Capital-Savvy Principles for Governing Boards
(Adapted from the writing of Clara Miller in
The Nonprofit Quarterly: Spring 2003)

Every organization has a capital structure. Do you understand yours and how it intersects with the financial life cycle of your organization? How well does your capital structure align with your needs? With your plans for how you intend to grow the organization?

The core elements of capital structure are sorted into the key components of your balance sheet: assets, liabilities, and net assets. The mix of these constitutes your capital structure. In particular, you need to understand assets from the perspective of:

- Adequacy and Alignment between what you have and what you will need
- Diversity and Liquidity, with particular attention to degree of restriction and fixedness
- Risk inherent in the capital structure you have and are developing
- Trends and changes, both within the organization and in the operating environment

Some key points:

Focus on your core business as a nonprofit. Before you pursue or accept a grant, recognize that it will operate within the larger nonprofit “business” that will have to support the work of the grant. Recognize that it is separate and take the time to understand how acceptance of the grant, with its implicit capital structure elements, will influence the core business. You can never treat these as entirely discrete or separate.

Plan for the evolution of your capital structure needs in explicit ways by developing forecasts and plans in the form of income statement and balance sheet projections. And consider whether they are realistic and what it will take to bring them to reality.

Design and make financial investments to support the development and evolution of your capital structure over time. Seek funder support in making the most useful types of investment in your organization.

Be sensitive to transitional states (such as a major expansion or phase of growth, merger, etc.) and what they will require (or force) with regard to capital structure and changes in capital structure. Growth usually requires greater overhead costs as a share of budget.

Organizations that are experiencing high growth are particularly vulnerable to grants that are not supportive or reflective of the core business; these great opportunities can be destabilizing because they can create major new or different capital needs.

Restrictions create risk, and the greater the restriction the greater the risk. Likewise, asset “fixity” results in less flexibility and therefore less liquidity. This increases risk, even when your financial position looks great on the balance sheet.

Recognize that any restricted grant creates an expense for your organization. This increases your organization’s burden to raise unrestricted cash to cover this expense. This is in direct proportion to the size, complexity, and degree of restriction of the granted funds.

The organization is a financial system with its own life cycle and characteristics. Elements of this system include cash, facilities, human capital, and other forms of organizational capacity. They all are interdependent, so changes in one element results in change to the other elements as well. If you accept assets that build capacity in one area, recognize that this will require that you grow capacity in these other areas. Recognize and take this into account as you plan for your future.