

Reading Between the Red Lines

Tools for Strategic Grantmaking in Tough
Economic Times

International Human Rights Funders Group
January 27, 2009

Table of Contents

| | |
|------------------------------|---------|
| Goal | Page 3 |
| Context | Page 4 |
| Grantmaking Assessment | Page 7 |
| • Financial - "Telltale Two" | Page 10 |
| • Burn Rate | Page 12 |
| • Surplus/Deficit | Page 15 |
| • Leadership & Governance | Page 19 |
| Grantmaking Grid | Page 25 |
| About KrasnePlows | Page 28 |

Goal for Today

- Provide a simple, objective decision-making framework to decide how best to:
 - Maximize program impact
 - Support your grantees
 - Allocate your limited resources
- *A framework to use in good times & bad*

The Context Externally

This recession is different:

- Longer: 1-2 years with a slow recovery
- Unlikely to return to 2007-level asset values in near- or medium-term
- Reduced grantmaking capacity for years
- Every grantee funding source is affected
- Global recession impacts grantees worldwide

-- *Past grantmaking practices may not serve you or your grantees well*

The Context Internally

Your funding philosophy shapes grantmaking choices:

- Breadth vs. depth -- how concentrated in program areas, geographic reach
- Grantee profile --
 - New vs. mature
 - Small vs. large
 - Local/grassroots vs. national or international
- Grantee mix -- new vs. existing
- Maximum grant size as % of grantee budget
- Your involvement -- how interventionist

Key Issues in Grant Decisions Made Tougher in Recession

- How do you allocate scarcer grant dollars?
 - Amount: Less for all or same level for some?
 - Purpose: Change mix of program, general operating, capacity building?
 - Grantees: Some new or only existing?
 - Term: Mix of single or multi-year grants?
- Who should you support & how best can you support them?
- How do you communicate to your grantees?

Grantmaking Assessment

The two critical factors:

- I. Program quality and impact
- II. The grantee's ability to deliver the program as promised
 - Financial health
 - Organizational capacity

Funders assess the first factor well; we will focus on the second, then tie them together for more effective grant decisions.

Why Assess the Organization, Not Just the Program

- Leadership and governance capacity: Provides strategy, focus, direction and oversight
- Infrastructure resources: Supports program staff's ability to deliver effective programs
 - Facilities
 - Computers and technology
 - Communications
 - Monitoring and reporting
 - Human resources support
 - Fund-raising

Financial Assessment: Guiding Principles

- Use a “reasonable person” standard:
An ordinary, prudent person exercising due care in decisions and actions
- Focus on what is material:
Significant change, whether big \$ or %
- If an explanation is unclear, it's OK to ask questions to clarify

Financial Indicators: Introducing the “Telltale Two”

| Indicator | What It Tells Us |
|---|---|
| 1. Bottom line surplus / deficit - current year, last year | 1. How well is a grantee doing? Does revenue keep pace with expenses? |
| 2. Burn rate - unrestricted net assets / average monthly expenses | 2. How long can a grantee operate with cash available? |

Financial Indicators: “The Telltale Two”

- Simple, but not simplistic
- Easy to apply
- Uses readily available data: public sources like US IRS 990, audit, other
- Limited timeframe: 2 years (easy), 3-5 years (trend)

