



FINANCING ALTERNATIVES FOR NON-PROFIT ORGANIZATIONS

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Abstract:

A Non-profit Organization is an organization whose motive is not concerned with profit but with the fulfillment of a social cause or advocating a particular viewpoint. In other sense, it uses its surplus to further facilitate its domain function rather than distributing among members or shareholders or donors or trustees or other stakeholders. Due to growth oriented economy measurable only in terms of business quantum, there is a gap created in certain aspects like human welfare, environment protection, economic inequality issues and etc. However, for the purpose of seamless functioning of the Non-profits there is substantial need for finance, which has to be raised within the scope of regulatory framework of the land.

So, this study contemplates on the different sources of financing available to the non-profits by analyzing the financial position of select non-profits which are seemingly well funded and interpreting different sources from the financial statements of each. With the aid of previous studies and the fundamental analysis of the select non-profits, the different sources and the factors to be considered while rising are analyzed.

Keywords: Financing Alternative, Non-profit, Finance resources, Financial Statement Analysis, social cause

Introduction:

This project is performed on “Financing Alternatives of Non-profit Organizations (NPOs)”. NPOs face a lot of challenges and difficulties in raising finance for its initial corpus and implementing projects, when compared to other profit-making entities. The retail investors, venture capital firms and other investing entities invest in profit-making enterprises as they are observed attractive in terms of return yield. Hence, financing NPOs has now become very difficult.

The origin of the NPOs came from the Industrialization era in Europe. During this age, the concentration of economic power has been witnessed due to which the concept of donating or giving some resources to downtrodden was originated. Thus, many organizations were formed to provide resources to the poor directly. In the later stages, the concept of providing services to downtrodden and in areas which lack governmental and other's attention, came into existence. Later on, the NPOs focused on conducting empowerment programs like

educating on human rights, skill development etc. which are still in existence. In the modern-day scenario, the concept of Social Enterprise, which enables social development along with business activities, came into being.

Objectives of the study:

- Ascertain amenable financing alternatives for Not-for-Profit Organizations and management implications.
- Analyze financial statements of typical Non-profits and interpret the financial stability and liquidity.
- Examine the most important factor for raising finance effectively.

Scope of the study:

This study is largely focused on the Indian context and source of data is from the non-profits present in and operating in India only. India is a large diversified country with its stakeholders belonging to different categories of the society. This fact comes with an issue that legal structure being more complex with exceptions, explanations, conditions and etc., as one rule doesn't fit for all, especially when it comes to the situation of law regarding non-profits. Many of the Acts related to non-profits doesn't require compulsory registration, which makes it difficult to count them. This study will be focusing on only the registered non-profit entities as they provide audited financial statements publicized. The mode of Sampling for this study is Judgmental Sampling which is based on the professional judgment.

Research Design:

Thus, financial statements are taken as the main source of data to analyze further for the purpose of this study. Considering the items present in financial statements, the sources of finances are extracted and categorized. Further, the analysis of financial statements can be made using different ratios attributable to non-profits.

- This study is more inclined to inductive study and might form the basis for further exploratory research.
- This study is being made from the point of view of the user of the financial statements of such particular entity.
- The universe of the study cannot be accurately determined because there is no system as consolidated database for recording the number of non-profits on the part of government.
- Thus the sample may be selected when the universe is unknown using the following formula:
 - $Required\ Size\ of\ the\ Sample = [(Z\text{-score})^2 * Standard\ Deviation * (1 - Standard\ Deviation)] / (margin\ of\ error)^2$
- The required information would be extracted from the data in financial statements for the purpose of study.
- The Financial statements are analyzed through ratio analysis applying few concerned ratios.

