SUMMARY

Liquidity Management in Non-Profit Organizations

Nina Londer – 707 991

Double-Degree in International Management

The following research aims at exploring liquidity management, which represents an integrated part of Financial Management in the non-profit sector. This field of research was chosen due to the high relevance and timeliness of the topic, which can be attributed to the fact that the recent Financial crisis of the year 2007/08 marked a turning point, not only for the for-profit, but also for the not-for profit world. Furthermore, the non-profit sector has seen a steady rise in popularity over the past years and is as such being increasingly in the focus of attention of researchers.

Given the recent nature of the topic at hand, the pool of available research is rather limited and this work aims at contributing to fill this gap, by providing first and foremost a concise review of the available literature, which is in the following being complemented by two case studies on two different organizations.

Research Question

Financial Management and liquidity management have represented a central area of interest for most for-profit entities from the very beginning of the organizational life. Long-standing experience and many practices which became an essential part of everyday-business in the for-profit world, are relatively new or have not even been applied in the not-for profit world. The reasons for this are diverse but can to a big extent be attributed to some special features of non-profit organizations, which will be outlined in the following section. Keeping these special features of the not-for profit world in mind, while taking the long-standing experience of the for-profit sector into account, the research question was chosen to allow for a comparison of theoretical findings and applied industry practice.

The main aim of this research is to identify key areas of NPO-liquidity management, to develop a deeper understanding of how these key areas are connected and how ideal liquidity management, which gives the organization financial flexibility, would function.

To be able to understand non-profit liquidity management, a considerably extensive part of the work aims at understanding the special features of non-profit organizations and their impact on Liquidity Management.

Methodology

As a starting point for conducting the research, a systematic literature review was conducted. First and foremost, the most popular research engines for scientific literature in the field of Business studies as well as one from the field of social science have been consulted, namely EBSCO, ProQuest, JSTOR and Science Direct. Furthermore, google scholar has been used to develop an initial search pool and to identify further research that had been mentioning used articles and to identify valuable insights from less scientific but still high-quality newspapers, as well as to identify relevant books.

An important feature of the literature review is that it has been conducted in several phases, to eliminate irrelevant findings as well as arrive at a sufficiently broad scope of sources to be consulted. The book "Financial Management for Non-Profit organizations" by Jo Ann Hankin, Alan Seidner and John Zietlow (2012) provided an important starting point to understand the full scope of the topic, see the relevance of liquidity management in the complete Financial Management-context and to identify the aspects of liquidity management that need further examination. The search for literature was performed for two topic-areas with two distinct sets of search terms. In the following, two search iterations were performed for each of the two topics. Backward- and forward snowballing were applied to expand the pool of utilized literature and allow for the development of a full-picture of the available literature on the topic.

The theoretical insights from the literature review were in the following tested against the applied industry practice via the development of two case studies. The case studies were based on 61 questions who were structured in Modules that correspond to the focus areas identified in the literature review. Furthermore, publicly available information on the company was consulted, meaning the company's website as well as the financial statements, if applicable and relevant to the research. The two chosen organizations are located and operate in different regions, which was consciously chosen to account for the impact of differences in the economic systems as well as other external factors on the organizations liquidity management practices.

Defining the non-profit sector

Any attempt to define the third sector needs to be careful to account for the different features of non-profit organizations and their daily business around the world. These regional differences can not only be attributed to the different legal requirements but are to a big extent also caused by the different economic systems in which organizations operate. For the purpose of this work, the choice of organizations for the case studies was also based on the regions in which they operate: The United States, a liberal economy with a comparatively weak welfare state and little government activity, leave a different set of areas to cover for the non-profit sector than in Europe, where the social system is very strong. (Casey, 2016)

What is a commonality for non-profits in both regions is that they are exempted from paying income tax and that they have a very strong orientation towards mission attainment. The latter can be compared with the focus of for-profit organizations on the financial output of their operations. (Figueroa, 2017 & Evers & Laville, 2004) Apart from that, the sectors in both regions have seen a rise in popularity in the last years, which lead to a grwoth of the sector as a whole. The number of organizations in the United States did for instance rise from 300.000 to 1.6 million between 1970 and 2016. (Zietlow, Hankin, Seidner, & O'Brien, 2018) With the steady growth in numbers, the third sector also saw interesting developments regarding the increasing adoption of business-like practices, which started in the last 70s and is probably also connected to the increasing collaboration of NPOs and the private sector. (Beck, Lengnick-Hall, & Mark, 2008)

Liquidity Management & Financial Management Theory in NPOs

Given the strong orientation of the sector towards mission attainment, the role of the financial manager is different than in the for-profit world. This is reflected in the split management theory, which shows that while in the for-profit world, financials are taken into consideration in the decision making of almost every executive, this responsibility does in the non-profit world rest with the specialized financial manager. (Wacht, 1984 & Meliones, 2000 & Sinclair, Hooper, &

Lei, 2009) To assist this financial manager in making his priorities being well-received and understood throughout the different areas and levels of the organization, it is advisable to define an appropriate liquidity target (ALT), as the primary financial objective that provides valuable orientation for all liquidity management activities. (Zietlow, Hankin, Seidner, & Timothy, 2018)

Defining Liquidity in the NPO world

A universal definition of liquidity is yet to be developed, nevertheless several industry-actors and researchers, as well as organizations themselves have developed various concepts. While the case-study sections provide more information on the organizations individual definitions, the framework developed by Zietlow (2010) provides a good basis for further thoughts: Starting from narrow liquidity, which denotes the nearness of an organizations assets to cash, which together with an organizations ability to meet its liabilities (solvency), organizations develop long-term view towards the topic, which means that they aim at achieving a certain degree of financial flexibility. This financial flexibility allows organizations to confront unexpected situation of financial distress as well as to take on unexpected opportunities regarding program expansions. All three mentioned aspects combined are denoted under the term ‘broad liquidity’ (Zietlow & Seidner, 2007)

Why is liquidity management crucial in the NPO world?

Liquidity management is by nature a difficult topic for the NPO-world, since the sector has a strong culture towards viewing the holding of excess cash in a rather negative light – a perception that has been changing drastically since the financial crisis of 2007/08, as already mentioned above. (Wiley, 2018) Apart from that, non-profit financial management personnel do often lack the necessary educational background and do therefore confront a need to catch up on this initial knowledge gap, while often facing challenging working conditions, depending on the area in which their organization operates. (Ebrahim, 2003)

In the aftermath of the crisis, organization also improved their understanding of the impact of different external and economic factors on their liquidity management activities and developed a routine of monitoring these factors. Finally, it has to be understood, that in the non-profit world it is often more important to understand which projects not to take on, than which projects to take on.

Ratio Analysis for NPOs

Financial ratio analysis is a standard practice in the for-profit world and does without doubts have huge potential to inform liquidity management practices in the non-profit world. Before giving an overview of some of the most important ratios, it must be noted that the case study examples show a limited usage of financial ratios or the usage of some ratios, but with a different terminology than the one suggested in the literature.

Apart from financial ratios, the literature also suggests the use of cash-flow statements and the computation of the net working capital (current liabilities – current assets). Throughout different scholars, the current ratio, the quick ratio, and the organizational liquidity funds indicator are being introduced as the core financial indicators to inform liquidity management decisions, the respective formulas are provided below. (Klump & Cole, 2014)

$$\frac{current\ assets}{current\ liabilities} = \text{current ratio}$$

$$\frac{(current\ assets - inventory)}{current\ liabilities} = \text{quick ratio}$$

$$\frac{expendable\ net\ assets}{monthly\ total\ average\ expenses} = \text{liquidity funds indicator}$$

Zietlow (2007) introduces additional measures, namely the assets ratio, the cash ratio and the net liquid balance.

$$\frac{current\ assets}{total\ assets} = \text{asset ratio}$$

$$\frac{cash\ \&\ cash\ equivalents}{current\ liabilities} = \text{cash ratio}$$

$$(Cash\ \&\ short\ term\ investments) - (short\ term\ notes\ payable\ \&\ current\ share\ of\ long\ term\ debt)$$

$$=$$

$$\text{Net liquid balance}$$

The most complex measure of the narrow liquidity of an organization is lambda, which can be computed as below and does also take the probability into account with which an organization will be able to meet its liabilities. This probability is reflected in the denominator of the formula, which includes the standard deviation of operating cash-flows.

$$cash\ + short\ term\ investments\ + unused\ short\ term\ borrowing\ capacity$$
$$= initial\ liquid\ reserve$$

$$\frac{initital\ liquid\ reserve + projected\ operating\ cash\ flow}{STD\ of\ operating\ cash\ flows} = \text{lambda}$$

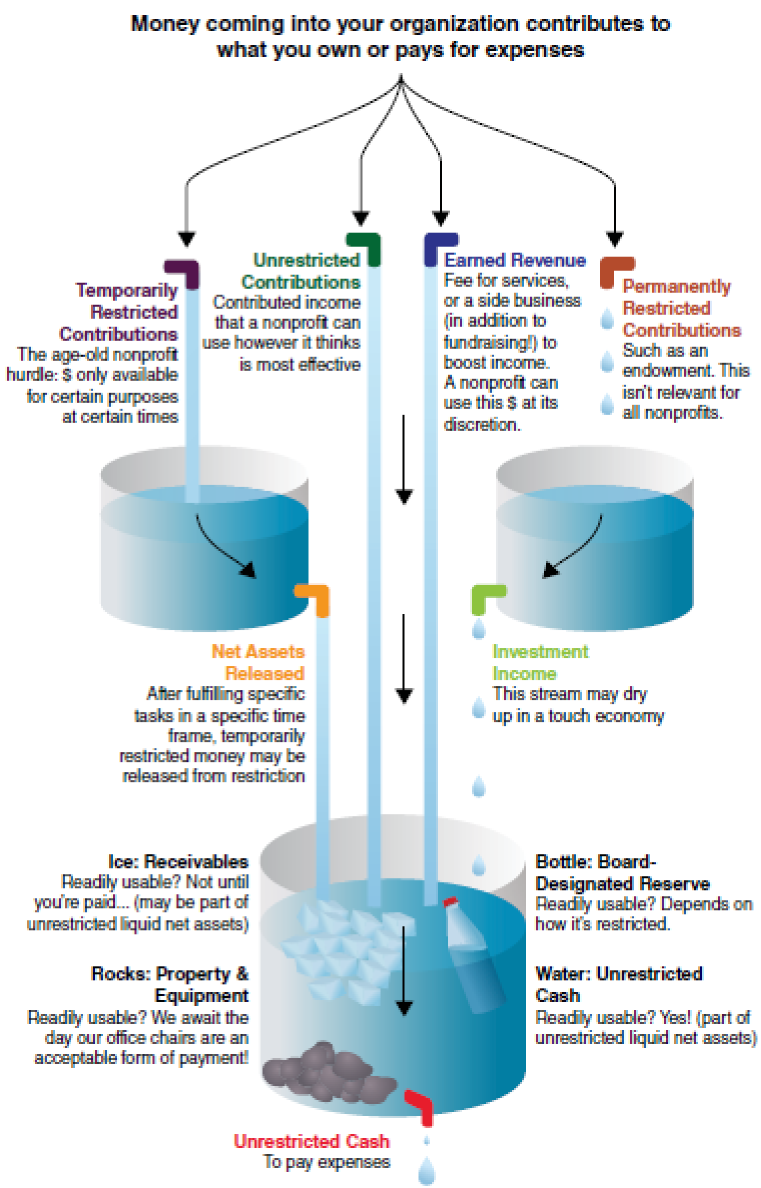
Apart from these ratios, there is a set of financial measurements related to the cash conversion cycle of an organization, which can be seen in greater detail in the section of the work dedicated to financial ratio analysis.

NPO Cash Flow structure

Apart from thoroughly analyzing the different tiers of organizational liquidity, financial managers in the non-profit sector need to dedicate a big part of their time towards understanding the cash-flow structure of their organization, which does depend on the type of donors as well as on the restrictions these different types of donors place in the funds they provide to the organization. This complex cash-flow structure is one of the central differences between the for-profit and the not-for profit world, the depiction below provides a good image of the complex cash-flow structure that organizations need to manage.

Third-sector organizations do in many cases have access to a limited amount of unrestricted funding if they have any access to funding which is not attached to a specific purpose, project or region. Furthermore, the cycle of income streams does often not correspond to the cycle of organizational expenses, leaving the organization with situation of under- or oversupply in financial terms, that needs to be addressed. Among others, endowment funds and operating reserves are frequently used tools to account for this special situation allow financial managers to ensure stable provision of their program activities to their clients, as well as to ensure the quality standards which the organization set itself. (Zietlow, Hankin, Seidner, & O'Brien, 2018 & Zietlow & Seidner, 2007)

Non-profit cash-inflows



Source: *(Non-profit Finance Fund, 2017)* in (Zietlow, Hankin, Seidner, & O'Brien, Financial Management for Non-Profit Organisations: Policies and Practices, 2018)

Operating reserves & the role of endowments for NPO liquidity management

As non-profits avoid holding excess liquid resources, due too a strong adverse industry culture towards too much liquid funds, financial managers needs alternatives to hold cash resources that go beyond a certain limit.

One option is to put funds in operating reserves, also called ‘quasi-endowment’ or ‘board-designated reserves’, which leaves the funds to be used at discretion of the board. Generally speaking, these funds should cover three to six months of an organizations operating expenses and are meant to protect and organization against adverse shocks to their cash-inflows, allowing them to maintain their service level, even under higher financial pressure. (Wiley, 2017) To determine the adequate level of operating reserves, it is suggested that the organization does in a first step turn toward understanding their financial goal over the next five years. In a next step, the organization performs a risk analysis for all key elements of their daily business, which needs close collaboration of the management and the department heads. These defined risks are in a next step quantified and by assigning weighted probabilities to possible cases of downside performance and calculation the net-present value of the identified cases of downside performance, the Financial Manager arrives at a sum for the organizations adjusted risk exposure. (Paul, Joseph, Mark, & Matt, 2012) The set-up of these reserves should be accompanied by defining how they can be used by the organization to ensure that there are no risks of misusage. Even though there is a generally suggested level for the amount of operating reserves to hold, organizations should avoid comparing the level of operating reserves they hold to other organizations, since the adequate height depends on several organization-specific factors, which have been considered in the above-mentioned process.

Another instrument used by many NPOs to keep excess cash are endowments. Endowment funds can take the form of different assets, ranging from stocks to bonds over venture capital to property. In most cases the principal of the endowment remains untouched, while only the investment income is used by the organization to cover expenses. The amount of this continuous investment income does of course depend on the type of investment used for the endowment.

(Helms, Henkin, & Murray, 2005) Given the fact that the risk of abuse of these discretionary funds is high, organization tend to have rigid procedures to determine how they can touch their endowments. (Gläser, 2003)

Case Study I

The first case study was conducted with Horizons for Homeless children, a US-based organization supporting homeless families and children via several program activities, ranging from direct support to the children's educational path as well as strengthening the parents capacities to improve the family's situation in the long-term.

The Financial Manager, Tammy Reder, was interviewed via Skype and provided valuable insights in her work at the organization at hand, as well as in other experiences she made over the past years while working in the third sector. Horizons for Homeless children can be classified as a 'thriver' in the framework provided by Zietlow (2010), which means that the organization does understand the value of maintaining a certain degree of financial flexibility to be able to capture opportunities for program expansions and also be prepared to confront potential challenges due to sudden changes regarding the availability of funding.

The case study demonstrates that Horizons does apply many of the concepts introduced and performs many of the activities suggested in the literature. Mrs. Reder highlights that even though liquidity management requirements do at the first glance sometimes conflict with mission attainment, the financial manager can often play an important role in ensuring that the organizations activities are adequately focused on the organizational mission and the key capabilities of the organization. Furthermore, the case-study revealed that regarding the usage of financial ratios, there seems to be potential for the organization to better inform the liquidity management activities. Nevertheless, it has to be noted, that this is often a question of terminology, since the organization does use ratios that have also been found in the literature, but under a different name and sometimes computed in a slightly different manner.

Given the high fixed costs that the organization faces, since 80-85% of their expense consist of payroll and a high donation, held in reserves, boosting the confidence of the organization's members and executives, Mrs. Reder was facing the challenging task, when she joined the organization, to make members understand the importance of sound and forward-looking liquidity management practices. This situation is a powerful illustration of the special challenges non-profit financial managers face and underlines the high importance of their previous experience and financial management literacy.

Case Study 2

The second case study was conducted with the support of the secretary general of the Istituto per la Cooperazione Universitaria ONLUS (ICU), a rome-base organization operating in 10 different developing countries.

The case-study of ICU was strongly influenced by the special implications of the situation of the regions in which the organization mainly operates, as well as the organizations donor structure. While Horizons funding comes from different types of donors, meaning also from private, individual donors and corporations, ICU does only receive funds from institutional donors. This has important implications on ICUs liquidity management, since it contributes to a more complex cash-flow structure and leaves ICU without access to unrestricted funds, as the institutional donors give funding that is determined to be used for a specific project or activity only. This complexity of cash-flow structures, is typical for the third sector as such and a recurrent topic in the liquidity management of many organizations (Zietlow, Hankin, Seidner, & O'Brien, Liquidity Management, 2018).

Apart from that, ICUs operations do mainly take place in developing countries, which means that the organization faces high risks regarding inflation and currency exchange rates. Since traditional hedging would be too expensive, ICU tries to mitigate against the entailed risks by avoiding holding funds in instable currencies or if they need to meet obligations in the local currency, they delay the conversion until the last possible moment in time.

ICUs activities are mostly cash-positive, which means that they receive the funding upfront, before starting the project. During the project lifetime, they received a second tranche of funding – the last 10% of ICUs project expenses are covered by themselves and recovered from a donor after completion of the project. This means that the activities of ICU are cash-positive for the major part of the project life cycle, which is an important difference from Horizons and explains why ICU does not utilize cash-flow statements in the course of their liquidity management activities.

Conclusion

Non-profit organizations fulfill an important function in a society and an economy, regardless of the underlying system. Given the momentum that the financial crisis gained, financial managers in the third sector have an important chance to facilitate a paradigm-change for their sector, allowing them to look towards a financially stable future. Instead of viewing liquidity as a necessary evil, there lies a lot of potential in organizations understanding of the importance of financial soundness for their mission attainment. Ultimately, the non-profit can draw on many lessons from the for-profit sector regarding successfully management of liquid funds – the introduced concept and resources are adaptable to non-profit needs and standards, as the literature review as well as the two case-studies demonstrate successfully.

LUISS Guido Carli

Department of Economics and Finance

Chair of Corporate Finance

Liquidity Management in Non-Profit Organizations

Supervisor

Prof. Pierluigi Murro

Candidate

Nina Giuliana Londer

707991

Co-Supervisor

Prof. Riccardo Bruno

Table of Contents

1. Introduction

Throughout the whole world, non-profit organization are an important pillar of peaceful societies and economies, as they serve important needs which would otherwise remain unserved, and have the potential to mitigate the effects of serious economic crisis on the societies we live in.

Keeping this in mind, it becomes apparent that it is desirable to maintain financially healthy non-profits as a part of an economic system. Financial health does above all require sound financial management – taking into consideration that non-profit organizations do not consider financial gain as their primary objective, but do instead focus on mission attainment, while financials seem to play a secondary role, it becomes obvious, that financial management for non-profit organizations has to account for a complex set of sometimes contradicting demands from the organization itself, but also from its outside customers and stakeholders.

At the heart of this complex set of demands, lies the organizational liquidity management. After a long history in which the prevalent view of the sector towards holding excess cash was a rather negative one, the financial crisis of 2007/08 marks a turning point for non-profit liquidity management, as many organizations slipped into serious cash crunches during that period, leading them to reconsider their liquidity management practices up-to-date and towards understanding that maintaining their liquid resources is not an obstacle towards spending enough on program activities to be able to attain the organizational mission, but instead the first represents a prerequisite for the latter.

The following work analyses the techniques, concepts and good practices for successful liquidity management, developed and suggested by researchers around the world and does in the following test the theoretical findings against common industry practice, represented by two case-studies. This comparison provides valuable insights on the status quo of liquidity management in the sector and provides suggestions for organizations to adapt their financial management activities to create a financially stable future.

2. Methodology

Given the strong cultural determinants of the third sector, as well as its general rise in popularity, that could be observed during the past years, the appropriate methodology had to be identified. Understanding that the field to work on, is comparatively new, while a systematic review of existing research can be a good starting point, it was clear that the theoretical research had to be complemented by practical insights. To allow for this comparison of theory and every-day organizational practice, the practical insight which completes the systematic literature review consists of two comprehensive case-studies. The case studies pick-up the identified focus-areas and main points of the literature review and tests the theory and concepts against praxis. In the course of the literature review, analysis-techniques and frameworks had also been employed to facilitate scoping as well as a multi-dimensional view on the topic.

The systematic literature review has been conducted using several resources. First and foremost, the most popular research engines for scientific literature in the field of Business studies as well as one from the field of social science have been consulted, namely EBSCO, ProQuest, JSTOR and Science Direct. Furthermore, google scholar has been used to develop an initial search pool and to identify further research that had been mentioning used articles and to identify valuable insights from less scientific but still high-quality newspapers, as well as to identify relevant books.

One important feature of a systematic literature review is its conduction in several phases which serve the same end but eliminate irrelevant findings and allow to focus on the most relevant research as a basis for the following work. (Maier, Meyer, & Steinbreithner, 2014) The literature review for this work has been conducted as follows: To begin with, after the thematic area had been chosen reasonably narrow, as Liquidity Management presents one part of Financial Management for NPOs, the book "Financial Management for Non-Profit organizations" by Jo Ann Hankin, Alan Seidner and John Zietlow provided an important starting point to put the chosen focus-area in context and see it interconnected with other Financial Management areas. Apart from choosing search terms and conducting reiterative search runs, the named book also provided a high number of further articles to consult.

The search terms were developed after broad explorative search on Financial Management in NPOs as well as after thorough processing of the book. Apart from covering the area of Liquidity Management in Non-Profit organizations, research regarding the organization's specific features and their implications on NPO's liquidity management has also been conducted. To better understand the specific features of NPOs liquidity management, it is necessary to have a sound general understanding of the sector and its most important determining ideas, as well as managerial philosophy.

Phase	**Step**	**Purpose**	**Techniques**	**Result**
Scoping activities	Define appropriate scope & research areas	Specify initial search terms	Close reading of 2 respective books, 5 articles and 2 relevant studies on NPO Financial Management | Exemplary Stakeholder-analysis to better understand the nature and scope of Topic I	Initial search terms related to: Topic I = NPOs features & their implications on Financial Management Topic 2= Liquidity Management in NPOs | Development of Criteria for selection of relevant literature
First iteration topic I	Identify potentially relevant literature	Create a pool of potentially relevant literature to be used for snowballing process	Automated database-search based on initial search terms	123 potentially relevant publications
	Select relevant literature	Filter relevant literature from	Application of refined criteria for	25 relevant publications and pool for

		potentially relevant one	selecting relevant publications	backward and forward snowballing
	Backward and Forward Snowballing	Identify further relevant literature	First backward snowballing from reference lists and then forward snowballing	3 additional relevant publications
	Extract and analyze data	Identify relevant information from literature	Set-up qualitative data-file with text passages and page numbers of the selected literature	Analysis of the relevant publications according to concepts, methods, research questions
First iteration topic 2	Identify potentially relevant literature	Create a pool of potentially relevant literature to be used for snowballing process	Automated database-search based on initial search terms	421 potentially relevant publications
	Select relevant literature	Filter relevant literature from potentially relevant one	Application of refined criteria for selecting relevant publications	37 relevant publications and pool for backward and forward snowballing
	Backward and Forward Snowballing	Identify further relevant literature	First backward snowballing from reference lists and then forward snowballing	4 additional relevant publications

	Extract and analyze data	Identify relevant information from literature	Complement the set-up qualitative data-file with text passages and page numbers of the selected literature	Analysis of the relevant publications according to concepts, methods, research questions
Second iteration topic 2	Identify additional relevant literature	Expand the pool of potentially relevant literature to be used for the snowballing process	Automated search in databases based on further refined search terms	23 potentially relevant publications
	Backward Snowballing	Identify further relevant literature	Backward Snowballing from reference list	7 additional relevant publications
	Extract and analyze data	Identify relevant information from literature	Complement the set-up qualitative data-file with text passages and page numbers of the selected literature	Analysis of the relevant publications according to concepts, methods, research questions

As shown in the table above, the review was carried out in three phases, of which some were applied repeatedly and applied in an adapted form. The first phase had the purpose to define the scope of the research as well as to generate initial search terms for two areas: NPOs key features and their implications on Financial Management and NPO-Liquidity Management practices. In the course of the second and the third phase, containing one or two search iterations, several criteria was applied to filter the search results:

- Sources must be on NPOs distinctive features & relevant differences from for-profit organizations (search for topic 1) and furthermore on NPO-liquidity management practices (search for topic 2). As already mentioned above, the search was performed for two topics since the nature of NPOs and the managerial sector culture requires to develop an understanding of this nature to be able to perform a sound analysis of liquidity management practices

- Sources must be written in English, using scholarly, technical terminology and be published in peer-reviewed journals (exceptions were made to include relevant information from high-quality newspapers and blogs regarded within the community – this also takes adequate account of the recent nature of the topic under review); Attention was also given to the fact that used sources were cross-cited in other publications in relevant peer-reviewed journals
- The publication venue should be consistent with the determined geographical scope of this research
- Attention was given to the publication date of the sources: Only articles with a recent date were chosen, exceptions were made to include long-standing theories and standard works which are still being recognized as valid and relevant for todays research in the field
- Sources should provide an adequately detailed view to the applied liquidity management practices and provide empirical evidence for the application of described practices
- Sources that successfully passed a rostering by all the criteria listed above are first analyzed based on their abstract, final decision about including them was undertaken based on careful review of the most relevant parts of the paper

For the application of snowballing, the above-mentioned criteria provided important guidance, with the first point of reference of the examination of source lists or citations in other papers, being the title of a new potential source.

	First iteration topic I	**Second iteration topic I**
Sector-related search terms	non-profit organizations; non-profit; NPO; NGO; non-governemental; civil society; volunteer; not-for-profit; third sector; philantropy	

Topic-related Search terms	non-profit organizations AND features	non-profit AND for-profit AND differences
	Third sector AND europe	Third sector AND Italy
		non-profit organizations AND Italy
	Third sector AND US	
		Non-profit AND business-like
	Non-profit AND trends	Non-profit AND sector-trends
		Non-profit AND Financial Crisis
	Non-profit AND ethics	Business ethics

First iteration topic II	**Second iteration topic II**
Liquidity management AND non-profit/NPO/NGO/non-governmental/civil society; volunteer; not-for-profit;	Liquidity Management AND third sector
Liquidity AND philanthropy	non-profit AND endowments
	non-profit operating reserves
	non-profit cash-flow structure
	non-profit AND funds restriction
non-profit/NPO/NGO/non-governmental AND cash management	non-profit AND financial theory
	non-profit AND financial crisis
non-profit/NPO/NGO/non-governmental AND performance measurement	non-profit AND accountability
	non-profit AND financial ratios
	non-profit AND financial management AND best practices
	Non-profit AND financial management staff/personnel
non-profit/NPO/NGO/non-governmental AND funding source	Non-profit AND donors

After the systematic review of the theoretical research, which had been conducted on the topic at hand, two organizations were chosen for a comprehensive case-study which aims at testing the retrieved theoretical insights against the practices observed in day-to-day business of Financial Managers. The two chosen organizations are Horizons for Homeless Children, a charitable organization based in Massachusetts in the United States and the Istituto per la Cooperazione Universitaria Onlus (ICU), an Italian organization. The case studies were developed based on publicly available information on the homepage of the organizations, a review of their Financial Statements and an extensive questionnaire. The questionnaire picks up on the main topics identified within the literature and aims at understanding to which extent these are being applied on practice as well as were the practice diverts considerably from the literature. (See Annex I for questionnaire) The questions were answered in the course of an interview with the Financial Management responsibles of the organizations, conducted via Skype.

