

## Institutional Advisors

# Your Nonprofit's Financial Health: A Journey Not a Destination

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Assessing a nonprofit organization's financial health involves more than having enough money to keep the lights on. It's about effectively carrying out your mission, building relationships with donors, and securing the resources you need to make a lasting impact.

So, how do you define "financially healthy" for a nonprofit? And how can you measure and benchmark your organization's financial health? There is no one-size-fits-all definition of financial health for nonprofits. However, some general indicators can help you assess your organization's financial well-being, including:

### **Having a budget that is realistic and achievable**

You should base your budget on your organization's goals and programs. It should take into account all of your expected income and expenses.

### **Tracking your income and expenses regularly**

You need to understand the real costs of programs to make decisions about them. And keep track of your overhead, which can be the biggest challenge for any organization. This will help you identify areas where you are overspending or under-raising funds.

### **Having a plan for diverse fundraising**

You should have a variety of fundraising strategies in place, and you should track the effectiveness of each one.

### **Investing in your staff and infrastructure**

Your staff is your most important asset, so investing in their training and development is important. You should also have the right systems and technology in place to support your fundraising and operations.

### **Making accountability a priority**

The Internal Revenue Service (IRS), state attorneys general, donors, the media – everyone is demanding answers about how you receive and use your financial resources. A clear investment policy and a solid financial committee can go a long way to assuring fiscal credibility.



## Measuring and benchmarking financial health

There are several ways to measure and benchmark your organization's financial health. Comparing financial performance to the budget regularly helps to identify budget or fundraising gaps. The following are among the metrics you can use for comparison:

### **Operating margin**

Measures your organization's profitability, calculated by subtracting your total expenses from your total income.

### **Fundraising efficiency ratio**

Measures how much money you raise for every dollar you spend on fundraising, calculated by dividing your total fundraising revenue by your total fundraising expenses.

### **Debt-to-equity ratio**

Measures your organization's level of debt, calculated by dividing your total liabilities by your total equity.

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The integration of return on investment (ROI) metrics, especially in planned giving, can also be a critical measure for validating your organization's financial performance. Among the leading ROI indicators are a well-structured contact plan, the frequency with which you engage donors, and how you track planned-giving programs. These indicators not only improve fundraising effectiveness but also contribute to the overall financial health of the organization.

You can improve your fundraising effectiveness by monitoring these questions about planned giving:

- How many donors do you recognize annually?
- How many revocable intentions are you stewarding?
- How many (if any) were rescinded?
- How many did you designate to a legacy society to encourage future gifts?

But your ROI tracking can get even more sophisticated with more detailed monitoring methods that can help you optimize your fundraising efforts, including the following:

## **Studying prospect pools**

Chart who's making gifts, how they interact with your organization, and what types of gifts they make.

## **Analyzing demographics**

Baby Boomers will have the largest transfer of wealth over the next 30 years, about \$30 trillion, and deserve your attention. But are you forgetting about GenX and Millennials? Cultivating them now can be important for long-term growth.

## **Monitoring your communication channels**

There are numerous ways you can communicate with donors and potential donors — direct mail, emails, website traffic, social media, and surveys. Which channels are producing the most action or generating the most leads? Which give you the most bang for your buck?

## **How do you know if your nonprofit is having an impact?**

Sometimes it's not enough just to measure dollars and numbers. Most organizations can benefit by thinking differently about how to report impact. You need to ask if you're changing lives or contributing to your communities. To learn that, you need to answer and assess questions such as:

- What are we aiming to accomplish?
- Which key strategies will make this happen?
- How well-equipped are we to do this?
- How will we know if we are making progress?

But it's not enough that you know the answers to those questions. You need to tell your story to your key audience. Your messaging needs to show your target audience is feeling the impact of your efforts. Make it more about them and less about you. To do that, you need to determine which media channel will be most effective. And you need to make the message relatable and not just about the numbers. Show the people who are benefiting from your work.

It's equally important that the message, in whatever form, doesn't just convey progress but also motivates more support from the community.