Literature Review:

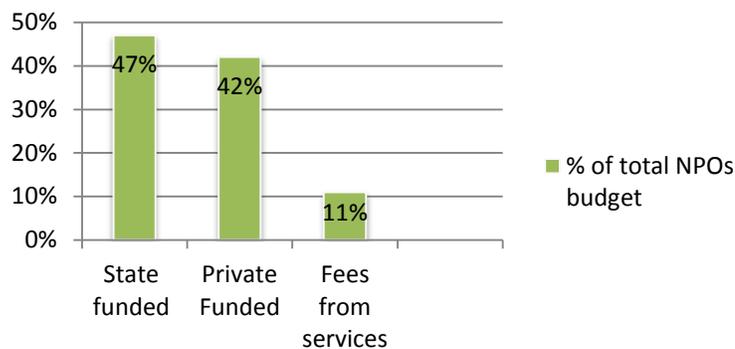
According to research done by Matej Sande from University of Ljubljana on self-financing of NPOs, it is described in the following manner. Basically, the funding methods or the income sources of the NPOs can be categorized into three types: (i) State funded, (ii) Private funded or donation, (iii) Fees for services rendered.

According to International NPO research titled 'Global Civil Society: Dimensions of the Nonprofit Sector' done by Lester M. Salamon and Helmut K. Anheirer on data of 13 different countries it is observed that the total budget of the NPOs constituted as follows:

1. 47% of the total budget is state funded.
2. 42% of the total budget is from private donations which include funds from members, private firms, companies etc.
3. 11% of the financing is sourced from fees for services.

Figure 1

% of total NPOs budget (World)

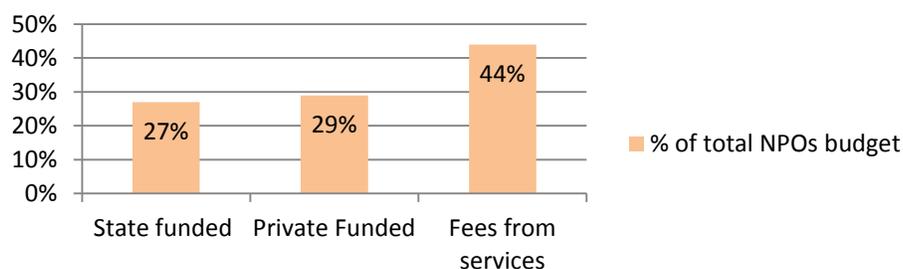


The methodology followed in research done by Salamon and Anheirer is followed in research done by Matej Sande, for which data is collected only from Slovenia. According to this data NPOs total budget constituted as follows:

1. 27% of the finance is made from state
2. 29% is from private donation
3. 44% from fees for services

Figure 2

% of total NPOs budget (in Slovenia)



As the number of projects is increasing, the dependence on government and other financial institutions for funding is also increasing. So it has become inevitable to look for alternative sources of financing.

The necessity of self-financing is viewed in the article of Matej Sande as follows:

1. Self-financing enables less and less control of government on the NPO.
2. Self-financing brings immunity from the sudden scarcity in the other sources of funding.
3. With the stable form of finance, the services rendered for the mission of NPO can be improved.

According to L. Davis and N. Etchart in their work 'Definiranje samofinanciranja' (1999) in order to utilize the funds in a better way, the NPO has to attain stability in working with clear vision and mission, and realistic strategy. It must also have great amount of supporters supporting for the cause. Ability to adjust to the change in the political and other environment is also a key aspect. The entire NPO should be led by an effective leadership by which the programs run can be appreciated with favorable outcomes.

In this regard, there are seven common fields in which specific strategy can be implemented for self-financing. The modes of self-financing are membership fee, fees for services in case of NPOs rendering services or giving knowledge, selling products, own or manage real-estate, selling patents and financial transactions (dealing in stocks and other type of funds).

According to L.Salamon, W. Sokolowski and R. List in their work 'Global Civil Society: An Overview' (2004), as the self-financing progresses, the gap between private profit making entity and NPO narrows down. This leads to only one characteristic less for NPO i.e., the earnings earned by NPO is completely used for the mission for which it is initiated. This necessitates the requirement of defining the relationship between a private profit making firm and an NPO by legislation and including that in the statute.

