Analyzing the Dynamics of Funding: Reliability and Autonomy

Editors’ Note: An earlier version of this very popular article appeared in the Fall 2002 issue of the Nonprofit Quarterly. This version provides a deeper cut, making explicit a set of eight common nonprofit financing models or archetypes. Each archetype carries with it a constellation of management challenges and an advised set of management priorities to address those challenges. Pratt is a master of this kind of simple but profoundly helpful sorting of information. We recommend it as an excellent reading for board members.

Every nonprofit organization begins with high hopes and aspirations for public benefit, with a mission to make the world a better place. An immediate challenge is how to put these goals into action, and how to finance the organization. Or, as one cartoon caption under a drawing of Moses holding two large stone tablets put it, “What about funding?”

Money is a limited and competitive resource; organizations without a permanent source of funds must do their best to accommodate the preferences and conditions of funding sources. Striking necessary bargains with devils and angels constitutes the defining struggle for nonprofit boards and managers. This existential dilemma is played out in every nonprofit budget and strategic plan: how does the organization raise funds to realize its long-range purpose while also scrambling for its existence?

The way an organization handles decisions about funding sources sets in motion an ongoing chain of consequences, further decisions and compromises about what the organization will and will not agree to do. Throughout the history of nonprofits, major changes in size, direction, and strategy (and even new names and purposes) are more commonly due to shifts in revenue than to changed intent.

Among the funders of nonprofit activity, attaching conditions and targeted funding are considered valid methods for increasing the accountability and effectiveness of grantees. Whether it is a government agency or a private foundation, the allocators of funds have authority over a finite resource with many requests from the outside. They conclude from previous experience which types of activities are most likely to succeed, and seek the “biggest bang for the buck” by focusing and restricting their money to this narrower range of activities.

For nonprofit organizations, not all funding has an equal effect on the bottom line. Complying with the conditions attached to funding—and coping with fluctuations in revenue—imposes direct and indirect costs, and occupies the attention of managers and boards. The drawbacks of this situation are self-evident to anyone who has managed a nonprofit organization, but board meetings and financial reports can have the effect of simplifying the problem down to “will we take in enough money to cover expenses?”

Board members, nonprofit employees, and clients (and even other funders) frequently believe that an organization has more latitude over how and when it spends its funds than is actually the case. This limited autonomy squeezes nonprofit managers by putting them in the onerous position of enforcing and defending compliance with funding conditions, sometimes in the face of solid arguments for an alternative course—all the while being criticized that “if they wanted to do it, they could.” Or worse still, different parts of the organization disagree about the conditions that exist, the wisdom of compliance, or the likelihood and severity of sanctions, causing internal conflict or even misappropriation.
An organization-wide appreciation of these revenue-source issues is in the interest of the board and staff, informed by an examination of the two major variables: reliability and autonomy. This does not lessen the constraints—but can clear the air so that decision making is based on a common understanding of an organization’s available degrees of freedom and the future implications for revenue changes.

**Reliability of Funding**

To what extent can an organization predict its revenues year-to-year for budgeting, staffing, and program planning? Is it reasonable to expect a particular funding source will be renewed? This information—projecting and tracking revenue and expenses—is key to managing any enterprise. Boards and nonprofit managers are under a legal mandate to exercise their best judgment concerning what revenue will be available, with serious consequences if they are wrong. The decisions they make will be based on their confidence level regarding the relative stability or volatility of each element of the organization’s financial support.

The Reliability-Autonomy Matrix divides twelve common types of nonprofit funding into three levels of reliability: high, medium, and low. This necessarily gross categorization is useful to identify funding sources on a continuum from dependable to speculative, although an individual organization’s experiences will vary. (The placement of any specific funding source on the reliability axis can vary considerably based on the organization’s relationships, existing commitments, and other constraints influencing the funding source.) The three levels of reliability include:

- **High reliability:** Small to medium-sized individual contributions, endowments, memberships, United Way support, rental income, advertising.
- **Medium reliability:** Fees for services, ongoing government contracts, third-party reimbursements, major individual contributions, corporate charitable contributions.
- **Low reliability:** Government project grants, foundation grants, corporate sponsorships.

**Organizational Autonomy**

Dependency theory indicates that the autonomy of nonprofit organizations is directly related to the extent of their reliance on suppliers of funds.

From government contracts to foundation grants, organizations know they are signing onto a variety of conditions that are attached to funding, comparable to “if you take the King’s shilling you do the King’s bidding.” These conditions can range from the general targeting of an activity to extremely detailed specifications dictating the ingredients, personnel, time, place, and manner of activity. For the donor, these conditions represent due-diligence assurances that funds will be effectively and responsibly expended, while for the recipient organization, a number of these conditions are unwelcome, burdensome, and counterproductive.

