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BUFFERING AGAINST UNCERTAINTY:

Working Capital and the Resiliency of BIPOC-Serving Organizations

Rebecca Thomas, Principal, Rebecca Thomas & Associates
Zannie Voss, Director, SMU DataArts

Image courtesy of Alonzo King LINES Ballet, San Francisco, CA. Image credit: RJ Muna

SMU DataArts

Buffering Against Uncertainty

Prior to the COVID-19 pandemic, the U.S. economy was in a record-long period of expansion, lasting from June 2009 to February 2020.[1] Household incomes and real gross domestic product grew during a period of record-low interest rates and low unemployment.[2] In the midst of this Goldilocks economy, we shared a sobering analysis of the financial health of the arts and culture sector. Our report, *Five Steps to Healthier Working Capital,*[3] showed that in 2016, most organizations operated with minimal liquidity and were ill prepared to manage risk, whether inside or outside their organizations.

Fast forward to the end of 2019, right before the onset of the COVID-19 pandemic. The adequacy of working capital became critical. With it, organizations could take steps to plan and reposition. Without it, organizations would be poorly prepared to weather unprecedented declines in audience and income.

In this context, SMU DataArts refreshed its analysis,[4] which paved the way for us to focus on these questions:

1. From 2016 to 2019, when the economy was strong, did arts organizations take actions to build liquidity to levels that could buffer the storm brought on by a pandemic?
2. How well prepared were arts organizations that primarily serve Black, Indigenous, and People of Color (BIPOC) communities through their mission-related work compared to peers that do not self-identify as primarily serving a community of color?[5]

SMU DataArts' new research shows that working capital in 2019 hovered at precariously low levels for the majority of cultural organizations, just as it did in 2016. During this period, most organizations ended their fiscal years near the break-even point and did not achieve surpluses. Their expense growth slightly outpaced their growth in operating revenue, so they had nothing to squirrel away. Moreover, **while working capital did rise for some, 47% of organizations had fewer months of working capital in 2019 than they did in 2016, and for many others, working capital was relatively unchanged.**

These findings are stark as we consider the forced closures and exceptional reductions in staff and artist employment that resulted from COVID-19—challenges that still persist as of the time of writing this report. While many grantmakers and donors rose to the call to provide relief funds to cultural organizations, their support can only be a temporary stopgap. Most arts groups will need more short-term liquidity and other flexible capital than they have now to survive, recover and rebuild.

In this paper we share findings and observations about the working capital levels of arts and cultural organizations, with particular emphasis on BIPOC-serving organizations. We offer suggestions for grantmakers as they invest in the recovery and rebuilding efforts of their grantees. As cultural organizations adapt for an uncertain future, we recommend they undertake immediate planning to assess short-term liquidity needs and identify strategies for stabilizing and restoring healthier working capital post-pandemic.

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1 National Bureau of Economic Research (2020). See **https://www.nber.org/news/business-cycle-dating-committee-announcement-june-8-2020**.

2 Bhutta et al. (2020), "Changes in U.S. Family Finances from 2016 to 2019: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin,* September, 26 (5).

3 Thomas, R. and Z. Voss (2018), *Five Steps to Healthier Working Capital,* SMU DataArts, Retrieved from https://sites.smu.edu/Meadows/WC-532018-Final.pdf.

4 Findings reported in this paper are from SMU DataArts' Bottom Line and Working Capital Report, which shares detailed findings for 1,024 arts and cultural for 2019 along with 2016-2019 trends and can be found at **www.smu.edu/artsresearch**.

5 We identified organizations as BIPOC-serving for this study based on their response to the following questions in SMU DataArts' Cultural Data Profile (CDP): Does your organization primarily serve a particular racial/ethnic group? If yes, primary racial/ethnic group served? We have chosen to use the terminology "BIPOC-serving organizations" and "BIPOC organizations" for brevity, with recognition that any attempt to speak of a variety of heritages and cultures as a group is fraught with imperfection. These terms refer to organizations that self-select as primarily serving Black or Indigenous communities or people of Asian, Hispanic/Latinx, Arab, or multiracial descent. We acknowledge, celebrate, and honor each of these individual communities' rich artistic and cultural traditions, as well as the diversity of individuals and preferences among them.

