Dispelling the Myths of Nonprofit Organizations

It is the rare community indeed that does not at some time need the services provided by nonprofit organizations. Even in places where the economy is thriving, unemployment is low, and life is good, there will always be the need for social and special services that are not provided by either the private sector or the government.

These social and special services include affordable housing for low-income families, food shelves for the hungry, emergency shelters for the battered, financial or psychological counseling for the troubled. The nonprofit organizations that provide such services are many times the only thing between a family and an abyss. And they usually provide these critical services efficiently and timely because, after all, that is the nature of emergencies.

But there is a persistent myth that nonprofit organizations are inefficient, poorly run and unsophisticated organizations, operated by people who mean well but who really don't behave in a businesslike fashion or who don't really understand what it takes to make an enterprise survive, much less thrive.

While there may indeed be examples of such poorly operated nonprofits, the majority of nonprofits do not fit that description.

Furthermore, nonprofits work in an atmosphere of near anonymity and low recognition—they get no respect, as Rodney Dangerfield would say. Even the most wildly successful ones are rarely, if ever, profiled in a major business newspaper or journal.

The myth of unprofessionalism can lead to real lost opportunities. It is likely that their "out of sight, out of mind" situation prevents some profitable and creative collaborations with financial institutions from occurring. While it is natural for businesses to seek solutions to problems from within their own circles, the collaborations cannot be formed if nonprofits are not in those circles. The range of possible solutions is therefore smaller than it could be, and both parties miss out.

This article attempts to dispel some of the illusions about how nonprofits operate so that greater understanding—and profitable relationships—between banks and nonprofit agencies can result.

Bankable assets

Just like other businesses, nonprofit businesses sometimes need cash to meet short-term obligations, like payroll, and they sometimes need capital for buildings and equipment. Many times the local bank is the source they go to. What influences how a bank perceives the nonprofit's request for funds?

Sometimes nonprofits are viewed as not viable business organizations that represent too great a risk for the bank to consider making a "regular" loan to. The fact is that nonprofits and the for-profit businesses that bankers are used to dealing with sometimes operate quite differently because of their differing purposes.

Private businesses tend to make quicker decisions because they are more influenced by market forces that may affect profitability, while nonprofits, because of their management structure, tend to be more inclusive and may take more time reaching decisions. Also, the ownership and management structure of a private business typically allows for quicker decision-making. Neither is more viable or efficient than the other. They are, though, different.

Efficiency, for nonprofits, is many times related to social benefits that are much more difficult to quantify (families helped, children counseled). At times it may even be impossible to accurately quantify a nonprofit’s "success."
COMMUNITY
DIVIDEND

Usually we feature a question from our readers and answer it in this column. In this issue, we turn the tables and ask you. See how many terms from the Dictionary of Banking Terms you can answer. Answers are on page 5.

**Pa'anga, n.**
1. What happens when you borrow your father's new ear and total it.
2. A highly secured loan that you need to take out to pay him back.
3. The national currency of the Tonga Islands.

**Dirty float, n.**
1. A dessert, made in a greasy spoon cafe in the rural Midwest, using a glass with water spots, where the server puts the ice cream in first and then pours root beer over it, so the ice cream gets an icy crust that you have to eat before you can get to the creamy part.
2. A foreign exchange rate that is influenced by market intervention by the issuing country's monetary authority.
3. A short-term loan, given on an emergency basis only, to keep a business solvent while it collects from its debtors.

**Tugrik, n.**
1. Mongolian currency.
2. Tugboat Annie's best friend.
3. A clause to protect the bank in the event of computer fraud by children under 15 who reside in another state.
4. The penalty for improper completion of or neglecting to complete a Currency Transaction Report.

**Forward spread, n.**
1. A medical condition that happens to 80% of men, often starting around the age of 40.
2. The price difference between the spot price and the one-month forward rate.
3. An accounting practice used to record money that isn't at that time in the possession of the account holder.

**Forward forward, n.**
2. Especially obnoxious basketball players.
3. Forward market contract where the dealer takes two different forward positions at opposite sides of the market.
4. A mutual management moratorium policy deferring value-added accounting goals while qualifying hazard measures in perpetuity.

