



DRIVINGFORCES

Adding peak performance to business practice

NEWSLETTER

Spring 2008

In this Issue:

EASY MONEY: *Workout vs. Bailout*

TAKING THE MEASURE OF THE NFP SECTOR

Workout vs. Bailout

What many thought couldn't happen, has happened.

The world's financial markets have been in a state of meltdown. Only extraordinary action has prevented complete collapse. And we are not out of it yet.

How did it come about? Why wasn't it foreseen? Does it have any application to sport and the not for profit (NFP) sectors? If so, what lessons can they learn from it?

It happened because lending institutions chose to ignore the fundamentals of their business. They plunged heedlessly into the mortgage market and it went bust. Prudent financial and risk management were abandoned in favour of 'easy money'.

There is a parallel here in New Zealand – albeit on a much smaller scale.

Of concern to *Drivingforces* is the growing reliance by sport and the NFP sector on trust and government agency funds. This is easy money. Little effort is spent getting it and, in the case of trusts, there is little accountability after the fact.

Drivingforces has seen many instances where trust and government funds make up 60% – 70%, sometimes as much as 90%, of a sport's total income.

Trust and government funds are legitimate sources of income but commonsense says such reliance on easy money, dispensed by people without any connection to the activity concerned, carries high risks.

It only takes a change in the strategic priorities of a funding agency for a dependent organisation to take a severe financial hit. There are several recent examples of this occurring. In each case the damage was considerable – large debt, curtailment of programmes, staff redundancies, loss of board and management reputation and eventual bailout by a government agency.

Sound familiar?

There is certainly a parallel with recent events on the world's financial markets. Sport (and other) organisations in New Zealand would be foolish to assume it won't happen to them.

So, what risk strategies ought to be considered to ensure your organisation doesn't fall prey to easy money? Consider these:

1. Put in place prudent financial and risk management policies, and be sure to monitor and enforce them. For example, do you have

policies around the level of financial risk that your board is prepared to accept?

2. Review current income streams and compare their different weightings. For example, what percentage of your funds comes from trusts, sponsors, members, government agencies and other sources? Is there suitable diversification or is the organisation vulnerable to shifts in policy/strategy by one or several of these funders?

3. Divide your expenditure budget into two categories:

a) The amount needed to cover the organisation's core operating activities and services, i.e. those it has to perform to justify its existence.

b) What you need in order to cover non-core activities – additional programmes/services, i.e. those that are nice to have but are not immediately essential.

4. Divide funders into two basic categories:

a) External funders, i.e. those who have no long term obligation to the organisation, such as trusts and government agencies.

b) Internal funders, i.e. those who do have an enduring stake in the organisation, such as members and sponsors (the latter have a commercial commitment).

5. From this develop an income strategy that, when applied, creates an acceptable risk balance between internal and external funding sources. This creates a form of hedge (insurance) against the event of external funders reducing/delaying funds. Your strategy may involve increasing internal funding.

6. Communicate the reasons behind any fee/sub increase to your membership. An argument often put up to *Drivingforces* is that internal (member-derived) funds are insufficient to cover even core costs and members are resistant to any increase.

Drivingforces' experience is that members simply want to know how their money is spent and the reasons behind any increase. So tell them. Members need to be reassured they are getting value for their money.

7. Don't reduce membership fees because of one or two profitable years. Membership in many organisations is declining, which brings with it a reduction in internal funds.

When this happens organisations turn to external funders to make up the difference. So the cycle starts all over again. And with that goes self-reliance.

How big is the NFP sector?

Very! According to a recent study it is worth \$9.8billion (made up of \$6.5b operational expenditure and \$3.3b volunteer value), employing 200,000 FTE staff/volunteers, equivalent to 9.6% of the economically active population.

Its revenue comes from three primary sources:

- 55% user pays/fees
- 25% government
- 20% philanthropy (trusts/donations)

Sport and other NFP groups should note this.

How true

"All the financial incentives in the world won't transform CEOs into better decision makers". Stephen Kaufman, Harvard Business Review, October 2008



"A desire for Peak Performance is the force that must drive any successful organisation."

Further information about what Drivingforces does go to:
www.drivingforces.co.nz