Addressing Racially Biased Financial Analysis

Why color-blind financial analysis is racially biased, and what funders can do about it.

Many social-sector funders that are committed to addressing racial equity don't understand how their own practices exacerbate injustice. Common approaches to evaluating a nonprofit's financial fitness – and "readiness" for a grant or loan – unwittingly reinforce divides; nonprofits that have money have an easier time getting more, and nonprofits that don't – and the communities that rely on them – lose out.

As an organization that has made loans to nonprofits for almost 40 years, and has advised hundreds of nonprofits and foundations on financial health, we know that we have been part of the problem. We haven't paid enough attention to how the realities of racial inequity distort what we thought were "objective" measures of financial health. NFF is committing to do better ourselves and to work with others to improve how we all operate.

Here's a look at what's wrong, and specific actions we can take to more accurately understand a nonprofit's strengths and opportunities.

Blindspots	General problem	Example	How this exacerbates inequity	How funders can address it
Whose board gives	Levels of board giving are used as a proxy for how engaged the community is in the organization's work.	A health clinic that recruits board members from communities that have historically lacked fair access to care, aiming to stay accountable to the people it serves, may not have the same level of board giving as some of its peers.	Funders will underestimate the support that some organizations without wealthy board members have from its community, and over-estimate the community engagement of others.	Count board commitment in other ways (e.g., total hours volunteered by board members, client representation on the board) and count community engagement beyond the board with similar focus on total value, rather than money donated.
Who can afford below-cost contracts and grants	Government contracts especially tend not to cover full costs.	A community center asked to start an early childcare program as part of a city effort to make universal pre-K available, incurs a $1,000 annual deficit for each student it enrolls when the city contract offers below-cost reimbursement rate.	Organizations with connections to private donors can take on this expanded contract and the revenue that comes with it, while those without these connections and the ability to invest in additional fundraising cannot.	Cover full costs. There is no way to be equitable without that. Help grantees understand and advocate for full-cost coverage from contracts and grants.

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Who can benefit from matching grants	Matching grants are required to unlock a donation, either as an attempt to motivate an organization's donors or to ensure funding gets leveraged by others.	A dance collaborative in need of new performing space hesitates to accept a $1 million gift that comes with the requirement to raise an additional $1 million because they don't have access to wealthy donors and it isn't a realistic ask of their supporters.	Matching grants will steer funding toward organizations already able to find the match, or inadvertently set up other organizations to fail to get the match but expend a lot of energy and worry in the process.	Do not make funding contingent on securing a match. Find other ways to motivate additional giving by offering to connect grantees to other donors, amplifying their communications among donor networks, etc.
Minimum revenue required to secure some grants keeps small organizations small	More money flows toward organizations that have money, because revenue/budget size is seen as a proxy for the organization's abilities and its impact and importance in the community. Government funding compliance rules require making investments in people and systems that only large organizations can afford to do.	A successful, community-led effort to address recidivism in a community will not receive multi-million-dollar grants when they become available because their organization's overall budget is too small to meet the requirements.	Organizations without community financial wealth have a much harder time raising individual donations and managing "revenue risk," as well as being "stable" enough for institutional funding. This leaves important, community organizations vulnerable as they rely on small grants from institutions, if any, or on one large grant from one institution.	Don't apply revenue size and composition blindly as a hallmark of financial health. Consider the history of the organization and implications on access to resources when thinking about revenue composition. Consider the opportunities that are unlocked when an organization that has not received steady investments begins to receive them. Provide funding for small organizations to build their capacity to manage larger contracts, and then set aside some money to fund smaller organizations with larger grants.

