers of gifts
- While corporation and foundation giving was steady in '08-'09 for many agencies, most reported or expected decreases for 2009 and beyond
- 93% reported increases in demand for services and 89% expected demand to continue to rise
- 46% expected to add services (generally employment assistance or service referrals for individuals)
- 49% reported reduced staffing
- 44% reported a change in staff allocation for fundraising (more time from more people)
- 32% had begun to tap reserves, 25% had no reserves, and 6% had already depleted reserves. Of those now tapping reserves, 68% had less than 6 months of reserves
- 25% had considered merging in past 12 months
- 33% indicated they were concerned or very concerned that their agency would close in the next year

What's An Agency To Do?

Discussions rage through the philanthropic literature among funders and grantees about the need to completely rethink the philanthropic sector and the way not-for-profit agencies function and relate to other agencies, funders, constituencies and the general public. It is now presumed throughout the field that traditional funding mechanisms will no longer be sufficient for nonprofits to operate as they have over the last 100 years. One natural area for restructuring is the cost structures of multiple independent organizations.

There is a broad assumption that collaborations (on programming, back-office services, staffing) or even mergers will reduce costs and make the sector more efficient. On the one hand, so the discussion goes, there are too many nonprofits, and many of them operate inefficiently and with insufficient expertise in certain arenas. Conversely, others argue that not-for-profits do not have a "middle management" cohort to reduce in a merger, and applying efficiency of scale arguments to not-for-profits whose "bottom line" is social benefit is inappropriate. Studies to date prove what many have feared: nonprofit mergers seldom work, and collaborations may produce important program enhancements, but are often *more* expensive in time and money, at least in early years.

Nevertheless, and perhaps inevitably in a time of shrinking resources, funders are looking for efficiencies, defined as collaborations (even within their own staff operations). They are asking for reports on collaborative efforts from grantees, and favoring applications that include them. Even though few if any funders individually determine a grantee's survival, several of those interviewed mentioned the wrenching decisions they now face about *when* to stop funding agencies – "Will one more grant help soften the decline, or only prolong the inevitable?" Efforts to find new business models in program or organizational collaborations may be the best solution for many agencies; they can also inspire funders.

An excellent recent article in Stanford's Social Innovation Review [30] describes the range of partnership options now being explored, from strategic alliances to collaborations to partnerships, with examples of each from across the country. Shared or restructured back-office services are the most commonly explored restructuring options, and usually the most achievable. As confirmed in La Piana's article and experience, while various scenarios of sharing bookkeepers, technology, human resource staff, etc., may increase an agency's performance, they do not always reduce costs. Often agencies are not providing the service in the first place, or are using untrained staff to provide it; when subcontracting or sharing the service, they seldom reduce employment, but add or upgrade the service and redirect the time of staffers who used to do it to activities more appropriate to their skills. At the very least they choose to wait for attrition to reduce staff members' time instead of letting people go. So shared services may be a good thing for an organization's impact and performance, and for the sector as a whole, but it is likely to disappoint as a cost-saver unless staff cuts are added to the mix.

Nevertheless these collaborations are starting, both across the country and in our region. United Way chapters are reviewing a nationwide collaboration for their own back-office services; in Greater Hartford a few agencies with similar purposes have shared a "circuit riding" technology staff member for several years with success. A consortium of cultural organizations in central Connecticut is seeking funding to start sharing some back-office services. The Pro Bono Partnership, a provider of free legal expertise for nonprofits, has been offering seminars on how to collaborate or reduce services in this environment, and has been a party to some general explorations. Many discussions about collaboration are occurring across the state, but no one can yet track actual agreements in any number here in Connecticut. There is still room for a trend-setter to take the lead.

In the trend toward "a new normal" for the not-for-profit sector, funders expect even the strongest agencies to review their operations and think differently about how to deliver their services. Some funding is available to support this process, but it is unlikely to be enough to fully implement major restructuring without an investment from the agencies themselves. The funders' intention is to help nudge organizations toward solutions that will strengthen the agencies in the long run and thus justify their own investment (prompting a "chicken and egg" argument for most nonprofits).

Conclusion

Readers who have not yet stopped reading, or thrown up their hands in despair, will hopefully be among those able to see opportunity in this grim landscape. Unlike the private sector, which is forced to make constant improvements in products and services by competition in the marketplace, the not-for-profit sector is slow to change. Paul Ylvisaker, formerly of the Ford Foundation, said in 1966, "Frankly, there is more that's new outside philanthropy than there is inside philanthropy. Which is not to say that we in philanthropy are not changing or that we are not getting better. But simply, to admit that the world around us is changing an awful lot faster than we are."

The dramatic changes in our economy and our culture, the advent of a global economy and almost instant communications, all spell opportunity for not-for-profits to bring fresh perspectives to their original missions. What does preserving history mean in 2010? How can we best tell the story of our past in an electronic age? Do people need to be physically in our museums to learn from them? The role and importance of history has not changed, but the way we teach and learn its lessons certainly has.

Economic reality has thrown down a gauntlet before us. It is up to us to take up the challenge.

FOOTNOTES

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[21] Interview with President, Capital Area United Way, November 12, 2009.

[22] Giving USA Foundation, 2008 report on *Giving in America.*

[23] Ibid.

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[25] Giving USA Foundation, 2008 report on *Giving in America*.

[26] Di Mento, Maria and Caroline Preston, "A Slow Year for Bug Gifts Spurs Wealthy Donors to Creativity", *Chronicle of Philanthropy*, February 11, 2010. http://philanthropy.com/article/A-Slow-Year-for-Big-Gifts-S/63904/

[27] According to a survey of 465 nonprofits across the country in October and November, 2009 by Grant Thornton, an accounting and business advisory group, 87 percent of organizations responded to the economy by reducing expenses, 57 percent cut personnel and 53 percent delayed capital projects. Grant Thornton's 2009 "National Board Governance Survey for Not-for-Profit Organizations" is available online at http://www.gt.com/bgsurvey.

[28] Nonprofit Finance Fund, as presented by the Hartford Foundation for Public Giving, October 21, 2009. Available at: http://www.hfpg.org/Portals/0/Uploads/Documents/Public/GreaterHartfordNonprofits_04.2009.pdf

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