3. What is a Non-Profit Organization?

Any attempt to develop a definition of a non-profit organization (NPO) and its most important features, it is important to take regional differences, due to different legal frameworks, as well as different management practices, into account. What is clear above all the differences, is the fact that NPOs are normally not allowed to distribute any surplus they might make in the course of their activities and that they rely on voluntary contribution in the form of money or work. The types of organizations in the non-profit world do meanwhile vary greatly and comprise hospitals, churches, educational facilities, social service projects, projects to develop the local neighborhood, development aid and recently, more needed due to the international migration crisis, refugee assistance. (Zietlow, Hankin, Seidner, & O'Brien, Understanding non-Profit Finances, 2018) As it has been phrased by Casey (2016): “The nonprofit sector is immensely heterogeneous, spanning from large, multibillion dollar, mainstream, professionalized institutions that function similarly to for-profit firms and have close relations to governments and corporations, to small, hardscrabble all-volunteer organizations providing shoe-string services or pushing for systemic change from the fringe.”

The following analysis and definition of the non-profit organization, also named not-for-profit organization or third sector, as such, as well as some of its important features focuses on two regions: The United States and one region in Europe, precisely Italy. The reason for this regional focus is to be found in the last part of the Thesis, where a Case-study with two organizations, one based in the United States and one based in Italy, aims to map out differences between the theoretical findings and the everyday-practice of NPO's in their respective field.

a. Defining the third sector in the United States and Italy – legal framework, determining factors & differences from for-profit organizations

When looking at the definition of NPOs on a cross-national level, it is important to consider country-specific differences. These differences regard the used vocabulary, the regulatory frameworks & regulatory bodies, the socio-economic & socio-political environment and historical developments, which lead to the given conditions. The comparison of the above-mentioned factors for Europe and the United States reveals first and foremost differences in the terminology used and a big gap regarding the role and function of what is called the third sector, as it is embedded in the societal and economic system. (Evers & Laville, 2004) Despite these differences, rooted in historical developments, which will be illustrated in the following, similarities can be found in some areas of legislation.

In the United States, the term non-profit organization has a rather broad scope, it denotes organizations that are allowed to make a profit but at the same time they must not distribute any of their profits to the ones who own the organization in a sense of control. Fulfilling that criterion, the organization at hand needs to apply for consideration for tax-benefits with the Internal Revenue Service (IRS). After being recognized as being entitled to receive the tax-exemption status as an organization, the NPO enjoys several advantages: They are generally exempted from the payment of federal income taxes and the filing of an annual income tax return. In turn, the donors of these types of organizations also enjoy certain benefits, denoting in this case the possibility of deducting their contributions from the taxes they need to pay. The scope of the exemption may be even bigger, including property tax, use tax and sales tax, depending on the state the organization operates in. The named legislation can be found under section 501(c)(3) of the IRS-code. (Internal

Revenue Service, 2019) The reason for the variances in States law can mainly be classified as political and budgetary reasons – some states limit the exemptions to make-up for shortcomings in their own budgets. (Zietlow, Hankin, Seidner, & O'Brien, 2018)

To obtain an idea about the scope and impact of the sector, looking at some facts & figures is a good exercise. The United-States based National Center for Charitable Statistics (NCCS) regularly publishes numbers on the non-profit sector in the United States: Between 1970 and 2016 there was a huge increase in the number of non-profit organizations, namely from 300.000 to 1.6 million – and these numbers regard only the registered organizations. As it is often seen in the for-profit sector, some large organizations source a big part of the turnover – to be more precise, the biggest 15% account for 50% of the sector's revenues in the United States. 1,57 million organizations with tax-exempt status make 1,5 trillion Euros of revenue, using assets worth 2,6 trillion € to do so and encountering 1,43 trillion € expenses. In addition to their revenues, 314 billion € of charitable contributions were sourced from individuals, corporations and foundations. While organizations in education and healthcare are responsible for the biggest part of the revenues, the biggest part of charitable contributions goes to religious organizations. The NPO-sector employs about 10% of all paid employees in the United States and employment in this sector is growing at a higher rate than the US-economy itself. (Zietlow, Hankin, Seidner, & O'Brien, 2018)

The European third sector needs to be viewed in the historical context, with the end of the second world war as a major event, boosting its importance and determining the role within the society and the economy. At the heart of its development lie in many European countries' shortcomings of the modern welfare state, that developed into crises and social inequalities. From what Europe saw in the decades after the second world war, globalization lead to diverse structural changes, while the known problems regarding social welfare remained essentially the same. The third sector nowadays presents an answer to the call for social security, while it has also established a relationship with the market itself. The acknowledgement of these relationships finally lead to further development of economic concepts, such as the welfare triangle which was then advanced to the plural economy triangle. The latter concept allows to see the third sector in Europe in a broader context with the modern economic system in democratic societies. (Evers & Laville, 2004) From this viewpoint, the non-profit organizations act as an intermediary between the classical agents contributing to the welfare generation in an economy. If we see the market, the community and the family as the three poles in an economy, the third sector can be a catalysator for redistribution attempts, while experiencing constant tension due to hierarchical structures.

Coming back to understanding the historical context and keeping in mind the considerations about welfare, the strength of the third sector in Europe is rooted in the strength of the European labor movement – which was relatively powerful, compared to the United States. While according to the US-definition, organizations that might distribute profits are exempted, there are organizations in Europe, fulfilling that criterion, that have to be taken into consideration as part of the not-for-profit sector. Housing cooperatives are, for example, in many European countries, allowed to distribute their profits. Still, their mission is dedicated to serve the community rather than maximize the return for their owners and the housing cooperatives in Sweden, did for instance never distribute any profits for a considerable amount of time. So, the determining factor in Europe is not that there is no return on individual investments, but that there are limits imposed on personal gain, while maintaining the generation of collective wealth as the main purpose. This limit on profit generation can well be viewed as an illustration of the socialist and capitalist imprint of the respective EU- and US-economy. (Evers & Laville, 2004)

At this point it must be mentioned that the EU lacks consistent regulation of the sector, due to conflicting opinions regarding taxation and tax-exemption by the member states. Member states highly value their ability to tax and see it as their privilege, which they do not want to give away to the EU-body. Besides this lack of consistency regarding the concrete rules, the states could agree on leaving space for members that wish to give tax-exempted status to different types of third-sector organizations. Above that, the need for a proper statute, agreed by all member states, is widely acknowledged – such a statute would also reduce barriers to cross-national NPO-initiatives. (Breen, 2008)

Italy recently saw legal changes for the area, with the introduction of the new code of the third sector which states clearly that only organizations engaging exclusively in not-for-profit activities can be part of the sector. The owners are not entitled to receive benefits, with occasional exceptions regarding organizations that rely on the contribution of volunteers: Those are entitled to reimbursement for expenses they encounter in the course of their activities. Due to the classification of NPO's activities as non-commercial, they do not have to pay income tax. To facilitate the sourcing of funds, credit institutions issue so-called “titoli di solidarietá”, which are solidarity bonds that can be issued without being obliged to pay a placement fee. (Figueroa, 2017) Placement fees depend on the specific deal structure and are mostly paid to a placement agent or intermediary by the fund-seeking agent of the deal. (Pilbeam, 2018)

Organizations with education-related purposes are the ones to dominate the Italian third sector as they hold a share of 80% of NPO-interventions, followed by healthcare (72%), food security as well as agriculture and water (68%) or humanitarian support (63%) and migration related issues (48%) – to name just some of the many fields of action.

Even though different historical events lead to different definitions and frameworks, there are several points that are valid for the NPO-sector in both regions: the mission to serve the public good, the possibility to get awarded a tax-exempted status, as well as the possibility for donors to deduct contributions from taxes to pay and a specific organizational structure that ensures together with appropriate governance practices, that self-interest and the strive for individual financial gain cannot be realized.

The tax-exempted status, as a powerful legal factor, accounts for many differences between the non-profit and the for-profit sector: If an activity generates income, it has to have a close connection to the mission, otherwise it may be taxed unlike the rest of the organizations activities. The financing is entirely provided by sources of debt, no stocks are issued, no NPO-Financial Manager will ever be concerned with paying out dividends. This also means that the organization is considerably free from stewardship attempts by company outsiders that want to exercise direct control over their operations, like it can be observed in the for-profit sector. (Zietlow, Hankin, Seidner, & O'Brien, 2018) This is of course just one side of the story, as we know from the business world, that the decision for appropriate debt-to-equity ratios is not an easy task and is made based on multi-faceted calculations. Among many other, case-specific fine adjustments, every debt-financing is based on an assumption on the ventures future ability to pay back the money it borrowed today. Such a prediction of payback-ability does with no doubt come at a risk. (Hovakimian, Opler, & Titman, 2009) Apart from that, also debt incurs costs, that must be paid, depending on the contractual agreements, on a regular basis. Needless to mention, that these regular payments do not correspond to the fluctuations of societal needs NPOs might be confronted with due to their mission's close links to crisis-situations. This highlights even more, how NPOs must rethink their main Financial Objectives to be equipped to respond to these special challenges.

Another side note on that: Even though organizations of this kind might not be dependent on shareholders, there are still the donor's interest to be taken into account, as well as the conditions these donors attach to the provision of funding, which will be shown in Chapter 4, when analyzing the cash-flow streams of non-profit organizations. What had been observed in the past is that some organizations, especially the ones aiming at considerable organizational growth and wishing to reach a size that puts them among the biggest players in the sector, tend to focus on one or at least a small number of donors. This focus allows them to adapt the organizational structures, make them more professional and align interests with that specific donor, ensuring a steady flow of funding. Often the organization was lucky enough to find a donor that is a very good fit to their motives and ideas, favoring such a close and exclusive connection. (Foster & Fine, How Non-Profits get really big, 2007)

Regarding the organizational mission, its orientation towards serving the public good makes it incompatible with the concept of ownership and the related motive of financial gain. Earned surplus is either reinvested in the organization's activities, kept as a reserve or given to other organizations, whose activities also serve the public good. When an organization has successfully developed a mission statement, what follows, is the identification of the clients to serve, as well as a selection of appropriate sources of funding. (Evers & Laville, 2004) As it had been mentioned at the beginning of this chapter, NPO's serve completely unrelated needs and their organizational structures must first and foremost cater these needs. An educational facility needs different conditions to be run successfully than a center for medical research or a dining hall for homeless people. So, the organizational type determines how it is governed and how complex the governing processes are. (Zietlow, Hankin, Seidner, & O'Brien, Understanding non-Profit Finances, 2018)

What adds another dimension of complexity, is the recent trend towards the emergence of hybrid organizations, which can neither be entirely public nor as entirely private and do therefore have to be treated more consciously. This recent development is likely to continue and does still require more thorough consideration by policy-makers and the general public. (Hyyryläinen & Viinamäki, 2011)

Apart from the legal framework, the economic system of the region in which an NPO operates, determines which activities they carry out and that influences any attempt to define this sector.

The United States are commonly seen as an example for a liberal economy. Liberal economies are generally marked by a small scope of welfare-state and government activity, combined with an institutional framework that facilitates the establishment of associations, fueled by individual motivation and personal engagement. Philanthropic organizations and voluntary activities fulfill an important function in the society and are part of a common cultural norm. The organizations develop to be relatively strong, while their capacity to mobilize the civil society determines their strength in advocating activities. Between the government and the individual organizations, bilateral arrangements, based on contractual agreements, which also need continuous negotiation are the basis of collaboration.

Like most countries in central Europe, Italy can be identified as a country with a corporatist structure concerning the positioning and activities of the third sector. The state as a central actor delegates certain social service activity to non-profit actors. In such a system, the relations between the state and the organizations are institutionalized and long-standing which means, that it is sometimes difficult to distinguish who plays which role in certain processes. The NPO does in this case work in close concert and embedded within the welfare states activities, also being supplied with funding by the government. What is important to note is, that the corporatist structures have recently seen periods of change: There seems to be a general trend towards the liberal structure of the United States. (Casey, 2016) It can be assumed that this shift would entail a variety of consequences – first and foremost regarding the scope of any non-profit organization's activities.

After the defining aspects of the third sector have been illustrated, the following sections will cover some important determinants and influences on the Financial Management routine.

b. Financial Policy-Making in Non-Profit Organizations

Policies are crucial for any organization in which several hierarchical levels exist, and tasks are being carried out based on distribution of labor, since they insure compliance with legal requirements as well as adhere to principles and values agreed by the company's leaders. To understand the functioning of a Policy, it is worthwhile to set out three distinct concepts: policy, procedure and work instruction, where the policy represents a summary of all the rules and guidelines from internal and external source, providing important orientation to the staff. Procedures then help to put policies into practice. As Zietlow, Hankin, Seidner & O'Brien stated (2018): "Procedures are the steps that must be taken to comply appropriately with policy."

They also provide guidance on how to deal with conflicts arising in the work process. From the procedures, work instructions are developed, which specify the exact steps to be undertaken in reporting, in using a check-list, or e.g. a software-tool, as well as the frequency and order with and in which these steps have to be undertaken. It is highly important, that the organization ensures, that employees have understood the illustrated structure to prevent them from confusing the different stages and the purpose of each of these stages. Frequently, the understanding of the bigger picture is not given, leading employees to focus narrowly on the work instruction rather than the initial purpose, contained in the policies description and finally leading to high inflexibility regarding changes of the procedures or work-instructions. This inflexibility can make organizational development difficult and is often hard to counter by the training-personnel, entrusted with communicating new procedures and work instruction to the employees. A high degree of detail laid down in written can also help to overcome the described issues. (Zietlow, Hankin, Seidner, & O'Brien, Understanding non-Profit Finances, 2018) By explaining the detailed thoughts behind procedures and policies employees are encouraged to follow the policymaker's path of thinking and understand the intention of policies, rather then just carrying them out.

In general, the world of policy is a hierarchical one, meaning that there are certain organization-specific internal policies, as well as externally determined rules, mostly imposed by official bodies, institutions and governments. These different sources of policies have to be combined into a consistent code of rules.

This code then defines and ensures the compliance with so-called standard operating procedures, which together facilitate the onboarding of new Financial Management personnel and help to balance different levels of topic-specific knowledge, they keep management executives from engaging in so-called 'Micro-Management' which means to interfere in every decision until the very last detail is set out and last but not least, policies fulfill important control and protection functions regarding financial soundness and, as named by Zietlow, Hankin, Seidner & O'Brien (2018) "fraud prevention/internal control, risk management, investments, debt, employment (background checks), and employee relations (harassment, confidentiality, discrimination, bonding)".

Financial policies are laid down in categories ranging from accountability to data integrity. The board of directors is the body responsible for formulating and laying down the policies in an adequate manner, seeking valuable advice by the management executives just as the board treasurer. Still, the policy-making is ultimately the responsibility of the board. (Miller-Millesen, 2003)

When considering the nature of policies, one can distinguish between restrictive and prescriptive policies. If restrictive policy-design is applied with an acceptable degree of prudence, it still leaves space for creative solutions in the case of newly arising challenges, which might be favorable over prescriptive policy design. What is more, prescriptive policy design, depending on the complexity of the organization environment, might soon reach its limits, since it is very difficult to anticipate certain events leading to changes in an organization's funding environment. One of these events will be discussed in the next section of the chapter, namely the recession of 2008/9. (Zietlow, Hankin, Seidner, & O'Brien, 2018)

c. Trends in the third sector & their implications of Financial Management practices

As it became apparent with the development of the definition above, the non-profit sector is determined by some major differences from the for-profit sector. Nevertheless, in recent years there has been a globally observable trend towards more civil society engagement, privatization of public service sectors, growing organizations and a rise in popularity of organizing for actionist activities. Governments answer differently, but often with a rise in legislation and restrictions, aimed at limiting the acting space of civil society organizations.

For the two regions which this analysis focuses on, the United States and Italy, one of the most interesting trends regards the adaptation of practices, that are characteristic for the profit-oriented business world. Starting from the 70s, NPOs began to implement business-like tactics, which induced the development of Strategic Management tactics for NPOs. Competition for funding, physical facilities and resources and even for clients was a strong driver behind these developments (Beck, Lengnick-Hall, & Mark, 2008). Often the financial pressure leads to sponsorship – especially in art-related fields, which means that the NPO enters in a relationship with a business sponsor. (Mittilä, 2014) The adoption of business-like practices influences governance structures and the organizational goals (to be more precise – a stronger orientation on generating revenue) as well as the style of communication, regarding the narrative about their mission and the layout of their visual communication. (Maier, Meyer, & Steinbreithner, 2014)

According to (Maier, Meyer, & Steinbreithner, 2014) the source of the forces behind this development can be identified along several dimensions: In the relation of an organization with its environment, evolving from inside the organization itself or from outside the organization, having in any case an impact on the operations.

There might for instance be more and more for-profit organizations providing the same service as an NPO or simply more non-profit organizations competing for sources of funding. The sources of funding do not only have an impact on liquidity management, as it will be demonstrated in the following chapter, but also an external driver for NPOs to adopt business-like practices: If a considerable part of NPO's sponsors is represented by business organizations they might openly or implicitly transfer their preferences for carrying out transactions in the same way they carry out their transactions with other for-profit organizations.

Sometimes it might even be the personnel itself, as professionals wish to apply the practices they were taught during their educational years. Political donors might be interested in business-like practices due to accountability considerations. So, the organizations environment, with its societal, political and economic frameworks does directly influence the daily management practices. If the push towards adopting business-like practices comes from within the organization it might be fueled simply by ideology, by characteristics of the board itself, by organizational culture or by the field the organization operates in. Taking a look at the relationship the organization has with its environment, it collaborates with governments and political actors, with companies and professional associations - among all these, the NPO wants to preserve its legitimacy. This seeking for legitimacy might be at the heart of developments of the NPO towards adopting more business-like practices. (Maier, Meyer, & Steinbreithner, 2014) Though NPOs are adopting more and more business-like practices, the sector is dominated by strong moral limitations and a sector culture that influences management practice to a big extent. The section on ethics will provide a more detailed picture on these issues, while the chapter on liquidity management attempts to present a concept on how to overcome these barriers by appropriate liquidity targets and establishing a more positive image of excess cash reserves.

The effects of the adoption of business-like practices can be observed for different outcome factors. Looking at the effects on funding, there is a whole range from crowding-in, crowding-out or compensation of commercial funding by other types of funding and vice-versa. When one analyses the effects on the attainment of the organizational mission, the effects differ depending on the nature of the mission. If an NPO is mostly providing services, commercialization can have positive impacts, meaning that the organization might provide a bigger variety of services to the public and invest more on constant development. For advocacy-type activities, there might be adverse effects: While the professionalization might help the organization to be heard by the government and other political actors, it might at the same time also limit their ability to advocate controversially against government rationales. Rather than radically countering the governmental narrative, NPOs then happen to tell a story which is compatible with the political majority-opinion. Regarding the relationship with volunteers, increasing professionalization often comes with the employment of more professionals, which in turn means that volunteers perform less core functions and more auxiliary work. (Maier, Meyer, & Steinbreithner, 2014)

As it had been briefly mentioned in the first section on defining the third sector, a trend towards liberalization can be observed. This means that, even though the traditional corporatist structure still exists, there is a trend towards a more differentiated pluralism within the non-profit world, combined with more and more competition, resulting in bidding for service delivery. (Casey, 2016) As we understood the current drift towards the adoption of more business-like structures, it is worthwhile to see the connection between these developments. Less corporatist structures might come with a smaller welfare state, which leads to more responsibilities for the sector, as well as a loss of sources of funding. So, these developments might lie at the roots of the increased adoption of business-like practices and professionalization, simply developing out of a need for funding. If the tendency is maintained, the non-profit sector has to prepare for filling a more and more important role within societies, which is apart from funding considerations a strong motivator to understand the potential of thorough strategic management and lessons to be learned from the corporate world.

While the before-mentioned tendencies must be viewed as developments over time with maintaining a future outlook, there was one historical event which drastically shaped the sector, and which will repeatedly demonstrate its impact throughout the next chapters: The recession from

2008-2012. During this time NPOs found themselves in a complex, adverse situation: While the dire economic situation forced many private and public donors to cut down their spending, the need for social aid was higher than ever. (Zietlow, Hankin, Seidner, & O'Brien, 2018) This placed many organizations on the edge of insolvency and marked a turning point regarding the sectors attitude towards Financial Management – especially regarding the task to ensure liquidity, as it will be analyzed in further detail in chapter four.

d. Role of Ethics in NPO Financial Management

The challenges non-profit organizations face when understanding the impact of ethical considerations are very different from those encountered by for-profit entities. Leaving these special implications aside for a moment, it is a worthwhile exercise to understand the general developments regarding business ethics. The topic has been seeing an increase in public attention over the last years. This can be attributed to a high number of cases of unethically behaving firms, operating in fields ranging from financial services to energy provision, being taken note of by the public with high levels of outrage. The public reaction to questionable behavior by entities like among many others, Enron, Tyco, WorldCom, Price Waterhouse Coopers, Deloitte or KPMG, indicates that the public seems to have a natural thrive towards preserving justice, moral standards and not to forget, the underlying mission of a venture, which should for many types go beyond profit maximization. (Duska, 2004)

The factors that lead to such questionable ethical behavior are numerous and have various considerably different sources. One factor that is essential for the for-profit world is the adherence of its involved actors to what they were presented during their education in business schools around the world, based on the neo-classical economic theory. Boosted by the ideological foundations of this theory, it seems that the business world has seen a development that put the individual pursuit of self-interest and personal wealth maximization above the goal of creating a product that satisfies societal needs. The theory of economic rationality does often find itself in conflict with the requirements of an ethics code, as viewing business actors as opportunists, looking for the biggest payoffs does not combine very well with considerations related to sustainability or common good.

Young, aspiring professional, entering that world of rationality theory, driven by career ambitions, start to understand how what they learnt in theory applies to the daily practices. If ethical considerations were not part of their educational years, one can raise the question, if these will gain importance throughout their working years, since they were not part of the business environment beforehand. Actually, what happens might turn out to be just the opposite: The theoretic value systems determine the ones applied in the corporate world. (Dobson, 2003) One might intuitively say that the above-mentioned factors are not playing a role in the NPO world, since ethics should be at the core of their identity and organizational mission, but even though that might be true, there are other mechanisms that drive NPOs to distort from ethically sound behavior.

In the following, a map of the drivers of unethical behavior, the arising challenges connected to Ethics, as well as possible solutions to these problems, will be developed. Before doing so, it must be noted that non-profit organizations rely on people contributing to their operations, either by monetary donations or voluntary work. Even though there might be variations for individual organizations because of the nature of their operations as well as the source of their funding and the attached conditions, every NPO must maintain a steady image towards the general public and the community it is being supported from. Since the maintenance of public trust is at the heart of an NPOs activity, it is the responsibility of each individual member of the board to contribute to this goal, even though it is not directly related to the organization's activities or the individual responsibilities of the board members. (Wiley Periodicals, 2018 & Miller-Millesen, 2003)

Keeping that importance in mind, we can know try to understand what criteria the organization must fulfill with its activities, in order to be perceived as acting ethically by the general public. The concept of social responsibility is something that different areas of life and business making have in common. In general, it describes the notion that an organization is aware of the consequences of its actions and deals with these consequences responsibly. (Boukaert & Vandehove, 1998)

To understand the challenges that can arise while fulfilling this criterion, one can look at management theory to be precise, the principal-agent theory. Applied to the non-profit world, it means that the management personnel has to deal with the tension of being responsible towards two different entities: One the one hand, there are authorities that employed him, the agent, with the goal of delegating responsibility and to let him carry-out tasks leading towards the fulfillments of the organization’s specified targets. On the other hand, there are the stakeholders in the world outside the organization which, as mentioned above, for the case of non-profit organizations, have an especially strong interest in its activities. Though one might argue that the goal of any NPO is socially responsible from the beginning and should not be threatened by conflicts of interest between the management or the organizations founders and the general public, but this view fails to understand the complex nature of the web of stakeholders and their various expectations (Wooten, Coker, & Elmore, 2003).

The organizational goals set-up by the founders are often very specific and tailored towards the interests of an equally specific target group, but at the same time the organization might fulfill, consciously or unconsciously, other functions and serve other societal interests. The organizational effort towards this secondary generation of so-called ‘social profit’ then in turn leads to expectations of the stakeholders about the extent and nature of the social value that the organization should add, as well as the ethical standards it should maintain while doing so. (Boukaert & Vandehove, 1998)

Apart from that, some NPOs happen to develop a very narrow image of their responsibilities over time, leading to a loss of sight of their position in the societal environment. This excluding mechanism is being referred to as ‘Social cocooning’ and has to be viewed in connection with the economic system in which the organization operates and the duties taken-over by the welfare state within that system. (Boukaert & Vandehove, 1998) The societal claims being presented to the third sector in a liberal market-economy differ greatly from the ones in a socialist economy with a strong welfare state. (Casey, 2016)

One common deviation among NPO-professionals is the application of what Zietlow, Hankin, Seidner, & O'Brien (2018) called ‘situational ethics’. This denotes behaviour in which individuals understand their case as an exception from the rule and therefore act against their best knowledge and not in compliance with previously established ethical rules. This does not necessarily imply that the individual engages in behaviour adverse to the organizations best interest – sometimes this individual deviations are to avoid excessive red-tape, which happens with the best intentions possible. (Zietlow, Hankin, Seidner, & O'Brien, Ethics, 2018) Even though a credible line of argumentation can be built in favour of avoiding bureaucratic barriers to fullfilling and organizational mission, one such deviation might entail a number of deviations. As it has been mapped out above, individual behaviour can be an introduction in a behavioural culture for a bigger group, sector or industry. If one creates a code of ethics and guidelines to later on allow any deviations from the initially set-up guidelines, the question has to be raised why the code has been introduced in the first place. If one ends up with a situation where exceptions seem to be the rule, it can be assumed that the ethical paradigms the organizational authorities had in mind when setting up the operations will not be considered in a respectable manner.

In many cases, conflicts of interest arise from individual projects and engagements of board members. Since the board members of NPOs often perform several functions in other organizations and companies, they might e.g. wish to direct business activities to these insurances, banks or law firms. Apart from that, the United States increasingly saw a practice of NPOs providing their logo to be printed on packaging and even credit cards. Companies use the reputation of the NPOs brand to make their offering more attractive to consumers. (Zietlow, Hankin, Seidner, & O'Brien, Ethics, 2018) Given the fact that the NPOs operations and the companies business might in many cases not be related in any way, it is obviously questionable if there is any justification for these branding practices. The NPO in the end just lets its brand be used for advertising purposes, which does not contribute to its mission and does also not comply with ethical standards.

Taking a step back to understand the bigger picture, it becomes apparent that the root of any deviating behavior can often be found in fields of tension between individual considerations and the greater good, or company mission. Even though it might be in an entities interest to have personnel with a high degree of commitment - which is especially true for the third sector, as it will be demonstrated later when understanding possible solution paths for the described challenges – a high degree of commitment might lead to blind decisions. There might be individual career aspirations or simply an exceptionally high organizational commitment, the result is a similar one.

