LEAP OF REASON

MANAGING TO OUTCOMES

IN AN ERA OF SCARCITY

Saving the Ship by Rocking the Boat

Mario Morino
November 2011

Repurposed article from *VPPNews*
Venture Philanthropy Partners monthly newsletter

In my September column, I implored those who serve on nonprofit boards to "summon the courage to face the music and prepare for the future, even if things are going swimmingly today." In this column, I will arm you with the six questions I believe every nonprofit board and executive team must ask to prepare for rough financial straits ahead.

Fair warning: The questions below are not a tame, staid checklist. Wrestling with these questions will require you to challenge long-held assumptions, stir conflict, and venture far from your comfort zone.

Before I share the questions, allow me to share a good example of the bold thinking that our times require. Shockingly, this story comes from the Ivory Tower of academia, a sector that is notoriously tradition-bound and change-averse.

Smith College, in Northampton, MA, has recently launched a "Futures Initiative" to take a hard look at some of the basic assumptions that have guided the college for well over a century. Under the leadership of its president, Carol Christ, the college is "reconsidering not only the financial model of the institution, but also the types of students the women's college attracts, ways it can move beyond the residential campus model, and how it goes about delivering instruction," according to Inside Higher Ed.

The fact that an institution like Smith is undertaking this initiative is an important harbinger. Smith has faced budget cuts, but it's under no imminent threat. It's a thriving, highly selective college with a billion-dollar endowment. Smith's initiative is a great example of the proactive planning we all need to do in this disruptive new era.

The Critical Six

The tricky part is posing these important, tough questions to prepare for change ahead as you stay focused on the here and now—the management and day-to-day execution of your organization. Here's one approach to consider: Create an ad hoc group made up of key board members, executives/managers, and outside advisors (six to nine people total) to answer these future-focused questions. The rest of the leadership team can maintain its focus on ensuring the organization continues to run well.

Question 1: What conditions could change precipitously, endangering our mission and those we serve?

In high school I played left field for a gifted baseball coach who taught us to be prepared for anything. He demanded that each of us "live the play before it happens." Given that I was the only kid on the team whose IQ was higher than his batting average (and my IQ wasn't that high!), I paid very close attention to anything that would improve my game. Between every pitch, I would see in my mind's eye the batter singling to right; I'd imagine running in to back up a throw to second. Then I'd "see" the batter grounding to short; I imagined hustling in to be there in case of an error. And on and on.

In my professional life I drive folks crazy as I'm constantly asking, "If this happens, then what?" All I'm doing is trying to see the play before it unfolds.

The "play" that so many of us are watching develop is the decline in public funding. For organizations that are highly dependent on public dollars, these cuts can mean drastic cutbacks, even shutting the doors. If I'm a charter or parochial school and scholarships (read: vouchers) are cut, what percentage of my tuition revenue is hit? Are there alternative revenues to offset this loss? Can we continue?

Even if you're not the direct beneficiary of public funding, please don't assume that you don't need to think about public funding cuts. The competition for foundation grants, major gifts, and fee-based contracts will skyrocket as those whose public monies are cut look to other funding sources—like yours.

The loss of public funding is far from the only adverse thing that we could find at our doorstep one day. For instance, if you run an independent school, what would you do if a securely endowed, proprietary, competing school opened for business in your locale with a lower tuition? What if you work to reduce gang violence and your local government cuts the number of police officers, inadvertently placing a greater strain on the services you provide? What are the implications?

If you have outstanding debt, what protections have you put in place to guard against higher interest rates once inflation raises its ugly head? Could you withstand the increase in debt servicing costs? Should you consider doing something to "collar" the rate? Or better yet, should you try to clear or reduce the debt to lessen your vulnerability?

Can your endowment withstand a severe market hit, and at what cost in programs and services?

Question 2: Within current constraints, what can we do to improve the outcomes of our programs?
This sounds so basic, yet too many organizations give this subject little more than lip service. They dwell in long discussions of "process" and never actualize big, non-incremental improvements that can save more lives, enable more youth to graduate college, or help more unemployed workers get a living-wage job.

Some years back I was in a board retreat where we were trying to prioritize a set of strategic initiatives. I stressed that we needed to focus first and foremost on financing, because I was worried that the organization was in a precarious financial state. Another board member, the CEO of a major firm, respectfully but assertively took issue with my position. "I disagree with Mario on this," he said. "The quality of our product is number one. Not finances. If we don't get the quality right, finances won't matter." He was absolutely right.

I can't guarantee that quality will pull an organization through a crisis. But an organization doing great work and making a discernable difference will certainly have a better chance than others to compete for scarce resources and capitalize on disruptions in its space. So please don't curtail your creative thinking with the excuse "we don't have the money." You have a staff and advisors with a lot of knowledge. So tap them, free their thinking, create "improvement circles" where folks come together to brainstorm. Explore together how to increase quality, lower cost, and improve outcomes. Do the same with those you serve; you might be pleasantly surprised.

