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The Original Investment Office™



Financial Equilibrium

Balancing Your Mission and Resources

Nonprofits require more than a balanced budget to be successful. Too often, they get caught in the short-term exercise of matching annual revenues with expenditures without thinking about the long-term effect of depleting assets or deferring costs. Buildings must be maintained, new programs should be created and cutting-edge technologies need to be adopted. Meeting this year's budget is important, but sustaining the mission for decades is the greater challenge. That requires striving for financial equilibrium, not simply a balanced budget.

A balanced budget measures whether revenues and expenses align over a single fiscal year. Financial equilibrium asks a broader question: Are you generating enough resources today to sustain your mission indefinitely? An organization can report balanced budgets year after year while quietly exhausting the people, facilities, technology and financial resources on which its future depends.

What is Financial Equilibrium?

Financial equilibrium is a budget model that allows you to fulfill your mission without draining the resources you need to sustain your organization in perpetuity. The key tenets of financial equilibrium are as follows:

1. Annual operating revenues are greater than or equal to operating expenses (i.e., the traditional concept of a balanced annual budget);
2. Revenue growth meets or exceeds expense growth over time, ensuring that future budgets can be balanced.
3. Operating budgets fully fund the resources necessary to carry out the mission.
4. Support from the endowment is at a level that maintains the purchasing power of financial assets over time; and
5. Reinvestment in the physical plant and equipment is sufficient to preserve their useful life.

Maintaining financial equilibrium ensures that today's beneficiaries are not supported at the expense of future generations. It recognizes that true stewardship extends beyond balancing this year's budget—it requires preserving an organization's financial, physical and human capital for decades to come.[1]

[1] *Endowments must be managed to maintain purchasing power over time. A critical formula for endowment management is Investment Return = Spending Policy + Inflation − Volatility.*

Beyond a Balanced Budget

One of the greatest challenges facing nonprofit organizations is that financial statements often tell only part of the story.

A balanced budget can create the appearance of financial health while masking structural weaknesses that become more difficult, and more expensive, to address over time. Deferred maintenance accumulates. Technology becomes outdated. Staff salaries fall behind market levels. Fundraising teams are stretched too thin to cultivate future donors. Reserves are depleted to solve recurring operating shortfalls.

None of these decisions may create an immediate crisis. Collectively, however, they gradually erode an organization's ability to fulfill its mission.

Financial equilibrium recognizes these hidden liabilities and seeks to address them before they threaten the organization's long-term sustainability.

Taking the Long View

Achieving financial equilibrium requires organizations to think beyond the next fiscal year and build a financial model capable of supporting their mission over many decades.

You should think about what changes are required to create sustainable revenue sources. You may need to create new programs, invest in technology or expand fundraising efforts. Drawing down reserves, overspending the endowment or relying on one-time gifts to balance recurring operating budgets will eventually exhaust your institution's resources. Instead, consider building a sustainable long-term financial model.

Long-term sustainability requires budgeting for:

- Appropriate contingencies to address uncertainty
- Program development that creates future revenue
- Facilities that support those programs
- Competitive compensation that attracts and retains talent
- Fundraising capacity that fuels future growth
- Proper maintenance of buildings and infrastructure
- Technology that improves operations and service delivery
- Operating reserves that provide flexibility during periods of uncertainty

These investments are often viewed as discretionary because they do not always produce immediate results. In reality, they are essential investments in an organization's long-term capacity to fulfill its mission.

Balancing Your Mission and Resources

There is often a significant gap between what an organization needs to fulfill its mission and what it can afford. This discrepancy serves as the basis for a critical discussion about how to balance the mission and resources to achieve financial equilibrium. Each organization will need to evaluate structural versus incremental change and the inherent tradeoffs.

Boards frequently face difficult choices. Should additional resources support expanded programming or be invested in technology? Should the organization increase spending today or preserve purchasing power for future beneficiaries? Should deferred maintenance be addressed now or postponed another year?

There are rarely perfect answers. The objective is not to eliminate tradeoffs but to make them consciously, understanding their long-term consequences.

Ultimately, achieving financial equilibrium requires compromise. Continuing to budget from year to year, plugging holes and hoping for relief, is not a viable long-term strategy. It damages morale, depletes resources and gradually weakens an organization's ability to fulfill its mission.

Financial equilibrium offers a different framework. Rather than asking whether this year's budget balances, it asks whether today's decisions strengthen or weaken the organization's ability to serve future generations.

Organizations that consistently operate in financial equilibrium place themselves in the strongest position to adapt, innovate and fulfill their mission—not only today, but for decades to come.



ARE YOU IN FINANCIAL EQUILIBRIUM? A BOARD DISCUSSION CHECKLIST

Organizations in financial equilibrium can check "yes" to most of the below items.

- ○ Recurring operating revenues cover recurring operating expenses
- ○ Revenue growth is keeping pace with—or exceeding—expense growth
- ○ Programs are funded at a level to assure mission success
- ○ Salaries are competitive enough to attract and retain talented employees
- ○ Deferred maintenance is not growing
- ○ Technology investments keep pace with organizational needs
- ○ Fundraising capacity is sufficient to support future growth
- ○ Endowment spending preserves purchasing power over time
- ○ Operating reserves are stable or increasing
- ○ The organization is investing in innovation rather than simply maintaining current operations

IF SEVERAL OF THESE STATEMENTS ARE NOT TRUE, YOUR ORGANIZATION MAY BE BALANCING ITS BUDGET WITHOUT ACHIEVING FINANCIAL EQUILIBRIUM.



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John is a Director and Endowment Specialist with Hirtle & Co. He has over 35 years of higher education experience. From 2003 until 2014, he was the Chief Financial Officer and Treasurer of Bryn Mawr College. As the Treasurer at Bryn Mawr, he oversaw an $850 million endowment, managed cash, issued debt and was responsible for budgeting and strategy planning. At Bryn Mawr, he assisted in modernizing and diversifying the endowment. During the latest recession, Bryn Mawr was one of only a few colleges whose debt rating was upgraded. Prior to Bryn Mawr, John spent 15 years in various financial roles at the University of New Hampshire. John started his career at Coopers & Lybrand. He earned a Masters in Finance from Bentley University and a B.A. in Business Administration from the University of New Hampshire.

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