As it has already been pointed out at the very beginning of this chapter, NPOs are constantly concerned with their public image, since they rely on donator’s trust. This leads to various practices to make the organization look less wealthy on paper: A second entity is set-up and activities generating a bigger surplus on a regular basis, as well as valuable assets are transferred to that subsidiary. The activities of this subsidiary are at the same time not being mentioned in the consolidated statements of the organization. Ironically, the goal of these changes is to look more trustworthy towards potential donors.

The applied hiding-practices depend on the legal environment of the organization. In France for instance, companies would legally be obliged to present consolidated statements of companies they exercise control over, but a KPMG-survey showed that 26% do not follow that rule at all and 52% do present consolidated statements but insufficient ones. The effect of this lack in transparency is a problematic one: Organizations that might simply be badly managed, achieve to source a considerable portion of funds by donors – funds that would otherwise have gone to organizations successfully reaching their mission. (Sinclair, Hooper, & Lei, 2009) As it had been demonstrated in the section on special implications, recent economic developments, to be more precise, the crisis of 2008/09 changed the understanding of non-profits as well as the general public regarding the generation and treatment of surplus. As the next chapter will focus on NPOs liquidity management, the described unethical hiding-practices lie at the core of this work. Therefore, when exploring appropriate liquidity targets as well as understanding how to reach them, reflection on how to finally change the public notion about excess liquidity for NPOs, must be made perpetually.

Having understood the various factors that make organizations fail to live up to high social responsibility standards, one can turn the attention towards factors facilitating socially responsible ways of acting. First, research proves the set-up of formal structures, entrusted with taking care of issues related to ethics, such as a code of ethics, as well as committees and departments taking care of complaints as well as engaging in the set-up of trainings. (Boukaert & Vandehove, 1998) It is intuitive that these trainings need to be made in a holistic way, connecting the central role of ethics with the goals an organization might have in other functional areas, such as ensuring its liquidity. Even though ethics plays a central role, it should never be forgotten, as we mentioned above, that NPOs need to attribute the same importance to financial goals if they want to be able to successfully fulfill their mission.

Although a code of ethics represents a powerful tool to communicate values and provide guidance to employees, it must be understood, that it is not enough to ensure ethical behavior. What is more desirable than making employees understand and follow specific rules, is to make them know and understand the values underlying these rules. (Zietlow, Hankin, Seidner, & O'Brien, 2018 & Gallagher & Radcliffe, 2002) This also helps to prevent employees from mistakenly understanding work instructions as procedures when applying Financial Policies, while the latter simply where derived to follow the former and in the end fulfill the intention of the policy.

What is more, it proved to be successful that not-for-profits aim at creating a climate of participation, which is characterized by flat hierarchical structure, high degrees of individuality inducing participation and creativity and boosting personal commitment and attachment to the organizational goals. (Boukaert & Vandehove, 1998) As survey-based research has shown, the high degree of individuality is ideally also combined with personal accountability. If everyone is held responsible for his or her individual actions, the adherence to ethical guidelines is higher. Not surprisingly, the survey also underlined the importance of consistency, in the application of guidelines as well as in the communication about practices. (Ethics and Compliance Initiative, 2019) Additionally, the organizations should provide employees with trustworthy points to file any enquiries on how to deal with an encountered ethical issue. These points can also collect employees experiences with the guidelines, to understand via regular monitoring if the environment has changed in a way that demands amendment to the existing guidelines. (Zietlow, Hankin, Seidner, & O'Brien, Ethics, 2018)

Finally, the organizations management plays an important role in ensuring compliance with the mission. (Boukaert & Vandehove, 1998) This responsibility is of course also born by managers of entities outside the third sector but given the special implications of NPOs social liability towards the ones, who entrusted them to work with their money towards serving the needs of the groups, they declared to serve.

It must be understood that during daily business, the ethically correct decision is not always obvious but often the different options of acting are to be found in grey zones. Zietlow, Hankin, Seidner, & O'Brien (2018) suggest to examine every ethical consideration using three categories, called ‘tiers’. The lowest and first tier is concerned with respecting the legal requirements and has to be considered by any actor in the organization at any time. The second-higher tier asks the question if an impartial observer from outside would qualify the organizations behaviour as ethical, prudent and informed, as well as beneficial to all parties involved. The third tier takes the judgement to another level and asks if the behaviour is indeed contributing to a greater good to an extent that the people it conducts business with, enjoy benefits from the operations, while the organization itsself might even incur cost.

Deviations from ethical behaviour can lead to disproportionately high damage to any NPOs operations and it is important for the organizational authorities as well as any member of the organization to keep that in mind when conducting daily activities. As it had been shown in the chapter on recent trends in the NPO environment, already a shift regarding the practices used, in this case a shift towards more business-like practices, can be so meaningful that it changes the organizations orientation in a way that might violate the mission. If a formerly strong advocacy-organization happens to be so donor-oriented, that it looses its uprooting momentum, it is highly questionable if the benefits of the new orientation outweigh the ethically questionable deviation from the original activities. Therefore, when proceeding to the next chapter, which develops a review of NPOs liquidity management practices, as well as possibilities to improve these practices according to current challenges, the presented ideas and considerations regarding ethical standards have to be present constantly.

4. Liquidity Management in NPOs

In recent years, NPO-liquidity management has moved more and more towards the center of attention – of the general public as well as of industry specialists. This increasing interest can for sure be attributed to the economic downturn in 2008/09 and the wide-spread appearance of cash-crunches in the aftermath of this period of recession, as it had already been mentioned above. In the following, a definition of liquidity management in the NPO-context will be developed, as well as a depiction of its determining factors and an outlook on the future of the sector.

a. Financial Management Theory & Financial Goal-Setting for NPOs

Already 30 years ago, before the bigger financial crises of the past years, researchers came to understand, that financial management for NPOs does not work according to the same mechanisms and rules as in the for-profit world (Meliones, 2000; Sinclair, Hooper, & Lei, 2009; & Zietlow, 2010). Given that the benefits arising from ownership, do not exist in the same way in the NPO-

world, where the emphasize lies on goal-orientation rather than wealth maximization, the normally followed planning and decision-making processes cannot be applied here.
The first step undertaken in financial management theory to take these different conditions into account, was to split management for mission attainment and management for financial stability and prosperity. While any organization, non-profit or for-profit, might employ a general manager and specialized financial management personnel at the same time, for non-profits the differences in their goal orientation seems to be bigger, leading to a very pronounced dual structure: since sustaining organizations financial health is a prerequisite but not a guarantee for mission attainment, one manager focuses attention on the latter while the financial management professional focuses on the financial side. In the for-profit world, these functions might overlap more, while for the NPO-context it can in fact be crucial that the financial manager focuses his attention exclusively on financial goals. Even though it might be tempting to simply develop a way to monetize the social welfare generated by mission achievement instead of the suggested dual structure, experience showed that this practice often leads to illiquidity, since monetized utility cannot be used to pay bills, repay debt or fulfill any other financial obligations that an organization might find itself confronted with. (Wacht, 1984)

After having defined NPOs liquidity management dimensions and having developed an idea about its importance as well as the position of management professionals, these insights in the dimensions of liquidity management and within that into the role of financial management personnel shall in the following provide landmarks for policy development and financial goal setting. Important for organizations to be kept in mind, are the implications of ethical considerations, which were discussed in greater detail in chapter three. Professional education in management school does often not attribute enough importance to these areas of education, leaving young professionals without clearly defined ideas about these considerations and their implications on daily practice.

Regarding liquidity-management as a subcategory of the broad category denominated financial management, experience showed, successful non-profits orient their financial management actions towards an approximate liquidity target (ALT) which can be received by adding up cash and cash-equivalents, short-term investments and unused borrowing capacity. This sum has to be put into context with the amount of risk an organization can recoup – in the section on financial ratios, a measure called ‘lambda’ will be introduced to facilitate the inclusion of risk in liquidity-measurement. The organizational actions are then planned and undertaken according to the developed liquidity-target. The last concept, unused borrowing capacity, is especially meaningful in the NPO-context, because its scope gives an idea about the operating cash-flows an organization normally generates. Since most NPOs do not have inventory or other assets that could help credit institutions to determine the adequate credit line, its scope is based on the projected future cash-flows. (Zietlow, 2010)

The following sections are dedicated to taking a closer look on the described elements and show how these elements should work in concert with each other to allow for financial soundness.

b. Defining liquidity in the NPO-world

For every organization, there is a variety of stakeholders and related actors that are interested in understanding how liquid an organization is at a given point in time. Starting from donors, there are as well banks, rating agencies, creditors and other types of lenders. Many supporters include liquidity as a central part in their considerations regarding the sustainability of an organization. Depending on the type of stakeholder, the sophistication of the assumptions about the proper definition of liquidity may vary greatly. While some might understand it as just the amount of cash an organization holds, others, such as rating agencies and accounting standards development boards, do often have a very detailed and precise concept of liquidity measures. (Klump & Cole, 2014) What creates difficulties in understanding an organization’s liquidity and even more, benchmarking it, is the variety of measures that is used to arrive at conclusions about organizational liquidity.

Especially regarding the comparison with other organizations, Klumpp & Cole (2014) point out that a lack of information regarding the organizations investment policy, a lack of information regarding how organizations plan to meet short-term financial needs and difficulties arising from the complexity of restricted funds and fund-designations made by the board can often be identified. Nevertheless, several measures are being applied to standaradize NPO’s information-giving about their liquidity as much as possible. Furthermore, apart from outside stakeholders, it might as well be the organization’s internal management that wishes to gain a better understanding of how the organization is doing compared to other, similar types of organizations. In the following, several views on liquidity will be assessed, choosing one definition which will serve as the basis for the following analysis and development of an appropriate liquidity target.

To begin with, it is worthwhile to look at liquidity from an accounting perspective. Since the main aim of accounting is to deliver a depiction of an organization's assets and liabilities at a given point in time, it also provides a snapshot of an organization's conditions regarding liquidity. The American Financial Accounting Standards Board (FASB) developed codified standards regarding liquidity, financial flexibility and liquidity risk, with the first one being defined as the nearness of an asset or liability to cash, subject to donor-restrictions on conversion. Financial flexibility denotes the capability of an organization to develop adequate and timely responses to unexpected financial needs by changing the cash-flow structure. For liquidity risk, the definition has not been set out clearly, but it can be understood as the measures regarding an organization's ability to meet its obligations. It must be noted that it is not always obvious to which of these areas related to liquidity, an item from an organization's balance sheets contributes. Borrowing for instance, might well contribute to a company's financial flexibility but cannot be classified as a liquid asset. (Klumpp & Cole, 2014)

Taking the 'accounting-glasses' off again, and turning towards the definition provided by Zietlow (2010), when analyzing the impact of changes in the economic situation on the sector, which will be analyzed in greater detail in one of the next sections, a broader and more complete view to the above-described aspects of liquidity is introduced: First and foremost, organizations experiencing perpetuated cash-crunches need to understand that liquidity management is the root of their issues. Furthermore, organizations need to evolve over time, since the financial objective pursued in the first years after being founded is often merely to break-even. Obviously, the bigger and more complex an organization's operations get with time, this view is not adequate anymore. The more promising definition of liquidity, according to Zietlow (2010), is one consisting of several tiers rather than one just focusing on one of the following aspects: Operating budget, solvency, narrow liquidity and financial flexibility.

The introduced concept of solvency denotes the amount of assets an organization holds relative to its liabilities. It is one way to understand how well the raw material is transformed to liquidity in the course of operations. One issue with the ratios used to measure solvency, which will be described in detail in the section on ratio analysis and liquidity, is that they can only show approximations on the company's abilities to meet its obligations, since cash is the only means to pay bills and any asset has to be transformed to cash first, before it can be used to settle obligations. The solvency-measures are computed based on Financial Statements, which means that they are developed by using a stock-, rather than a flow-concept. (Zietlow & Seidner, 2007) A set of popular solvency measures is computed using an index to determine relative liquidity. This approach proved to be successful to measure long-term solvency, though it can be challenging to arrive at a comprehensive relative liquidity-index, since one must determine an adequate probability distribution to arrive at a good sample estimate. (Emery & Cogger, 1982)

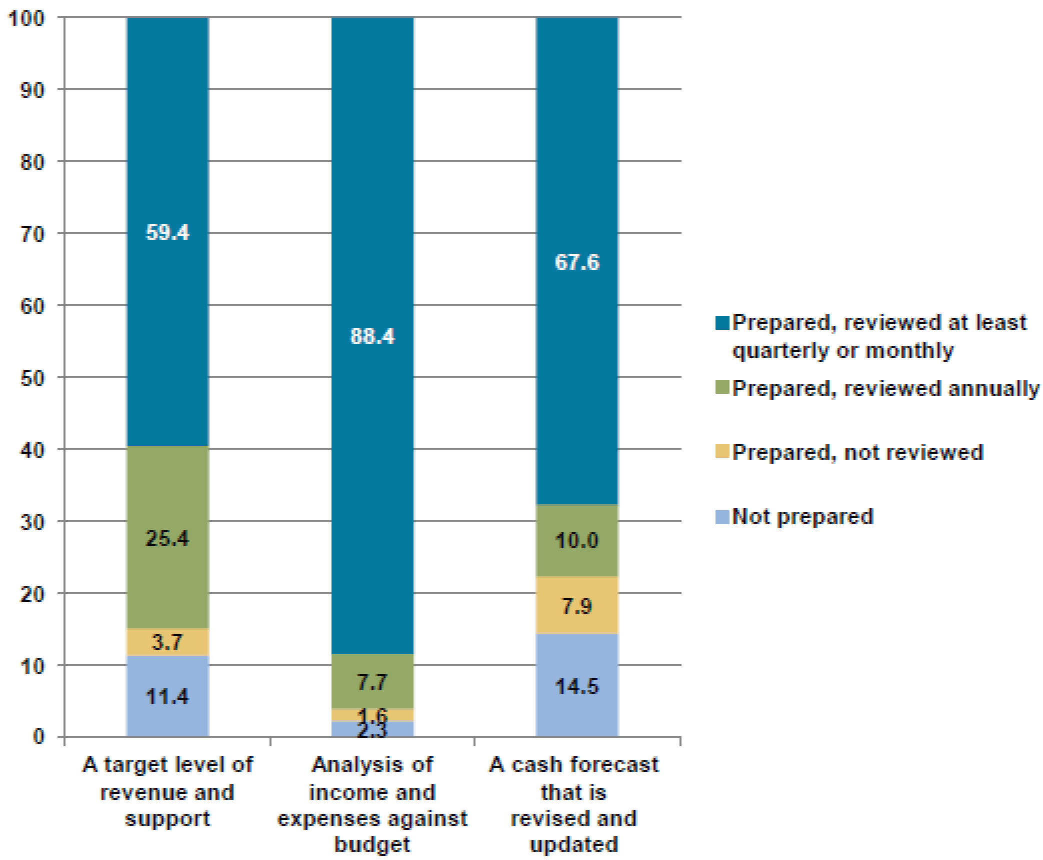
The understanding of liquidity starts from solvency combined with an evaluation regarding timing – namely the time needed to convert the assets into cash or settle the liabilities with the adequate amount. The given definition of liquidity has, as an underlying idea, an interesting thinking experiment, as if the organization was liquidated and all the single items are being sold at their book values – the theoretically achieved selling revenues are then compared to the organization's liabilities.

Liquidity measures, which will also be specified in the section on financial ratios, are also an advancement to solvency measures because they incorporate the notion that the balance sheet does at the given stage not incorporate all the cash inflows and outflows that happen during a year of organizational activity. Zietlow (2010) specifies in his work that this definition of liquidity describes 'narrow liquidity', applicable to short-term financial planning, while long-term financial planning on the other hand requires to broaden management's view towards aiming at achieving financial flexibility for your organization.

Organizational practices to achieve financial flexibility start already with consuming unused credit lines, a common operation in the for-profit sector and as well in the not-for-profit environment. In the NPO-logic, due to their strong orientation on mission-achievement, financial flexibility allows an organization to expand their current programs and add to services on demand, while being confronted with rather unstable cash-flows. To be financially flexible, an organization must be able to increase future cash-flows if needed, which also means that the organization must be able to project that increase in future cash-flows reasonably precise and that the developed financial policies must be based on these projections. Of course, not every increase of financial need that happens is foreseeable, so also the ability to react spontaneously is an important contribution to true financial flexibility. (Zietlow & Seidner, 2007) The scope of flexibility exceeds the definition of solvency and liquidity: Therefore, it provides an understanding of the reputation, which is also connected to the second point, the organizations ability to exploit or extend credit lines and to issue debt or equity. The latter is, in Italy and the US, not legally possible for the organization itself but requires the set-up of for-profit subsidiaries (a practice that should be accompanied by appropriate accounting policies to deliver a truthful image of an organization's financial status to its stakeholders). Furthermore, statements on an organizations financial flexibility inform about the ability to sell assets and lease them back and the ability to take on additional lending which is mostly determined by the availability of collaterals. (Zietlow, Hankin, Seidner, & O'Brien, 2018)

Combining the defined terms, narrow liquidity, solvency and financial flexibility with sound budgeting practices allows the organizations financial managers to arrive at a broader view on liquidity. This framework of definitions is based on the understanding "that a nonprofit's primary management objective is to achieve its mission and that its primary financial objective is 'to ensure that financial resources are available when needed, as needed, and at reasonable cost, and are protected from financial impairment and spent according to mission and donor purposes", according to (Zietlow, Hankin, & Seidner, 2007) To better understand at which point an organization is on the path to achieving the above-described understanding and taking every-day actions accordingly, phases of organizational evolvement are developed and categorized by name. These categories will be described and put in context in the section on financial policy-making and organizational development. Regarding the related sector-practices, one can observe, that the attention given towards more strategic financial management is still rather low. If organizations work with setting target levels of revenue, a big part of them does not recognize the need to review these targets and while the analysis of income and expenses against budget is a commonly adapted practice, this cannot be said for the set-up of cash forecasts. Though the latter is widely adapted as a practice, the need for constant review, which is necessary to make this tool valuable, is not understood on a broad scale. (See Figure 1)

Figure 1: Percentage of Organizations that prepared and reviewed Target Level of Support, Budget Analysis and Cash Forecast (%)



Source: Moodys Foundation. (2011). *Financial Literacy and Knowledge in the NPO-sector.*

Putting back on to the 'accounting-glasses' of the FASB, in addition to the definition, guidelines for providing a clearer picture of an organization's liquidity for outsiders as well as members, can be found. In the light of the high complexity of NPO-cash flows, one of the most important information the Financial Statement must contain, is a detailed picture on the restrictions the organization faces regarding the use of its assets, which can be imposed by donors, contractual agreements and legal requirements. In order to do so, several actions are being proposed, some of which are generally valued standards in the for-profit world: First and foremost, it is important to classify assets and liabilities in current and non-current ones. Secondly, it is advised to sequence the assets according to the quickness and easiness with which they can be converted to cash. Thirdly, the notes of the Financial Statement must give additional information on the restrictions that an organization's funds are subject to. Furthermore, the Financial Statements should provide information on the amount of financial assets being held at the end of the period, the scope of liabilities that need to be settled soon, as well as the part of financial assets that cannot be used to settle near-term liabilities, due to restrictions. Finally, an organization should inform its stakeholders about its liquidity management practices, particularly about the applied timeframe and the used sources of cash, as well as their hierarchy in the organizations cash-flow structure. (Klumpp & Cole, 2014)

After portraying these isolated views and concepts on liquidity, it is important to notice that not all organizations have already adopted such an understanding of liquidity-related topics and are often still oriented towards cost-minimization while maintaining liquidity. (Wacht, 1984) In one of the following sections on development, execution and review of liquidity management policies, a framework will be introduced to understand in which stage of liquidity management an organization can be found, and which actions would be necessary to evolve.

Above all, it seems advisable for organizations to keep an eye on their closer competitors to spot the sector's best practices and learn from those. (Klump & Cole, 2014) To identify these practices, performance measurement and analysis are needed, which will be further discussed in one of the following sections on financial ratio analysis.

c. Why is liquidity management crucial in the NPO world?

The importance of liquidity management has seen growing attention in the non-profit world in the past years. This development encountered strong resistance, due to the strong implications of the sector-specific view on holding excess cash. The mission-driven nature of NPOs and the entailed expectations that are held by stakeholders and supporters lead to a highly negative image of holding more cash than needed to meet current responsibilities. (Wiley Periodicals, 2017) Organization's management often exacerbates the situation, lacking the topic-specific educational background and being highly mission-oriented. (Ebrahim, 2003) After a long history of several smaller cash-crunch crises, which affected different organizations in different ways, depending on their main donors and their revenue structures, the financial crisis of 2007/08 brought the necessary push for a bigger shift within the industry. Being confronted with exploding service-demand on the one hand and reduced financial support due to cuts in government funding and drastic cuts on funding by donors on the other hand, organizations started to acknowledge that the nature of their operations and the underlying mission, need a different approach to liquidity management. (Zietlow, Hankin, Seidner, & O'Brien, 2018 & Wiley, 2004)

The state of an economy, as well as any changes of its indicators, directly affect NPOs business. Since an NPO does not offer its products in a marketplace to a range of consumers, it might not be obvious, how economic forces have an impact on NPOs day-to-day business. To better understand the most-important dynamics and their effects, which is crucial to determine adequate financial goals and an appropriate liquidity target, the following paragraphs give a quick overview of the relevant economic factors and the nature of their impact.

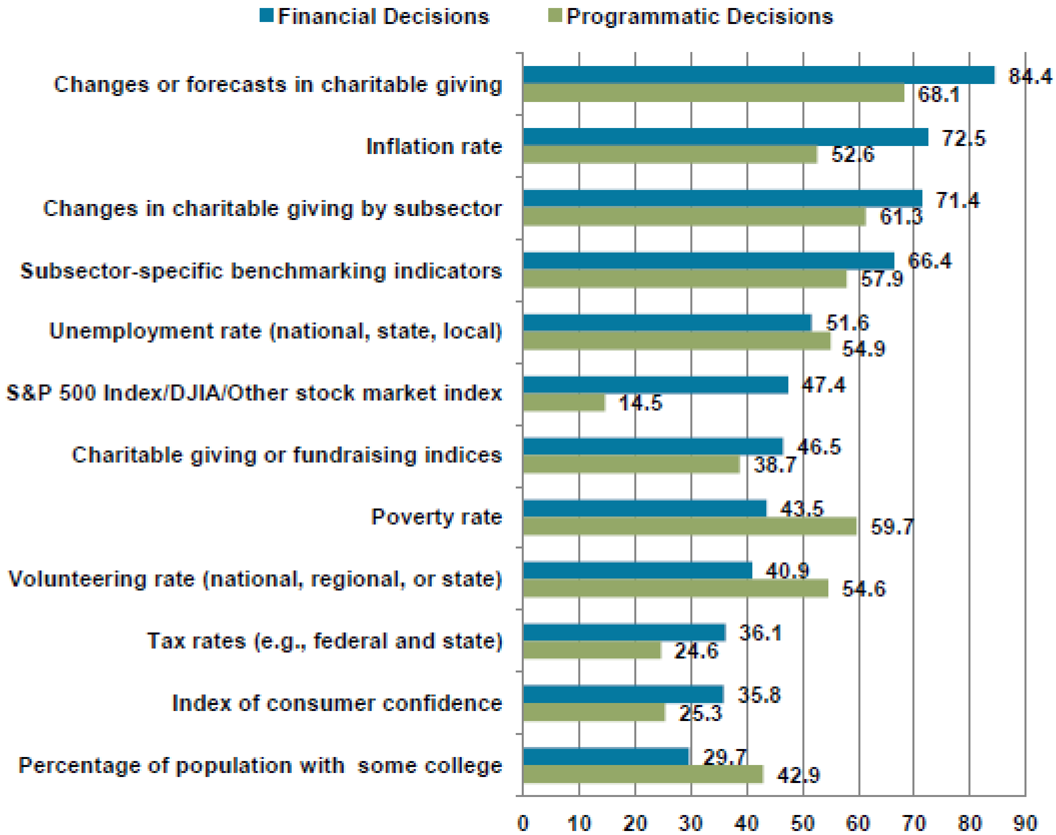
The third sector is directly affected by changes in an economies growth rates, since these translate to higher unemployment, lower real incomes and a lot of uncertainty among the general population regarding the future of their retirement plans, savings or fear of inflation. Service demand rises while the ability and willingness of donors to contribute sinks, leading to a paradox and problematic situation for organizations. When consumers' willingness to consume sinks, the confidence to spend money for charitable purposes sinks as well. What is more, NPOs revenues from paid services are also declining during these periods, since general consumption expenses are declining. What might partially offset the negative effects might be a rise in volunteer-contributions, as well as the sudden availability of highly qualified management executives, which find themselves without an adequate position, due to the crisis. Government-reactions to precarious economic situation in the form of tax-reductions or cuts on the budget deficit are often long anticipated by organizations without any substantial results, as it could be observed in the US after 2008/09. (Zietlow, 2010)

Rises or declines in indices of the stock- and housing market do as well have a direct and indirect influence on NPOs operations in many aspects. Indirectly, donors cut down their giving, as they see their wealth in form of property or their portfolio decline. The direct impact mostly comprises declines in the endowment funds owned by organizations (Zietlow, 2010) Endowments are funds, held by NPOs for investment – often, there are detailed restrictions on when and how an NPO can tap the funds, as well as on how interest income, if existent, is being spent. (Zietlow, Hankin, Seidner, & O'Brien, 2018) In case of declines in equity- and housing markets, endowments, as well as their income streams, see a drop in value.

Furthermore, economic downturns also entail credit crunches, affecting especially smaller non-profits, which might not be able to provide any extra-collateral to attain funding or extensions of their credit line. Possible donors might be affected by a credit-crunch as well, leading to lower giving. These two adverse effects are offset by lower interest rates, introduced by central banks as a counter-crisis measure. Apart from central banks and financial institutions, political institutions and their decisions do also directly affect any NPOs operations. As Zietlow (2010) makes the example for the US-market, monetary policy changes the value of the domestic currency, relative to foreign currencies in which NPOs might provide services or perform sourcing activities. Among a wide range of effects, monetary policy does influence growth in real or numerical terms and inflation rates, which do – as mentioned above, influence donor's willingness and ability to spend and more importantly, nurture a general feeling of insecurity regarding the future economic situation. This is certainly not forming an encouraging environment for neither donations nor for non-profits to undertake unpopular decisions regarding provisions to ensure future liquidity, though these activities might in those times be more important than ever. During the last years from 2012 until now, gross domestic product (GDP) and inflation-rates in the US were fluctuating between 1,57% and 2,88% and between 0,12% and 3,14% respectively. (Statista, 2019) Compared to historical fluctuations, it can be understood that in the years since the crisis, these fluctuations have stabilized around a certain level, it goes beyond the scope of this paper to understand if these developments contributed to a greater sense of security among donors or not. (coinnews mediagroup LL, 2018)

Apart from that, many NPOs, among them the biggest and most successful ones, rely heavily on government grants as a source of funding and are highly affected by cuts, which means that political decisions regarding spending directly affect their operations. (Foster & Fine, 2007) Looking at research regarding NPO's use of indicators (see Figure 2) to guide their programmatic and financial decision-making, it becomes apparent, that industry practice and theoretical insights converge only partly. While some indicators, such as inflation rates and projections of charitable giving, are widely recognized and used as decisive factors for financial management's decision-making, other factors, such as consumer confidence indices are underutilized. (Moodys Foundation, 2011)

Figure 2: Use of Indicators for Programmatic and Financial Decision-Making



Source: Moodys Foundation. (2011). *Financial Literacy and Knowledge in the NPO-sector.*

Regarding reserves, a sub-category of liquidity management, due to above-mentioned reasons, the following should be added: organizations reach a higher level of autonomy and self-dependency by employing appropriate liquidity-management measures, such as holding enough cash reserves. They are less affected by market-risks, they are less likely to be confronted with situations where they need to compromise on their long-term mission-oriented goals to survive financially in the short-term and last but not least, they are better prepared to counter industry-specific risks. (Paul, Joseph, Mark, & Matt, 2012)

Apart from the impact of economic developments and risks, various features of non-profits do itself present strong reasons to pay more attention to liquidity management. While in the for-profit world, maximization of profit is the clear stand-alone objective and allows to manage accordingly, in the non-profit world goals are more complex and often amorphous. This becomes even more apparent when turning attention towards performance measurement: In the for-profit world, shareholders and company-owners use measures directly related to the financial soundness of a venture, such as profitability, to understand how well the organization performs. (Kaplan, 2001) Given this omnipresence of financial objectives in the for-profit world, one must consider how in the NPO-world these can be understood as barriers to mission attainment. In these organizations, even the financial managers happen to be so strongly mission-oriented, that they do not put the financial aspect of their decisions at the center of their decision-making process. Consequently, organizations take on projects which don't have any connection to their mission and their capabilities and since these primary goals are not fulfilled, one can question if there will be any thought given to the financial aspects of their decisions. Kaplan (2001) gives the example of an international relief agency, taking on a land-mine relief project without understanding how well they are equipped to contribute in that field in a sustainable and meaningful way, relative to other actors in the sector.