“Burn Rate”: What & Why

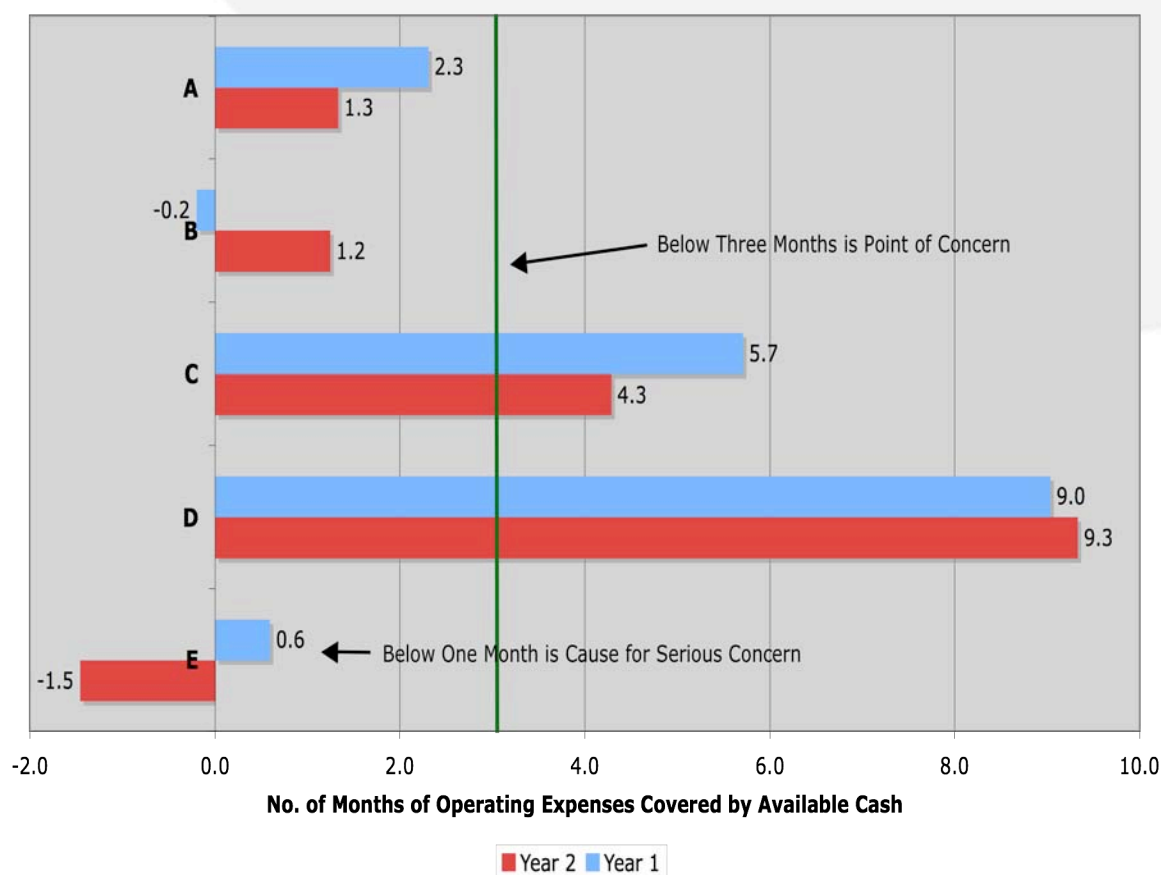
- Liquidity: Grantee's cash cushion
 - Measures # months a grantee can operate -- pay staff, other expenses -- with currently available cash
 - Calculation: $\frac{\text{net unrestricted assets}^*}{1 \text{ month's operating exp}}$
 - More months = more cushion;
fewer months = less cushion
- * Can substitute “cash on hand” for international grantees without 501(c)3 certification

Burn Rate: Key Questions

- Is the burn rate 3 months or more?
If yes --> no worries
- If the burn rate is less than three months --> cause for concern
 - May have trouble meeting payroll and other ongoing expenses
 - May be hard to pay for unanticipated expenses
 - May have less ability to deliver quality program

Burn Rate: How to Assess

Burn Rate: Examples
No. of Months of Operating Expenses Covered by Available Cash
(How quickly does the organization "burn through" its cash?)



Surplus / Deficit: Key Questions

- Is there a surplus in each of the past 2 years?
If yes --> no worries
- Is there a deficit in one year? (Not unusual)
If Yes --> how big is loss as % of total expenses?
 - If equal to or less than 10% --> no worries: deficit is not material
 - If more than 10% --> cause for concern

