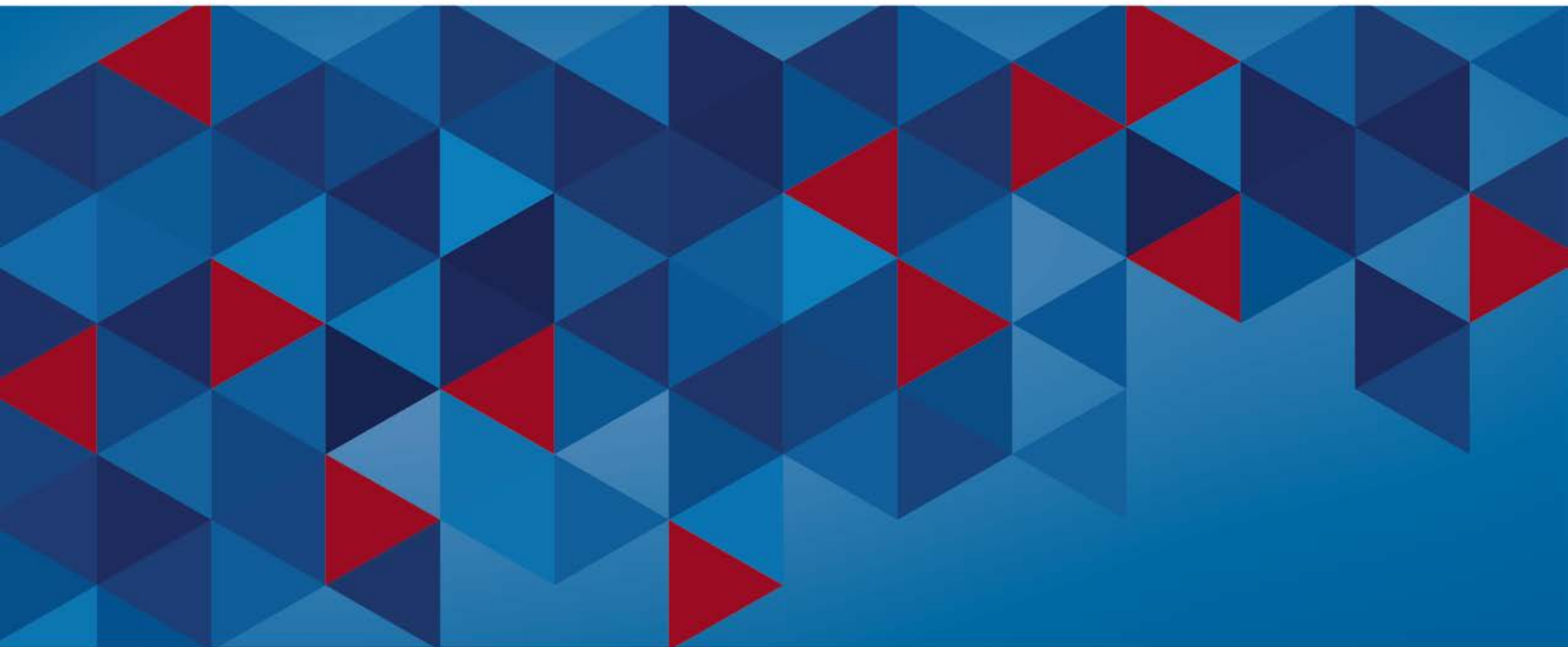# Early Warning System for Nonprofits

A Three-Phase Approach to Understanding Michigan Nonprofits' Status, Risk, and Recovery

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JOHNSON CENTER
AT GRAND VALLEY STATE UNIVERSITY

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Michigan Nonprofit Survival Rates: More Important Than Ever

In 1995, there were 5,539 reporting charitable nonprofits in Michigan — that is, 501(c)(3) charitable nonprofits actively engaged in service delivery and with more than $25,000 in annual revenue — out of the total universe of 16,185 registered charitable nonprofits in the state. As a portion of the overall sector, reporting nonprofits in Michigan have been growing steadily to 9,310 in 2006, and 10,087 in 2015.

But peer beneath the top-line figures and a starker reality emerges:

- If you start with all 16,185 Michigan nonprofits that existed in 1995, only 3,507 still existed in 2015 as a reporting nonprofit — a survival rate of 22%. A similar share — 24% — of nonprofits created in 1995 were reporting organizations 20 years later.