In the non-profit world it can be more crucial for success to decide which projects not to take on, than to decide which projects to take on. Liquidity management can contribute significantly to a solid decision basis for understanding which initiatives to undertake and which ones are better left to another organization or another point in time.

In the following sections, special attention will be given to NPO cash-flows structures as well as some selected parts of organizational liquidity management. In the discussion of these specific elements of adequate liquidity management, the main factors supporting their use will be given and a context with other tiers of liquidity management will be provided.

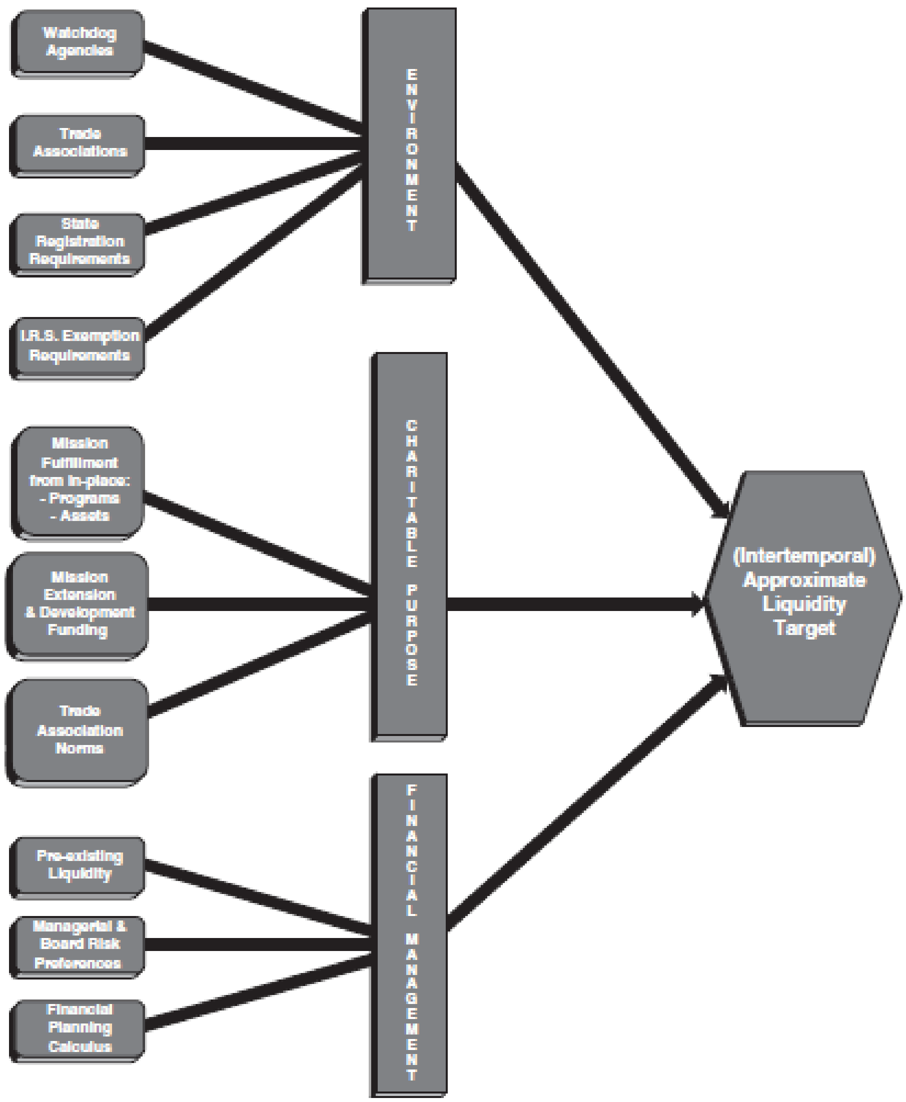
d. Appropriate liquidity target (ALT)

Above all the subordinate aspects of liquidity management that will be discussed in the following, one of the most intuitive actions to undertake to allow for professional liquidity management, is for sure the setup of a quantified liquidity target. This target level can be an orientation for the organization to be kept within sight throughout exercising operations and financial management related activities. This also means that the organizational cash reserves do not have to amount to exactly that given amount at any time throughout the year, but that they can instead be above or below that target, if these diversions happen in a certain range, close to that target. (Zietlow, Hankin, Seidner, & Timothy, 2018)

The suggestion of the authors is to take this appropriate liquidity target as the primary financial objective of an organization's activities. The reasons to do so are diverse but above all, many other financial objectives, such as accurate accountability, are the central focus of other areas of management or even external stakeholders to the company – for the case of accountability, that would be the organization's auditors or regulatory bodies. The non-profit world is complex, not only due to the different restrictions and conditions placed on funding, making organization's access to funding considerably difficult in many cases, but also due to the community of different stakeholders. As a further refined graphic of the appropriate liquidity target model and its determinants shows how all the stakeholders and NPO-specific factors or goals feed into the appropriate liquidity target (Figure 3). The calculus-part of the depiction comprises management philosophy factors as well as infrastructure that allows for the drafting of budgets and financial statements.

As already mentioned above, the ALT does not have to be exactly reached to be recognized as such and does provide the necessary foundation for an organization to keep the focus on mission-attainment, which does in turn allow for necessary product expansion and the constant attraction of new donors and sources of funding, as these get more and more aware of the importance of liquidity for mission attainment. (Zietlow, Hankin, Seidner, & O'Brien, 2018)

Figure 3 - Intertemporal Appropriate Liquidity Target Model



Source: Zietlow, J., Hankin, J. A., Seidner, A., & O'Brien, T. (2018). *Financial Management for Non-Profit Organisations: Policies and Practices.* John Wiley and Sons.

The ALT cannot have a generic level across different organizations and sectors, since it is in any case linked closely to organizational activities and first and foremost also to the organizations level of revenues as well as the level of liabilities they need to cover.

e. Ratio analysis & liquidity

Financial ratio analysis is a valuable tool to assess an organizations' overall financial condition and its liquidity. It can also help to determine areas in your organizational performance that need improvement. Several actors within the NPO-sector developed ideas about the best ratios to be applied in the NPO-context.

Among these, Klump and Cole (2014) identify three ratios as being the three most important ones: the current ratio, the quick ratio and the organizational liquidity funds indicator. To compute the current ratio, they divide current assets through current liabilities and suggest a target-ratio of 2-3, indicating that the organization has enough assets to meet its near-term liabilities.

$$\frac{current\ assets}{current\ liabilities} = \text{current ratio}$$

The quick ratio is being computed similar to the current ratio apart from deducting the inventory from the current assets before dividing. Here the suggested target is 1-2 which means that you can meet your liabilities without having to touch your inventory.

$$\frac{(current\ assets - inventory)}{current\ liabilities} = \text{quick ratio}$$

The organizational liquidity funds indicator is computed in two steps: First, one needs to compute the expendable net assets by subtracting restricted endowments, fixed assets and prepaid expenses from net assets. Secondly, the expendable net assets are being divided by the monthly total average expenses.

$$\frac{expendable\ net\ assets}{monthly\ total\ average\ expenses} = \text{liquidity funds indicator}$$

$$\begin{aligned} expendable\ net\ assets &= net\ assets - restricted\ endowments - fixed\ assets \\ &\quad - prepaid\ expenses \end{aligned}$$

This last suggested measure tells an organization how long it can pay its expenses before having to touch the liquid assets it holds, under the assumption that there are no other sources of revenue. For this last ratio, the organizations desire it to be as high as possible.

In the course of developing a broad definition of liquidity, Zietlow (2010) also provides several related performance measures to quantify the organizations condition along the specified dimensions of liquidity. Regarding the measurement of organizational solvency, in addition to the current ratio and the quick ratio as described above, net-working capital and the asset ratio are introduced. Net working capital is calculated by subtracting the current liabilities from the current assets and the asset ratio is received by dividing the current assets by the total assets.

$$current\ assets - current\ liabilities = net\ working\ capital$$

$$\frac{current\ assets}{total\ assets} = \text{asset ratio}$$

The net working capital ratio an organization targets does depend on the sector it operates in, as the asset-intensity of an organizations operations might vary due to the sector it operates in – a hospital will have different needs regarding the use of assets to fulfill its mission than a faith-based organization supporting school children with difficult social background.

What adds to the informative quality of all these measures is the fact that they include working-capital positions such as accounts receivable, accounts payable, accrued expenses or inventory. Nevertheless, since some of these working capital positions take more time to be converted into cash, some professionals developed more conservative measures of NPOs' liquidity, being focused on cash positions which are disposable. Two measures are proposed under this last viewpoint: the cash ratio, received by dividing cash and cash equivalents by current liabilities and the net liquid balance, received by subtracting short-term notes payable and the current share of long-term debt from cash and short-term investments.

$$\frac{cash\ \&\ cash\ equivalents}{current\ liabilities} = \text{cash ratio}$$

$$(Cash \,\&\, short\ term\ investments) -$$
$$(short\ term\ notes\ payable \,\&\, current\ share\ of\ long\ term\ debt)$$
$$=$$
$$\text{Net liquid balance}$$

The amounts used in the cash-position of the ratio's formula should ideally contain only unrestricted funds. (Zietlow, Hankin, & Seidner, 2007) Obviously, higher ratios are desirable for the just-introduced conservative solvency measures.

Moving on from measuring solvency to measuring liquidity, the focus of attention switches to a company's cash-flow statements and other cash-related measures. Zietlow (2010) suggests, among the different cash-flow measures included in a company's statement of cash-flows, to use cash from operations. To do so, he introduces four straight-forward measures and computes them as it follows:

- cash conversion efficiency: divide cash from operations through revenues
- cash conversion cycle: days sales outstanding + days inventory held – days payables outstanding
- cash reserves ratio: divide cash and cash equivalents through annual expenses
- current liquidity index: add cash, short-term investments and incoming operating cash-flow

$$\frac{cash\ from\ operations}{revenues} = \text{cash conversion efficiency}$$

$$\frac{cash \,\&\, cash\ equivalents}{annual\ expenses} = \text{cash reserves ratio}$$

$$days\ sales\ outstanding\ + days\ inventory\ held$$
$$- days\ payable\ outstanding\ = cash\ conversion\ cycle$$

$$cash \; + short\ term\ investments \; + operating\ cash\ flow = \text{current liquidity index}$$

As another measure for broad liquidity, Lambda is introduced as a measure to understand how likely the organization will run out of cash and when it will do so – it provides organizations with a way to handle uncertain cash-flows. It is more than a liquidity measure, since it captures aspects of the organizations financial flexibility by measuring the organizational capacity regarding unused short-term debt. To be able to compute Lambda, a new measure must be introduced, dedicated to delivering an image of the riskiness of the organization's projected cash-flows. The basis for developing this riskiness measure is formed by historical operating cash-flows. Then the organization needs to develop a projection of its operating cash-flows to which it adds the unused short-term lending capacity, cash and cash equivalents and short-term investments. (Zietlow, 2010) From all the presented measures and ratios, lambda is for sure most suitable to make a well-informed judgement on the organizations narrow-liquidity conditions.

$$cash \; + short\ term\ investments \; + unused\ short\ term\ borrowing\ capacity = initial\ liquid\ reserve$$

$$\frac{initital\ liquid\ reserve + projected\ operating\ cash\ flow}{STD\ of\ operating\ cash\ flows} = \text{lambda}$$

STD in the formula denotes standard deviation. Lambda measures the probability of running out of cash over the planning period and can be compared to the z-score frequently used in statistics (Zietlow, 2010).

Moving on from narrow liquidity to the next broader concept, one arrives at financial flexibility, which cannot be captured by any of the straight-forward measures introduced above but by understanding an organizations condition along several dimensions: the stability of its operating cash-flows (most favorable if these cash-flows do not stem from governments but are generated by the organization itself), low debt-ratios, potential to exploit granted credit-lines and the existence of stable donors which do in the best case also possess potential to expand their giving in case of emergencies or program expansions. (Zietlow, 2010)

Given the complex nature of this financial dimension, the literature reviewed did not make any suggestions regarding a measure for financial flexibility, neither did the case studies bring a measure for financial flexibility to light. In the following, an attempt is made to suggest a measure to determine and quantify an organizations financial flexibility.

This measure would need to take several factors into account, external and internal ones: First and foremost, it has to capture the organizations ability to source additional funding quickly, meaning through using unused credit lines or asking additional funds from existing donors. The attraction of new donors is not considered for this purpose, since it is assumed, that this would be too costly and would more importantly take too much time to be suitable as a response to sudden changes in an organization's financial needs. In a first step, it could be a worthwhile exercise to compare the additional liquid funds that the organization can generate to the liquid funds it is holding now, to develop an understanding of the relative size of the new liquid funds -compared to the regular cash-inflows of the organization.

Therefore, it would be suggested to add the organizations unused credit line amounts, if it already requested a credit line with a financial services provider, to the projected future cash inflows. If the organization did not ask for an unused credit line, it would be advisable to liaise with the bank with which the organization collaborates to receive an estimation of the credit line that the organization could be granted, according to their bank. If this is not possible, the organization could quantify the value of the collaterals held, to determine the possible extent of a granted line of credit. For the sake of simplicity, this part of the ratio shall be denoted 'unused credit-line' To this unused credit-line, in the following, the non-operational current assets should be added – to account for assets that the organization does not need to supply their program activities and can liquidate in a period shorter than three months. In a last step, an average of the projected cash-inflows for the next three years shall be added, this projection of cash-inflows would be made, based on past cash-inflows and planned program expansions or other financially relevant activities. The important point is, that at this stage only factors that are internal to the organization, are considered. The sum of these three factors is in the following divided by the average cash-inflows incurred over the past five years. The result shall be denoted cash-inflow step-up, as it denotes the capability of the organization to expand their cash-inflows in the short term.

$$\frac{unused\ credit\ line + current\ assets + projected\ cash\ inflows}{average\ past\ cash\ inflows} =$$

$$\text{cash-inflow step-up potential}$$

In a next step, a measure which includes cash-outflows, as well as factors that are external to the organization, is introduced to complement the above-mentioned measure which is only based on factors related to internal factors.

To do so, the organization performs a projection of cash-outflows. This projection of cash-outflows shall be based on the organizational average cash-flows over the past five years and take into account the changes of external factors most relevant to the organizational operations, meaning among others growth rates, inflation, demographic changes – importantly, at this stage, the loss of major donors is not taken into account. To be able to do so, the changes in the most important external factors would need to be quantified and assigned a probability of seeing the projected change, as well as their impact on organizations program expenses and income from donors. In a next step, a good practice for a program expansion or new project should be chosen from inside the organization and the additional cost that the expansion incurred shall be quantified. If the organization wishes to understand their financial flexibility more related to possible adverse shocks to their cash-inflows, it shall look at a cash-crunch crisis it encountered, and the related financial loss suffered. If the organization did not yet encounter a cash-crunch crisis, the financial manager could consider an event such as the loss of a major donor. The program expansion our adverse financial shock shall be denoted 'additional financial need'.

The above-derived projection of a potential increase in cash-inflows is then put into relative context with the projected cash-outflows plus the financial impact that a program expansion or adverse shock to the organizational liquidity could have. The derived measure shall be called 'financial flexibility index' – the organization would aim at holding this measure as high as possible.

$$\frac{unused\ credit\ line + projected\ cash\ inflows + current\ assets}{projected\ cash\ outflows + additional\ financial\ need} =$$

financial flexibility index

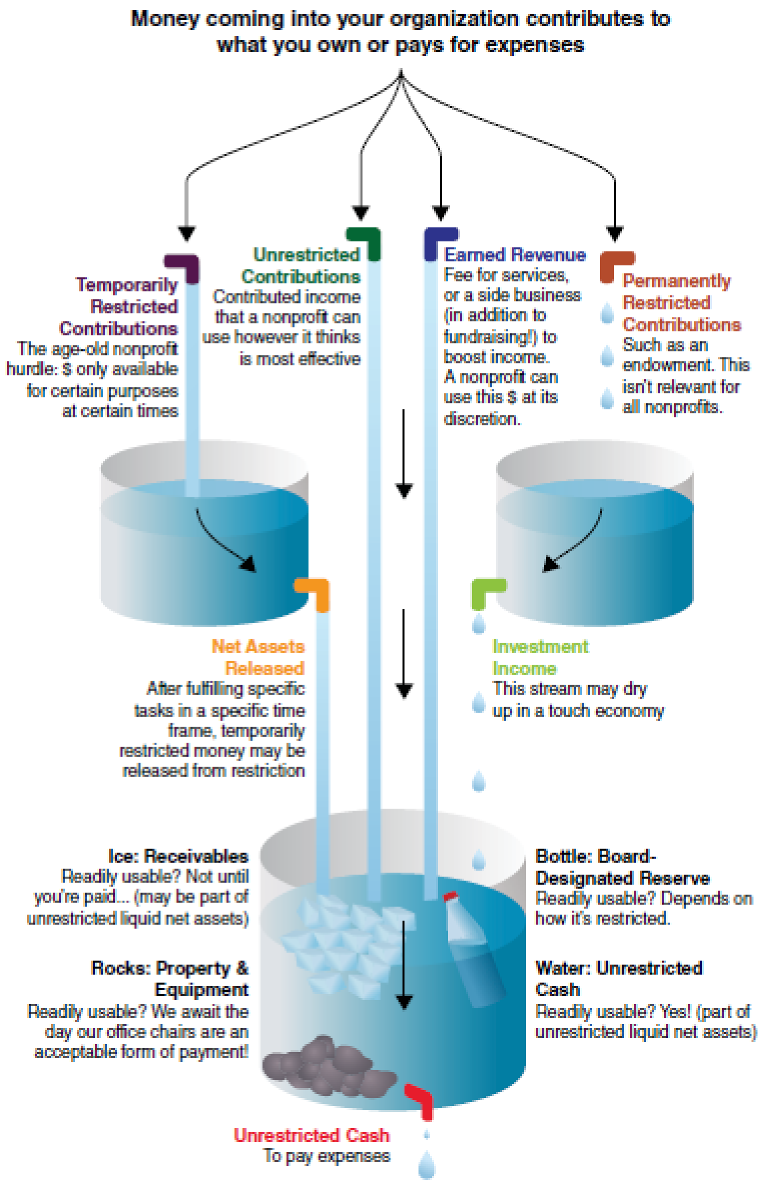
The suggested measure for financial flexibility relies heavily on organization-specific factors. As the case-studies in the last chapter will show, the organizations donor structure has an important impact on the organizational liquidity, especially regarding the flexibility of the organization to adapt quickly top big shifts in terms of financial demands. The measure aims at accounting for this through its adaptability, as well as the individually determined probability of certain risks – close collaboration of the heads of all departments and the executive level would be needed to allow for the development of such a measure.

f. NPO Cash-Flows: Structure & Characteristics

From analyzing the different tiers of liquidity, the next step consists of analyzing the cash-flows generating it. Non-profit cash-flows structures are considerably more complex than in the for-profit world. This can be attributed to the fact that there are many different sources of cash, entailing different consequences. The first distinction can be made between commercial sources of revenues and non-commercial, donative sources. While some non-profits rely on one of these sources solely, others rely on a mix, whose composition is subject to constant changes. (Ecer, Magro, & Sarpca, 2016 & Borgonovi, 2006)

While the commercial revenues are unrestricted and at the free disposal of the organization, the donative revenues are mostly subject to restrictions. These restrictions can be permanent or temporary - in the first case, the funds are held as an endowment income from which the organization generates revenue in the form of interest. In the latter case, organizations must fulfill certain tasks before gaining access to some funds. The preferred sources of funding for most organizations are unrestricted donations or commercially generated funding, since most of it will be freely disposable at any time, except for board-designated reserves, which can only be used according to certain conditions. (Zietlow, Hankin, Seidner, & O'Brien, 2018) Figure 3 gives a complete overview of the cash-inflows in the non-profit sector and the liquidity of some of its assets and can be a valuable tool for financial managers to plan their actions accordingly.

Figure 4: Non-profit cash-inflows



Source: *(Non-profit Finance Fund, 2017)* in (Zietlow, Hankin, Seidner, & O'Brien, Financial Management for Non-Profit Organisations: Policies and Practices, 2018)

In general, it can be expected that financial managers will aim to generate as much unrestricted funds as possible, since the assignment is least complicated with these kinds of funds. As it will be discussed in the chapter on reserves planning, to be able to perform strategic planning, organizations need to have access to a certain amount of unrestricted funding. What seems to be an important and decisive factor for NPOs regarding long-term and sustainable capacity building, is the attitude of donors towards giving. If donors understand the benefit of leaving funds at NPO's discretion, challenges regarding cash-flows crunches can be resolved before they even arise. (Wiley, 2017) Of course, unrestricted funding does also provide room for abuse and even though the NPO sector is characterized by a very strong mission-orientation, this does not mean that abuse of funding does never occur. The section on endowments will discuss these issues further and explain why especially endowments receive special attention from donors suspecting abusive use of their giving.

Nevertheless, some of the most successful NPO's in terms of size of the organization and their operations followed a different logic to reach their success: They focused their fund-sourcing activities on specific donor-types, via step-by-step adaptation to the information needs and interest focus of these donors. (Foster & Fine, 2007) Obviously, the increased efficiency is in this case counterbalanced by higher dependency of those large-scale donors, which also entails little risk-distribution.

g. Endowments role in liquidity management

To begin with, two types of endowments need to be distinguished, true endowments and quasi-endowments. True endowments pay only a certain interest income, while the principal itself cannot be used. Quasi-endowments are different, as the organization can also use the principal-funds, under the condition of respecting certain predetermined rules regarding the usage. (Non-Profit business advisor, 2014) The investment can take any kind of form regarding the used assets, ranging from stocks and bonds, over venture capital to property. (Helms, Henkin, & Murray, 2005) As a fixed part of any non-profit's financial management, endowments are an important tool for financial managers to protect an organization against diverse instabilities and shocks in the incoming stream of funds. (Glaeser, The Governance of Not-for-Profit Organizations, 2003) As it is neither in the interest of the donors, nor of the organization's financial managers that adverse financial shocks are passed on to the organization's beneficiaries via program cuts, at a first glance, it should be in the interest of both groups that an organization sets up endowment funds.

In practice, the power that is left to the management for deciding on the use of these endowment funds, does in some cases lead to abuse. Unlike in the for-profit world, where elements of corporate control give shareholders significant power over an organization's operations, in the non-profit world, organizations and their management often remain very independent in their decisions from donor's preferences. This could be observed especially in big organizations holding large endowment funds. Given the fact that non-profit leading managers are mostly selected from the former pool of top-level employees, some NPOs do in the end resemble a worker's cooperative and instead of serving their original donor's interests, they cater to the interests of the employees. What must be taken into account, when following this line of thought, is the strong altruistic motivation that is typical to NPO-sector's executives, which can of course be completely in tune with donor's motivation to donate. Apart from that, the third sector is not completely free of any competitive pressure, since organizations face steady pressure to compete for donations and funds, which means that there is ultimately no complete absence of mechanisms that pressure for behavior according to donor's preferences and interests. (Glaeser, 2002)

In the light of these issues, why are endowments funds still one of the most commonly used tools in the third sector? (Moodys Foundation, 2011) As various authors point out and as it was mentioned across different sections of this paper, organizations need to have discretionary income to be able to maintain their current service-level, as well as to invest in their program initiatives with an outlook on sustaining future service provision in an adequate manner. (Helms, Henkin, & Murray, 2005; Sinclair, Hooper, & Lei, 2009; Paul, Joseph, Mark, & Matt, 2012; Wiley, 2017) The awareness for this, though already in existence before, has been growing since the recession of 2007/08 and the entailed cash-crunch crises, happening across different industries within the third sector. Endowment funds, among others, are an important tool to guarantee availability of this type of discretionary financial resource that can help to prevent the occurrence and adverse effects of such crises. The decisive factor here is the stability of the cash inflows, which is higher for endowment income than for other financial sources, e.g. commercial income. (Non-Profit business advisor, 2014)

Still, one could ask the question, why donors do not simply promise to make up for shortfalls in funding in the future, instead of leaving money in an endowment. The reasoning is quite straightforward: To have to source additional funding might in the end only cause additional costs to the organization in the case of unexpected needs. (Glaeser, 2003) This is obviously not in the best interest of managers, but also not in the best interest of donors, that want the organization to invest the biggest share of their funds into their program and services. Apart from that, even if they entrust an organization with and endowment fund, donors do have discretion over how easily that fund is accessible to organizations management, laid down in related conditions and types of endowment. Additionally, several governance mechanisms allow for follow-up monitoring, which should ideally be accompanied by an understanding of specific requirements of the organizational type. (Glaeser, 2003) In the following, best-practices for responsible endowment-set-up will be brought up, accompanied by inspiration on possible monitoring techniques.

Non-profit organizations should pay increased attention to their management of endowments, since this is not only one of their most important sources of funding but does ideally deliver an important signal to other potential donors about the organization's stability and permanent existence, thus encouraging other donors to contribute as well. (Non-Profit business advisor, 2014& Glaeser, 2002 & Gläser, 2003) In turn, bad practices regarding the management of endowments, can lead to the opposite effect and frighten off potential donors. At the heart of a good way of dealing with endowments lies an Investment Policy Statement (IPS), which lays down several conditions regarding the treatment of the funds: First of all, they set out in which type of financial asset the funds are held, how long the endowment should be held in the form of that asset, how high the targeted return is and in which mode, as well as at which time, the returns can be spent for organizational operations.