What is working capital and why does liquidity matter?

Sustainable cultural organizations have the financial resources to support their missions over the long term. They can reliably cover their full programs and operating costs with a mix of earned and contributed revenue streams, generating surpluses that build working capital over time.

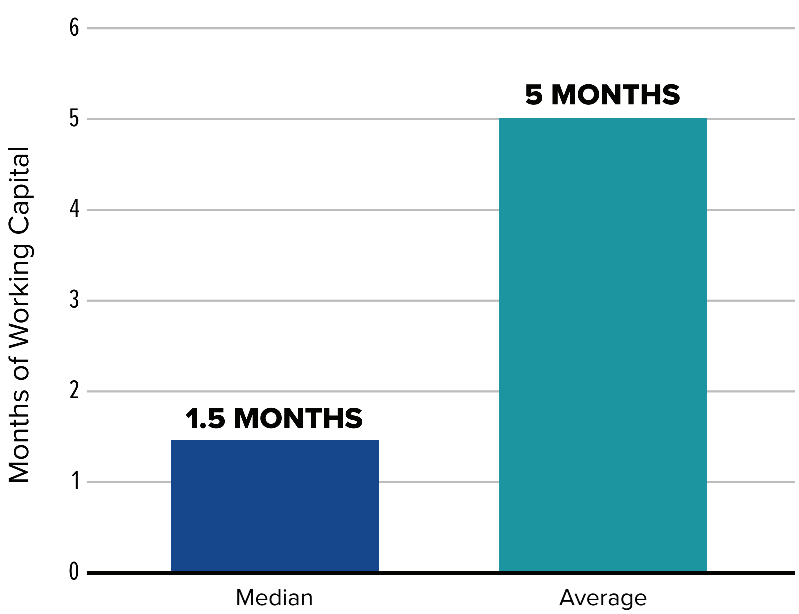
Working capital measures ready access to flexible cash. Healthy working capital gives arts leaders breathing room. Faced with uncertainty or the prospect of loss, organizations with adequate savings can plan the best path forward, knowing that a deficit won't put them out of business. They have access to cash to keep operations flowing smoothly and to navigate temporary or unpredictable shortfalls in revenue. They can be resilient, adapting to changing community needs to remain relevant. Over time, once organizations meet their basic liquidity needs, they may be able to set aside some portion of savings into reserves for artistic or business experimentation, or to improve or replace building systems and equipment.

We define and measure working capital as unrestricted current assets minus current liabilities. Working capital doesn't measure all savings, but it includes assets that most quickly become cash. *Months of working capital* is a useful metric that shows how long an organization can survive at its current expense size in the absence of revenue. Months of liquidity declines when organizations run operating deficits, often because they encounter unanticipated revenue losses or expenses.

Working Capital: The story in the numbers

In 2019, arts and cultural organizations averaged working capital equivalent to 5 months' worth of total expenses. This level of financial health is misleading, however, because it reflects very high levels of working capital concentrated among a minority of large institutions. Median figures, which show the midpoint of organizations in the sample, tell us more about the experience of a majority of organizations. **Most cultural groups had inadequate working capital pre-COVID—just 1.5 months (see Figure 1).** Moreover, nearly half of the organizations in our sample experienced a decline over time: 47% of organizations had less working capital relative to their expenses in 2019 than in 2016. In fact, other analyses have shown that **in some sectors, organizations were worse off before the current crisis than they were before the last recession.**[6]