According to Moyer M in his work 'Marketing for Non-profit Manager' (1994), the non-profit manager has to design a long-term strategy for self-financing and create products and services to attract the chosen segment in order to effectively implement self-financing to achieve sustainability. Further, NPOs should learn from profit making businesses about implementing strategies for self-financing.

Methodology and Data Collection:

For the purpose of this study, we consider the source of data at the financial statement of the sample. As the population is unknown we therefore use the following formula to derive sample size.

$$\text{Required size of the sample} = (Z\text{-score})^2 * \text{Std. Deviation} (1\text{-Std. Deviation}) / (\text{margin of error})^2$$

where,

Z-score depends upon the confidence level

For the purpose of this study, the confidence level is assumed to be 90%.

At 90% confidence level, $Z = 1.645$ and the standard deviation is observed to be 0.1

Margin of error can be taken as $\pm 5\%$.

$$\text{Required Sample size} = [1.645^2 * 0.1(0.9)] / (0.05)^2$$

= 2.961 or 3 samples

Therefore, the given data derived at the sample size which is equivalent to 3.

Thus, 3 Non-profit Organizations (NPOs) have been selected as a sample for the purpose of the study. Those are:

1. Magic Bus India Foundation
2. CRY (Child Rights and You)
3. CSISI (Civil Society Information Services India)

Magic Bus India is an NPO aimed to support the education of the poor children. Main mission is to break the poverty cycle by enabling children and youth in downtrodden communities to enroll and finish the education through activity based learning programmes and earn a respectable living. Its operations are a spread across India. It is registered under Section 8 of the Companies Act, 2013 (erstwhile Section 25 of Companies Act, 1956) and also registered under Foreign Contribution Regulation Act, 2010.

CRY (Child Rights and You) is an NPO which mainly fights for the purpose of preserving children's rights. The main activities include protection of children from sexual abuse and child labor. Its operations are spread across India and some parts of the world. It is registered as a Trust under the Public Trust Act of Maharashtra, 1950 and also registered under Foreign Contribution Regulation Act, 2010.

CSISI (Civil Society Information Service India) is a non-profit which act as an online supporter and repository for other NPOs through its initiative called Guidestar India. It provides online operability for NPOs and audits their transparency level, compliance level and supports them in raising funds.

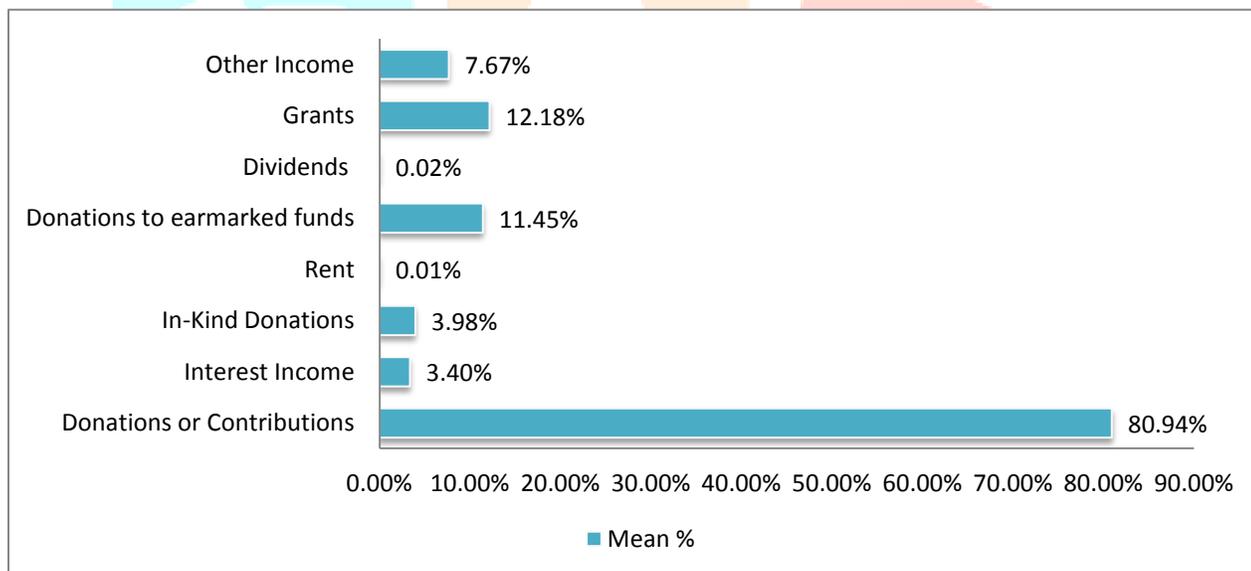
This particular study is more of inductive nature, in which the analysis is made from the data collected through observations, and hence there can be rare chances of forming a formal hypothesis. As there can be more of data extraction and bringing out the items that form part of the financing alternatives for the Non-profits, the hypothesis formation cannot be considered.