**Checkless society, n.**
1. The social structure existing before banks used checks, characterized by use of coins, paper bills issued by each bank, and barter.
2. The concept that the social structure of the future will exist without the use of checks, and instead transfer all money electronically.
3. Rampant crime, sex, drugs, and prime-time soap operas.

For example, can a suicide hot line really say how many suicides it has prevented?

Businesses, on the other hand, look at efficiency in terms of time and money—profit. Nonetheless, many nonprofits do measure efficiency in terms of dollars and cents. Most nonprofits must measure efficiency in dollars not only because it makes good business sense, but because their funding sources require it and because scarce financial resources require them to manage their money conservatively. But by and large, the balance sheet of a for-profit business and a nonprofit business will look the same. (Retained earnings will be replaced in the nonprofit balance sheet with fund balance, but otherwise they will look about the same.)

**Business know-how**

When a bank looks at the financial strength of a business to determine if a loan is justified, it considers the track record of the business, its credit history, its market, the business savvy of the management team, its overall debt-to-income ratios, and other indicators of financial and managerial strength. A bank must do the same for a nonprofit business if the nonprofit is seeking a loan: how long the nonprofit has been operating, its credit history (if there is one), and its overall rate of leverage. But many banks too often fail to equate the commitment and knowledge of the nonprofit agency's management team with the business savvy it attributes to a for-profit. Just as a good business will understand its market, so will a good nonprofit management team understand its "market."

To illustrate, a bank may approve a loan to a business
operating with a historical market share of 10% of the local market for, say, denim jeans. The market for denim jeans will probably remain strong over the life of the loan, and given the track record of the business, it will likely continue to enjoy a 10% share of the denim jeans market.

Similarly, if a nonprofit food shelf needs a loan to improve its warehouse facility or to upgrade its computer equipment, is it not practical to look at both the funding track record of the nonprofit and its market share? In all likelihood it will have enjoyed something approaching a 100% share of the “market” for emergency food for needy families. Sadly, it is more likely that the whims of fashion will change away from denim before the need for food shelves declines.

Check and you will probably find that management of the food shelf knows every possible source of donated foodstuffs. Further, the management team will have a long-term relationship with foundations, government agencies, private philanthropies, and individuals on whom it has relied in the past for funding and donations. Is that not business savvy?

Alternative lenders

To further illustrate, there is a nonprofit industry that monitors efficiency very closely in dollars compared to services provided and will be perhaps more easily understood by the banking industry than our jeans and food shelf example. That is the field of alternative lending. Alternative lending is the general name for nonprofit lenders that provide loans to other nonprofits, that make microenterprise loans to very small emerging businesses, that lend to affordable housing developers or other service providers.

Many of these alternative lenders are very sophisticated and, in fact, have staff who are very learned in more than one area of expertise. For instance, there are the many nonprofit organizations throughout the country that engage in economic development through lending, technical assistance, and deal structuring.

To accomplish their goals they have staff who are able to put together business plans, who understand credit analysis, and who are adept at bringing together a variety of individuals and organizations to close a deal. These individuals and organizations typically include the business owner or investors, the local government, the banker or other lender, government agencies that often participate, including the Small Business Administration, the Federal Housing Administration, the Economic Development Administration, and any of a number of others. The nonprofit staff many times is also adept in the field of accounting, investing, computers, fund-raising, and proposal writing. In reality, these nonprofits have staff members who have become masters of many trades.

An example of such an organization reported to have this level of expertise is WomenVenture, a St. Paul, Minnesota, organization which promotes social and economic independence of women and their families. It employs 31 staff

What's a Nonprofit?