FIGURE 1: Median vs. Average Months of Working Capital, 2019, Overall



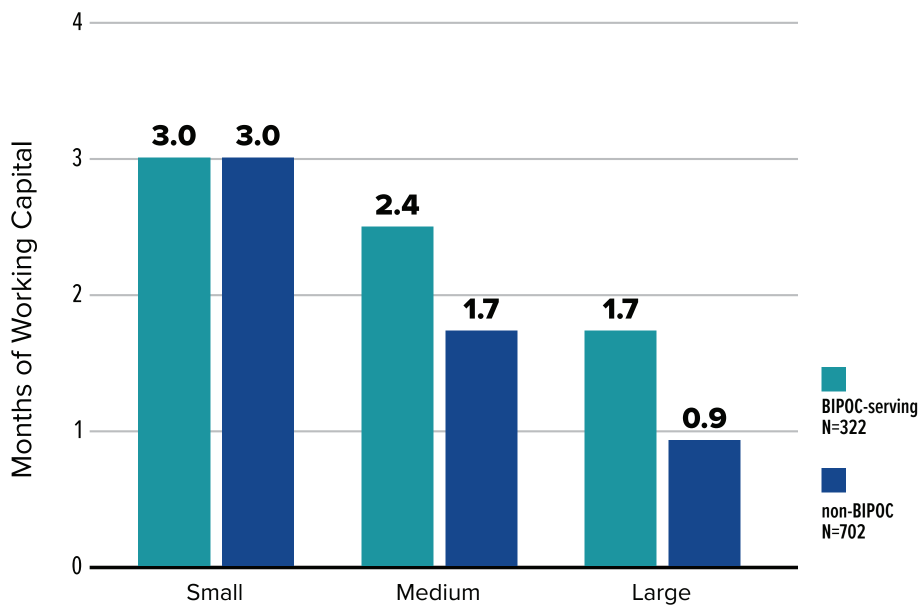
6 Voss, Z., M. Lasaga, and T. Eyring (2019), *Theatres at the Crossroads: Overcoming Downtrends & Protecting Your Organization Through Future Downturns,* SMU DataArts and Theatre Communications Group. See **https://culturaldata.org/pages/theatres-at-the-crossroads/**.

Working Capital: The Majority of BIPOC-Serving Organizations Are More Liquid Than Their Non-BIPOC Peers

Overall, organizations that serve general audiences had higher average working capital than BIPOC organizations. However, averages are again skewed high by a few large organizations that possess a lot of liquid capital and that do not self-identify as BIPOC-serving.

When we look at the median, or midpoint in the range, rather than the mean, we see that a **majority of BIPOC organizations were equally or more liquid than most non-BIPOC groups.** This was the case each year from 2016 through 2019. As shown in Figure 2, the majority of medium and large BIPOC organizations had more liquidity than their non-BIPOC peers, with the gap increasing with organization size. The median small organizations in both cohorts had a solid three months.

FIGURE 2: Median Months of Working Capital, 2019, BIPOC and Non-BIPOC by Size



If organizations of color have inequitable access to revenue and capital, as other studies tell us,[7] why are they more liquid?

Our research suggests that BIPOC organizations tend to be more financially stable for a number of reasons, including their small budget size, careful financial management and overly lean operations.

1) Small organizations of all kinds tend to be more liquid than larger ones (Figure 3).

Smaller organizations generally have more liquidity than larger ones because they have more flexible operating structures. They often rely on sweat equity, low-cost or free space, and volunteers or contracted workforces, so they can more readily adjust budgets to achieve surpluses. With these surpluses, they build working capital and become more resilient in the face of crisis.

As organizations grow, by contrast, they are more likely to incur additional fixed costs that are not readily offset by new revenue, resulting in deficits. Medium to large organizations often employ staff full time and may own or have responsibility for a facility. This makes them less nimble and more likely to spend than to save cash.

We cannot say whether small organizations will continue to show greater relative balance sheet strength throughout the pandemic. At least anecdotal evidence suggests that they have had a harder time securing relief funds. SMU DataArts will analyze and report on pandemic-era data in summer 2021, once organizations close their 2020 fiscal year and provide data from this period.