Data Analysis and Interpretation:

The Data Analysis comprised of extraction of data associated with financing sources from the financial statements and preparing the proportions of the each type of income with the total income raised. From the analysis, the different alternatives for financing that are more prevalent in Indian context for non-profits is ascertained, which is illustrated in the following table.

Particulars	Percentage of Total Income			Mean
	Magic bus	CRY	CSISI	
Donations or Contributions	91.98%	86.48%	64.36%	80.94%
Interest Income	0.09%	1.82%	8.29%	3.40%
In-Kind Donations	7.90%	0.06%		3.98%
Rent	0.00%	0.01%		0.01%
Donations to earmarked funds		11.45%		11.45%
Dividends		0.02%		0.02%
Grants			12.18%	12.18%
Other Income		0.17%	15.17%	7.67%

Figure 3 Percentage of each Financing Alternative out of Average Total Funds



From the above table and figure it is evident that donations and contributions are the major source of finance for the non-profits.

From this historical data analysis, one can state that non-profits only look for donations and contributions as the major source of income. The nature of non-profits is solely work for their mission and it is difficult for them to engage in activities to generate income and hence the most feasible way is to rely on donations.

It is also evident that the Magic bus India Foundation which is precise in its objective and mission was able to get donations with less cost when compared to CRY- Child Rights and You which has wider scope in the mission. However, CRY has raised significant amount for specific project.

Magic Bus, which has the mission and objective more specific in nature, has received higher donations especially foreign with relatively lesser cost incurred in fundraising

CRY due to its larger scale of operations, the funds received are huge in quantity and larger proportion sourced from individuals. But also in order to raise such huge amount of funds from individuals there is a high amount cost incurred on it

CSISI being the non-profit of non charitable nature has significantly less than 50% of total income being donations

However, there are other sources of finance for non-profits which can be extracted from the available studies related to this topic and data. Some of those financing alternatives are

1. Donations from individuals, other foundations and NPOs, corporate and UHNIs
2. In-Kind donations
3. Returns from investments in financial instruments
4. Partnership for programmes and projects
5. Funds raised from events
6. Interest income earned from bank deposits
7. Members' Contribution
8. Contribution as a part of CSR initiative by the Companies
9. Philanthropic or own funds
10. Sale of merchandise or other products
11. Fees for services rendered
12. Grants from government, foundations and statutory bodies
13. Earn by becoming platform for advertisement in websites or etc.
14. Any Innovative Approach subject to circumstances (this keeps the exploration of financing activities open-ended)

The finance source largely depends on the mission or social cause that is addressed by the non-profit, management structure, internal and external environment of the organization.



FINANCIAL ANALYSIS OF NON-PROFITS

The ratio analysis and the results of the non-profits are shown in the table below.