Nearly a million nonprofit organizations are operating in the country today. What constitutes a nonprofit? The IRS categorizes nonprofits into 27 groups. Here are some of the major ones in the Internal Revenue Code:

- Section 501(c)(3) Religious, educational, charitable, scientific, literary, testing for public safety, to foster national or international amateur sports competition, or prevention of cruelty to children or animals organizations.
- Section 501(c)(4) Civic leagues, social welfare organizations, and local associations of employees. These organizations promote community welfare through charitable, educational, or recreational activities.
- Section 501(c)(7) Clubs organized for pleasure, recreation, and other nonprofitable purposes. No part of the net earnings may inure to the benefit of any person having a private or personal interest.
Terms Used in the Nonprofit Sector

In his book *A Legal Guide to Starting and Managing a Nonprofit Organization*, Bruce R. Hopkins defines the following terms:

**Nonprofit organization.** An entity that is organized so that its net earnings do not inure to the benefit of individuals in their capacity.

**Tax form 1023 or 1024.** The IRS form by which a nonprofit organization seeks recognition of tax-exempt status from the IRS.

**Not for profit.** An activity that is engaged in without a profit motive (that is, a hobby), where the expenses involved do not qualify for the business expense deduction.

**Charitable organizations.** The federal tax law definition of a charitable organization contain at least 15 different ways for a nonprofit entity to be charitable, including relieving the poor and distressed or the underprivileged; advancing religion, education, or science; lessening the burdens of government; beautifying and maintaining a community; preserving natural beauty; promoting health, social welfare, environmental conservancy, arts, or patriotism; caring for orphans or animals; promoting, advancing, and sponsoring amateur sports; and maintaining public confidence in the legal system.

Charitable organizations are classified as either a public or private charity. One of the ways to avoid private foundation status is to be a publicly supported organization, and one of the ways to be a publicly supported organization is to qualify as a donative charity. An organization can achieve that classification by meeting a facts-and-circumstances test where the amount of public support normally received by the organization may be as low as 10% of its total support.

**Private foundation.** A true private foundation has three fundamental characteristics:
- Its financial support came from one source, usually an individual, family or company
- Its annual expenditures are funded out of earnings from investment assets, rather than from an ongoing flow of contributions (in this way, a private foundation is much the same as endowment fund)
- It makes grants to other organizations for charitable purposes, rather than operate its own programs.


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**Calendar**

**April 18-21**  
National Center for American Indian Enterprise Development, economic summit, and trade fair, Phoenix, AZ. Contact: (800) 462-2433.

**April 23-26**  

**April 25**  
Federal Reserve Bank of Minneapolis, Fair Lending Workshop, Fargo, ND. Contact: (612) 340-2277.

**April 27-28**  
Bank Lending Institute, Fair Lending and CRA Compliance, Washington, DC. Contact: (202) 872-1500.

**May 14-17**  
National Main Street Center, National Town Meeting on Main Street, Little Rock, AR. Contact: (202) 673-4219.

**May 15-17**  

**July 27-28**  
Federal Reserve Bank of San Francisco, ABA, USDA, Rural Community Development Corp., National Rural Development Conference. Contact: (415) 974-2968.

**September 24-26**  

**October 1-3**  
Assistance for Minnesota Nonprofits

A service for nonprofits worth highlighting is the Minnesota Nonprofits Assistance Fund (MNAF). MNAF, a program of The Minneapolis Foundation that was founded in 1980, serves nonprofit corporations with 501(c)3 status, throughout Minnesota. Its goal is to increase the financial stability of nonprofit organizations through loans and technical assistance.

MNAF’s Loan Program began with just $265,000 but today features a $3.2 million revolving loan fund, which has made over $20 million in loans over the last 15 years. While the fund was originally established to stabilize cash flow problems, it now offers a wide variety of financing including cash flow, fixed asset, working capital, inventory, short-term real estate, and occasionally, seed capital and debt consolidation.

During the loan application process, MNAF concentrates primarily on the client’s ability to repay and management capacity. MNAF’s collateral requirements are often more flexible than those of traditional lending sources. For instance, receivables, equipment, leasehold improvements, contracts, and confirmed foundation grants are all types of collateral to be considered.

The amount of MNAF loans varies depending on the specific circumstances and need, ranging from $2,000 to $400,000. Clients pay interest but no points or origination fees. Loans have a five-year term limit, although the average term is between 18 months and 3 years. The assistance fund performs all loan-related tasks: it underwrites, administers, and collects. The default rate is .067%.