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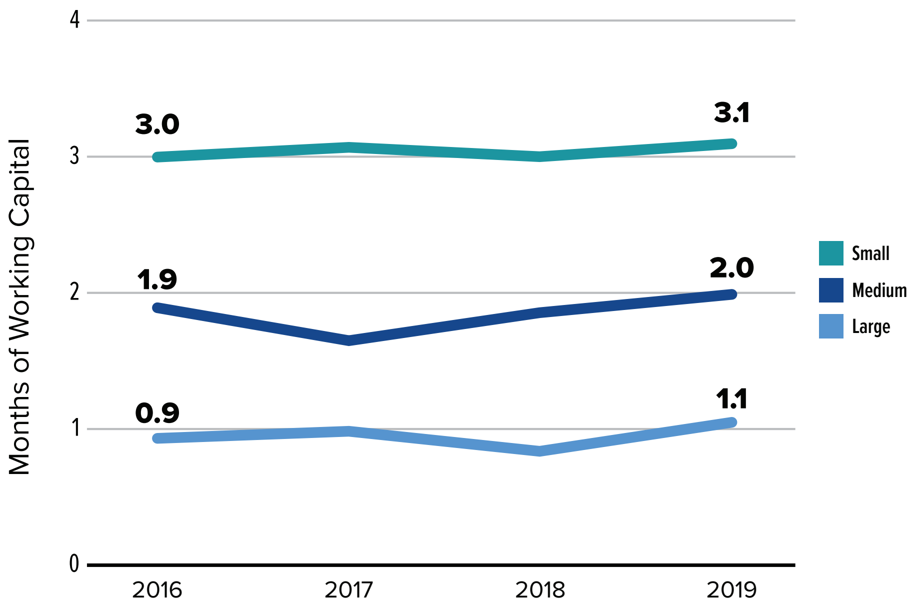
7 See for example: Sidford, H. and A. Frasz (2017), *Not Just Money: Equity Issues in Cultural Philanthropy,* Helicon Collaborative, July, retrieved from **http://www.notjustmoney.us/docs/NotJustMoney_Full_Report_July2017.pdf**.

FIGURE 3: Median Months of Working Capital, 2016-2019, All Organizations by Size*



*Median total annual expenses by budget group, with rounding: Small = $200,000; Medium = $900,000; Large = $7.5 million

2) **BIPOC-serving arts organizations are less likely to grow large. They tend to be smaller than their non-BIPOC counterparts at every size grouping**. For some organizations, staying small and focused may be a choice. Growth is not an ambition for every organization, nor is it a hallmark of success or stability.

   However, many BIPOC organizations want to grow but face barriers because they lack access to capital and revenue. Qualitative research tells us that many of these organizations don't have equitable access to cash—e.g., lines of credit, bank loans, access to Paycheck Protection Program funds—due to policies and practices reflecting structural racism.[8]

   In addition, leaders of BIPOC organizations told us that their **reliance on unpaid or underpaid staff and artists keeps them below budget size thresholds that might open them up to resources to invest in critical capacities and programs.** Some leaders cited a vicious cycle: their budget size limits the amount of foundation and government funds they are eligible to receive, which then limits budget growth potential. When these organizations also serve low-income communities that cannot afford high ticket prices or make large individual contributions, they have no other engine to fuel revenue growth.

   BIPOC organization leaders also cited an unexpected consequence of the movement toward equity, diversity and inclusion (EDI) priorities. **Institutional funders increasingly fund EDI efforts, but often direct these dollars to organizations that do not primarily serve BIPOC communities.** This has largely marginalized the arts organizations that are rooted in these communities and have a long history of serving them effectively.

   Within this context, when cash from institutional sources is limited or nonexistent, organizations may have no choice but to stay small.

3) **Despite inequitable access to revenue and capital, BIPOC-serving groups have a strong track record of living within their limited means.** From 2016 to 2019, the average BIPOC organization demonstrated an increasing trend of surpluses, whether measured as total unrestricted surplus or operating surplus before depreciation. Over time, these organizations increased their unrestricted operating revenue at a faster rate than they added expenses. This **data contradicts any historical perception, or racial bias, that BIPOC-serving groups are more of a funding risk,** or that perhaps they can't manage their finances as well as larger non-BIPOC counterparts. Our data shows that this is not the case. In fact, non-BIPOC organizations' operating bottom lines were lower than those of their BIPOC peers each year. They began and ended the period with deficits, on average, rather than surpluses.