The height of return that an organization withdraws annually will depend on the type of endowment of course, as a general point of orientation, it can be set that this amount should range between four and five percent. Apart from an investment manager, there is usually an investment committee and a board of trustees in place, who all fulfill different roles regarding the set-up and implementation of an investment policy – roles, that need to be specified and laid down in detail adequately. It is important for an organization to ensure that the employed investment manager is skillful and knowledgeable in his field. As it had been mentioned in previous sections, the educational background and capabilities of an organizations financial management personnel can be game changing for its success, this is of course also valid for the person overseeing the setup and treatment of endowments. Apart from the named actors, the board of directors will also play a role in making the mentioned decisions, but most likely under consultation of experts from the just-mentioned bodies or even by employing outside consultants. (Non-Profit business advisor, 2014)

After the financial crisis, organizations are also determined to pay more attention towards holding endowment funds readily transferrable into liquid resources in an adequate amount of time. Furthermore, the IPS needs to ensure that the holding of endowments does not have an adverse effect on organizational fundraising efforts. (Non-Profit business advisor, 2014) Though the endowment size varies considerably according to the industry an organization operates in, since that determines the instability of cash-flows, the ability to take on debt and the ability to sustain resource-intensive production processes, Glaeser (2003) suggests to follow the National Center for Non-Profit Boards guidelines, which say that endowments should not exceed two years of expenses.

After the endowment has been set-up the investment management as well as the endowment itself should be reviewed regularly. For the endowment itself, the advised review-period lies between three months and a year. (Non-Profit business advisor, 2014) Reviews might also be needed due to the restrictions under which an endowment was given to an organization: The good intentions with which a donor sets up the terms for his gift do often not comply with the experienced reality: The program he dedicated his resources to, has to be ended, due to low demand, or due to the fact that the facilities he intended to invest in, are too outdated to be renovated and have to be torn down. (Helms, Henkin, & Murray, 2005) Continuous review of the restrictions placed on endowment funds, followed by negotiations on necessary amendments of these restrictions can prevent organizations from being left with ‘locked-up’ endowments. (Hughes, 2013)

Talking about monitoring possibilities, several channels allow donors to better understand the activities of non-profits. One of these observatory bodies is formed by governments and governmental organizations. As it had been understood for the United States, these governmental oversight activities may vary greatly from one geographic region to another, leaving the donors with the challenge to understand these regional differences and act accordingly. Apart from governmental bodies, the media is a powerful oversight-actor, especially with the rise of the internet and its vast variety of opportunities. Glaeser (2003) gives the example of ‘Better Business Bureau’ and ‘Guidestar’ as two US-based organizations, that understood how to use the internet to spread their insights in organizations governance. Apart from that, donors making extraordinarily large contributions, just as large shareholders in the corporate world, have the power to exert a monitoring function, by requesting to be represented on the board of an organization. In the following board meetings, they are expected to defend donors’ interests on behalf of a broad community of donors. (Glaeser, 2003) Obviously, the presented monitoring tools must work in close cooperation to function effectively, since e.g. simple media activity alone will most likely not induce a change in organizational behavior if it is not followed by according governmental action.

h. Operating Reserves as a part of liquidity management

When non-profit financial managers use the term cash-holdings, this refers to cash reserves, to be more precise about their nature, they are often also being called operating reserves. The important aspect that makes these holdings so valuable for the organization is the fact that they can be used without restrictions. This means that they are not determined to be spent for a specified purpose, during a specified time and they are not bound in the form of an endowment, set-up to benefit donors in perpetuity. When looking at these items on the balance sheet, they are sometimes denoted as ‘board-designated reserves’ or ‘quasi-endowment’ which indicates that the board has the discretion to determine how they are being used. This discretion is mostly used to deposit part of the cash holdings in short-term investments. The rest of the operating reserve serves to overcome seasonal or monthly imbalances of cash-inflows and outflows, confront unexpected lows in the revenue stream or higher incurred expenses, protect against the risk of sudden credit line reductions and hedge the risk of issues stemming from imprecise forecasting. (Zietlow, 2010) The operating reserves cover events that are happening in regular and normal business conduct and under normal economic conditions.

As with all forms of precautionary diversion of funds, special attention must be given to adequate procedures and well-defined use-cases for this type of funds. If an organization fails to have sufficiently regulated and determined procedures in place, can lead to misuse. Often an increase in managerial compensation can be observed with higher donation inflows in organizations with a lack of appropriate governance structures. (Fisman & Hubbard, 2005)

In the aftermath of the crisis of 2007/08, several studies, focusing on the relation between rudimentary liquidity management and lower organizational performance, were conducted – focusing also on reserves-holding practices. Among those, a study by the Urban Institute, a US-based research institute, which looked at poorly-performing and failing organizations over a time span of seven years, demonstrated that low liquidity was directly connected to the decline in performance: 52% of these declining organizations held operating reserves covering only one month or less of their annual expenses and the median level of reserves held amounts to only one third of the level of those who successfully operated throughout the seven years. (Zietlow, 2010)

What is more, the crisis did not only have an impact on private donors giving attitude but also on the level of government spending. (Wiley, 2018) In the light of times with political changes becoming more and more the norm than an exception, it seems to pay off for NPOs to be as little dependent as possible on singular sources of funding, to maintain their current service level, at least.

Within the third sector, many suggestions regarding the adequate level of reserves are circulating, starting from three and six months to one year. While it is intuitively understandable that different organizations should target a different level of operating reserves, it might be hard to determine in every single case what this level should be, even more when one considers that the definition of reserves varies according to the ones defining it. Paul, Joseph, Mark, & Matt (2012) define reserves as a sort of insurance for the organization comprising a subgroup of liquid net assets that organizations can use to come up for unexpected rises in expenses and dips in revenue as well as to take on suprisingly arising opportunities.

A four-steps process is suggested to reach an adequate level of organizational reserves. A long-term financial goal marks the starting point of the presented planning process. Long-term in this case indicates five years and is undertaken to understand which drivers and factors could be more crucial in the following years than they might seem according to the operating budget.

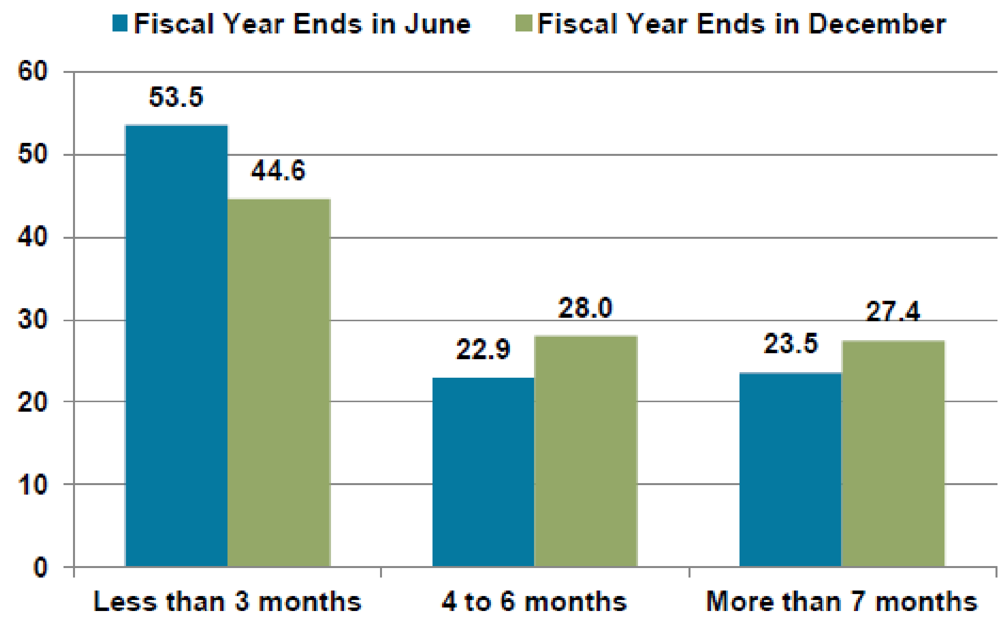
The second step consists of a risk analysis: The potential risks for all key elements that have an impact on the organizational budget's bottom line, must be evaluated by the management. This captures external factors which cannot be controlled by the management, as well as the likelihood that an organization can realize against its own budgeted plans. This can only happen in close collaboration with the department heads or to be more precise, the responsible staff members with the closest insights on day-to-day business and trends for the specific budget line items. This bottom-up risk analysis is conducted in a similar way as the set-up of an annual budget and does at the same time also align management members regarding their future reserves-holding policy.

In a third step, the organization's risk exposure must be quantified, after the points of exposure have been identified and this is achieved by a portfolio-approach towards the individual risks. The downside-performance across all items is identified and to the losses, weighted probabilities are assigned to arrive in the following by the aid of net-present-value (NPV) calculations at a sum for adjusted average risk exposure. Even though the individual risk levels vary, the basket-approach does in sum provide reasonable results regarding risk-exposure. What is needed in a next step, is an appropriate reserves target, as well as the procedures how to reach it, laid down in an appropriate manner. The level of reserves held, as well as the time horizon of the plan will vary from company to company – so will the funding source. While some companies might be able to generate enough revenue for the reserves, others will have to rely on external funding sources as well and develop a funding plan to be able to do so. If an organization can neither draw on external, nor on internal funding sources, it must understand, how to cut down spending now to be able to set aside an appropriate amount of reserves. (Paul, Joseph, Mark, & Matt, 2012)

Research shows, that the third sector is in practice in many areas not yet reaching what would be suggested by theory. A recent report by the accounting firm BDO found that 40% of organizations hold between one month and less than six months of reserves, Of the organizations surveyed 25% do not hold any reserves. As many other industry insiders and researchers, the consultants also view a target from six to twelve months of expenses as adequate, acknowledging that the latter might be very difficult for many organizations to argue towards donors which often want their funds to be used for very specific purposes. (Wiley, 2018)

In Moody Foundation's report on financial literacy and professional knowledge in the third sector from 2011, for which 500 sector professionals were interviewed, the image shown about the sectors practice is even more serious. The section on reserves reveals that, depending on the end of their fiscal year, 45% - 53.5% of organizations had less than three months of operating reserves. What is more, only 23 – 28% have more than six months of operating reserves, while the report suggests a target level of three to six months, with the bottom border to amount at least one full payroll and the upper boarder around two years of the total budget. (see Figure 2) After giving this orientation, the report is very clear on the fact that every NPO has different needs and reserves targets should take that into account. (Moodys Foundation, 2011)

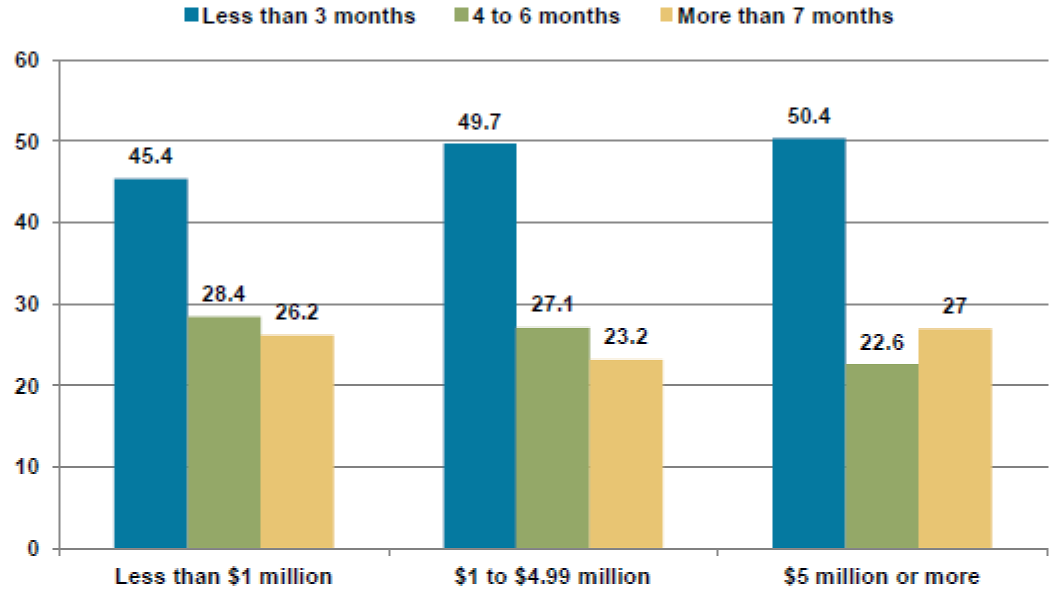
Figure 5: Percentage of Respondents Reporting Number of Months of Operating Expenses available (%)



Source: Moodys Foundation. (2011). *Financial Literacy and Knowledge in the NPO-sector.*

Nevertheless, there are factors, which seem to determine the level of reserves held across all organizational types: Especially in newly founded organizations, the risk of illiquidity seems to be very high: A study among approximately 2600 "young" US-nonprofits, meaning that they were founded in the last five years, regarding the amount of cash reserves they hold, brought interesting results. The amount of operating reserves of two-thirds of these organizations covered only three months of their operating expenses, which is clearly below the suggested standard-target of six months. For more mature organizations, meaning over 30 years old, this share drops to 50%. (Zietlow, 2010) Also, the size of the organization plays a role, as it can be seen from Figure 3.

Figure 6: Percentage of Respondents Reporting Number of Months of Operating Expenses Available, by Organizational Revenue (%)



Note: *May not be statistically meaningful because the sample contains fewer than 50 respondents.

Source: Moodys Foundation. (2011). *Financial Literacy and Knowledge in the NPO-sector.*

A successful reserves policy does not end at setting aside a certain amount of funds. It also includes detailed procedures regulating how to access reserves, when to review risk projections and how to undertake corrections to ensure funding, as well as a definition of who is responsible for what part of the procedure. Apart from that, an organization needs to stay aware of the fact that their budget-forecasts will directly influence their risk-measures which means in turn, that it will lead to a different level of reserves – more conservative forecasts will lead to lower risk exposure while the opposite is true for less conservative forecasts. Apart from that, organizations should avoid comparison of their reserves with other organizations, though that might seem tempting, for the sake of understanding that different organizations and different organizational natures need different reserve levels. (Paul, Joseph, Mark, & Matt, 2012) Above all, any organization should not forget, that reserves are a part of liquidity management, an area that does deserve special attention but must be viewed subordinate and in context with the three tiers, combining into broad liquidity.

i. Development, Execution and Review of Liquidity Management Policy

To better understand, where organizations are positioned, when benchmarked against other homogenous members of the sector and which actions they need to take, to evolve to a more sophisticated level of liquidity management, Zietlow (2010) developed a framework consisting of four categories. The basis of this framework was developed with the aid of a poll, done among a small sample of considerably homogenous organizations, evaluating their financial management practices.

The first category of organization is denoted as 'Muddlers' and consist mostly of small organizations, with annual revenues below one million $ or 700.000 $ and young organizations, meaning founded in the last five years. These organizations are not engaged in developing cash-flow projections and their primary financial objectives seems to be to break even. The incurred annual expenses either meet or slightly exceed the amounts laid down in the budget. Very often these organizations lack expertise in the form of financial management personnel with the specific educational or professional background, which in many cases leaves the CEO as the primary and only focal point for all decision-making related to financial management (Kim & Peng, 2018). Given the short-termed nature of their primary financial objective, these organizations are prone to get stuck in the so-called 'current services trap', meaning that their financial resources are exhausted by living up to current service requirements, not leaving any financial resources to develop program expansions or sustainably prepare for future adaptions of the program to adequately fulfill the organizational mission.

The second category is named 'survive' and may last for a long period of the organization's lifetime. Organizations in this phase target a certain level of liquidity – meaning that they engage in management of their cash position, see higher degrees of professionalization among their staff-members, they have understood the importance of the above-mentioned concept of solvency (assets held relative to liability) and the bank holding their cash deposits is an important point of contact for all organizational requests regarding liquidity management. This bank can also play a facilitating role in the evolvement to the next category.

The third category, called 'progress', means a stronger focus on cash-flows. These organizations start to develop forecasts which are also monitored. The cash management performed in accordance to their measurement allows them to undertake program expansions. Their liquidity management does not yet comprise all tiers of broad liquidity but is focused on 'narrow liquidity'. The understanding of reserves is more sophisticated, meaning that the organizations do hold reserves designated to e.g. undertake adaptions to their program or to perform repair- or replacement-tasks, rather than just covering unexpected expenses or make-up for unplanned dips of the revenue-stream. This organizational aim to hold operating reserves covering 3-6 months of their annual expenses and understand the added value of using their credit-lines as a means of short-term financing.

The fourth category is called the 'thrive' phase and is marked by a long-term perspective on the organizations financial position, equally valuing the current services level and the long-term organizational survival, including program expansions. These organizations focus on maintaining financial flexibility, indicating that they understand which donors have potential for bigger donations and that they know about the possibility to issue tax-exempt bonds, if they are not yet doing so. Flexibility and fiscal leanness have been gaining more and more attention as a valuable source of stability for every organization (Mitchell, 2015). 'Thrivers' base their management decisions on historical and projected financial ratios and statements, and even employ an adapted version of the balanced scorecard and its metrics, as described in section e. These organizations know very well how to leverage their current strengths to ensure future successful attainment of their mission. (Zietlow, 2010) An overview of the four categories, as well as their strategies and most important targets can be found in the table below.

Figure 7 - Organizational profiles - four financial paradigms

Table 1: Organisational profiles — four financial paradigms

Financial paradigm	Finance strategy/lens	Financial target	Outcome
I. Breakeven or small surplus	Cover expenses Internal: CEO lens	Meet or slightly exceed budget	Muddle
II. Solvency	Meet payroll External: Depository bank lens	Be 'cash positive'	Survive
III. Liquidity	Manage cash position & cash flows External: Donor/grant/foundation lens coupled with short-term lender lens	Meet near-term ALT Meet 3-6 months of operating expenses in cash	Progress
IV. Financial flexibility or broad liquidity	Manage present and future cash position and cash flows while maintaining 'Augment-ability' External: Major donor, foundation, bondholder & rating agency lens	Meet multi-term ALT to achieve sustainability Meet strategic liquidity so 'Projected ALT' adequate in short, medium and long run	Thrive

Source: Zietlow, John. (2010). *Non-profit financial objectives and financial responses to a tough economy.*

j. Managerial Philosophy, role of the Financial Management personnel & sector culture

Managerial and sector culture are crucial for the processes of any organization, in the case of the non-profit world, this culture has hindered effective liquidity management in many cases, as it has been demonstrated in the sections on reserves planning, the historical insights illustrating the cash crunch crises many organizations encountered in the aftermath of the economic crisis. The framework developed by Zietlow (2010), presented in the section above, goes one step further, by underlining the role that the degree of financial management professionalism can play in facilitating organizational development to more sophisticated liquidity management practices. Furthermore, he is just one author among many others, that acknowledge the importance of the literacy of financial management personnel in their respective domain. (Casey, 2016; Glaeser, 2003; Zietlow, Hankin, Seidner, & O'Brien, 2018)

The fact that many different authors highlight the importance of the quality of education of financial management professionals, should be taken even more serious, when taking a look at the insights of the Moody's study on Financial literature once more: During exercises involving self-rating, the majority of financial managers considers their own capabilities as sufficient – not reaching the level of experts, but reaching an adequate level of literacy for their function, a slight increase in the self-perceived level of expertise could be observed with increasing organizational revenue. In the study, the self-evaluation of financial managers was followed by a short thematic quiz, consisting of three questions, as it can be seen in figure seven below this paragraph. Apart from the question on financial markets and their instruments, which is question one about bond prices and interest rates, the self-evaluation of financial managers corresponded to the results of the short questionnaire, regarding their capabilities to answer the questions correctly. (Moodys Foundation, 2011) It can be questioned at this point, if such a short questionnaire does provide enough evidence to rate theoretical literacy of financial managers. For a more complete picture, a more extensive questionnaire, covering different areas of general knowledge regarding the principles of financial management, financial markets and economic factors, as well as NPO-specific financial management tasks, could provide more profound insights in the actual educational background of financial management professionals in the sector.

Figure 8- Question to measure financial literacy - Moody's report

- *If interest rates rise, bond prices will rise.*
- *When an investor spreads money between 20 stocks, rather than 2, the risk of losing a lot of money increases.*
- *Buying a single company's stock usually provides a safer return than a stock mutual fund.*

Moodys Foundation. (2011). *Financial Literacy and Knowledge in the NPO-sector.*

Above all, the Chief Financial Officer (CFO) does often find himself confronted with a broad set of expectations and requirements, along several organizational dimensions. Apart from the financial-management related duties, he is often being entrusted with many organizational and general managerial tasks as well. Though there is still a focus on controlling organizational activities and understanding when and how to engage the board to take necessary pre-cautionary measures or set the ground for mitigation strategies, communication, personnel management and the adoption of state-of-the-art information technology have become integrated parts of CFOs ordinary tasks, which also indicates that its an invaluable skill for them to understand how to delegate, if they want to be able to keep up with the organizational challenges they find themselves being confronted with. (West, 2017) & (Pinkowitz & Stulz, 2006)

Apart from understanding the basic principles of their function, financial managers must therefore understand how to launch new initiatives strategically and furthermore, how to actively engage their subordinates in this process. Executives can draw upon lessons learned from change management processes successfully carried out within their organization and they should understand the value of adequate communication, which is a major facilitator for successful policy implementation. What is more, as it had also been suggested in the section on reserves planning, to support one's argument, the development of projections based on probabilities, can help to justify the allocation of resources. (Paul, Joseph, Mark, & Matt, 2012) As in the case of reserves, measures introduced with the goal to refine organizational liquidity management, are often conceived as rather unpopular, since they are oriented towards long-term perspectives that might counter short-term programmatic interests. Financial managers must be prepared for the organizational resistance and be ready to counter it with strategical planning of their line of argumentation.

While the board of directors does for sure play a determining role for the organizational success, it must be noted, that the financial success of an organization seems to be determined more by the strategic dimension. Strategic leadership and how on organization follow through on the strategic planning seems to have bigger importance for the organizational success than the performance of the board of directors during this path. (Brown, 2005)

5. Case Studies – Design and Main Goals

Complementing the analysis of available research in the field, the case-studies aim at testing the gained insights from the literature against everyday industry practice. For this reason, the organizations website and the financial statements were examined to compile an overview of the organization's activities, mission and focus and the applied accounting practice. The main pillar of the case-studies, allowing for comparison of theory and everyday organizational practice, is a qualitative interview, based on a questionnaire consisting of 61 questions.

The questionnaire was developed for an interview with the financial-management responsible – depending on the organizational structure, that would be the Financial Manager or e.g. also the Secretary General. The questions have been organized in 10 Modules. The structure and content of the modules, as well as the questions themselves, were developed based on the insights from the literature review. The ten thematic modules are the following: Role of the organizational mission & general practice, Cash-Crunch Crisis, Liquidity definition & general practice, Accounting practice, Financial Ratios for NPOs, Financial Management Personnel & Financial Management Personnel & literacy, Funding sources (donors, creditors), Liquidity Management tools (endowments & operating reserves) and Ethics. The complete list of questions can be found in the Appendix.

The interview followed a so-called 'guide approach' with a mixture of open questions and closed questions. The closed questions do mostly contain follow-up-questions to obtain further details in case of yes and no answers. The questions were modified slightly in the course of undertaking the interviews, to account for answers that had been given, covering already parts of one of the next questions. The full interviews can be consulted in Annexe I and Annexe II. In the following, an overview of the organizations will be provided, as well as the main findings of the case-study interviews.

a. Case Study I: Horizons for Homeless Children

Horizons for Homeless Children was founded in 1988 and is based in Boston, Massachusetts. The organization works with homeless children and their families, aiming at supporting them to cope with the traumatic experience of being homeless, as well as facilitating self-aid, meaning that they support parents in developing a strategy to improve their and their children's situation, as well as supporting the children in following an educational path successfully, ultimately providing them a brighter future. The organization's program does rely on the work of nearly 1000 volunteers providing 600 hours of voluntary work.

The services provided by the organization's programs can be divided into four parts which will be named and described in the following. The three 'Community children's Centers' target children, aged between two months and five years, providing early education to them, while supporting parents to break the cycle of homelessness and facilitating their transition to living self-sufficient again. Since the centers were started in 1994, 3000 children have been served and 175 are being served every weekday. Under the playspace program, since 1990, children in the greater Boston area, living in family homeless shelters, are being provided with a space to play and have fun, while volunteer engage them in educational activities. The 20,000 volunteers, serving at least two hours a week, are the main pillars of this program.

The organization is also engaging in providing technical assistance and training to professionals that work with homeless families, to improve the quality of delivered services, by knowledge sharing. The target of the engagement are educators, social workers, shelter staff and government agencies. Therefore, Horizons also co-sponsored workshops and trainings and even seven conferences in the Massachusetts area. The fourth part of the program consists of the evaluation program, which is a key program to arrive at a more formal, better informed program design process and to utilize and incorporate the experiences made in other programs. It also feeds into the organizations efforts in policy building.

As it will become more apparent in the following description of the interview findings, Horizons for Homeless Children represents an example of a 'Thriver', applying the criteria from a framework developed by Zietlow (2010) in the course of his research on the responses that NPOs developed towards a challenging economic environment. Thrivers take a broad outlook on liquidity, aim at maintaining a certain level of financial flexibility, have an idea about long-term financial goals and draw from diverse sources of funding. Mrs. Reeder also points out, that transparency is one of the top priorities at Horizons, which also helps to ensure that donors and managers interests are well -aligned and that the organization uses the donor's funds in ways which are being supported by them.

i. Interview Findings

In the following, the findings from the interview with Tammy Reeder, CFO at Horizons For Homeless Children (Horizons), will be compared with findings from the literature review to understand similarities and differences regarding the described practices. In general, the interview with Tammy confirmed several ideas derived from the literature, but also brought some points of difference to light.

Conceptual Ideas and General practice

As it had been pointed out in chapter 3)a) on general features of NPOs, chapter 3)d) on ethics, as well as in the first paragraph of chapter 4, the strong mission-orientation is one of the key features of NPOs and is reflected in the organizational practice and in its Financial Management in many ways.

This raises the question, if Financial Management requirements can be a barrier towards mission attainment or if the objectives of Financial Management can get in conflict with the requirements of the organizational mission, as it had been outlined in the first section of chapter 4. In the case of Horizons for Homeless Children, it can be confirmed that mission comes first and financials come second, which is the exact opposite of what can be observed in the for-profit world. Nevertheless, Mrs. Reder highlighted that these financials are essential, because they fund the mission and she describes her role as understanding what can be achieved, with a desired level of quality, given the available resources. This does sometimes produce conflicts with program staff, that wishes to realize a broader scope of activities. To allow her to better understand the best combination of the before-mentioned factors, Mrs. Reder classifies the organizational activities into core and fringe-activities – when encountering a budget constraint, parts of the fringe-activities might be dropped, while the core activities are being kept.

Interestingly enough, Mrs. Reder does only in part confirm the theory about split functions, outlined in section a of chapter 3, which indicates that mission attainment is in the focus of general management while the CFO does inly focus on Financials: While she points out, that mission does probably have a stronger impact on the work of the program staff, she seems to play a crucial role in the attainment of sufficient focus. Taking into consideration the limiting features of the budget and the constant safeguarding of financial resources, she plays a crucial role in preventing mission drift. During board meetings, Mrs. Reder does take the position to point out when raised ideas about program expansions are not in line with the organizational mission to safeguard that the organization focuses on the areas where its strengths lie and ensures that these services are provided at the quality standards, which the organization has set itself. So even though mission attainment might not be the primary focus of a CFO, the function can take an important role in ensuring an organization's focus on the essence of their mission.

Cash Crunches

Cash crunch crises are the final consequence of poor liquidity management practice and in the worst case the event that finally leads organizations to realize that they were adopting poor Financial Management practices. Apart from that, as described in Chapter 3, section c, the Financial crisis of 2007/08 lead to serious cash crunches for many NPOs, re-shaping the third sector composition and culture. Therefore, the second cluster of questions addresses the history of Horizons regarding cash crunch crises.