As an unintended result of MNAF’s lending and technical assistance, its clients often become “bankable.” Curiously, clients that could go to banks often continue doing business with MNAF because of the excellent service they receive and the strong relationship that has formed.

Kathleen Corley, a loan officer with the fund since 1992, says she is proud of the fund’s responsiveness and relationship-based approach to doing business. “If you help people when they need it, if you are responsive, a relationship develops, which helps to retain clients and expand the customer base,” Corley says.

Technical assistance is central to MNAF’s mission. It specializes in the areas of fiscal and cash management. It offers personalized assistance and classes, and has published a helpful workbook entitled Cashing in: A Nonprofit’s Introduction to Borrowing Money, which is available without charge by calling MNAF at (612) 647-0013.

MNAF’s client list is diverse; it serves arts organizations, resource centers, development corporations, community groups, educational organizations, advocacy groups, daycare centers, and social service agencies, to name a few.

MNAF is made possible through foundation grants and investments from banks, foundations, churches, and social investors. The loan fund, which is self-supporting, is administered by The Stevens Group, a financial and management consulting firm.

In addition to financing and technical assistance, MNAF has twice published a report on the financial health of Minnesota nonprofits and has held public forums to discuss the findings. The report synthesizes first-hand knowledge of nonprofits with information gathered through a survey. This report is also available free of charge from MNAF. 

New! New! New!
The Community Reinvestment Clearinghouse has just been launched, providing technical assistance, a resource library, regulatory alerts, and conferences. Call or write:
Community Reinvestment Clearinghouse
New York Law School
57 Worth St.
New York, NY 10013
(212) 431-2899

Answers to “Ask the Fed”:

- Forward forward 3. Forward/Forward
- Forward forward 2. The price of the forward contract is the one-month forward rate plus the difference between the spot price and the one-month forward rate.

Togliq' clipart computer

Community’s monetary authority is the issuing bank, which is authorized to issue currency for the government. The currency is denominated by the dollar sign ($). For more information, visit the Federal Reserve website.
members and since 1977 has served over 5,000 clients in its career and business programs. Women Venture has an annual budget of $1.5 million which it derives from many sources. Competition itself for funds breeds sophistication, explains president Kay Gudmestad.

Another example is the American Indian Business Development Corporation (AIBDC) in Minneapolis, Minnesota. Organized in 1975 by its current executive director, Brenda St. Germaine, AIBDC has developed three properties in one particularly stressed Minneapolis neighborhood which are now home to 31 businesses employing over 325 and contributing about $150,000 in taxes.

In addition, AIBDC provides advice and expertise to other communities and to Indian reservations. AIBDC enjoys a AAA credit rating with the City of Minneapolis. Although AIBDC is a nonprofit, many in the industry regard it as a professionally operated and managed organization that shares the most critical characteristics with its successful for-profit colleagues—hard-nosed business acumen and consistently good results.

For yet another example, look at some of the hundreds of housing-related nonprofits throughout the country. It is not uncommon for a nonprofit housing developer to have 10 or 12 different financial instruments in place on a single project. It might, for example, combine Affordable Housing Program funds from the Federal Home Loan Bank, Community Development Block Grant funds from the city or county, foundation loans and grants, Low Income Housing Tax Credit funds from private investors, tax-exempt bond funds for the bulk of their debt, secondary loans and so-called “soft seconds” from alternative lenders such as the McCauley Fund, a nationally known alternative lender, and a myriad of other sources—all for one project. The only way this will work is if the nonprofit has the talent and sophistication to corral

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Form 507235-89854 (Rev. 890890-95)

**Part XXXIV Activities and Operational Information (Continued)**

**2062** Does the organization perform a useful social purpose? 

- Yes 
- No 

If “Yes,” explain thoroughly in the space provided:

**2063** Is anyone in any way involved in the organization related to anyone else in any way involved in the organization? 

- Yes 
- No

If “Yes,” explain why.

**2064** Is anyone in any way involved in the organization a friend of anyone else in any way involved in the organization? 

- Yes 
- No

If “Yes,” explain why.