8 Qualitative findings reported in this paper are from Voss, Z. G. and G. B. Voss (2021), *The Alchemy of High-Performing Arts Organizations, Part II: A Spotlight on Organizations of Color,* SMU DataArts. See **www.smu.edu/artsresearch**

In summary, BIPOC organizations receive less of the revenue pie, so are more likely to stay small, which means they can take decisive action to contain costs and build some savings. Growth is not a universal ambition, and the ability to remain nimble is good news. However, **exclusion from equitable access to revenue and capital means many BIPOC-serving organizations that want to grow are denied agency.**

BIPOC organizations are often under-resourced in a broader sense, even when their financials show more cash. In interviews, leaders of financially stable BIPOC organizations repeatedly identified their top challenges as low compensation levels and insufficient organizational capacity. This, in turn, leads to difficulty recruiting high-caliber talent and burnout for those who stay. The BIPOC leaders we interviewed recognize the importance of investing in professional marketing and fundraising staff who can generate higher levels of revenue, but they frequently have insufficient resources to do so.

In short, adequate liquidity often comes at the expense of adequate investment in infrastructure and critical human capacities. Many BIPOC organizations have made great sacrifices to live within their means, even when the consequence is not paying staff equitable wages or putting off critical community programs. Sweat equity, volunteer or underpaid labor, and donated spaces are "made to work"—until they don't. Systems for data collection, analysis and reporting are frequently inadequate, undermining these organizations' fundraising efforts and fiscal management. With limited access to cash from lenders and funders, the resiliency of BIPOC organizations largely depends on their self-reliance and deep community ties.

Recommendations for Grantmakers

To address historical inattention and create a more equitable field, funders of cultural organizations must make intentional, long-term investment in under-supported communities and the organizations that primarily serve them. **They can be confident that many BIPOC organizations are well equipped to put higher levels of funding to good use given their historical strong stewardship of financial resources.**

During this moment of challenge and change, we encourage funders to take risks on nonprofit strategies that have the potential, over time, to lead to healthy businesses, the accumulation of working capital and reserves, and more equity in the field. This will require flexible and patient support.

i. **Support recovery, reimagining and rebuilding.** Cultural organizations need revenue to replace what they've lost before they can start to build savings. Many will also need multiyear investments to adapt to new or changing community and audience dynamics. We encourage funders to support grantee-defined strategies for recovery and adaptation. Place bigger bets on BIPOC organizations, whose communities have been disproportionally impacted by the pandemic and may have recovery needs that measure in decades.

ii. **Invest in capacity-building.** Many small cultural organizations, including a preponderance of BIPOC organizations, need the capacity to make greater investments in the people and functions that serve to strengthen their long-term financial health. Provide flexible multiyear capacity-building funds for staff positions and salaries so organizations can address gaps in human capital. Support underdeveloped administrative capacities in fundraising, marketing and finance, *before* encouraging program growth and facility expansion.

iii. **Reinforce new business models.** As organizations find their footing and emerge from the pandemic changed or smaller, they will need a mix of flexible support to sustain programs and operations. Signal trust in grantees by making unrestricted grants, offered for longer periods, to organizations that show resilience through the crisis and discipline to balance their budgets over time. For BIPOC organizations, the trajectory to robust and reliable earned and individual revenue may be longer, so institutional funding needs will be greater. When providing operating grants to them, funders should assume their support will be needed for an extensive horizon of time.

iv. **Help prevent history from repeating itself.** Let's not write this same story in three years. The pandemic presents grantmakers with an opportunity to support working capital in addition to funding strong programs. Contribute to cash reserves for future operations, rainy days and facility stewardship once organizations have achieved reliably surplus operations. Funders who are working towards equity with BIPOC organizations should consider adding reserve funding to their operating grants.

Recommendations for Cultural Organizations

We encourage cultural nonprofits to use this period of uncertainty to plan creatively for how they will recover, change, and find a better balance among human, financial and artistic priorities.

i. **Know your financial risks.** Ask yourself: How much cash does your organization have on hand (and readily available) to manage core operating expenses, outstanding bills and debt service? Can your organization afford a deficit this year? If one materializes, how will you plan to eliminate it moving forward to avoid cash depletion or snowballing debt? Prepare a monthly forecast that shows predicted and actual cash receipts vs. expenditures for the next 12 months. When cash is tight, this tool can help you make decisions that reduce the monthly cash burn and extend your stability.