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Funders associate small organizations with community authenticity	Organizations will intentionally limit their revenue (often below $1 million/year) to remain eligible for "small organization" grants, because some funders will cut them off when they become larger. But, they still can't make the leap to effectively compete against larger organizations for larger grants, given the dearth of funding options for organizations in the $750,000-$3 million/year revenue range.	A community garden that relies on a few grants from local corporations, small family foundations, and individual donors turns down an opportunity to join a bid for a large urban renewal program because they worry about their current donor base thinking they no longer need support.	Small, community-based organizations stay small and disconnected from larger donors with minimum-size rules. Leaping the funding gap between small and large organizations is easier for organizations with well-resourced board members and staff who can write large checks or generate their first large grant based on personal connections and trust.	Assess proposals based on the organization's potential to do the work, not its historic revenues; for larger funders, explicitly carve out some funding for smaller organizations to invest in their capacity to compete for and win larger grants.
Salaries can be much lower than the market value of the services being provided	Willingness or necessity of some nonprofit staff to work for below-market salaries can result in an under-estimation of their skill and experience.	An executive director of a domestic violence shelter in an immigrant community takes a pay cut to $30,000/year to avoid other cuts when a promised grant falls through.	Low salary for the executive director, or low average salary for other staff, signals to funders a lack of skill and experience or lack of financial savvy among the potential grantee's leadership, making it harder to secure a grant, and reducing the grant size once secured if it is pegged to day rates of salary being paid.	Understand the value of the work being performed under a grant and provide larger grants to cover a reasonable rate for securing these services. Do not make funding rules that pay differential rates for the same work based on an organization's historic budget size.

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Only certain volunteers count financially	Pro bono services only count as revenue and expenses under GAAP (Generally Accepted Accounting Principles) rules if provided by credentialed professionals.	A well-connected youth group can count the value of the hours its pro-bono corporate lawyers spend as part of the revenue it generated; a community-based youth center that relies on volunteers to staff its after-school mentoring program cannot count the value of their time as revenue. The community-based center will have relatively less reported revenue.	If grant size is pegged to a set percentage of an organization's revenue, or general view of its "size," then the organization better-connected to credentialed professional volunteers will be eligible for larger grants.	Don't rely on set ratios that limit grants to a certain share of total revenue without adjusting for the context an organization operates in. Take the time to understand all the resources the organization mobilizes to its mission when assessing its actual size.
Endowment existence/size	Endowments are used as a proxy for financial health and community interest.	A thriving neighborhood community center doesn't have access to donors who prioritize endowments as a giving strategy. Even if it did, leadership has determined that endowments are not the most effective or prudent structures for impact given community needs, operational constraints, and economic realities.	Funders who consider an endowment a marker of success may not give to the community center, despite its efficacy serving its community and its resulting popularity.	Do not use the existence of an endowment – or lack thereof – as a consideration for funding. Find other ways to measure community support, and understand how an organization mitigates risk and pursues opportunity, whether through financial resources, its network, its community, or its people.

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What counts toward a reserve	According to GAAP, the only assets that count as a reserve are those held in the form of money or liquid securities.	An organization has very low official reserves but strong social capital, including an informal pledge from a local business owner that they will step up with a donation in the case of an emergency.	Organizations that rely on social capital rather than financial capital will appear less resilient and riskier to a funder concerned about their grantees' financial health. Organizations with little to no cash reserves may be turned down because they appear more fragile than they actually are.	Do not rely only on ratios of reserves/expenses to assess the financial resilience of a potential grantee. Include an understanding of an organization's social capital, and how it could translate that into financial capital if needed, when assessing its resilience.
Whether grantees use cash or accrual accounting methods	Accrual accounting is time consuming and requires a specialized skillset, generally available only to larger organizations with extensively trained staff.	A small, community-based advocacy center relies on a volunteer to run its financial reporting. The volunteer uses cash-basis accounting because it's more intuitive and less time-consuming.	If an organization is using cash-basis accounting, which counts money when it is received or spent, rather than when it is earned or billed, their finances appear less stable. This can lead to suspicion about the soundness of their leadership and overall financial health, and create a perception that making a grant to this organization is riskier than if they were using accrual accounting.	Provide grants that cover the core functions of an organization (such as professional accounting staff) and allow for a narrative report to explain the content of the organization's financial history and prospects that could uncover greater stability than the numbers imply.

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