## **Developing a plan for your nonprofit's financial health**

You need to develop a plan for the lean months when you know fundraising will slack off (often the result of seasonality). You can ensure that activities and campaigns are well-placed throughout the year by charting when income is expected and anticipating ROI. If you review these events annually, you will be able to measure whether more dollars are coming in than going out.

Consider creating operating reserves, too. Pre-pandemic, the best practices were to bank 3–6 months of operating expenses. Since then, most nonprofits are keeping 12–18 months in reserve.

Feasibility studies can also help determine the likely success of your fundraising. They can provide a clear picture of how your organization is perceived, informing questions such as:

- Do you have the credibility to reach a campaign goal?
- How effective is your board?
- What are your specific accomplishments?

Of course, such studies only have value if you listen to what is said.

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## Funding: Finding the Right Mix

Nonprofits have a variety of options for funding their work, including:

### Government grants

Many government agencies offer grants to nonprofits that provide essential services.

### Foundation grants

Private foundations also award grants to nonprofits that align with their mission.

### Individual donations

Individuals can make donations to nonprofits online, by mail, or in person.

### Corporate sponsorships

Businesses can sponsor nonprofit events or programs.

### Earned income

Some nonprofits generate income selling goods or services.

The best funding mix for a particular nonprofit will depend on its mission, size, and location. It is important for nonprofits to carefully consider their options and choose the funding sources that are most likely to be sustainable.



## Watching over your investments

Two factors can help ensure the financial future of a nonprofit organization: a strong investment policy statement and a qualified investment committee in place to oversee the organization's investments. Trustees and investment committee members bear a fiduciary responsibility to act in the best interest of the fund/organizations and the beneficiaries/stakeholders. This means that trustees must put the interests of the nonprofit above their own and make decisions that are in the best financial interests of the organization.

The investment committee is typically a subcommittee of the finance committee, responsible for providing guidance and oversight of asset pools that are used to support the organization and its beneficiaries. An investment committee member's most important contribution is setting a policy statement for the organization's investments. The investment policy statement should be created by the organization (not provided by an investment advisor) after carefully considering how to program funding and how you trade off risk for return to achieve the mission of the organization and promote sustainability.

The investment committee bears responsibility for reviewing investment policy statements periodically or as appropriate. But the ability to stick to your strategic priorities during times of market turmoil will protect the organization from ill-timed actions that can be counterproductive. Favorable markets can conceal uninformed and poor trustee oversight; weak markets magnify fiduciary risk.

Understanding the fund's mission is key to creating an effective investment policy. All asset pools exist to provide certain benefits to beneficiaries. Understanding what, how, and why these funds are used creates more informed decisions to balance risk and return.

Establishing clear and concise objectives for the investment program better enables trustees to define successful outcomes. The objectives should be measurable and established in advance. Trustees should focus on creating policies and procedures that are in the best interest of beneficiaries, exclusive of personal preferences.

For example, a committee member may prefer to exclude certain types of investments due to personal bias or unfamiliarity with the strategy. Trustees should be open to ideas, suggestions, and alternatives that have the potential to optimize returns and seek education from their investment advisor to make informed and unbiased decisions.

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## Conclusion: Financial health goes beyond the numbers

Assessing a nonprofit's financial health is not just about dollars and cents. It's a dynamic dance between mission impact, resourcefulness, and sustainable growth. Budget adherence and fundraising efficiency are crucial, but they're only part of the story. The true measure lies in impact: how lives are changed, communities are transformed, and missions are fulfilled. To gauge success, consider the following:

- Ask critical questions about goals, strategies, and progress.
- Track not just dollars raised, but lives touched.
- Share compelling stories of transformation, not just financial reports.

Financial stability underpins this impact. Build reserves for lean times, diversify funding sources, and invest wisely with a clear, mission-aligned policy. Trustees and committees hold a fiduciary responsibility – the nonprofit's well-being comes first.

Ultimately, financial health is a journey, not a destination. Regularly evaluate, adapt, and innovate. Foster a culture of accountability, transparency, and open communication. By aligning resources with mission, measuring impact beyond numbers, and prioritizing sustainability, nonprofits can dance towards a future where financial health fuels lasting societal change.

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For more information on these topics and how KeyBank Institutional Advisors can meet your needs, please contact:

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Page 4 of 4

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