METRICS FOR EVALUATING NON-PROFIT PERFORMANCE

By FocusCFO

Non-profit organizations serve an important role in our society, providing services that for- profit organizations are either not interested in providing or can't provide profitably. These non-profit organizations are extremely diverse, ranging from charitable socially-focused organizations to member-based groups.

Increasingly, non-profits are developing performance measurement systems that allow them to evaluate their progress toward achieving their missions. Metrics focused on how organizational activities are fulfilling the non-profit's mission combined with financial performance indicators allow entities to understand how effectively they are serving their communities. The way these organizations execute their mission is very different from the execution of for-profit entities, but there are common approaches to performance measurement that can help organizations to manage their operations and to sustain their ability to serve. Here are three areas of focus for measuring non-profit execution.

Activity Effectiveness

Efficiently operating a non-profit is essential. Just as in any business, efficient operations generate additional cash flow for the organization, but in a non-profit it also demonstrates effectiveness to potential non-profit "investors" (donors, grantors and/or members) which can result in increased funding. Operational efficiency measurements vary for different types of organizations, but the metrics should measure progress toward the mission and the effectiveness of programs implemented. Activities to be measured should include a measure of productivity (mission-related outputs such as constituents served divided by inputs such as staff or dollars). Other appropriate measures of performance for organizations may include staff effectiveness, the hiring and retention of skilled staff, increased donations from current donors, or increased donor loyalty and retention.

To determine organizational financial efficiency, non-profits should analyze several standard performance categories including:

- Program Efficiency (program expenses divided by total operational expenses)
- Administrative Efficiency (administrative expenses divided by total operating expenses)
- Operational Sustainability (operating revenue as a percentage of costs - which measures the net dollars the non-profit spends providing aid and support to the community)
- Fundraising Efficiency (fundraising expenses divided by total operating expenses)

The general consensus is that non-profits should spend at least 65% of their total expenses on program activities. Many believe that organizations spending less than a third of their budget on program expenses are ineffective. “Best of Class” organizations often spend 75% or more on program activities. Typically, efficient non-profits are expected to spend 15% or less on administrative expenses and 10% or less on fundraising expenses. These standards can change depending on the non-profit’s business segment. For instance, museums typically have above- average administration costs as compared to other types of charities because of the costs to maintain their facilities and collections.

Utilizing and Expanding Capacity

Effective non-profits are successful at mobilizing their resources. Organizations should measure their capacity utilization and their ability to grow capacity. Depending on their cause, that may require measuring efforts to increase donations from current donors, expand the current donor base, pursue funding from public sector agencies and government, increase market share, grow the number of volunteers, or recruit high-impact board members.

From a financial measurement perspective, non-profits should track their revenue growth compared to similar organizations, program expense growth compared to others in their industry segment, and their working capital to expense ratio. Comparing revenue and expense growth to others in a non-profit’s industry segment allows the performance metrics to be adjusted for economic trends. The working capital to expense ratio is important in determining how long (in years) a non-profit can sustain its level of spending using only its net unrestricted assets.

When growing capacity, it is important that the non-profit convince donors to fund infrastructure instead of only program services. Fundraising is critical to capacity expansion, and infrastructure is needed to support that capacity.

Fundraising Effectiveness (fundraising expenses divided by the total funds the organization receives as a result of that effort) is an important financial measure. “Best of Class” non-profits typically have fundraising expenses that are less than 35% of related funds raised. Although the expected ratio differs significantly by industry segment, generally non-profits should work to maintain a working capital to expense ratio greater than 1. Donor Dependency (operational surplus subtracted from donations, divided by donations) is another common financial capacity measure.

Long-term Objectives and Planning

As opposed to for-profit organizations where profitability and increasing owner value are the goals, non-profits are measured by their ability to fulfill their mission. Fulfilling the organization's mission may require incurring financial deficits while providing more services to constituents in recessionary times. Surpluses may be managed in other economic situations. As a result, the long-term focus of a non-profit should be on sustainability.

Measuring progress toward the mission and the non-profit's long-term objectives should drive high-level organizational focus. As a result, it is especially important that non-profits maintain strategic plans typically for three-year intervals. Cultivating a "sustainability" culture among board members, staff, donors and grantors is essential so that the organization can be a reliable service provider when recession comes. A common metric in measuring compliance with the non-profit's strategic plan is to track the percentage of operating priorities that align with the organization's mission.

From a financial perspective, three-year financial models and their related annual budgets are very important to long-term objectives and planning. Plans that include deficits are acceptable, but non-profits should not outspend their means. When an organization runs a combined deficit over time, its sustainability is suspect and it runs the risk of not fulfilling its mission. As a result, financial models should include combined surpluses over time and the establishment of cash and investment reserves for

lean stretches. The working capital to total expense ratio discussed above is an important measure of long-term performance. Additionally, a common metric for successful non-profits is the ratio of the organization's net unrestricted assets to annual expenses. It should be about three times the larger of the prior year's expenses or next year's budgeted expenses. It is important, however, to avoid accumulating assets beyond that point and tying up funds that could be used for current program activities.

Non-profits play an essential role in our society. In order to fulfill their vital assignment, it is important that they sustain their existence by performing at the appropriate level. Managing to key performance indicators like those discussed above will significantly help non-profits to achieve their mission.