As with the reliability index, the matrix divides eight common types of nonprofit funding into three levels of autonomy: high, medium, and low. This similarly gross categorization distinguishes between conditional and unconditional sources, and an individual organization’s situation will vary. (The location of any specific funding source on the autonomy axis can be adjusted based on the organization’s relationships, existing commitments, and other constraints influencing the funding source.) The three levels of autonomy include:

- **High autonomy:** small to medium-sized individual contributions, fees for services, foundation operating grants, endowments, memberships.
- **Medium autonomy:** major individual contributions, corporate charitable contributions.
**Low autonomy**: Third-party reimbursements, government project grants, ongoing government contracts, foundation project grants, United Way support.

**Understanding an Organization’s Reliability/Autonomy Profile**

The revenue situation for any particular organization will have special characteristics, and could change over time. To understand an organization’s “center of gravity,” it is possible to calculate an overall reliability/autonomy score using a spreadsheet and formula on the Nonprofit Quarterly Web site. The eight revenue archetypes set out some typical situations and management responses. A closer analysis of a single organization can reveal a greater level of detail and more options. Organizations are free to change the rating for funding types based on a frank assessment of their own situation and relationships.

**Management and Governance Implications**

The Reliability/Autonomy Matrix is designed to reveal priority issues for board and management attention and indicate strategies needed to handle the relative reliability and independence of its revenues. The profiles and archetypes, themselves, are difficult to shift (e.g. dramatically increasing autonomy) since most mature organizations have an established mix of funding. Wherever a funding source falls within the matrix, it carries with it a variety of management options, many of which, in turn, increase the complexity of the management task. Increasing the number of sources and transactions is generally a useful strategy to increase organizational autonomy and security—though it demands more administration.

One critical additional variable is the sheer number of funding sources. Most organizations work hard to diversify their sources of funding, both in type and number of sources, in order to reduce funding volatility and lower their risk of catastrophic loss (such as when a major funding source withdraws its support). Boards of directors expect to be involved in budget planning and monitoring, but in many organizations they are often not aware of the degree of volatility of their funding, or what the organization should do about it. Organizations with funding that is low in reliability have a variety of possible actions to reduce the uncertainty in their environment:

- Maintain higher cash reserves to fill in gaps and reduce the roller-coaster-budget effect.
- Give greater management and board attention to cash management and financial systems, thus predicting shortfalls and allowing quick decisions.
- Use volunteers, consultants, and temporary employees to increase flexibility of the workforce, and thus reduce dislocation.
- Develop close relationships with organizations in the same subject area to track industry changes, and share information on funding source preferences and behavior.
- Submit multiple applications to offset low-response rates.

Organizations low in autonomy have a special set of problems, because although their funding sources are definitely willing to transfer funds to them, they want to do this in a particular way. An African proverb says that “if you want to give a man a goat you have to let go of the rope,” but of course many funders have perfectly good reasons why they can’t completely “let go of the rope.”

Boards of directors are less aware of their role in monitoring the restrictions placed on the funds their organizations receive. Low-autonomy organizations must also develop a special set of skills to preserve sufficient maneuvering room:
• Emphasize negotiation skills and develop a persuasive case of what the organization brings to the table (local community knowledge, flexibility, reputation, track record, volunteers, leveraged money, etc.) to equalize exchange and offset unwanted conditions.

• Monitor (via the board) the consonance between the organization’s mission and the nature of the projects it is asked to undertake.

• Be prepared to resist and reject incompatible conditions by having a gift-and-grant-acceptance policy.

• Maintain a robust financial system to track and comply with conditions and restrictions on funding and effective segregation of funds. Monitor conditions on funding. Discuss as a board the purpose of funding and contract monitoring.

• Increase the total number of funding sources, even if they are low autonomy, to reduce the degree of control of any one source. An organization with a dozen or more low-autonomy funding sources can mitigate the lack of flexibility by diversifying.

• Take part in policy networks and coalitions to resist or reduce excessive conditions by government funding sources.

One of the easiest types of organizations to manage, and the most satisfying for a board experience, is a high-reliability/high-autonomy organization. These organizations are better able to chart their own course and stay flexible, and have the time and freedom to ask the big questions and make long-term plans. More complex are high-reliability/low-autonomy organizations, which are often large institutions enjoying tight relationships with government or the United Way; they are generally long-term relationships in which funding conditions are accommodated over a long period of time.

The most difficult organizations of all to manage are low-reliability/low-autonomy (a.k.a., Dante’s Seventh Circle of Hell). These organizations are stuck in an ongoing loop of project creation, submission and approval, and have a high need for both negotiation and earnings management, which sometimes are in conflict.

Many organizations are so steeped in their existing funding patterns and relationships that they no longer recognize or think about the nature and limits of their situation. The Reliability-Autonomy Matrix enables boards and managers to take a systemic view of their revenues by providing a framework for examining them in a relevant, strategic context. The value of the Matrix is its ability to help nonprofits easily identify funding limitations and flexibility within their organizations, which is central to effective strategic and financial planning.

*Jon Pratt is the executive director of the Minnesota Council of Nonprofits and a contributing editor to the Nonprofit Quarterly.*