In fact, the organization founds itself in a rather special situation during the Financial crisis of 2007/08: Right before the important events of this period unfolded, it raised 20 million US-dollars through a campaign, which was placed in reserves at the time. In the year 2007 and its aftermath, over about 8 to 9 years, Horizons experienced continued constant deficits of one to two million US-dollars every year which lead to continuous dipping into the before-mentioned reserves. Mrs. Reder joined the organization four years ago and was alarmed by the continuous deficit. Nevertheless, she describes that the organization and its management did at the time of her coming onboard not yet understand how problematic it was that they were not able to raise enough funds to cover their program expenses. After joining the organization she spent a lot of time and energy, making the executive level and staff understand, that the reserve will be used-up one day and that the organization might then find itself either in serious financial troubles or loose an important opportunity, because of a lack of sufficient funds. The main message that she attempted to deliver was that the organization might not be able to fulfill its mission at some point by having been fiscally irresponsible for such a long time and not managing towards achieving a small surplus or at least a balance.

Since Mrs. Reder has been active in Financial Management in the third sector since a longer time, she included the example of an organization she had been working for before joining Horizons, which she describes as living ‘from payroll to payroll’. This situation created an atmosphere of continuous stress for the employees and lead the organization to quickly accept her proposed financial strategy, which also included the holding of reserves to avoid constant stress about the ability to be able to pay monthly payroll.

Liquidity: Definition, relevance and daily practice

In the course of the literature review, several different definitions regarding liquidity in the third sector have been identified, as described in section b) of Chapter 4. As Horizons is based in the United States of America, it is worthwhile to take the definition of the Financial Accounting Standards board into account, which denotes liquidity as being determined by the nearness of an asset or liability to cash, taking into account restrictions on conversion, imposed by donors.

Financial flexibility goes a step further in the FASB-definition, as well as in definitions found in Zietlow et al’s work which has a similar definition regarding nearness to cash as a starting point, naming it narrow liquidity and constantly broadens this view to arrive first at solvency measures and finally financial flexibility – which all combined are denoted as broad liquidity. (Zietlow, Hankin, Seidner, & O'Brien, 2018) Financial flexibility allows organizations to react to unexpected developments in the sector as well as to carry out program expansions.

Horizons seems to have undergone a recent transition from a narrow view on liquidity to a more broader outlook, also incorporating financial flexibility-measures. This development did rather evolve naturally due to the recent building of a school next to the organizational headquarter, which required taking on a loan from a bank, which also took the organizations investments as a collateral for that loan. While the organization does not use debt as a regular funding source for the provision of their normal program activities, it was necessary for the program expansion, represented by the construction of that school, which illustrates one of the main advantages of managing an organization's liquid funds with a view towards financial flexibility: The possibility to do program expansions. (Zietlow & Seidner, 2007)

From a definition-viewpoint, Mrs. Reders understanding corresponds to concepts from the above-mentioned literature review, though with differences in labelling the concepts. Precisely she defines it as current assets over current liabilities, with current assets being those that can be converted into cash, without specifying a time-range. This goes beyond the presented definition of narrow liquidity, as presented by Zietlow (2018), corresponding to the outlined definition of solvency and is in line with the accounting-perspective, which the FASB takes on liquidity. Her introduced definition of solvency - cash and current assets divided by current operating budget cannot be related with any of the definitions found in the literature.

$$\frac{Cash\ \&\ current\ assets}{Current\ operating\ budget} = \text{solvency measure of Horizons}$$

What is more, Mrs. Reder describes the incorporation of a weekly cash-flow report in her activities – this practice corresponds to another tier of financial flexibility, as described in chapter 4. The weekly report informs her about her balances and cash-projections of about nine months, based on trends and actions from the year before. This as she calls it 'budget for cash' is being consulted by her on a weekly basis and quarterly or even monthly together with the CEO. In all the described process, the consideration of restrictions plays a subordinate role, which can be attributed to the fact that Horizons draws from mostly unrestricted funding sources with the only exemption being grants from foundations, which are mostly attached to a pre-defined specific purpose, e.g. specific part of the program.

Regarding the holding of excess cash, as more thoroughly discussed in section b of Chapter 3 and section j of Chapter 4, Mrs., Reder demonstrates a rather positive view of her organization towards the topic, highlighting that there is always a way to explain excess cash to donors, as it provides valuable opportunities for smart growth, as Horizons is experiencing it at the moment. Apart from that she describes from experience, that the 'right' level of excess cash seems to be a question of definition, as she learned through discussions with grant providers: While 50% excess cash seem to be acceptable, 150% seem to raise questions with most grant providers. Connecting the question of the sector view on excess cash with the before-discussed problematic of cash crunch crises, Mrs. Reeder confirms that the crisis of 2007/08 contributed to an ideological turn-around for many organizations, since many formerly highly active donors suddenly could not provide funds anymore.

At the center of Horizons Financial Management is the challenge of balancing between high fixed expenses on the one hand and not-fixed funding on the other hand, stemming from the fact that 80-85% of the expenses consist of salaries. Put into the context of theory, this would be named the organizations primary financial objective (Wacht, 1984). This situation combined with the fact that there are not too many financially literate staff members, leave the CFO with a high responsibility to ensure regular and reliable payroll and stable financials at the same time.

To stay on top of all the numbers, Tammy Reder and her team start to work on an annual budget three months before the end of the fiscal year, which seeks board approval about a month before the fiscal year starts. Set revenue targets are being reviewed quarterly under normal circumstances, even though Mrs. Reder points out, that the current situation with the bank loan prompts a higher pace of revision and adaptation, since there is an external pressure towards more monitoring and reacting quickly of a trend off-budget is being identified. The forecast is receiving more attention from the whole team, meaning also the managers of the individual components of the program, is according to Mrs. Reeder the half-year forecast.

As suggested by Zietlow, Hankin, Seidner, & Timothy (2018), Horizons does work towards a quantified appropriate liquidity target (ALT), precisely towards a liquidity-ratio of 1,5 to 2, while the organization is currently somewhere between 1 and 1.5. Apart from being at the heart of sound Financial Management, the ALT fullfilled another important purpose in the organization where Mrs. Reder worked before joining Horizons: Starting with a liquidity ratio of 0.13, Mrs. Reeder took the chance and used the concept of managing towards a quantifid ALT to make the staff understand the importance of sound Financial Management. Explaining that this ratio indicates that the organization earns 13 cents on every dollar they owe, helped her to make people realize that the practice adopted at the time had to change. As it had been reflected in the Theory in chapter 4, section d, also Mrs. Reeder does not monitor the activities of other organizations, operating in a similar part of the sector to understand the appropriate level of the ALT. This confirms that the ALT is not generic, but instead attached to the individual needs of the organization. The pressure from various stakeholders towards the attainment of a specific target, does not seem to be highly immanent for Horizons, since the ALT is in their case used mainly for internal purposes.

Apart from plain, daily-business related policies, the organization does also have an investment policy, which limits Mrs. Reeder in undertaking Financial Management decisions whithout involvement and approval of the board. The finance committee wants to be able to ensure that all financial decisions are being made in tune with the organizational mission and therefore requires to be involved before the CFO can undertake and investment or draw-off made investments.

Regarding the headging of potential risk, Horizons invests in a capital company operating solely for non-profits and therefore applying a more prudent approach towards carried out activities to not loose thousands of investors funds within a single risky operation, even though it might have a huge upward potential. The average return on investment of Horizons which is about 5%, does reflect the low-risk nature of their investments.

Economic indicators

Operating in a web of stakeholders and being subject to several external influences, NPOs are highly affected by economic indicators and profit substantially from understanding in which way and to which extent this is valid. In section c) of chapter 4 "Why is liquidity Management crucial in the NPO-sector?", several economic indicators, as well as their direct and indirect impact on NPOs' liquidity have been described. In the view of Horizons, not all these factors are relevant.

The organizations' monitoring of external factors does mainly focus on the market, meaning stock indices, to understand if any action needs to be taken regarding investments and the economy as a whole, to understand if any plunges in donations should be expected. As described above, the biggest part of Horizons expenses consists of fixed payroll payments - Mrs. Reder needs to keep and eye on inflation, since it drives staff to demand a corresponding raise in salaries. Since the organization is operating close to break-even in the course of their normal activities, and the standard annual increases amount up to 3% at the moment, a certain growth in revenues needs to be seen as well. Therefore, Mrs. Reeder names inflation, combined with the organizational growth in revenues, as the most important indicators to monitor.

This is closely followed by ability of donors to donate, which can and has to be monitored by regularely consulting charitable giving indices. Given the dependendency on governement funding for a part of the organizational revenues, elections are also being followed, to understand if there is the possibility of a cut in funding and represent the third-most important external influence on Horizons' liquidity management. Apart from that, demographic developments, reflected in birth rates, do play a role since the organization works with children.

Since Horizons for Homeless Children works with homeless families, there is one indicator which was not mentioned in the theory but does play an important role for the specific area, the organization operates in: average cost of living, which is in the end also connected to inflation measurements, with a focus on rent. As Mrs. Reeder points put, the rents in Boston, the area where the organization operates, have been growing at an alarming rate, reaching levels that correspond to the situation in New York or San Francisco which means that the demand for Horizons service is steadily rising.

Accounting practice

The Financial Statements of Horizons show a distinction in current and non-current assets, as well as a sequencing that takes the nearness to cash into account – e.g. cash is the first position under 'current assets', while 'promises to give ' is listed as the second-last items under assets. Regarding cash and cash euqivalents, it has to be noted that the organization defines cash equivalents as assets that can be turned into cash within three months, which corresponds to the understanding generally applied in accounting.

One item in the Organization's Financial Statements that deserves more attention can be found under page five of the Financial Statements in the Statements of Financial Position, designated 'Investment in limited liability company' and showing a sharp increase in value from 150.000 for 3,6 Mio USD from 2017 to 2018. This is connected to the acquisition of a building, as it had been described earlier, which is carried out through the limited liability company 'Horizons Watermark LLC' in which Horizons for Homeless children holds a 35.9% stake, which is changing from time to time, since this stake corresponds to the organization's share of the net rentable square footage of the land that is being developed. Mrs. Reder explained that this structure was created for legal purposes and that Horizons does not generate any kind of revenues or receive funding from that LLC, nor does it issue debt – which is legally the only possibility for an NPO to issue debt. It is the first time in the about 31-year long history of the organization that it had been operating through and with a for-profit entity. Given the strong ethical standards that non-profits have to live up to, as they are described in the section d), Chapter 3 named 'Ethics', since they operate with donations and governemental money, they are also confronted with special requirements regarding their transparency and Horizons does live up to high standards in this aspect. The Financial Statements which were consulted to arrive at the before-mentioned observations are publicly acessible on the organization's homepage and the notes provide detailed information on the practice regarding the LLC as well as other items of the financial statements. (Horizons for Homeless Children, 2019)

Financial Ratio-Analysis and Liquidity Management

Evaluating the use of Financial Ratios to inform the Financial Management process, leads to the conclusion that those do on the one hand play a rather subordiante role for Mrs. Reeders every-day pratice and are on the other hand often being utilized unconsciously, meaning under a different name or a different concept as introduced in the theory, as presented in section e) on ratio analysis and liquidity of chapter 4. One example which illustrates that very well, is the formula Mrs. Reder uses for computing the liquidity ratio, which is also being utilized to determine the appropriate liqudity target (ALT), and does in fact correspond to the definition of the current ratio, as found in the literature (Klump & Cole, 2014).

The quick ratio is irrelevant for Horizons, since the organization operates without inventory, which can to a big extent be attributed to the organizational type. The liquidity funds indicator is a further development of the quick ratio which also takes into account endowments, but as it will be understood in one of the following sections, Mrs. Reders organization does not use endowments for conducting its activities.

The net liquid balance, as presented in theory – subtract short-term notes payable and the current share of long-term debt from cash and short-term investments – could easily be calculated, based on the Balance Sheet, as it does list all the items detailed enough and labels also their nearness to cash accordingly. The calculation of a risk-measure called lambda to determine liquidity-risk is not being performed at Horizons. An important factor determining the sophistication of an organizations risk-mitigation and hedging strategies might be the responsibility, as well as capacity of the organization in that regard. Since the for-profit pressure towards utilizing any means of possible profit maximization is not at the heart of non-profits organizational efforts, it is fair to assume, that many of those organizations leave the risk management and hedging activities, involving financial markets, outside of their own sphere of responsibilities – as it will be shown in one of the next sections, this practice is also being applied at Horizons for Homeless Children.

For Horizons, the net working capital does play a role, but not in the form of a ratio or as part of a ratio or metric. Since Mrs. Reeder works on the basis of regular cash-flow projections, which are in turn based on cash-flow statements, the net working capital is an integral part of her everyday monitoring, since it makes up a part of the mentioned statements. So it is an example of rather unconscious regular usage of a metric to inform liquidity management practices. The broad experience in the sector, which Mrs. Reder brought with her to her engagement at Horizons, does without any doubt play a big role in informing her financial management efforts.

As already mentioned in the section above, Mrs. Reder recieves several months of cash-flow projections, based on experience from previous years and informed by decisions made in the past year. The cash conversion cycle, as well as the cash conversion efficiciency, are being utilized once a year. In the course of revising the status of Horizons accounts receivable, Mrs. Reder takes the cash conversion efficiency into account to understand if there is the need to write off a part of the accounts receivable. She describes the cash conversion efficiency evaluations as a part of the 'bigger perspective' that she tries to take on the companies financials, meaning to get a sense of how much time and resources the organization finally must invest, to convert the assets into liquid resources, according to their nearness to cash. Even though she does not identify the cash conversion cycle as the theoretical concept behind those considerations, she cannot detail the plain theory behind these thoughts.

The cash reserves ratio had gained more importance for her work recently, due to the stricter monitoring by the bank which provided the necessary funding for buying the building and land to develop, together with the LLC in which Horizons holds a stake. Neverthelss, Mrs. Reder points out, that even before that increased level of oustide control was imposed on the organization, she was monitoring how much the organization held in reserves compared to how much liquid resources it holds. Given the special situation with the 20-million reserve from the successful capital campaign, that determined the organizational culture towards spending so immensely when she joined the organization, Mrs. Reder was intensely confronted with the concept of operating reserves throughout her whole period at Horizions.

Apart from the mentioned ratios, Mrs. Reder introduces another ratio, which had not been coverd by the theory examined for the purpose of this work and which is computed by dividing program expenses through support expenses. This is a way to evaluate how much an organization spends on mission attainment and providing program components, relative to its other expenses and accroding to Mrs. Reeder, an important indicator donors and potential donors look at to get a sense of how responsible and organization is in dealing with the received donor funds. The target value towards organizations usually operate is 70%/30%, with 70% being program expenses and 30% support expenses. Horizons is at the moment somewhere around 72%/28%, which Mrs. Reeder attempts to maintain in the course of her Financial Management operations. She points out, as already emphasized in the section discussing the sector-view of holding excess cash, that most donors understand, why these support functions are essential for organizational success and that one can always explain to a donor, why an organization needs support expenses. Bearing in mind the special role that the CFO can play regarding preventing organizations from broadening their mission beyond the initially defined scope, the value of support functions is highlighted even more.

Support functions comprise all functions not directly related to an organizations prorgram activities, for example the salary of Mrs. Reder and her team are reflected in support-expenses. Combining the information of the financial statements and the interview, its becomes clear that the expenses for payroll, which account for the biggest part of organizational expenses, are mainly encountered for staff working directly in projects.

Financial Management personnel

The focus on the role of financial management personnel, that had been chosen for section j) of chapter 4, is a constant throughout the entire literature review, underlining the strong impact the vision and personal mission of the personnel has to form the strong sector culture of the third sector

(Casey, 2016). The educational background of the manager and his team can shape the organizations situation drastically, as the case of Mrs. Reder demonstrates – already in the section on the definition of liquidity, explaining her role in making staff understand how crucial sound financial management can be for organizational success, it becomes apparent that Horizons profits a lot from her background, which consists of a solid theoretical foundation through studies, developed further and expanded through the several career stations she had been passing through over her years in the third sector.

The financial management team of Horizons for Homeless Children consists of four staff-members, out of which three are employed full-time and one is employed half-time. Mrs. Reder herself has a Bachelor and an MBA, both in a program related to financial management. The part-time staff member is the only one without a formal education in the related fields, since the financial manager working for Mrs. Reder in her position as CFO, is a 'Certified Public Accountant' (CPA).

Asked for the qualifications that she looks for in her staff members, Mrs. Reder points out, that the theoretical background is in fact not that important, since practical experience mught prove more crucial. According to her, the level of practical experience allows a more informed opinion about a staff members' proactivity, ability to prioritize and delivers more high-quality work in less time in times of increased pressure and time constraints, as for example when reaching the month-end close. Rating her teams level of expertise with 4 out of 5, Mrs. Reder emphasizes that a formal education can make sense, but is not necessary and that she developed a sense for understanding if someone is literate in the field or not.

She considers a formal testing for prospective candidates an adequate measure to determine capacities and theoretic knowledge. Given the findings from the theory, as presented in section j) of chapter 4 and also incorporated in section d) of chapter 3 with a focus on ethics, it is worthwile to recall that very often, the practices being taught in formal education are developed and set-out in a way that was designed to fullfill the needs of for-profit organizations rather than the non-profit world, so it seems even more adequate, that Horizons does not focus to narrowly on the formal education of the financial management staff.

Funding sources

Horizons draws on several types of funding sources, which are important determinants for their cash-flow structure, qith respect to the model presented in chapter 4, section f). A considerably big part of the funding comes from public sources, to be precise, 40% is denoted by Mrs. Reder as program revenues, and those comprise also governement money, coming from the state and federal governement. The remaining 60% of the organizations funds can be grouped in 20% blocks, formed by: Individuals, corporations and foundations and the staff-benefits.

Mrs. Reder dentoes that only 10% of the organizational funds are restricted, due to a recent campaign, in the course of which people made pledges for a time-span of five years, which induced them to place restrictions on the type of activities for which the provided funds can be used. Apart from that, restrictions to their funding are mainly being attached to foundations funds and grants. Grants do in most cases just give you access to the funding after you fullfilled certain conditions. Apart from that, Mrs. Reder claims that it might be a regional cultural thing as well, since Boston is a highly competitive ground for non-profits in the search of funding.

Horizons donor structure does not have any strategical considerations at its heart, but had been evolving over the past 20 years, with showing increased consitency in the last five years. As there are many organizations in Boston competing for funds, Horizons aims at maintining a small growth every years, but nothing too exaggerated in terms of value.

In terms of precautionary measures, Mrs. Reder applied for a line of credit. This strategy is a good illustration of the fact that Horizons is a 'Thriver' in Zietlows (2012) framework as it had been described above, with and understanding of the high value of financial flexibility. It is the first time in the history of Horizons, that it operates with a line of credit – the 20 mio. USD-reserve played a role in not having that funding sources taken into consideration earlier. For Mrs. Reder, the line of credit represents a form of back-up to prevent a serious cash-crunch-crisis and to ensure that in more difficult conditions, the quality of the program services can be preserved.

Endowments

Horizons does not employ endowments as a financial management tool.

Operating Reserves

Given the particular situation created by the long-standing holding of a 20 mio. USD operating reserve, Horizons was dealing with operating reserves for a considerable amount of time. This becomes apparent, when understanding that the organization still holds about 75% of their yearly expenses in annual operating reserves – a big part, taking into account the theorectial background provided in section h) of chapter 4.

From an accounting standpoint, the reserves are being held in an investment account and in the equity section, which is board-restriced, as capital reserves. Connected to the topic of holding operating reserves, Mrs. Reder goes further into the organizations long-term financial goals, which evolved mainly around being able to enlarge the surplus further above merely breaking even. In the case of success, this could allow Horizons to buy the building which the are currently paying rent for and also consolidating alll activites from a location-viewpoint to generate sufficient savings. She remains confident that the organizaton whill continue to thrive on this path an be able to expand further in a regional as well as a program sense.

The organization's operating reserves are being monitored regarding their risk exposure, as it had been suggest in the theory. The revision is carried out by the finance committee on a quarterly basis.

Ethics

To begin with, Mrs. Reder confirms the observations from the literature, that Ethics are an integral part of any functions main responsibilities in a mission-driven non-profit organization. She remarks that for her position as well as some executive management position the dimension of accountability adds to the high prioroty of the topic, since they can be held directly responsible for adverse behaviour.

Apart from following the accounting and auditing-informed standards regarding ethically responsible behaviour, Mrs. Reder draws from a long experience of working in departments, responsible for fraud-prevention and she emphasizes that 'opportunity' is the top of every fraud triangle, so she focuses on limiting tempting opportunties for staff to engage in fraudous activites.

Concluding remarks

Horizons Financial Management has without doubt undergone massive developments throughout the last years, driven also by the new capacity and knowledge that the appointment of Mrs. Reder brought to the organization. The applied practice corresponds to the theory in many parts, apart from the application of financial ratios and the sophistication of the strategic process from a methodology-viewpoint. This can be attributed to the fact that many practices are being applied due to Mrs. Reders extensive experience, without being consciously classified as part of a specific strategy or theoretic concept.

Financial ratio analysis and the possibility to inform liquidity management accordingly can be an area of improvement, which could provide the organization important support in reaching its long-term financial goal and to deal more effectively with the challenges posed by their high degree of fixed cost.

b. Case-Study 2: ICU ONLUS Istituto per la Cooperazione Universitaria

The "Istituto per la Cooperazione Universitaria ONLUS" (ICU) is a rome-based organization, operating in 10 developung countries around the world, engaging in capacity building for the countries they need. The organization was founded in 1966 by a group of italian professors and does engage in supporting human and social growth in developing countries, as well as promoting a co-operation culture that preserves human dignity in development assistance.

Since the organization has been founded , it has completed 480 projects in 40 countries all over the world and deployed a budget of 150 million euro. The set of activities carroed out through their projects reaches from university cooperation over education and vocational training to sanitation and healthcare, rural development, agricultrue and irrigation, renewable energies, women's promotion, social development to emergency response.

i. Interview Findings

In the following, the findings of the interview with Andrea Vigevani, Secretary General of the "Istituto per la Cooperazione Universitaria" ICU, a Rome-based organisation are analysed and compared with the findings from the literature review as well as with findings from the previous Case Study. The interview was held via Skype.

Conceptual Ideas and General Practice

As it had been examined in Chapter 3) b) and confirmed in Case Study I, mission attainment plays a unqiue role in NPOs daily activities and therefore also in their Financial Management activities.

Mr. Vigevani confirms, that mission attainment is at the heart of the organization's operations and goes even one step further, explaining that the organization's main competences are strongly linked to the organizational mission. This indicates that projects which would not fit the organizational mission do in the end also not fit the organization's competencies and are therefore not considered to be part of the organization's activities. Furthermore, Mr. Vigevani could so far not observe any potential for conflicts between financial management and mission attainment.

In this aspect, ICU and Horizons show different views towards mission attainment. Both interviewees underline that mission attainment is important, but that this has to be in line with organizational capabilities. While Horizons needs to carry out reviews regarding 'fit to mission', and the financial manager can play a crucial role in ensuring that the mission is sufficiently focused, for ICU the connection between mission and capabilities seems to be even stronger and the financial pressure not needed to justify declining to take on certain projects.

This could on the one hand be attributed to the very complex technical nature of ICUs projects, which need highly specific technical knowledge but it could on the other hand be attributed to the geopgraphic scope of the activities taken on and the special implications of the regions in which the organizations operate. ICU is based in Rome, but operates outside of Europe and does therefore encounter different challenges regarding their mission attainment and program. Meanwhile Horizons operates in the United States, where the liberal economic system and therefore less-developed welfare-state leave more activities to the NPO-sector than in regions with a very strong social state. (Casey, 2016) This could explain, why Horizons sees itsself very confronted with the challenge of focusing their organizational mission while ICU seems to be able to make fast descisions regarding the fit to mission.

Cash Crunch Crises

The Financial crisis of 2007/08, discussed in Chapter 3) c) did not influence ICU's Financial Management in a noticeable way, as there had also not been a cash crunch crisis during this period of economic downturn. The only moment of financial distress that ICU experienced, took place before 2006 and was solved with the aid of one foundation which is among ICUs main donors. As it will be demonstrated in a later section on the donor structure of the organization, institutional donors are ICUs main source of funding, which can also be attributed to the above-mentioned highly complex nature of their projects.

Liquidity: Definition, relevance and daily management practice

In the light of the concept introduced in section b) of Chapter 4) on different definitions of liquidity, the definition provided by ICU has to be split into a conscious definition and an add-on to that definition, which leads to a broad liqudidity definition, when combined: To start off, ICU understand the cash holdings in their bank account as their liquidity, which could be denited narrow liquidity in the light of the concept provided by Zietlow (2007), denoting rather short-term financial planning.

Nevertheless, ICU holds endowment funds and denotes their financial strategy as being able to maintain a level of liquid cash that is sufficient to carry their program-activities. In case excess cash starts to congregate, the excess funds are transferred to the endowments and in case the organization is in need of funds, it takes money from those endowments. The appropriate level of excess cash, held outside of endowments is determined by a pre-set threshold. Whenever the organization surpasses the threshold, money is transferred to the endowments. This indicates the organizations rather negative position regarding holding excess cash, a topic which had been discussed in section j) of Chapter 4) of the literature review and does also include the concept of managing towards and appropriate liquidity target (ALT), as it had been introduced in section d) of Chapter 4) on the basis of the concept provided by Zietlow, Hankin, Seidner, & O'Brien (2018). This threshold or ALT is set in a way that it covers two months of operational expenses, any funds exceeding that limit are put into endowments.

While ICU does monitor their revenues and expenses against budget on a regular basis, cash-flow forecasts do not play a role in the organizations liquidity management. This can be attributed to the fact that most of their activities are cash-positive, meaning that the organization receives the money in advance, before doing the project. In one of the following sections on the donor structure, this process is examined in greater depth. With their management of endowments, the organization provides for unexpected future challenges and opportunities, taking one step further the short-term oriented understanding of liquidity towards a broad understanding of liquidity that incorporates the concept of financial flexibility. (Zietlow & Seidner, 2007)

Applying the concept of broad liquidity, as it had been defined by Zietlow, solvency does not explicitely play a role in ICUs considerations regarding definining liquidity– from a narrow understanding of liquidity as cash holdings, the organization moves right towards financial flexibility. The section on endowments will clarify how the restrictions, timeliness and conditions under which ICU receives funding and uses it for program expenditures is a strong determinant of the organization's overall view on liquidity management.

In general, ICUs view on liquidity management and the definition of liquidity management differ from the provided definition and above-mentioned concepts found in the literature, denoted by the term 'broad liquidity' (Zietlow, Hankin, Seidner, & O'Brien, 2018): From the organizational viewpoint, liquidity management does always have a short-term nature, while long-term does apply only to endowments, not liquidity management, which conflicts with the researchers viewpoint of understanding endowments as a part of financial flexibility.

Economic Indicators

The relevance of economic indicators to NPOs daily activities has been discussed with a general outlook in section c) of chapter 4) and specifically for Horizons in the corresponding section of Case Study I. What had already been demonstrated in these two parts, is that the sector in which an organization operates, represents the strongest determinant for the intensity of monitoring economic indicators as well as the impact those show on the organizational activities. (Zietlow, 2010)

In the case of ICU, one of the main factor to consider when analyzing the relevance of external factors, is the region in which the organization is active: Due to the fact that most of their activities are taking place in unstable regions with high risks regarding inflation or other economic pressures that might lead to serious financial distress, ICU has to perform external monitoring that responds to these risks. This is reflected in the focus on foreign exchange rates (FX or FOREX rates) between Euro and the currency of the specific country in which ICU is carrying out a project.