But, most of all, I urge you to consider undertaking a rigorous "theory of change" effort (not to be confused with strategic planning). David Hunter, the former director of evaluation and knowledge development at the Edna McConnell Clark Foundation, describes the approach very well in this essay from *Leap of Reason*, the book Venture Philanthropy Partners published in May.

I've long believed that this kind of thoughtful (and emotionally challenging) review of your programs and services by experts with deep domain expertise is an essential practice, not a luxury. Done well, it leads to clearer focus, improved program alignment, pruning of programs with incremental or tangential value, and tangible improvements in how you deliver on your mission. I've seen this with the VPP investment partners who have gone through this process. I've also seen it on recent site visits to organizations outside VPP's portfolio, including Congreso de Latinos Unidos and ROCA. Their redesigned, high-quality, high-performance efforts are a direct result of this investment in their theory of change. As one leader said, "Doing this helps save more lives."

Bottom-line: In times of crisis, improving quality is a way through. It's not a locked guarantee for success. But if you're not doing your job, you risk being toast when things really get tough.

Question 3: What is our organization's "baseline" budget for providing the minimum acceptable level of service to clients?
You don't want to be caught like a deer in the headlights should your organization incur a big cut in revenue (e.g., loss of funding from a patron funder), experience an unexpected disruption (e.g., an embezzlement or other scandal), and/or see your costs soar (e.g., the financial crisis-induced fee spikes on credit default swaps held by nonprofits and municipalities). These crises tend to come with little or no notice. Most organizations are forced to take extreme corrective action quickly, without the benefit of the thoughtful planning and deliberation that would ensure "smart actions."

Yet there is a way to prepare yourself for such unforeseen hits: Use zero-based budgeting as a way of analyzing the minimum funding you need to provide your core service with acceptable quality.

In the spring of 1988, my software and services firm recruited a young, talented businessman to join us as president. He had sped along the managerial fast track at GE and gone on to work as a senior executive in a major software firm. He brought strong business analytical skills into our rather loose managerial world. One of the valuable tools in his toolkit was the zero-based budget, which, after much initial reluctance, I eventually came to appreciate as an excellent way to look at activities and costs.

Unlike a traditional budget that uses the existing expense structure as its baseline, a zero-based budget assumes no history and starts with a baseline of zero—no activity, no costs. My firm used zero-based budgeting as a one-time exercise to find the critical set of activities we absolutely had to do to keep our doors open for business and the costs associated with this baseline. It made us evaluate each major component of our operation on its relative merit and cost. As you can guess, it was emotionally trying to do this. It was very hard, but necessary, to be highly objective and to keep history and allegiance from coloring our decisions.

With zero-based budgeting, organizations can create a doomsday-scenario plan for eliminating all the programs except those that are absolutely necessary for survival. For example, for a multi-facility organization, the first action might be to consolidate operations in one of the facilities and shut down or sell the others. A multi-service organization might cut back on programs that are not absolutely essential to its primary intervention model. A school might have to make the hard call of eliminating library services or the school nurse, or even look at higher student-to-teacher ratios.

The leader of a private school shared his experience with this approach: "I was guided through the process by one of our trustees, who was a retired CEO. We incorrectly started with the assumption that we would have all the same staff, which of course defeats the purpose of starting from scratch and trying to align staffing with mission. Having to justify each member of our team and program was an eye-opening process for me and the leadership staff at the school."

While the idea of bringing your expenses down to zero may be horrifying, there is tremendous value in this exercise. If your organization is able to clarify its priorities through a zero-based-budgeting exercise, your organization will do a better job of allocating resources around its core mission and knowing when to say no to less important efforts and projects. And when you hit those turbulent storms, your board, leadership, and key staff will already be "mentally there" and ready to move.

Question 4: Who would be our "knight in shining armor" if we needed one? In other words, who could we turn to if we were at risk of having to fold our tent?
In my corporate life, we strategically thought through which companies we would turn to if we had to sell the business for whatever reason. Please understand this was not something we wanted to do, but we felt it was necessary and prudent. When you engage in this kind of thinking, you take purposeful steps to get to know the potential "knights," understand their leadership and culture, even do partnerships or joint ventures with them. Then if you find yourself in a situation in which you need to sell the firm to protect your shareholders, staff, and customers, you can approach your "knights." This is far better than starting cold with someone you don't know at all or, worse, sitting prey to a hostile takeover.

I'm sure this thinking sounds brutally corporate, but it is absolutely applicable to the world of nonprofits.

What organization or organizations would be your logical collaborators or merger partners? What synergies would exist? What value would you bring to them and they to you? And what would be the cost in dollars and mission?