- Move forward four years, and the data gets worse. Only 12% of nonprofits created in 1999 — founded on the cusp of Michigan's "lost decade" — survived as reporting nonprofits in 2019.

We know, therefore, that larger economic trends in Michigan greatly affect nonprofit survival rates. But there are many things we do not know: Which organizations — or types or sizes of organizations — are at risk? What is the survival rate of limited-time nonprofits compared to perpetual nonprofits? Or hyperlocal community nonprofits versus multi-county nonprofits? Do organizational survival rates vary by location in Michigan? In the case of failure, what was the primary cause — finances, leadership, board oversight, or external forces? And what does the survival — or risk of failure — of nonprofits in a specific sector or region mean for diversity, equity, and inclusiveness of related programs?

In 2015, the Michigan Department of Treasury was granted the power by the Michigan Legislature to create an "early warning system" of school districts, and subsequently municipalities, at risk of financial distress. The Treasury could then work with these entities to develop plans to avert bankruptcy. Since approximately only one in five Michigan nonprofits make it to their 20th anniversary, we envision an early warning system that will help us:

- Assess the health of the sector as a whole,

- Address the needs of individual nonprofits from a lens of

  - capacity building,

  - targeted technical assistance,

  - mission (human services, arts, education, etc.),

  - their provision of services to populations most in need / most at risk, and

  - their business model and funding mix.

- Develop capacity building initiatives so that (a) organizations receive the right assistance at the right time, (b) the nonprofits most in need of services receive them, and/or (c) the organizations most at risk of entering a sustained period of rapid growth or decline get the needed supports.

Having a system that classifies nonprofits — new and old — based on a data-driven model will strengthen the sector and enable more strategic investments.

Are Michigan's nonprofits prepared?

To be a vibrant part of Michigan's future, the state's nonprofit sector needs:

- A robust and widely understood early warning indicator framework

- A system to assess the sustainability of nonprofits that will provide the needed supports to either become viable organizations or identify alternatives such as mergers, closure or strategic alliances

- A clear understanding of how the sector is changing with demographic trends

Short Term (next three months — starting now with target end by Labor Day, 2020):
Analyze immediate data and respond to COVID-19

The present health and economic crises highlight the need for data-informed strategies to support the sector. We are particularly concerned about the disparate impacts of these crises on organizations led by people of color and on communities of color. By looking at the health of nonprofits by various geographies, we will be able to identify the most at-risk organizations that are working in already under-resourced communities and target assistance appropriately. We're proposing using the most current data available to be able to describe the overall financial health of the sector as well as target immediate technical assistance where it is urgently needed. We are being contacted daily with requests for assistance related to cash-flow, emergency planning, program triage, staff and board transitions, and personal support for leaders.

Goal	Understand the current primary characteristics of Michigan's nonprofits
Primary activities	- Load, clean, and analyze IRS filings from 2016–2018 - Overlay Census and ACS information to identify nonprofits located in and/or near under-resourced communities - Identify key metrics and comparative statistics - Create statewide and regional fact sheets - Use identified data immediately in crisis-response technical assistance and professional development offerings - Identify advisory council to help guide research questions and provide counsel on technical assistance needs
Primary deliverables	- Six published public analyses - Custom data run specifically looking at organizations in high risk areas of the state and/or serving high need populations 6–10 virtual training sessions
Baseline for next phase	- Verified database structure to load historical data in next phase - Direct contact with the field to gather future needs
Budget	**$125,000 – $235,000** **Divided evenly between research and direct service**

Medium Term (next four months — August with target end by November 30, 2020):
Build the early warning system and prepare for organizational transitions

While the short-term activities will provide us with a good picture of where Michigan's nonprofits stood as they entered the current health and economic crises, we will not have a good way to compare the health of the sector to historical trends. That is what the medium-term activities are aimed at — providing an analysis of both (a) what happened to the sector during the Great Recession and (b) what are "typical" trajectories of growth, stability, and decline, for nonprofit lifecycles.