Apart from carefully monitoring inflation and currency risk, ICU adopts another risk mitigation strategy to account for the high exposure to inflation and foreign exchange volatility that is prevalent in the developing regions in which the organization operates: The organization aims at not holding too much excess cash in any foreign currency and towards holding their cash reserves in Euro as long as possible. This leads to two practices: In one case, the country where the project takes places does not have euro as a currency, but does still accept Euro, e.g. Tunisia or Jordan, the projects simply pay in Euro, even though this is not the local currency. If this is not possible, the organization holds the funds in Euro in the foreign bank accounts and arranges for the conversion to the local currency to be made right before the payment has the be effected. So far, the organization could successfully prevent to suffer from enormous foreign exchange losses. Hedging against these foreign exchange risks with financial products, which is a commonly adopted practice in the private sector, is not an option to ICU – according to the organization, the costs of adopting pratice are too hight to be justified and to be met in the long-term.

Apart from that, ICU observes the general state of the economy by monitoring growth rates and unepmloyment rates, as well as the stock exchange. The demographic development, as well as elections are also recognized by the organization as having an impact on their activities and are therefore being monitored on a regular basis.

Charitable giving indices, which play a huge role for Horizons, to understand the scope of available funding over which they need to compete with concurrent organizations, are not monitored by ICU at all. This can, according to the organization, be attributed to the fact that the nature of ICUs projects, showing a high degree if technical complexity, is not suitable to be advertised in the general public which also influences the organizations donor structure, in a sense that there are no corporate or private donors.

Given the strong implications of inflation and foreign exchange risks, the organization focuses their monitoring on these two factors, as they clearly have a daily impact on the program activities. This also entails the necessity, to keep the state and health of the financial system and the banking system of the countries in which the organizations projects are happening, under observation.

Financial Ratio Analysis and Liquidity Management

Financial ratios are a longstanding integrated part of financial management in the for-profit world and are also being applied in the course of not-for profit management activities. The evaluation of ICUs use of the financial ratios described in section e) of Chapter 4 on ratio analysis and liquidity demonstrates that the usage of financial ratios does often happen without being recognized as such. It has to be noted that different sources do suggest different ratios and different ways of computation.

While the terminology of the current and the quick ratio are not applied in this context, the organization computes and monitors the ratio of its assets over its liabilities and over the total invested capital, as stated on the organizations balance sheet. This corresponds to the definition of the assets ratio, as provided by Zietlow, Hankin, Seidner, & O'Brien (2018). Apart from that, the organization also monitors the net workign capital, which has also been suggest by Zietlow (2018) as an additional measure to monitor apart from asset-related measures. Regarding the measurement of liquidity, the net liquid balance seems to be the only indicator of those mentioned in the literature, that ICU monitors.

Apart from the factors mentioned in the literature, and due to the special structure of ICUs project financing cycle, which had been mentioned briefly before, to better explain, why cash-flow projections are not being used by the organization, the organization focuses the monitoring of internal factors which inform liquidity management on operational factors and indicators. As it had already been mentioned in the section on the general concept, the expenses and income are measured against budget, but to add to that, the expenses are also analysed in comparing the progress in a specific project with the progress as it had been planned for the specific project at the given time. This operational informations inform decisions regarding the appropriate threshold of excess cash, above which funds are transferred to the organizations endowments.

Apart from these operational indicators, the organization monitors another cash-related factor which also reflects the special structure of the organizations cash-inflows: As it had already been mentioned in the section on the organizations general practice, ICUs activities are mostly cash-positive, as the organization receives the funding before starting the project and using the provided funds – the only point in time of the project cycle at which the project is actually cash negative is at the end of the project lifetime.

As it had been described in section f) of chapter 4 on the structure and characteristics of organizational cash-flows, NPOs are frequently confronted with a rather complex cash-flow structure, due to restrictions based on thei cash-flows by donors as well as the strong moral requirements of the sector. ICU provides a good example of an organization exposing such a complex cash-flow structure, also attributable to the fact that the organization receives most of their funds from institutional donors, as one can see from the following example: At the beginning of a project, the organization receives 50% of the funding, in the following, after having spent that first tranche according to the project progress, the organization asks for another tranche of about 40% of the complete funding of the budgeted funds. At this point, after having received about 90% of the funding, the organization keeps spending until arriving at 100% of the budgeted expenses and receives those 10% that have been thrusted out before. After those 10% have been spent, the organization provides the donating facility with a final report and receives the last 10% of the funding as it had been budgeted. This means that at the end of the project life cycle, the organization is cash-negative for some time before the missing 10% of the funding have been provided.

Financial Management personell

The financial management personell holds a crucial role for achieving success in the third sector, as it had been discussed in further detail in section j) of Chapter 4 of the literature review, especially regarding their educational background. (Non-Profit business advisor, 2014) In the case of ICU, considerations regarding their personell have to be made in the light of the fact that their operations are mostly taking place in developing countries, which can make the recruiting and outposting of personell to these areas, challlenging.

To account for these challenges, ICU adopted the following organizational structure for its financial management department: In the rome-based headquarter, there is one financial manager and one in each of the ten countries the organization operates in. While the financial manager in the headquarter does an educational background in Finance, this is not always possible for the outposted personnel. To complement the knowledge of the outposted financial manager with some regional experience and insight, the organization employs a local with a background in accounting in each of the ten countries in which the organization operates. Overall, the organization does acknowledge the importance of and adequate education as a foundation of sound financial management, but does also need to account fot the challenges posed by the areas they mainly operate in.

Funding sources

The topic of funding sources had already been mentioned in some of the sections before, which indicates how important the donor structure is for several aspects of a projects operations and financial management practices. While Horizons receives funding from almost every source that had been identified in section f) of chapter 4 on NPO-cash-flow structures, ICUs main donors are institutional donors, meaning either governements, agencies and bodies of the United Nations or large foundations. These institutional donors can be public or private, but the organization does not do any fundraising from individuals or corporations. The funding received is furthermore linked to a specific project or a specific activity, indicating that ICU operates with restricted funds only, which does represent another difference compared to the activities of Horizons and can also be connected with the high importance of endowments for the organizations financial operations. One similarity could be identified in the sense that both organizations identify their donor structure as having grown rather organicly over time then being the result of a series of strategic choices.

Endowments

As described in section g) of chapter 4 on endowments, these funds are an important and powerful tool for organisations to maintain financial flexibility in the light of possible program expansions and threats to their financial stability, since they provide the organisation acess to funds that can be used at their discretion and since the cash-inflow from these sources does not entail additional financial effort, as the search for new donors might do. Apart from that, the cash-inflow from endowment funds is usually more stable than from regular commercial sources. (Non-Profit business advisor, 2014 & Glaeser, 2003)

For the case of ICU, the endowment funds do clearly fullfill the role of maintaining the organizations financial flexibility and are also named as the reasons for the organization not to consider credit lines or other debt instruments as a funding source. These endowments are held in different asset classes, meaning listed and not-listed assets. The listed assets comprise investment funds, while the non-listed assets used for endowments are real estate funds. The endowments of ICU are managed by the secretary general, who takes all decisions regarding their usage together with the executive level consisting of three people. These reviews are undertaken in the board meetings twice a year. In general, the principal of the endowment remains untouched, as only in emergencies, which could be attributed to delays in donor payments, the organization considers to touch the principal of the endowment. If the principal is being utilized, the literature denotes these endowments as 'quasi-endowments'. (Helms, Henkin, & Murray, 2005)

Operating Reserves

Regarding the use of operating reserves, which have been discussed in greater detail in section h) of chapter 4, the high importance of endowments for ICU does again play a role. While the organization holds operating reserves, those are claimed to be used merely to account for risks and liabilities, leaving it to be more of a paper issue than an operational issue. The operating reserves do not play a central role in the organization's considerations regarding liquidity management, since endowments have such a central role to the organization's considerations regarding liquidity. Instead they play a transitionary role when endowment funds are being used to meet liabilities encountered by the organization.

Ethics

Similar as in the case of Horizons, Mr. Vigevani confirms that ethical considerations play a central role their activities, but he also denotes that he does in general not see any special implications of the high ethical standards on liquidity management. Ethical considerations are at the heart of many operational decisions, regarding the acquisition of equipment and the provision of support to local governements but not for most areas of liquidity management.

The only part of liquidity management which is directly impacted by ethical considerations in a way that goes beyond mere compliance with legal restrictions, regards the endowments. When deciding in which kind of assets to invest, the organization follows the ESG principles: environmental, social and governemental.

Concluding remarks

ICUs liquidity management practices do in many aspects correspond to the findings in the literature, providing a good example of the power of liquidity management tools such as endowments to allow for more organizational flexibility and access to discretionary and unrestricted funds. Apart from that, the example of ICU demonstrates the relevance of the economic, socio-demographic and political conditions of the area an organization operates in, since operations in developing regions pose big challenges to sound liquidity management due to high risk regarding inflation and foreign exchange measures.

In addition, the complexity of the organizational cash-flow structure illustrates the complex nature of the financial managers daily work in understanding how to best account for the different restrictions and timing of funding, as well as the high importance of maintaining a constant outlook on financial flexibility as a core task of sound Financial Management.

6. Conclusion

Financial Management in the non.-profit world has received increasing attention by industry professionals and researchers around the world, which lead to a big leap forward in terms of available research on the topic.

The performed analysis underlines the high importance of liquidity management as a part of successful financial management and demonstrates that the increased attention on the side of resrearch corresponds to increase attention of industry professionals for the topic. Non-profit organization do increasingly understand the importance of liquidity management for their mission attainment and drop the notion that financials provide an obstacle to successful provision of their program activities.

Financial managers need to utilitze the momentum that the financial crisis created, to set new standards for liquidity management in their sector. The for-profit sector does provide valuable input for non-profit financial managers to consider and adapt top the specific needs of their world and the area they are active in. While it often seems to be more a question of terminology than actual practice, if the industry parctice and the theory seem to diverge, there is for sure big potential for organizations to improve in key areas of their liquidity management. On of those key areas regards the organizations financial flexibility which does at the end condition that it can fullfill its organizational mission at all times, which is the primary objective of any non-profit organization. Understanding the organizations financial flexibility, as well as the possible techniques and tools to ensure its existence over time, requires a deep understanding of an organizations cash.-flow strcuture, its donor structure as well as the adequate use of instruments such as endowments and operating reserves.

Having developed such an understanding, organizations and financial managers will be ready to fullfill the important function they hold for a society and economy, even in the light of unpredictable external conditions, as the ones our world is currently facing.

Bibliography

Beck, T., Lengnick-Hall, C., & Mark, L.-H. (2008). Solutions out of context: Examining the Transfer of Business Concepts to non-profit organizations. *Non-profit management and leadership*, 12-16.

Borgonovi, F. (2006). Do public grants to american theatres crowd-out private donations. *Public Choice*, 4-6, 19-20.

Boukaert, L., & Vandehove, J. (1998). Business Ethics and the Management of Non-Profit Institutions. *Journal of Business Ethics*, 1-7.

Breen, O. B. (2008). EU Regulation of Charitable Organizations: The Politics of Legally Enabling Civil Society. *International Journal of Not-for-Profit Law*, 3-8. Retrieved from http://hdl.handle.net/10197/8623

Brown, W. (2005). Exploring the Association between Board Performance and Strategic Leadership. *Nonprofit Management & Leadership*, 3-10, 17-20.

Casey, J. (2016). Comparing Non-Profit sectors around the world: What do we know and how do we know about it. *Journal of Non-Profit Education and Leadership*, 21-24.

Casey, J. (2016). Comparing Non-Profit Sectors around the World: What we know and how we know about it. *Journal of Non-Profit Education and Leadership*, 3.

coinnews mediagroup LL. (2018). *US inflation calculator*. Retrieved from inflation calculator: https://www.usinflationcalculator.com/inflation/historical-inflation-rates/

Dobson, J. (2003). Why Ethics Codes don't work. *Financial Analysts Journal*, 1-6.

Duska, F. R. (2004). Six Cures for Current Ethical Break-Downs. *Journal of Financial Service Professionals*, 1-2.

Ebrahim, A. (2003). Accountability in Practice: Mechanisms for NPOs. *World Development*, 4-9.

Ecer, S., Magro, M., & Sarpca, S. (2016). Relationship between non-profits revenue composition and their economic-financial efficiency. *Non-profit and voluntary sector quarterly*, 1-6.

Emery, G., & Cogger, K. (1982). The Measurement of Liquidity. *Journal of Accounting Research*.

Ethics and Compliance Initiative. (2019, January). *ethics.org.* Retrieved from 2016 Global Business Ethics Survey: https://www.ethics.org/wp-content/uploads/2018/09/GBESFinal-1.pdf

Evers, A., & Laville, J.-L. (2004). Defining the third sector in Europe. In A. Evers, & J.-L. Laville, *The Third sector in Europe* (pp. 24-45). Globalization and Welfare.

Evers, A., & Laville, J.-L. (2004). Welfare pluralism and the plural economy. In A. Evers, & J.-L. Laville, *The third sector in Europe* (pp. 15-20).

Figueroa, D. (2017, October). *Italy: Code to Regulate Nongovernmental Organizations.* Retrieved from Library of Congress: http://www.loc.gov/law/foreign-news/article/italy-code-to-regulate-nongovernmental-organizations/

Fisman, R., & Hubbard, G. (2005). Precautionary savings and the governance of nonprofit organizations. *Journal of Public Economics*, 1-2; 11-13.

Foster, W., & Fine, G. (2007). How non-profits get really big. *Stanford Social Innovation Review*, 7-9.

Foster, W., & Fine, G. (2007). How Non-Profits get really big. *Stanford Social Innovation Review*, 2-9.

Gallagher, M., & Radcliffe, V. (2002). Internal controls in nonprofit organizations. *Nonprofit Management & Leadership*, 2-3; 6-12.

Glaeser, E. L. (2002). Governance of Non-Profit Firms. *National Bureau of Economic Research*, 55-60.

Glaeser, E. L. (2003). The Governance of Not-for-Profit Organizations. *University of Chicago Press*, 45; 55-60.

Gläser, E. (2003). The Governance of Non-Profit Boards. *University of Chicago Press*, 6-15; 15-19.

Helms, L., Henkin, A., & Murray, K. (2005). Playing by the rules: Restricted endowment assets in colleges and universities. *Non-profit management and Leadership,* 1-4; 12-14.

Horizons for Homeless Children. (2019, May 9). *Financials.* Retrieved from www.horizonschildren.org: http://horizonschildren.org/about-us/financial/

Hovakimian, A., Opler, T., & Titman, S. (2009). The Debt-Equity Choice. *School of Business Administration*.

Hughes, J. (2013). A New Cost Efficiency Measure for Not-for-Profit: Evidence of a Link between inefficiency & larger endowments. *Atlantic Economic Journal*, 20-21.

Hyyryläinen, E., & Viinamäki, O.-P. (2011). Benefits of Hybridity organizations: Views from the public, private and the third sector. *The International Journal of Management Science and Information Technology*, 19-30.

Internal Revenue Service. (2019). *Tax Information for Charities & Other Non-Profits*. Retrieved from https://www.irs.gov/charities-non-profits

Kaplan, R. (2001). Strategic performance measurement and management in NPOs. *Non-Profit Management and Leadership*, 2-7.

Kim, M., & Peng, S. (2018). The dilemma for small human-service nonprofits: Engaging in collaborations with. *Nonprofit Management and Leadership*, 16-17.

Klump, L., & Cole, A. (2014). Are you telling the right story about your liquidity? *Non-profit world*, 1-4.

Klumpp, L., & Cole, J. (2014). Are you telling the right story about your liquidity. *Non-Profit World*, 2-4.

Maier, F., Meyer, M., & Steinbreithner, M. (2014). Non-Profit Organizations becoming business-like: A systematic review. *Non-Profit and voluntary sector quarterly*, 65-66.

Meliones, J. (2000, April 3). *https://hbr.org/2000/11/saving-money-saving-lives.* Retrieved from www.hbr.org: https://hbr.org/2000/11/saving-money-saving-lives

Miller-Millesen, J. (2003). Understanding the Behavior of Nonprofit Board of Directors: A theory-based approach. *Nonprofit and voluntary sector quarterly*, 8-13.

Miller-Millesen, J. (2003). Understanding the Behaviour of Non-Profit Boards of Directors: A Theory-Based Approach. *Nonprofit and Voluntary Sector Quarterly*.

Mitchell, G. (2015). Fiscal Leanness and Fiscal Responsiveness: Exploring the normative limits of strategic nonprofit financial management. *Administration and society*, 16-19.

Mittilä, T. (2014). Commercialisations of Non-Profit Organisations. *The 19th Annual IMP Conference in Lugano*, (pp. 6-9).

Moodys Foundation. (2011). *Financial Literacy and Knowledge in the NPO-sector.*

Non-Profit business advisor. (2014). Rigorous Management principles keep endowments healthy for stability. *Non-Profit Business advisor*, pp. 4; 1-3.

Non-profit Finance Fund. (2017). *Non-profit finance fund*. Retrieved from What's left over to pay bills: /nff.org/blog/what's-left-over-pay-bills

Paul, K., Joseph, M., Mark, O., & Matt, U. (2012). Reserves planning: A step-by-step approach for non-profit organizations. *Financial Literacy and Knowledge in the non-profit sector*, 1-5.

Pilbeam, K. (2018). Monetary policy and interest rate determination. In K. Pilbeam, *Finance and Financial Markets* (pp. 66-70).

Pinkowitz, L., & Stulz, R. (2006). Does the Contribution of Corporate Cash Holdings and Dividends to Firm Value Depend onGovernance? A Cross-Country Analysis. *The Journal of Finance*, 2-6; 26-28.

Sinclair, R., Hooper, K., & Lei, Y. Y. (2009). Virtues and Risks of Poverty. *Chartered Accounts Journal*, 1-3.

Statista. (2019, February). *statista.com*. Retrieved from Projected annual inflation rate in the United States 2010-2023: https://www.statista.com/statistics/244983/projected-inflation-rate-in-the-united-states/

Wacht, R. (1984). Financial Management Theory for NPOs. *The Journal of Financial Research*, 4-9.

West, A. (2017). Top challenges facing not-for-profit CFOs today. *The CPA Journal*, 1-3.

Wiley. (2017). Unrestricted Operating support needed to help NPOs adress liquidity issues. *Corporate Philantropy Report*, 1-3.

Wiley. (2018). Many non-profits vulnerable to uncertainty due to low operating reserves. *Non-profit business advisor*, 1-3.

Wiley Periodicals. (2017). Many non-profits vulnerable to uncertainty due to low operating reserves. *Non-Profit Business Advisor*, 1-3.

Wiley Periodicals. (2018). Ethics is everything to a Non-Profit board. *Wiley Periodicals*, 1.

Wiley, J. (2004). The Nature and Purpose of Risk Management. In J. Wiley, *Managing Risk in nonprofit organizations: A comprehensive guide* (pp. 3-33). John Wiley & Sons.

Wooten, T., Coker, J., & Elmore, R. (2003). Financial Control in religious Organizations. *Nonprofit management and leadership*, 20.

Zietlow, J. (2010). Non-profit Financial Objectives and Financial Responses to a tough economy. *Journal of Corporate Treasury Management*, 1-7.

Zietlow, J., & Seidner, A. (2007). Cash Planning & Liquidity. In J. Zietlow, & A. Seidner, *Cash & Investment Management for Non-profit organizations* (pp. 25-64). Wiley.

Zietlow, J., & Seidner, A. (2007). Cash-flow and your cash position. In J. Zietlow, & A. Seidner, *Cash & Investment Management for non-profit organizations* (pp. 1-23). Wiley.

Zietlow, J., Hankin, J. A., & Seidner, A. (2007). Liquidity Management in Non-profit organizations. In J. Zietlow, J. A. Hankin, & A. Seidner, *Financial Management for Non-profit organizations: Policies and practices* (pp. 60-92).

Zietlow, J., Hankin, J. A., Seidner, A., & O'Brien, T. (2018). Ethics. In J. Zietlow, J. A. Hankin, A. Seidner, & T. O'Brien, *Financial Management for Non-Profit Organizations* (pp. 129-130).

Zietlow, J., Hankin, J. A., Seidner, A., & O'Brien, T. (2018). Liquidity Management. In J. Zietlow, J. A. Hankin, A. Seidner, & T. O'Brien, *Financial Management for Non-Profit organizations: Policies and Practices* (pp. 35-37).

Zietlow, J., Hankin, J. A., Seidner, A., & O'Brien, T. (2018). Organizational Structure and Governance. In J. Zietlow, J. A. Hankin, A. Seidner, & T. O'Brien, *Financial Management for Non-Profit Organizations* (pp. 96-122).

Zietlow, J., Hankin, J. A., Seidner, A., & O'Brien, T. (2018). Understanding non-Profit Finances. In J. Zietlow, J. A. Hankin, A. Seidner, & T. O'Brien, *Financial Management for Non-Profit Organisations: Policies and Practices* (pp. 10-13). John Wiley and Sons.

Zietlow, J., Hankin, J. A., Seidner, A., & O'Brien, T. (2018). Understanding Non-Profit Organization Finances. In J. Zietlow, J. A. Hankin, A. Seidner, & T. O'Brien, *Financial Management for Non-Profit Organizations* (pp. 4-9). Wiley.

Zietlow, J., Hankin, J. A., Seidner, A., & Timothy, O. (2018). The appropriate liquidity target model. In J. Zietlow, J. A. Hankin, A. Seidner, & O. Timothy, *Financial Management for non-profit organizations: Policies and Practices* (p. 16). Wiley.

Table of Figures

ANNEXE I

Case Study - Interview

Role of the organizational mission & general practice:

What is your organization’s mission? (Maybe derive from homepage)
Do you review your projects regarding their fit to your mission? If yes, how?
Who ensures that this mission is at the center of day-to-day business activities?
Which role does the organizational mission play in your everyday work?
Do financial management requirements conflict with your mission attainment?

Cash-Crunches:

Did your organization experience serious cash-crunch crises since its foundation?
If yes, when?
If yes, how did you counter this crisis in the short- and long-term?

Liquidity definition & daily practice

How do you define liquidity? (sub-questions to see organizational understanding of solvency and financial flexibility; Is there such thing as a distinction between narrow and broad liquidity)

>> Importance of liquidity management:

- How do you/ your financial management executives view holding excess cash?
- Did the Financial Crises of 2007/08 change your view on holding excess cash/ liquidity management? If yes, how?

>> Liquidity management practice:

- What is the main goal of your liquidity management?
- Do you set target levels for revenue and support? How often do you review/revise them?
- Do you do cash forecasts? How often? Do you review/ revise them?
- Do you analyze and compare actual levels of income and expenses against budget?

- Do you monitor liquidity management practices of your closest competitors? If so, what can you gain from this?
- Do you have an appropriate liquidity target (ALT)?
- If yes, which importance does your ALT have compared to other financial objectives?
- How do you determine the ALT?

>> Economic indicators and their impact
- Do you monitor certain external indicators to guide and inform your liquidity management? If yes, which?
- Rank the following indicators/factors regarding their importance for your organization: Growth rate, consumer confidence, unemployment rates, tax rate, inflation rate, charitable giving indices, major stock indices, forecasted increases in temperature (climate change), demographic changes (birth rates, death rates), elections
- Then rank them regarding their actual impact on your daily liquidity management practice
- Are their any risks to your liquidity which are specific to your industry? If yes, which ones?

Accounting practice

(Questions will only be asked if any of these factors remains an open question after careful review of the Financial Statements of the organization)

- Are assets classified in current and non-current ones?
- Is there a sequencing according to nearness to cash?
- Do the notes give information on different restrictions given to funds?
- Is there any precise info on financial assets and liabilities, as well as how restricted the assets are?
- Do you inform your stakeholders about the most important features and time-horizons of your liquidity management, as well as your cashflow-structure?
- Do you have for-profit subsidiaries, if yes – how does their income enter the Balance Sheet and Income Statement?

Financial Ratios for NPOs

- Which of the following ratios do you use and if you use it, how do you compute it:
  - Current ratio
  - Quick ratio
  - Organizational liquidity funds indicator
  - Net working capital
  - Assets ratio
  - Cash ratio
  - Net liquid balance
  - Cash-flow from operations

- Cash-flow statement/ parts of it
- Cash conversion efficiency
- Cash conversion cycle
- Cash reserves ratio
- Current liquidity index
- Lambda

Financial Management Personnel:

Do you have dedicated Financial Management personnel?
What is the educational background do you have/ does your organization seek for in Financial Managers?
What is the educational background of you/your Financial Managers at the time?

Financial Management Personnel & literacy

- What are the most important criteria for you when recruiting financial management personnel?
- How would you evaluate the level of expertise of your Financial Management functions personnel on a scale from 1-5?
- How important do you think is a formal educational background for successful performance of that function?
- During recruiting for that function, do you test financial management literacy of the candidate? If yes, how?

Funding sources:

- What sources of funding do you use? (donors, government, generated revenue, credit) Which percentage of your funding comes from each of these sources?
- Do you have access to unrestricted funds? If yes, to which percentage and which type of unrestricted fund?

>> Donors

Describe your donors' structure (many small donors, some major donors etc.):
Did your donor structure grow over time or is it the result of strategic choices?
Do your donors add restrictions to the given funds? If yes, in which ways? (Time, project-specific etc.)

>> Creditors:

Did you/ do you plan to extend your credit lines?
Do your credit lines play a role in your considerations regarding adequate liquidity management?

Liquidity Management Tools

>> Endowments:

- Do you use endowment funding, and if yes, do you distinguish different types of endowment classes?
- Which asset form do your endowments mostly take?
- Did you ever experience a case of abuse of endowments, attempted use of endowments?
- Do you think the interests of your donors and of organizations management are well aligned? In how many percent of cases?
- Do you hold and investment policy status? If yes, what does it specify?
- Who manages your organizations endowment funds?
- Do you carry out regular reviews of your endowment funds and the restrictions placed on them?

>> Operating reserves:

- Does your organization hold operating reserves, if yes, how do you denote them and which part of your annual operating expenses is covered by them?
- Do you have a long-term financial goal and if yes, what does long-term in this case mean to you?
- Do you perform risk analysis for your operating reserves and if yes, who is involved in carrying out this analysis? Do you quantify your risk-exposure?

Ethics:

- Which role do ethical considerations play in your everyday work?
- How do you ensure that Financial Management activities are carried out in compliance with highest ethical standards?

ANNEXE II

Transcript of the Interview with Tammy Reeder, Chief Financial Officer (CFO) of Horizons for Homeless Children, a non-profit organization based in Boston. The interview was conducted via Skype on Monday, May 6.

My work is in general about Financial Management in NPOs and more specifically in Liquidity Management in NPOs. So, I did a comprehensive review of all the literature I could find on the topic and based on that, I developed a set of questions to be test the industry practice against the theory. So, the first block of questions is more conceptual and related to general practice:

Q1: So in the NPO-sector mission does of course play a big role. How does that impact your role, your function in the organization? Do you as a Financial Manager review projects also regarding their fit to the organizational mission, or is that the task of someone else?

And, if yes – how does this review look like? How does one review the fit of a project towards mission attainment?