ii. **Develop scenarios for surplus.** With your board, explore alternative pathways for the current and coming year.[9] These scenarios should be plausible and conservative. They should be informed by evolving world and local circumstances, and grounded in an understanding of your community's ambitions and needs. As you reinstitute programs and rehire staff, consider how much contributed revenue you must secure from others, or how much cash you may need to draw from your balance sheet, *before earned revenue returns.* Adjust the pace and timeline of your recovery plans, given your access to these resources. Your budget scenarios should show how your organization *plans to put itself back on track to generating operating surpluses and ultimately replenishing reserves, even in a still-constrained operating environment.*

iii. **Plan to redo your plans.** Your board-approved budget and additional scenarios won't be right, and that's ok! Uncertainty is a given, and the future is more uncertain than ever. Monitor your results regularly. Have a Plan B, and be ready to implement it if your organization misses a major milestone or budget target. Reforecast your budget as soon as you know you may need to course correct.

iv. **Start setting savings goals.** Assemble your board to discuss savings goals, and be realistic about the timeline and strategy for achieving them. What would it mean for your organization to be financially healthy and resilient? If the pandemic decimated your organization's working capital, plan to prioritize rebuilding cash to cover several months of operations, possibly at a reduced size. If your organization has maintained adequate liquidity through this period, congratulations! You may be ready to start planning and fundraising for unrestricted reserves to manage the next storm, address aging fixed assets or support future adaptation.

For more advice on setting long-term savings priorities, please read our more detailed Recommendations in the Appendix below from the 2018 publication, *Five Steps to Healthier Working Capital.*

Conclusion

Even with COVID-19 vaccinations ramping up, the future for the arts is uncertain. Government mandates will eventually lift. Arts organizations will welcome their communities again, particularly if their programming inspires, heals and brings us closer together. But audiences may not gather at previous levels for quite some time, or they may demand a hybrid of in-person and virtual experiences. Individuals may have emptier pocketbooks or look to give outside of the arts.

Liquidity provides a buffer against uncertainty and a springboard for the pursuit of opportunity and change. As cultural organizations reimagine a new, more equitable future, their leaders and supporters must not waste this chance to build back smarter.

9 Free scenario planning tools are available. See, for example: Ellis, A., D. Payne, H. Fisher-Jones, E. Gershman, N. Vartapetova and D. Benedetti (2020), *Navigating Uncertain Times: A Scenario Planning Toolkit for the Arts and Culture Sector.* Retrieved from: **https://www.wallacefoundation.org/knowledge-center/pages/navigating-uncertain-times-a-scenario-planning-toolkit-for-arts-culture-sector.aspx**

Appendix:

Reprint from Five Steps to Healthier Working Capital, pp. 5-8.

What can be done to build savings?

Nonprofits show leadership by taking sustained action to accumulate and maintain adequate savings. Grantmakers and donors increasingly put a premium on strong financial management. They expect organizations to act more as businesses, always for the ultimate sake of mission. Grantmakers in the Arts (GIA), the national association of public and private arts and cultural funders, has led a sustained effort to educate and influence institutional grantmakers on the importance of encouraging and incentivizing surpluses and savings. Many foundations are changing their due diligence and grantmaking practices in response.

Cultural organizations can capitalize on this moment by putting in place the discipline and practices that help ensure financial health for a long time to come. We offer the following recommendations:

1. **Set savings goals as part of long-term planning**
   Financial goal-setting is often perceived as the ugly stepchild of strategic planning. Cultural leaders, many of whom have never been trained in nonprofit finance, can be uncomfortable translating their artistic strategies into business assumptions with financial targets. Cultural leaders can mitigate strategic risks by integrating financial planning into their strategy development process. This work starts with setting appropriate financial goals:

   - How much working capital should we have on hand to ensure the timely payment of bills during slower months of revenue receipt?
   - How much unrestricted cash do we strive to place in reserve to manage an unexpected revenue shortfall?
   - Should reserve funds be set aside to help address the annual or periodic wear and tear on a facility or other fixed assets?
   - What artistic opportunities on the horizon might require upfront infusions of cash before a potential financial return?

   The next step is to develop a financial roadmap that plots out how, and over what timeframe, the organization plans to achieve its savings goals. Remember, every organization has a different set of balance sheet priorities and will follow a different path to meet them.

