Why Strategic Finance Is Difficult and How to Make it Easier

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In my last post, I explored the differences between **"compliance-driven"** nonprofit financial reporting required by outside entities and the **"strategic"** financial analysis that should be the basis for internal decision-making. We often find nonprofits using compliance-style benchmarks to monitor their financial health when customized strategic measures would be more appropriate, and in this post, I look at why this problem happens so often and offer some thoughts on implementing a strategic approach to benchmarks.

We should probably start by acknowledging that developing internal, strategic metrics simply requires more work (gathering and analyzing data, goal setting, etc.) than adhering to standard external benchmarks. Since nonprofit staff capacity is often stretched thin, it's not surprising that adhering to sector best practices seems like an attractive option. While there's no magic bullet here, transparency and broader organizational engagement in the financial decision-making process can help. Identify the key metrics and staff who will be tasked with gathering them and emphasize that achieving on mission will require a financial strategy grounded in your organization's particulars.

Beyond the issue of time, there's also a deeper challenge in the development of strategic metrics: done well, they require a level of comfort with underlying nonprofit financial concepts.

If you don't consider yourself a "finance person," a conceptual approach to financial issues can seem vague and tangential to the urgent day-to-day demands of running the organization. In our financial workshops, attendees often want to move quickly though conceptual material and get to the "more practical stuff" such as templates and specific advice about the organization's current financial situation. But absent conceptual background, templates and metrics provide a "what" without a "so what".

Yes, diligent monitoring can help you preserve at least three months of cash on hand, but without a framework linking this target to a complete financial picture of your organization, you don't know whether that amount of cash offers enough real liquidity.

Furthermore, as a nonprofit changes, the measures used to assess its financial health should also change. While financial needs and risks arise from growth, new program structures, added staff, or capital projects, the **compliance-style** benchmarks remain static. Even if they worked two years ago, they might not be relevant now.

Developing comfort with financial concepts gives you the ability to overcome these issues, first by tailoring your metrics to your organization's actual financial challenges and goals, and then by adapting your approach to data over time.

Finally, effective strategic metrics will usually require an understanding of not just one or two financial ideas, but several interconnected topics. For example, in order to determine appropriate levels of cash, it could be useful to incorporate analysis of annual cash flow cycles, balance sheet health, rates for receivables and payables converting to cash, and restrictions on net assets.

The good news is that you can diminish the complexity by sitting down with a limited number of well-designed financial reports and systematically asking a series of familiar and intuitive questions. For our liquidity example, you can start by examining an annual budget and monthly cash flow projections with an eye toward answering the following:

- Are there any times when we might not have enough cash on hand to cover our regular fixed costs?
- Are there any sources of revenue that might come in lower than expected or costs that might be higher than expected, and do we have the resources on hand to deal with those scenarios?
- Are we undertaking any new kinds of programmatic activity that involve changes in the way we do business? If so, what is the magnitude of the financial risk we face?

With these questions answered, you can start to discern whether there are any gaps between what you expect to have and what you need at any given point during the year. Ensuring that you maintain cash reserves sufficient to at least fill those gaps (and hopefully provide some extra cushion for contingency)

can be the first step toward developing a truly strategic liquidity metric.

The bottom line is that developing strategic financial metrics will require time and careful consideration, but with the right data and a conceptual framework to guide your interpretation, you'll end up with a much more accurate set of financial goals to guide decision-making.

Have you implemented strategic metrics that worked well? Or have compliance-driven metrics failed you? Leave a comment!

cash flow, compliance, how-to, Leadership, Strategic finance, strategy

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Karen Klein • 3 years ago

I am interested in knowing more. Can you recommend a simple book or resource that I can review?

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Andrew Mod → Karen Klein • 3 years ago

Thanks for your comment, Karen! You might have a look at Nonprofit Management 101: http://nonprofits101.org/ You'll find lots of useful stuff there, and the chapter by David Greco touches on some the issues Phil addresses in this post.

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