Apr 9th, 11:15 AM - 11:27 AM

The Financial Impact of COVID-19 on Nonprofit Organizations

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Abstract *— Scholars and practitioners have argued that effective financial management, particularly the development of operating reserves, can help nonprofits survive economic shocks. The COVID-19 pandemic, which has had a significant impact on the nonprofit sector, provides an opportunity to test whether nonprofits have followed that recommendation, and if so, whether nonprofits with operating reserves were better prepared for the pandemic. Using data from an original survey of more than 600 nonprofit human service and arts organizations, administered when most states had stay-at-home restrictions, we show that most nonprofits experienced an immediate impact on their programs and financing. Yet, those nonprofits with more reserves were less likely to reduce operating hours, lose staff, or experience difficulty acquiring supplies or vendor services. Our study provides rare empirical data on the benefits of operating reserves for nonprofits. Our results also confirm that arts and culture nonprofits were more severely affected than human service nonprofits.*

Keywords — Financial Management, Nonprofit Organizations, Economic Shock

Introduction

The COVID-19 pandemic has brought major disruptions to nonprofit activities. Within the first few weeks of the pandemic, many nonprofits had to suspend programs or quickly adapt their program delivery models, lost government contracts, or canceled fundraising events (Kim & Mason, 2020). Additional impacts are expected due to declining tax revenue, a portion of which is appropriated for nonprofits to deliver services (Mosley, 2020). In this paper, the author explores how nonprofits responded to the initial impact of COVID-19 and the resulting economic contraction. In the context of the COVID-19 pandemic, we explore whether organizations heeded past warnings to protect themselves through effective financial management (Hung & Hager, 2019; Park & Mosley, 2017). Specifically, did nonprofits develop operating reserves to help sustain operations, avoid layoffs, and protect their programs during economic uncertainty? We examine whether nonprofits with larger operating reserves were better able to absorb the initial impact of COVID-19. The impact of COVID-19 has not been monolithic, however. While it has forced many arts organizations to go dark (Fraser, 2020), some human service nonprofits such as food banks had a surge in demand (Kulish, 2020). Given differences in their programs and funding market, we also examine the pandemic's varying effects on human service and arts nonprofits.

Preparing for the Storm

Over the past decade, various financial management measures have been considered to estimate the financial vulnerability and resilience of nonprofits, with a special focus on operating reserves (Calabrese, 2013). The Nonprofit Operating Reserves Initiative Workgroup (2008) defines operating reserves as "the portion of unrestricted net assets that nonprofit boards designate for use in financial emergencies." A growing number of studies (Calabrese, 2013) have discussed the factors associated with the size of nonprofit operating reserves. The normative idea of creating operating reserves (rainy day funds) is increasingly embraced in the field. However, little evidence exists on the actual benefits of having rainy day funds during economic downturns. One exception is Calabrese (2018) who showed that nonprofits with adequate reserves are better able to weather short-term disruptions in revenue or increased spending and are able to maintain budgetary stability.

Different types of organizations experience economic shocks differently. Arts nonprofits often face additional pressure during economic downturns, given that they must compete for donations with human service organizations, whose needs are often perceived as more urgent (Kim, 2017). Furthermore, human service nonprofits tend to experience increased demand for their services during recessions (Hasenfeld, 2010) and may benefit from emergency foundation support and donations, at least in the short term, as funders seek to fill immediate community needs (Walker, 2020). Arts and culture organizations, however, depend largely on consumer spending and leisure activities (e.g., ticket sales, admission fees, and sponsorship for events), making them vulnerable to shocks (Grodach & Seman, 2013). COVID-19 has presented additional challenges for arts nonprofits whose programs rely upon community gatherings and shared experience. Still, Grizzle at al. (2015) found human service organizations to have smaller operating reserves than arts nonprofits on average and argued that could be because their relatively diversified revenue streams give them some sense of protection to weather financial storms.

Facing the Storm

Many state-level surveys and polls have been conducted, and in some cases, reports written, providing data from the field on how COVID-19 and the related economic crisis are affecting nonprofits. In addition, there are some nationwide and regional surveys and reports that provide insights. More than 30 state associations of nonprofits and other groups have conducted surveys and pulse polls on how nonprofits and communities in their states are being affected.

In general, these surveys provided clear evidence of a decline in revenue and individual giving that forced nonprofits to limit needed services and layoff, furlough, or reduce pay and benefits for their employees. Notably, nearly four fifths of organizations surveyed reported a decline in revenues, including a decline in earned revenue from events or other activities, and a reduction in individual giving and grants received. These events diminished both the organizations' ability to fulfill their missions and their ability to retain employees.

Impact on Fundraising and Operational Costs

Due to canceled fundraising events, frozen state budgets, changes in priorities for funding on behalf of institutions and foundations, individual concerns to donate during uncertain times, and decreases in renewable grants, nonprofit organizations have experienced slight or significant decreases in their organization's fundraising. However, a small percentage of organizations indicate that they have experienced a slight increase in fundraising, due to COVID-19 specific funding and grant opportunities, increased social media efforts, and emergency COVID-19 mutual aid programs.

Operations have changed drastically over the past several months, and, in some cases, this has impacted associated costs. Although some organizations have seen no change to operational costs, many have seen either a slight or significant increase to costs. Increases are often related to increased demand in service, the need to rely on additional staff instead of volunteers, and paying overhead with no additional funding coming in. Organizations that have reported a decrease in operational costs associate it with receiving COVID-19 related support, operating virtually, the existence of emergency or contingency plans, and not needing to pay contractors due to operating virtually.

Impact on Volunteer Events And Activities

While responses in other categories are more diverse, two areas that have seen a consistent change are volunteer events and activities and service needs. Organizations reporte either a slight or significant decrease in volunteer events and activities, caused by closures of physical locations, adherence to CDC guidelines, and hosting of virtual events. However, some citie that individuals depend more on nonprofits, spike in domestic violence (for nonprofits in that space), demands for shelter, and needs to keep children occupied.

Impact on Service Needs

When asked what resources or information they need to navigate the COVID-19 pandemic, the majority of nonprofit organizations indicated financial assistance. Other resources needed include technical assistance for online training and volunteer recruitment and engagement, grant writing support, and personal protective equipment. Additionally, organizations would like access to trainings to support time management, virtual communications, database and data analytics, board member trainings, undoing racism, financial management for unusual times, and general support and mentoring for executive directors.

Many organizations indicate that they have or will begin to relax their restrictions related to COVID-19, however, full re-opening will be dependent on guidance from city and state government officials, the CDC, and public school leadership. When the time comes to return to full in-person activities, responding organizations expressed a multitude of concerns, including the health of volunteers, staff, and service recipients, lack of reliability of others to take preventative measures, safely transporting youth, and a lack of resources and donations.

Conclusions

Findings from these surveys indicate that nonprofit organizations, across all sectors, have experienced profound challenges as a result of the COVID-19. The fiscal and financial implications of the pandemic have been particularly difficult. In general, nonprofits were not sufficiently prepared for the financial implications of the crisis. It is important to note that organizations with greater fiscal reserves were less likely to report being forced to reduce staffing and operating ours. They were also less likely to face difficulties in receiving supplies and services from vendors. Secondly, data indicate that arts organizations were more severely impacted by the pandemic and saw a greater reduction in programming and funding.

Acknowledgements

The author wishes to recognize the faculty and staff at the Caster Center for Nonprofit and Philanthropic Research and the IUPUI Women's Philanthropy Institute for their invaluable insight and advise during the development of this manuscript.

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