**2068** Does or will the organization directly, indirectly, or unconsciously engage in any of the following activities or transactions with any other organization (other than a 501(c)(4) or 501(c)( d ) organization): 

- a communication;
- b) go on a nice vacation together;
- c) hostile takeovers;
- d) carpool;
- e) high school reunions;
- f) bank at the same bank; or 
- g) exchange money, power, and influence? 

- Yes 
- No

If “Yes,” explain why.

**2076** Has any member of the organization or its governing board ever been disqualified as a person? Have you asked their teenage children or spouses? 

- Yes 
- No

If “Yes,” explain why.

**2067** Were any members of the governing body appointed because they are political gadflies? 

- Yes 
- No

If “No,” explain why they were appointed.

**2068** List all financial information for the current year and each of the seventeen years immediately before it in 1997 constant dollars.

<table>
<thead>
<tr>
<th>Current tax year</th>
<th>Prior 17 years (by year)</th>
<th>TOTAL</th>
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<tbody>
<tr>
<td>1. Gifts, grants, contributions, matching contributions (list every item)</td>
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<tr>
<td>2. Value of in-kind services provided by volunteers based on their sellworth</td>
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<tr>
<td>3. Receipts from admissions, bake sales, services paid for (list every item)</td>
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With apologies to the 501(c)(3) form, Application for Recognition for Exemption
Five Acres Under a Fir Roof

It's not unusual for Marquette, Mich., a city of 22,000 in the Upper Peninsula (U.P.), to receive 200 inches of snow. Nonetheless, thousands of people go out of their way to visit Marquette every winter, not only from the 15-county U.P. but also from the less snowy downstate Michigan.

The draw? Not just the skiing, and not a megamall or a natural wonder. Marquette has the world's largest wooden domed stadium, and this structure, called the Superior Dome, is one of the most versatile and well-used public buildings for large groups in the region.

On the campus of Northern Michigan University (NMU), Superior Dome rises 14 stories from playing field to peak and is the tallest structure in town. Made of 781 Douglas fir beams and 108.5 miles of fir tongue-and-groove decking, it caps five acres of playing field and 8,000 seats. Artificial turf covers the field for sports like football, soccer, and softball and then is rolled back for hard-surface sports like tennis, basketball, and track.

Superior Dome is interesting not just for its architecture and ability to hold up to the weather (it can withstand 60 pounds of snow per square foot), but also because it is more than a university athletic facility—it's become a community focal point for the region. Strictly speaking, Superior Dome is not a nonprofit, but it does have the community-building qualities that many nonprofits strive for, and it's solvent.

The dome has taken hold for the community as the place for large gatherings, such as conventions, trade shows, business expos, field days, evangelical crusades, and just plain escape from the weather for walking, running, and rollerblading. With its building capacity of 16,000 people, “the dome is a real resource for the region for large conferences and shows,” says Mike Clark, director of communications at NMU.

High school football teams from all over the U.P. and downstate Michigan play as many as 45 regular-season and playoff games under the fir dome. And these young players do not come alone. Family and friends trek to Marquette—a couple thousand each game. This in turn boosts the local hospitality industry.

“It's a good economic tool for the community,” says city manager Dale Iman. “It's a nice facility for a community of our size.”

Construction of the first phase of the $21.8 million dome was completed in 1991. This phase was basically a shell building over a field, seats, and a scoreboard. Because the project is a university facility, funding came from the state of Michigan, with operating costs of $540,000 paid by NMU.

Today Superior Dome is doing so well that the business it generates is funding construction of phase two, which is now nearly complete. This second phase added locker rooms; an adjacent building's
all of the participants and coordinate each piece of the pie. It is no easy process. They do this to lower the cost to the project, even if it means increasing the transaction costs to the organization. The result is very often a more stable project, with lower rents and therefore a wider pool of eligible tenants—something the conventional lenders in such deals should find very comforting.

In conclusion, the average nonprofit probably doesn’t look much like your average business. They may be more casually dressed. They probably bring a great deal of passion to what they do—feeding the hungry, housing the homeless, counseling the troubled. But make no mistake, many nonprofits realize that the passion they feel for their work must be matched by the competence with which they manage and operate their agencies. It is a matter of survival for the nonprofit, and a matter of business opportunity for the banks. ❖