   (For more on this topic, see 6 Steps to Sustainability Planning: http://www.rebeccathomas.com/blog/2017/09/14/six-steps-for-sustainability.html)

2. **Plan for – and manage to – surpluses**
   Organizations primarily build working capital through the generation and set-aside of surpluses. When arts leaders budget to the zero mark – often because they are encouraged to do so by board members or some funders – they unintentionally perpetuate a starvation cycle. They spend every last dollar of revenue raised or earned, making it impossible to create short- or long-term savings.

   As part of the annual budgeting process, cultural leaders should set surplus targets that connect to their savings goals. For example, if an organization strives to secure three months of working capital over three years, its budget should plan for annual surpluses equivalent to one month's expenses. Boards of directors and staff need to monitor progress toward surplus goals. If revenue starts falling short of goal, or expenses run materially ahead of plan, it's time to consider action to bring revenue and expenses back into alignment.

   Even in financially disciplined organizations, deficits happen from time to time. Predicting the loss of an important supporter, the departure of a critical staff person, or the onset of economic retrenchment is quite difficult. Still, cultural leaders need to be prepared to respond quickly, by doubling down on strategies to deepen relationships with audiences and patrons – or sometimes, by making tough decisions to do less, while returning their organization to predictable surplus performance.

3. **Explore special fundraising for reserves**

   Many cultural organizations find it impossible to achieve their comprehensive savings goals through surpluses alone. They may start or grow savings in reserve by making a special fundraising request, or expanding the goals of a capital campaign. Organizations should examine their donor relationships and ask:

   - Which supporters might seed the creation of, or grow an existing, cash reserve for risk management or periodic risk-taking?
   - Can a request for reserve funding be structured as a matching opportunity?
   - Does an upcoming or envisioned capital campaign present an opportunity to raise cash for facility preservation and stewardship, in addition to new bricks and mortar?
   - What role can the board play in kick-starting efforts to build one or more reserves?

   When making a request for savings, organizations should lead with mission, answering: What will having more cash allow us to *accomplish?* Funders give to artistic potential and outcomes, not to balance sheets. So make the connection.

4. **Set policies governing the use and replenishment of savings**

   Policies governing the use and expenditure of savings make it clear to all stakeholders – staff, board members, and supporters – that an organization has considered the responsible use of its hard-earned assets. As a communications tool, cash reserve policies can help dispel any notion that an organization is "hoarding" its cash.

   These policies clarify the purpose of cash held in reserve, specify who can approve drawdowns of a fund, and clarify the reasonable timeframe in which approved cash expenditures will be replenished.

   While it can be tempting for boards of directors to "bottle up" all working capital, we encourage them to resist this temptation. Some operating capital, usually a few or several months' worth, should always be readily available for use *at management's discretion* for the timely payment of bills.

5. **Build assets in the right order: Unrestricted liquidity comes first**

   This paper focuses on unrestricted working capital. Many cultural organizations hold *additional* longer term, fixed and/or restricted assets. In some cases, these assets bring added stability. For example, a museum may benefit from using the income from an endowment to help care for its collections. However, in building restricted or fixed assets, many cultural organizations unintentionally erode or neglect working capital. This is something to watch out for. Some examples:

   - *Endowments:* In pursuit of permanently restricted assets, cultural organizations can become distracted from raising flexible annual funds for operations. Financial performance, and consequently working capital levels, suffer. Endowments are a source of revenue, not liquidity. They can't be used for cash flow management, or as a cushion against risk.
   - *Fixed assets:* During and after facility expansion or improvement projects, cultural groups frequently experience significant declines in working capital levels. Project cost overruns are common. Transition costs are frequently underestimated. Operating deficits occur more often than not when program or staff growth accompanies the move to a larger space.
   - *Temporarily restricted assets:* Typically, these grants fall short of covering the full costs of their intended program or project. This can make it harder for organizations to achieve the surpluses that support working capital creation.

   Some of these impacts are outside of organizational control. Others are not. Regardless, short-term unrestricted liquidity should always come first.

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PO Box 750356
Dallas, Texas 75275-0356

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