Table 2.Summary Of Important Ratios In The Financial Analysis Of Non-Profits			
Particulars	Financial Year 2016-2017		
	Magic Bus	CRY	CSISI
Current Ratio (Current Assets / Current Liabilities)	0.848	1.181	0.952
Daily Cash on Hand* (in Rs.)	97.41	3263	3.658
Primary Reserve Ratio (Expendable Net Assets / Total expense)	5months1day	1 year 10 months	12days
Contributed Income Ratio (Contribution Income / Expenses from core activities)	1.09	1.99	0.295
Reliance Ratio (Largest type of Income / Total Income) (%)	99	97.65	64
Earned Income Ratio (Total Earned Income / Total Income) (%)	1	2.35	23.5
Self-sufficiency Ratio (Total Earned Income / Total Expenses) (%)	0.95	3.48	6.1
Administrative Ratio (Administrative Expenses / Total Expenses) (%)	6	10.5	1.4

It can be inferred that non-profits directly addressing the social issue with more specific mission was able to get higher donations with reliance ratio being more than 90% and which is formed for rendering services to non-profits i.e., indirect support of social cause has 65% of reliance . Also, organizations with higher contribution ratio being greater than 1, has more donations funded. The administration ratio is higher for the ones with higher reliance ratio.

Prime Reserve Ratio with 5 to 6 months time is reasonable as the net assets is sufficient to meet the expense requirement for such time period. Excess PRR indicates that the net assets are not utilized effectively. PRR with less than 3 months infer that net assets have to be improved or expenses have to be checked.

Thus, according the computed ratios, it can be inferred that the overall solvency of the organizations is good. However, there are issues with liquidity and risk of greatest reliance on one type of income. Hence, the non-profits have to look for other sustainable sources like earnings from investment.

Therefore, it is observed that actively managing the volunteers and other stakeholders to take active role in the activities of the more precise mission and able to communicate the impact created by that to the public with transparency, will enable not only the private donations and other sources but also the stakeholders come up with more innovative approach to raise finance.

It is also observed that, organization which spent contributed income on core activities had to incur less cost for raising funds.

Suggestions, Recommendations and Conclusion:

Based on the analysis made in the previous chapters and the previous studies on the subject and different interpretations made, the following aspects can be suggested which will help the non-profits in many ways, subject to the circumstances and personal judgment.

- It is advised, while rising private donations it is advised that for a charitable organization, that there must be a specific measurable charitable objective for which the amount raised is correlated with the social outcome.
- Non-profits have to spend income from donations as far as possible on related charitable objectives.
- Non-profits not involved in direct charitable mission should rely more on other income sources like interest from deposits & advances and other earned income.
- Non-profits must avoid under utilization of funds received to gain trust in the long run.
- Non-profits must involve the donor to take part and collaboration in the programs initiated for the said charitable purpose.

There are some recommendations based on the analysis and review made out of different literature concerned with the topic, which are specified as follows.

- Reduce the reliance on donations and contributions as a source of finance for the operations over a period, as it is usually risky and uncertain in nature..
- Invest some proportion of the funds mobilized in income yielding assets and investments, periodically in small amounts to achieve long term financial solvency and liquidity is maintained during economic pitfalls
- The amenable investing destinations are mostly considered as debt instruments and low risky instruments of financial markets.
- One more way of financing alternative would be engaging in mission related economic activities such as production and sale of products and services. However, one must be ensured of complete feasibility of such business activity. Also, at the same time proper care must be taken that expenditure on mission is not compromised.
- It is recommended to expend the donations of CSR funds more effectively on the core activities to gain trust and tap into more financial resources.
- There should be proper planning made for reducing underutilized cash reserves as well as keeping administrative expense ratio as low as possible.
- There should always be a scope given to innovative strategies among volunteers and other members in the organization for finding different approachable financing opportunities.

For an economy to propel with a multi-dimensional perspective there is a need for the overall development of human , social and environment through engaging all sections of the society and stakeholders. Non-profits play an important role achieving such sustainable development objectives. So, there is a need of finance for an NPO in order to perform seamlessly for a social cause.

Thus, having the awareness about the financing alternatives and approaches to acquire those finances would enable smooth functioning of the non-profit. This study has extracted such financing alternatives and their correspondence with the financial position and liquidity aspects of the non-profit.

Scope for further Research:

There is further possibility of conducting exploratory research on analyzing the most feasible financing alternative.

One can also perform the research on suitability of financing type for each individual type of Non-profit.

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