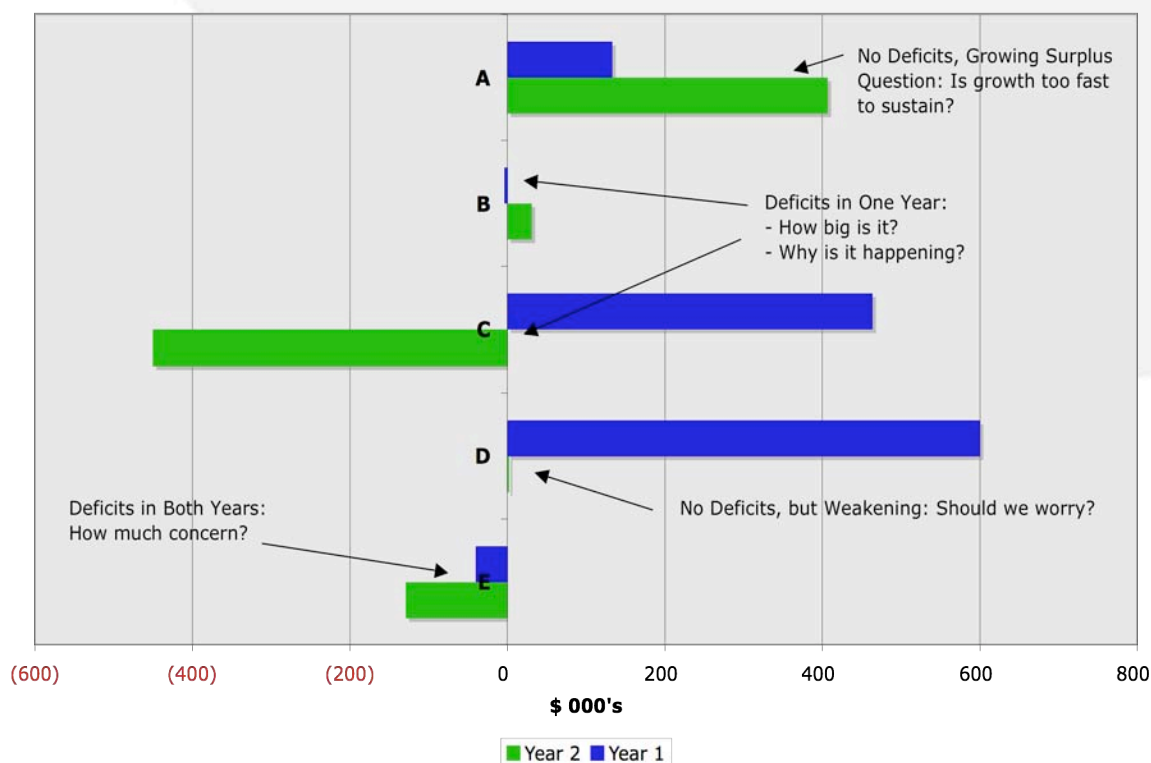
Surplus / Deficit: Key Questions, cont'd

- For deficits in both years: How big is it as % of total expenses?
 - If equal to or less than 10% --> OK
 - If over 10% --> cause for concern
 - Revenue either has fallen or did not grow enough to pay for expenses
 - Expense growth is not under control
 - Both revenue and expenses challenges exist

Surplus / Deficit: How to Assess

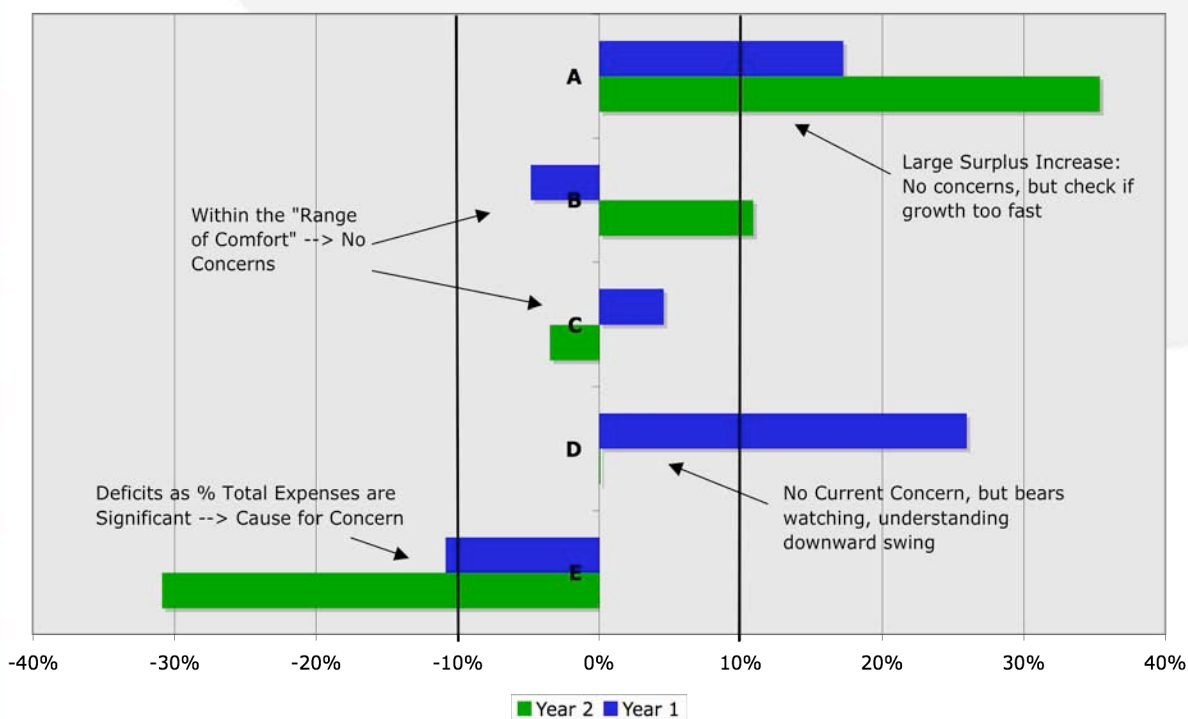
Surplus/Deficit Year 1 to Year 2: Five Examples