The medium term leverages IRS 990 filings going back to 1990 (or earlier if available) to calculate rolling averages at two- to five-year intervals for every charitable nonprofit in the state. We plan to calculate key ratios that will help identify

- Fast growing nonprofits (rapidly increasing year-over-year [YOY] assets and expenses)

- Regions / sectors / organization types that

    o Increased revenue faster than sector average

    o Increased assets faster than sector average

    o Decreased revenue faster than sector average

    o Decreased assets faster than sector average

- Regions / counties where nonprofit employment is

    o Growing faster than all-industry average

    o Declining faster than all-industry average

- Key risk ratios over time, such as

    o Risk of failing (increasing YOY gap between revenue and expenses)

    o Risk of exhausting endowments / emergency reserves (decreasing YOY asset balances)

    o Too focused on short vs. long term (increasing YOY revenue far more quickly than assets)

    o Rapid changes in the mix of funding sources (e.g., repeated rapid swings between a majority of funding from contributions versus grants or other earned revenue)

This information will help the center focus our professional development offerings on emergent needs as recovery begins. Specifically, we can build nonprofit resilience by focusing on building competencies in areas of nonprofit operations and governance that can decrease an organization's vulnerability in a crisis — such as succession plans; quick response workplace policies including employee safety, remote work, and the use of volunteers; and revisiting and revising strategic plans and assuring the organization continues to align with their mission before, during and after a crisis. Knowing the signals of an organization at risk — and sharing those signals with the sector as a whole — are key steps in identifying organizations, locations, and sub-sectors (e.g., human services, arts) that could most benefit from targeted and timely technical assistance.

Goal	Develop the early warning system and "return to service" professional development opportunities
Primary activities	• Load, clean, and analyze IRS filings from as early as 1990 to the present • Develop early warning system, and test indicators against actual 2016-2018 nonprofit data • Utilize advisory council to test early warning system concepts, preview findings, and confirm nonprofit professional development needs
Primary deliverables	• Create statewide and regional trend fact sheets • Two published public analyses per region • At least three published "lessons learned" articles regarding findings from the DEI community conversations, with at least one article documenting specific impacts to communities of interest to primary funder • Host community conversations regarding impact of the recovery on communities with from a DEI perspective • Implement series of trainings in a "Crisis University" cohort-style model in each region of Michigan in 2–3 waves — likely using the state's prosperity regions as well as Census-defined metropolitan areas as the base of analysis
Baseline for next phase	• Comprehensive historical data about Michigan's nonprofit sector • Regional trend lines prepared • Improved resilience of Michigan's nonprofit organizations as identified by key foundation partners
Budget	**$430,000 – $700,000** **Divided evenly between research and direct service. Roughly half of this amount is for statewide work, and half for regional work. The broad range reflects the ability to scale up to multiple focus communities/regions and/or multiple rounds of training throughout the state.**

Longer Term (next 12 months — starting now with target end April 30, 2021):
Publish a dashboard of the nonprofit recovery and sustain nonprofit operations

As the discussion shifts from "stay at home" to "back at work and school," how will we know the status of the recovery? Or, put more simply, are we there yet — and if not, how close are we? The goal in this phase is to leverage the current, historical, and early warning data to create a dashboard — updated monthly or quarterly — that tracks current performance against a goal of returning to employment and activity levels we achieved in February 2020. Tracking and monitoring recovery waves is critical in understanding the effects and impacts of recovery from diversity, equity, inclusion, and equitable growth perspectives.

A recovery dashboard will also give funders—and the sector — insight into recovery by nonprofit mission. Museums and theatres, for example, will have a much different recovery path — even in the same community — from health and human services nonprofits.

It is likely that this dashboard is a multi-year project, as the recovery itself is likely to be both multi-year and occur at different times in different locations across Michigan. During this period, the Johnson Center's own training offerings will be grounded in our competency-based approach to professional development. Our

focus will be on building crisis management competencies for Michigan's philanthropic organizations to reduce disruption, maintain capacity as we move into recovery, and prepare for a future crisis.

Goal	**Create an online dashboard — with visibility into distinct Michigan regions and/or counties and opportunities for customization — to track the progress to full recovery while supporting organizations to reduce disruption and regain programmatic capacity.**
Primary activities	• Create recovery dashboard and develop system to support the dashboard with regular updates over the coming years • Load early returns from 2019 IRS 990 data • Tailor trainings within Michigan regions as those regions step through a multi-phase recovery process
Primary deliverables	• Recovery dashboard • 100+ regional training sessions
Budget	**$250,000 – $450,000** **One-third for research and two-thirds for direct services**

For More Information

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