How real is this thinking? This discussion is already underway in the world of private, independent schools, as demographic shifts are leading to lower student enrollment. It has unfortunately been the bane of many Catholic Dioceses and independent Catholic schools, where there is a mandate to liquidate assets and decrease expenses, especially in older, poorer communities. It has been at play in an aggressive way in healthcare, as a result of a wave of hospital consolidations. Municipalities that have long protected their fiefdoms are increasingly looking to consolidate services across jurisdictions and, in extreme cases, even merge the jurisdictions—forced in most cases by declining revenues. And the beat goes on.

Identify those organizations and leaders to which you could turn if you were faced with saving your organization by consolidation and some form of collaboration. Develop relationships with each organization. Enter into pilot collaborations to get to know them. And develop scenarios for what you would propose and the rationale to support it.

Question 5: What are the "one-step away" opportunities? In other words, how can we change our prospects by building off what we already know?

In the '80s I got a chance to work with some top thinkers from McKinsey & Company, and that exposure helped me understand two related concepts better: the importance of exploring new opportunities that are directly tied to your mission and not more than one step away from your core competency; and the value in exploring whether your core products and services might be relevant in other areas (secondary markets), without the need to do a material revamping.

For example, if you run an independent or charter school for K-6 students, you may improve your outcomes and generate additional revenue by establishing an early childhood development program. Similarly, if you run a high school, you might offer a "preparatory year" to help students get a better foundation for college, both developmentally and academically.

Take this thinking further. Encourage (and incentivize) your staff and board to constantly be on the lookout for new ideas that could open up new opportunities to improve on your current programs or expand and grow based on the "one-step away" principle. But don't look only at your own niche and geography (e.g., healthcare in the U.S.). Keep your mind open to ideas from other sectors and industries and, especially, innovation occurring beyond our shores. I like futurist Faith Popcorn's idea of reading a trade magazine or journal in a field other than your own in search of ideas and developments that may have transfer value.

Question 6: What can we do to strengthen our revenue base?

In these times, it is imperative that boards and leadership teams do all they can to protect the revenue sources they have, while starting the arduous process of finding new ones. The first and logical step is to take an in-depth look at your attitude toward fund development and the capacity you have to deliver the required dollars.

First of all, break down the myth that raising money is the responsibility of the fundraising team. Everyone can and should play a role. We need to accept the brutal reality that higher education came to grips with years ago: The president is the chief fundraiser for the organization, with all hands at the ready to help. Next to ensuring the quality and integrity of your programs, this is the most important priority. Michael Worth, a colleague and respected thought leader in the National Capital region, does a nice job in laying out the key fundraising issues that organizations should consider in threatening economic times with his column "It's the Economy."

Rather than just focusing on increasing your current funding base, how are you considering new sources of funding, perhaps tying back to "one-step away" opportunities? But please be careful not to launch new revenue-generating ventures without serious consideration. The highway to these ventures is littered with road kill! Instead of bringing in significant revenues, they often lead to a loss of mission focus and a dilution of scarce internal resources.

That said, some nonprofits with strong leadership, mission focus, planning, and staff resources can do it well. My good friend Bob Templin, president of Northern Virginia Community College, has had good experiences. “I look for new lines of business that can be profitable for us,” Templin says. “For example, NOVA has been teaching immigrants and the children of embassy officials for more than 40 years. We’ve gotten to be very good at working with people from many different cultures, so it was not a big step from our core competency to launch a program to recruit international students. International students pay nearly two and one-half times the tuition that ‘in-state’ students do, and they enrich our collegiate environment by being here. In the last five years, our international student enrollment has grown by more than 70%, and these students now generate a ‘surplus’ of more than $1 million annually after all expenses are paid.”

The Unthinkable Isn’t

In my last column I outlined a number of “unthinkable” events that have come to pass over the last decade—from 9/11 to the financial collapse. Since I wrote that column, the Occupy Wall Street protest has grown rapidly across the country and become a magnet for deep frustration and anxiety about what the future holds. MF Global, a huge securities firm run by former Goldman Sachs CEO and former New Jersey Governor Jon Corzine, collapsed when a potential “knight” found accounting irregularities and backed out of rescuing the company. The city of Harrisburg, PA, filed for bankruptcy. Only a week after euro zone leaders sparked euphoria in financial markets around the world with their announcement of a massive deal to reduce Greece’s debt, the crisis is once again threatening the global economy, and the Greek government is teetering on the edge of collapse.

I hope that the parade of “unthinkable” events shakes us up. If we look at the kind of questions I’ve posed in this column through a purely intellectual lens, it’s too easy to keep them at arm’s length. As a good friend told me recently, “We in the social and educational sector need to get a sharp punch to our solar plexus, forced into a skunk works, and kept there until we start coming up with some new ideas.” I’m afraid he’s right.

We desperately need to get past nice discussions. We need to rock the boat during board meetings and leadership sessions. This is not about self-reflection and introspection as a touchy, feely New Age exercise. It’s about ensuring our organizations’ continued ability to make a material difference in the lives of those we serve. That’s why these tough questions are worth asking.

—Mario Morino