Surplus = Total Revenue - Total Expenses



A Closer Look: Surplus/Deficit as % Total Expenses

**Surplus/Deficit as % of Total Expenses
Year 1 to Year 2
If Deficit More than -10% --> Cause for Concern**



Leadership and Governance Assessment

- Why consider:
 - Leadership capability is key to organization's long-term success
 - Funder can provide support for leader to address concerns identified
- Data sources:
 - Structured interview with CEO/ED
 - Most recent board packet
 - Structured conversation with board chair if necessary

Leadership Indicators: What to Look For

- How well the CEO/ED:
 - Articulates recent, demonstrable accomplishments
 - Recognizes obstacles and provides a realistic plan to address them
- Response quality indicates:
 - How focused leader is on:
 - Ultimate goal
 - Outcomes and achievement measures
 - How well leadership anticipates and plans for the future, not just day-to-day operations

Leadership Indicators: What to Look For, cont'd

- Turnover:
 - Leadership: Transition point --> an uncertain time for organization
 - Staff: Benchmark against similar organizations' turnover rates
 - Relatively high turnover may indicate dissatisfaction with leadership, organization
 - May indicate organization in flux

Governance Indicators: What to Learn about the Board

- Engagement: Attendance rates, work done at and between meetings
- Composition: Skills needed to support the organization
- Turnover: Board continuity, fatigue, or dissatisfaction
- Planning with leadership: Existence of strategic, budgeting, fund-raising plans -- and contingency plans in today's economy

Board and CEO/ED Indicators

- How proactively are they addressing future challenges and opportunities?
 - Ability to describe challenges over next 2-5 years
 - Evidence of plan to achieve identified goals
 - Evidence of monitoring progress against current goals

Leadership & Governance: Measurement is Critical

Use a Scale to Measure Factors

| Leadership & Governance Factors | Low 1 | 2 | 3 | 4 | High 5 |
|--|----------|---|---|---|-----------|
| Demonstrates recent accomplishments | | | | X | |
| Recognizes obstacles & has action plan | | X | | | |
| Leadership turnover | X | | | | |
| Staff turnover | | | X | | |
| Board engagement | | | X | | |
| Board composition | | | | X | |
| Board turnover | | X | | | |
| Board & leadership planning | | X | | | |

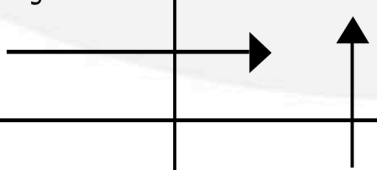
* Note that a high score is not always desirable. For example, that high board engagement is desirable, but high staff turnover is not.

Putting It Together: “The Grantmaking Grid”

- Compare grantees so you can use grant resources optimally, based on your goals and values
- Target your grant for maximum impact, after considering a grantee’s specific needs

Putting It Together: “The Grantmaking Grid”

Grantmaking Grid

| | | <i>Weaker</i> | <i>Stronger</i> |
|--|-----------------|---|--|
| <i>Financial and Organizational Capacity</i> | <i>Stronger</i> | Options: <ul style="list-style-type: none"> • Target grant to strengthen program • Encourage merger or collaboration with others who have stronger programs | Continue or increase support  |
| | <i>Weaker</i> | Options: <ul style="list-style-type: none"> • End support • If reason to continue: <ul style="list-style-type: none"> ○ Know why ○ Target support to key needs ○ Collaborate with others ○ Encourage merger | Options: <ul style="list-style-type: none"> • Target grant to increase organizational capacity • Encourage merger with others who have strong organizational capacity |
| | | <i>Program Strength</i> | |

In Conclusion

- Consider both the program and the organization's capacity to deliver it
- Use a few, simple, revealing indicators to assess financial and organizational strength
- Compare your grantees
- Target your grant investment to grantee needs

About KrasnePlows

- Founded in 2003, KrasnePlows is a boutique management consulting firm that specializes in mergers and partnerships, planning and restructuring, and leadership transitions for charities and foundations
- We work as partners, combining our clients' deep program and organizational knowledge with our executive expertise and ability to apply business principles where most useful
- We are based in New York City and can be found on the web at www.KrasnePlows.com