T: So, as a Financial Manager, uhm, I definitely doe play a role, probably not as much as everyone else, uhm, so, you know – people in our program staff, who run our program, probably – you know- look at that everyday, to make sure that we are providing our mission, accomplishing our mission, everyone knows what that is – not that I do not know what that is but obviously I am just trying to provide the Financial ability/es to do that. Uhm, but I will say sometimes, you know, organizations go through mission drift and people may have some ideas, you know, good ideas, great ideas – with good intentions, but I may be a person who says, you know – along with other people – but I might from a financial perspective kind of ask – how does that fit in out mission and do you fear that we have now gone off into something that is not our main focus. So yeah – I have definitely raised the hand sometimes when, you know, we, we – we actually did have a little mission drift in the beginning, when I came on and I feel now we are more focused, but sometimes, you know, people in non-profits want tHpro save every aspect of that person’s life, sometimes, and your know, again, as good as an intention that is, like we need to focus on what we do well and if we try to focus on other things, we might loose sight of our mission and not be able to provide the quality that we have kind of raised ourselves to in what we do.

Interviewer: Mhm, so?

T: So yeah, I do, not as much as our program staff, but I do definitely make sure that the dollars we are spending is appropriate.

Interviewer: Ok.

- Screen freezes –

Interviewer: … the requirements of sound financial management conflict with mission attainment sometimes. Like, do you think that Financial Management can fit with mission attainment, or is it something that someone has to make fit?

T: Can you, can you just repeat that one more time because I think you froze up a little bit, so I want to make sure I understand it right. (laughs)

Interviewer: Yeah, of course. So, you were just before giving the example of yourself raising the hand when things go a little bit out of hand and there is something like mission drift.

T: (nodding) -yeah, yeah.

Interviewer: Uhm, but can it also be that, uhm, Financial Management requirements are in itself in conflict with mission attainment? Does that happen?

T: So, yes and no. I think it's a little bit of a balance. I definitely, uhm I mean, uhm mission comes first in non-profits and then Financials come second while in for-profits Financials are here, you know - (makes high line in the air with the hand), so I think, you know, I am always looking at ways to though, make it as financially efficient as we possibly can. I think that does sometimes conflict with people in program, who want, you know – there is only so much you can do, with the amount of money you raised. So even if mission comes first, that Financials fund that mission, so, if you do not pull in enough to fund that mission, sometimes there is a conflict with staff about understanding that. And they obviously want to provide the best quality, uhm, we possibly can – so do I – but, again, sometimes there is budget constraints and it could have an impact on your mission. Absolutely, you may have to drop some – you know – you kind of have a core and a fringe and maybe you need to drop some of that fringe in order so you can continue to have that core. So, yeah…

Interviewer: So, adding up to that I will now go more into the sub-sections about the individual liquidity management practices, because that is also a good fit to what we just talked about. So the first topic and want to talk with you about is Cash Crunches. So, after 2007/2008, apparently many organizations went through this – so, did your organization experience a serious cash crunch crsis – (searches for words and does a) – cash crunch crises since you monitor it and if that happened, do you remember when and also how the organization countered that crisis in short- and long-term?

T: So we, we experienced that but – so, we have just had a campaign before the cash crisis, which enabled us to have about an extra 20 million dollars in capital, uhm, which we put in as an – you know, which we put into investments. Uhm, I would say though that over the course of probably right around there, right from 2007 and on, we experienced deficits, so we were feeling that we were not able to raise as much money as we needed to provide our mission every year. And so we dipped into these reserves substantially. Uhm, almost to the up to, at least half of it if probably not more over the course of 8 or 9 years. I mean, when I got on – I have been here about 4 years –

there was a huge, there was a million to a two million dollar deficit every year, uhm and probably consistently about five hundred … a million dollars every year. I mean, I did not think that was ok. Ironically, that subject, I have been in other non-profits, where my whole thing was to make sure, you know, that they were not loosing money and having the cash available uhm – I would say it was interesting (I do not know how you want to put that into your part) – I came from a non-profit, where they lived paycheck to paycheck almost. I mean it was literally scarce. But, they didn't see a reason, like – they knew they were in trouble since there was such stress – and people felt that. So when I kind of gave them a financial strategy, they accepted it, even though it was gonna be really hard. But they knew they would have at least that reserves in the future, so you would not need to be so stressed out about payroll. So, when I came here, there was a philosophy around the organization, which because of that 20 million dollars, unfortunately, it wasn't as serious – we just kept dipping into this reserve and people knew we had it and kept continuing to say: but, we have it – we have money, we know we have money and I continued saying: But, you know – one day we won't and you know, we will have lost all that money we could have had for a good opportunity. Whenever it came up and you know, we would be in a serious crisis mode. So, you know – I do not understand why we are not managing our budget every year and making sure we balance, or making a small surplus. Uhm, so – it took a lot to show people, that over time, this.. this little, this 20 million that we kept thinking, was just this, you know, tree in the backyard that had all this money, like - it would just go away you know and we then would not be able to fulfill our mission, because we would just not have been fiscally responsible for so many years. So… long answer, sorry. (laughs)

Interviewer: No, no, that's good. Its valuable input. We will talk about Reserves in one of the next sections of the interview, so you already made a start in a topic that we will discuss later on.

So, Cash crunches was our first module, the next module I want to talk about, is the definition of liquidity. So as you mentioned, you were in different organizations, so I guess there were also different ideas about what liquidity is. So…

T: Yeah, sooo – sorry, sorry, go ahead.

Interviewer: So, I was wondering, how you define liquidity in your organization now and if there is such a thing as a distinction between narrow and broad liquidity – if that rings a bell for you – so yeah, that is basically it.

T: Uhm, so I would just define liquidity, I guess yeah – we define it as current assets, you know current assets that we can turn into cash, over current liabilities. I think we do look at it, short-term and long-term. Uhm, in the past we had investments and money in investment, so the more we can, you know, not have to dip into our capital, the better. Uhm, aaand, so that's what I guess I would describe… that is how we look at liquidity. Solvency is kind of different, I saw that in your notes, I look at solvency as current cash, or what you can turn… current assets and then I would divide that by our current operating budget, to get to solvency. Uhm, we … coming back to cash crunches, so we, uhm, up until recently, and more recently we decided to build this building and when we went to build the building, we got a loan from our bank, uhm and they took control over all our investments as collateral for the loan, so now we are under a lot more cash strain and crunches, so uhm – I probably look and I have been looking at our liquidity and solvency uhm – not that I did not look at it before, but probably, I look at it monthly, probably with my CEO. I mean, I probably look at it weekly – we actually have a cash-flow report that I look at weekly, that shows me, what my balances are and it kind of projects about 9 months, you know, base on the actions and trends from the year before. So, uhm, I can see what, you know, what I think will be the balances. Kind of like a budget, but more for Cash. And then, yeah, so I probably look at that weekly, but then you know, I probably, with me CEO monthly, if not quarterly.

Interviewer: Ok, thank you, very interesting. Uhm, lets turn towards the importance of liquidity management. So, how do you or your, also your CEO and other executives view holding excess cash? You said already, your organization is holding reserves, so I think, in general…

T: Yeah uhm… So, I don't see any issue with holding cash. I have seen some non-profits think that uhm, you know, it's bad to hold so much cash, it seems like you do not need their money – I think you can always explain excess cash to donors. I think again, uhm, you never know what you might need that cash for. And you know, if you are always spending, if you do not have a big cash reserve, I think you have a hard time growing your mission, which I think you always want to uhm and the more you reserve and become financially stronger, the better you can grow in a smart way. And uhm, and impact more. So I think like, again its like, you know – if personally, if you want to buy a house – that's going to have a bigger impact eventually down the line, saving, than like- you know - just not saving at all. Interestingly enough I was lately talking to a grant-person that asked me, if you had less than 50% excess, they'd ask you a lot of questions and how and why you would not have more than 50% cash at hand for your annual, so your solvency. But if you had more than over a 150%, they wanted to know why so much, so I don't know – you know, in the end, I think you can always explain having a little bit more cash and what you would be using it for in the future.

Interviewer: And, do you think, or more from your personal experience, did the financial crisis of 2007/08 change the view of the sector regarding that topic a little bit, or not so much?

T: I, I mean I think it did, uhm, I think, yeah, I think from a non-profit standpoint it definitely changed, because some non-profits struggled with the crisis, because people who could be philanthropic, suddenly couldn't be and people got scared and just – you know – definitely wanted to secure their funds over maybe donating, which is unfortunate, but it took such a hit, that, I think, in all non-profits – again, a way to explain this to donors: You know, we will have years that are good and years that are bad and, you know, the years that are good, we should actually secure it and put it into reserves, just in case, we have not a good year or a couple of years, or 5 years, we are covered. So, yeah…

Interviewer: Ok, so, more about external factors: We are now going to do a block on liquidity management practice and then more on economic factors. Is that ok for you as well?

T: Ok, Yeah, yeah …

Interviewer: Ok, so, the liquidity-management practices. What would you say, is the main goal of your liquidity-management?

T: Uhm….

Interviewer: If you really have to nail it down – what is your main, your most important goal?

T: I guess, uhm… I take a lot of responsibility in it, just because I am responsible before providing the livelihood of our employees – we are extremely service-oriented, so… uhm 80- 85% of our expenses are salaries and they are all fixed, we do not have a lot of room, uhm – even though our funding is not fixed. So, I feel actual as a Financial Manager, I have responsibility around that. So, I think, from a Financial Manager viewpoint – we do not have a lot of Financial people in the organization and most non-profits don't… uhm… So, I feel, as a Financial Manager you have to own that a little, because, if you are not watching that, I can pretty much guarantee that other people in the organization aren't watching that and they would probably not even know how to make sure that we get payroll on a certain week, or for every months, so – you know, that kind of things.

Interviewer: (nodding) Ok. I see – Do you set target levels for revenue? And if you do, how often do you review or revise them?

T: So, we set an annual budget, you know – we work on that 3 months probably before our fiscal year ends and then the board approves it, uhm – you know about a month before maybe the fiscal year starts, somewhere around there. And then, we set revenue targets and then we, probably, we review everything quarterly and re-forecast. I would say, our first quarterly-forecast is not the biggest one – we kind of see and try to make sure that we are not totally off and then, I think our half-year point is pretty critical and I get pretty much most of managers to be part of that with me – to see like, if something is trending very off budget, what's going on with that. Uhm… do we need to readjust the budget… Right now, because of our cash-crunch a little bit and not having that collateral, being controlled by the bank – my CEO and I are constantly, you know, just at halfway – if something is not going right, we really have to make sure that we balance our budget until the end of the year and continue to be sustainable, because we just cannot have a loss. You know, for any loss, that we start to see, we have to adjust somewhere else.

Interviewer: Mhm ok – so you do not get into more serious trouble of course. So, the next question would have been on forecasts, but you answered that already since you said that you have a cash-flow forecast, so you have a cash forecast and you revise it. So, the next question would have been on analyzing and comparing income and expenses to budget, which you covered, because as you just told me…

(Both laugh)

Ok, so – do you monitor liquidity management practices of other organizations that are in the same field? Like, do you do that, do you try to learn from what others do, if its observable? I guess you took a lot of experience from your previous organizations to this one – but, I general, is that something, that you actually do?

Tammy: Uhm, probably not too much, as I feel I have my own kind of measurements, that are probably standard, you know… uhm… so – we, we definitely look at the norm. Do we look at similar organizations? Probably not so much. We probably look at non-profits as a whole and try to determine like the solvency rate and our liquidity rates and where you should be.

Interviewer: Do you have an appropriate liquidity target specified or quantified? And if yes, how important is it for your financial objectives?

Tammy: Uhm, so we – I think my standard has always been 1:1.5 – uhm, gosh, I do not know what our liquidity-ratio is right now. I guess it is about there – uhm, we do not carry a lot of liabilities, only in payrolls – so they are not like booked. Uhm, I have been… my last organization you know, was at a 0.13 when I first started there and that was when I was trying to explain to people like: This is bad! This is really bad. Like we have 13 cents on every dollar we owe – you know and I think people finally realized. And I mean, I explained liquidity and how you do the ratio and all of that. And they were like: Huuum. And I, I mean unfortunately I had to get personal on the board and I was like: Would you feel good, if that was your personal expenses and everybody was pretty much like: Well, no. and I was like: We have to change.

So yeah, our whole goal was to get above 1 and then closer to 1,5 to 2 actually. So yeah.

Interviewer: Mhm, so that answers also my question how you determine the liquidity target, so we can go onto external factors now, which are mostly economic indicators and we will talk about the impact you think they have.

Do, are there external indicators that you monitor regularly to guide and inform your liquidity management a bit? And if yes, which ones?

T: Uhm, external factors. Well, so – the market I would say, a little bit – because we do have our, our uhm… we are left with about 7 million dollars that we invest and uhm… I would never want something to crash, I would probably pull that out of the market, just to be safe with it – or a certain portion of it, because again – it would be all that we had and just would never want to loose – … now, I mean, if you loose some one day and it comes back – I mean when you start to see a really bad trend, I would pull out, just to be safe.

Uhm, other external factors – I mean, I guess yeah – the economy itself would be a big external factor. Uhm we get some government funding that is pretty consistent, that I don't see would be going away and uhm, we also fundraise about 60% of our dollars and uhm, if the economy… or we would just see a decrease in the amount of money people had to donate, you know – we would probably adjust according, there as well.

Interviewer: Ok, yeah. I would also list some factors now and you just tell me if you monitor them or not. Ok? And then, in the end – let's see, if you recall all of them, but it would be good if you could point out the 3 that seem most important for you.

So: Growth Rates?

T: Yeah, definitely, we look at that every year, uhm, because I actually need a certain amount of growth in revenue, to provide for inflation – more specifically for annual increases, for, your know, for our staff and then just some other inflation items. So since I – again, I am pretty much break-even right now – so if I do not have any growth, then I am going to have a deficit, because everyone wants to have 3% or whatever the norm is for annual increases here.

Interviewer: Ok, consumer confidence?

T: Uhm, I do not think we… yeah – no..

I: Unemployment Rates?

T: (sighs) it does not really play into our organization, so.. yeah…

I: Mhm, charitable giving indices?

T: (nods) ooooh, yes – yes!

I: Major stock indices, you mentioned already, when we were talking about the market.

Uhm, forecasted increase in temperature, meaning: climate change.

T: We have not seen affect us, no.

I: Demographic changes like birth rates, death rates, aging?

T: Yeah, I mean birth would have an effect on us if it would drastically change, since we teach children.

I: Elections?

T: Yes! (giggling) yes (nodding and giggling)

I: Ok, and I do not know if you remember all of them but which ones would you say, which ones do come back to your head and would you say are most important?

T: So, I would say, the top 3 would be growth rate, charitable giving and elections.

I: Ok, and are there any risks to your liquidity, that are very specific to the sector you operate in? And if yes, which ones would that be? Something you think is just for your organizational type or similar organizations that is affecting you especially strong? Nothing internal, just something outside of your organization?

T: Yeah, uhm, so I would guess cost of living is something that is huge. So, we live in Boston and to live in Boston has just become more and more expensive uhm and at kind of a, really, alarming rate, a little bit… and its becoming close to New York City and San Francisco and uhm, we deal with homeless families and children and so, more and more people cannot afford to live in Boston and are kind of being pushed out by others with a considerable amount of wealth and so, cost of living, you know – rent – so yeah, those factors have a huge impact on, how many people – you know, we try to serve.

I: Uhm, the accounting practices – I was looking at the Financial Statements and can mainly get it from there, the only thing I was wondering about, but I did not see this – do you have any for-profit subsidiary in your organization?

T: We don't, except… uhm – we have not, for 40 years or whatever that we have been doing this, but just recently, when we had to build our building – uhm, we are building a school right next to us, we partnered with somebody to build: Like, they take half and we take half and we had to create a subsidiary. But, it in no way provides funds to us and it does not cost us anything, so it kind of just had to be done from a legal perspective.

I: And, it is probably in the balance sheet, this subsidiary?

T: It is, yep – I think on the sheets you might be looking at, its small, but now it has gotten really big, uhm, because it more took off after these Financial Statements were created and it is now called investments and joint ventures.

I: Ok, and then – let us move on to Financial Ratios, as you mentioned already shortly. So, I would just give you a list of ratios and you tell me if you calculate it and if yes, how you compute it, ok?

T: Ok. (laughs)

I: Yeah?

T: No, I just laughed, it shouldn't be like an accounting lesson all over. But ok, let's go…

I: Don't worry if you don't remember, it is about showing the practice. I do not want to test you – like, this is not a test. A

T: I don't hope its like – yeah, go ahead….

I: Current Ratio?

T: We don't, yeah – we don't look at that too much.

I: The quick ratio?

T: No.

I: Organizational Liquidity Funds indicator?

T: Funds indicator (mumbling) uuuuhm… no

I: Net Working Capital?

T: I mean, we look at our capital. Do I put it in a ratio – probably not.

I: Assets Ratio?

T: Yeah, I mean, we definitely take into account how much assets we have over our liabilities. I cannot even remember what the asset ratio is though, unfortunately.

I: Cash Ratio?

T: No.

I: Net Liquid Balance?

T: Is that just your… ohhhh… uhm…

I: The questions are also about terminology, so…

T: Yeah, No.

I: Cash Flow from Operations – you said you have cash-flow statements, so that means yes.

T: Mhm, yeah!

I: Uhm, the cash flow statement, we managed that already – cash conversion efficiency?

T: Mhm, I look at it probably once a year, when we are looking at our AR and see if we should write it off or if there is anything we need to discount for, so, yeah.

I: The cash conversion cycle as a whole?

T: I guess that – maybe those are the same, kind of in my mind, but I know they are different. But, yes, we definitely look at it from a bigger perspective, probably, yeah – how long does it take us to convert to cash.

I: Mhm, ok, I see. Cash reserves ratio?

T: Yeah, I definitely look at that. Definitely, to make sure – I mean, now, I am just being controlled – but always, what we had in reserves vs. what we had in liquid cash.

I: Ok, mhm – current liquidity index?

T: Is that any different than just current liquidity? You might now.

I: Again, its really also about questioning the sue of terminology a bit.

T: Ok, yeah – we look at liquidity, but I do not know, yeah.

I: Is there something in that list that I did not mention? Is there something that is missing, that you compute regularly and that you like to look at?

T: Uhm, from a non-profit, I think uhm – the only thing that would be missing here: We are constantly looking at our ratio of program expenses over support expenses – it is a big thing that donors look at and it is what we – any non-profit is trying to spend at least 70-75% on their program and only 25-30% on support functions. I think it is just and indicator that you are spending your donor-dollars… that you are being responsible, uhm…

I: Sorry, you were stuck for a second. Could you repeat that, please?

T: So I think, non-profits are constantly looking at their ratio of program over support expenses and this means kind of evaluating how much you are spending on your program, on your mission, sort of. And what is also support: So its usually at least 70/30% - 70% being program, 30% being support and it just kind of indicates to your donors that you are being responsible with their dollars and uhm, kind off the program can always underline a bit more your mission. I mean, donors understand that you have to have support expenses, you have to have me and stuff like that (laughs) but uhm, if you are way off, if your are too far - it does not look good, so usually 75/25 is also where you want to kind of be… and also we're at like 72/28 right now. In our organization. So I am kind of always making sure that that needle does not go further over.

I: Ok, very, very interesting. I did not see that ratio nowhere, so very interesting. I hope, you have reserved a bit of time still, because we have some questions still open.

T (nods): Yeah, sure!

I: Uhm, so, the next part is Financial Management personnel – so, there is you – so there is Financial Management personnel. Are there more people, dedicated to Financial Management and if yes, what is their educational background and what is your educational background in terms of Financial Management?

T: Uhm, so – we have, uhm – we have a staff of four for Financial Management. Three full-time, one part-time. Uhm, we have myself, who is the CFO, who… I actually have a Bachelor and an MBA. I have a Financial Manager who is actually the CPA, I have uhm, an accountant who has a Bachelor and then a part-time accountant who has a Bachelor.

I: And its all in a related field, like Financial Management or something in that direction?

T: Yes, well – the part-time person maybe not always.

I: Ok. What is for you the most important criteria when you recruit a Financial Manager of Financial Management personnel.

T: Uhm, I guess kind of… I think you can kind off tell, when somebody knows Finance or doesn't. Though, I think one thing is to know something book-wise and one thing is to have some experience and know how you can handle the month-end close and stuff like that. Also gives you an insight to how they can apply and prioritize and get that kind of time period: You know, like, get a lot done in a small amount of time, or, you know – or be proactive, to get it – to schedule it…

I: How would you rate the level of expertise in your team now on a scale of 1-5?

T: Uhm, I'd say like a four. Yeah.

I: And, how important do you think – you kind of touched upon that with the answer before, but how important do you think is a formal educational background for successful performance in that function?

T: Uhm, I would say – I would probably give it a lower… I think it is good, I do not think it is absolutely necessary. I have seen people, who get accounting, uhm, who can self-teach them that. I have seen people operating, functionally operating. Income statements etc – they can understand all that. I mean, I think you always need somebody who is CPA or has that formal education, you know – I do not think everybody has to be, like a CPA or needs to have an accounting degree to work in an accounting department.

I: Ok, and – do you think, when you recruit for that function, a test of Financial Management literacy could be something useful? Could that work to figure out if a candidate is suitable?

T: Oh…

I: Like, a formal testing?

T: It, yeah … I think it could. Yeah, yeah – that is a good idea actually.

I: Then, a bit about funding sources: I want to understand what sources of funding you use. I think you started to mention it already bit by bit – there would be donors, government, generated revenues etc. – and also if you could do a rough percentage about how much comes from which source, that would be really good.

T: So, we have, uhm, 40% of our revenue is program revenue and that is kind of diversified though. It is coming from at least three different sources – so lets just say, out of that 40% - I know you might see numbers like 10 Mio. But lets say, if we are at 10 Mio. Uhm - let's say 40% program revenue is coming from, probably goes… uhm… 20% is one source, 15% is the other and 5% is the other. Uhm.. and then from a development standpoint – fundraisers, donors, all of that – we have 60% as the rest of that and that is coming from – actually, about 20/20/20 – so, 20% is individuals, 20% is corporate and foundations and 20% is our bens- we put our bens, yeah.

I: And credit – like loans, credit line, something like that?

T: Oh, uhm – we usually do not operate with that in our mind. Like, we do not create the budget with credit lines in mind.

I: And, government money?

T: That was part of the program revenue – it is all somewhat coming from the government. Yeah, state government, federal government, yeah…

I: And, as you have also program revenues, I guess you also have access to unrestricted funds, right?

T: Yeah. We do not have a lot of restrictions – we do have them here and there, but yeah. The only thing you might see in our Financial Statements, that has restrictions, is – we recently went through a campaign and uhm – those dollars were temporary restricted, because people were pledging like 5 years – so, yeah…

I: And, if you would have to put it into percentages – which percentage is restricted and which is unrestricted? Of your funds.

T: I mean, our normal operating activity in a year – we probably have 10% restricted. Most of it is unrestricted.

I: Ok – so – the donor structure, we talked about that already, I think – small donors, large donors, medium etc. So, did your donor structure over time just evolve, or was it a strategic choice, to have it like that?

T: It has evolved, definitely – yeah. I would say, kind of during the last 5 years or so, it has been consistent – but if you look back – you know, we had a lot of growth, like 20 years ago or so. Uhm, it appears to be in our capacity, we can have a little bit of growth every year – but nothing, uhm – we do not actually budget for any big percentage, because it's very competitive in Boston and there is a bunch of people trying to get after a couple of dollars and we just seem to not build… you know, the amount we have is pretty ok and we are trying to catch some more, here and there – but nothing substantial.

I: Ok – and, do donors, if there are major donors, themselves add restrictions to major funds and if yes, how does that happen? In which ways does a donor want to restrict.

T: Uhm, we do not have a lot of restrictions but I think yes – it is more foundations, so uhm-foundations will grant us – uuuhm – they will give us a grant. So I think it happens mainly with grants and grants usually have a specific purpose in mind and that is when you have to restrict those dollars for that purpose and that is when you cannot actually release those dollars until the purpose has been fulfilled. So, I would say – more times out of any, it is a foundation, imposing restrictions and more times they want you to build e.g. a playground or do something specific with it. In Boston it is kind of that: You are applying for something specific and that is what you are going to use it for.

I: Mhm, ok – so also the type of project. About loans, we talked about it already, but just for the sake of completeness. So, credit lines do not play a role in your considerations regarding liquidity, or do they?

T: Uhm, more recently, we got our first line of credit, that we have had in years. You know, because we had that 20 Millions, we did not need a line of credit. So, we applied for one more recently and got one – so yes, definitely it plays a role in that I know it is there, in case we get into trouble. You know, I try to manage around it and not pay – you know, there would be an interest rate – but, I think this where, I mean – I would tap into a line of credit before we are not fulfilling our mission. Or, you know, lowering the quality of our program in some drastic way.

I: So, we are going to move on now to our last module, which is on reserves and endowments. We talked about the first one already. And we will finish with Ethics, to round it off with something more, let's say – light! So, about liquidity management tools: Endowments. Do you have endowment funds and if yes, do you distinguish different types of endowment classes.

T: No.

I: Ok, and did you every have endowments in any organization so far?

T: No, we just never went there to…

I: Ok, do you think the ideas or the interests of your donors and the organizations management are well aligned?

T: I do, yes, I think, uhm – we try to be very transparent with our donors about where there dollars are going and what our mission is and so, if they believe in that, than I think we are aligned. Yeah…

I: Ok, do you hold anything like an investment policy status? Do you have an elaborated investment policy?

T: Oh, uhm – we do.

I: Yeah, and if yes, what does this investment policy specify?

T: Uhm, it is not a big policy, its is more uhm… so, it is a policy but we just, we make sure that we go through our Finance committee, our board and I have to make sure that anything we invest in or you know, I just cannot change investments or draw off investments, I would need approval from them. So, uhm that is kind of… and that the investment… that the Finance committee is going to do all in their power that the investment is being used to the best of the organization and the mission.

I: Ok, and, the next topic I want to talk about is operating reserves. So, do you hold operating reserves?

T: Yes, we do…

I: And, how do you denote them? Are they called operating reserves, or do you use a different terminology?

T: uhm, so we have them in an investment account, so we keep them kind of in a different account from a bank standpoint and then uhm, usually our capital reserves are also then board-restricted from an equity-standpoint, so, uhm we will have them separated in a different bank account and we will also have them noted in an equity account in our balance sheet.

I: And, which part of annual operating expenses would you say is in operating reserves.

T: So, we have about 75% of our annual operating in reserves right now.

I: Do you have a long-term Financial Goal and if yes, what is your time horizon when you think of long-term.

T: Uhm, so we do. Uhm, we have a long-term goal, where the whole building is actually to consolidate some of our mission and be more efficient with it. Uhm, right now, we can barely break-even and I would say, our goal in the next 5 years is to turn that around and be the owner of the building and not pay rent, uhm, consolidate in one place, so that saves a lot as well and to actually produce sur-pluses for our organization to just continue to build the reserves. And I think, that will also open up possibilities to expand and even expand in bigger places – I mean, depending on what that surplus looks like. I mean, hypothetically speaking, it looks like we will be able to, but again you never know. But everything points to – if we would move into that direction, we would be a lot more stronger and lass at risk of dropping into a deficit situation, yeah.

I: Ok, do you perform risk analysis for your operating reserves and if you do, who is involved in doing that?

T: We do, uhm – the Finance committee of our board looks into that, looks into the investments. I would say quarterly probably… definitely a couple of times a year, to make sure that we are not in a riskier portfolio and uhm that we are making money of the portfolio we have and if things were sliding downward, we would probably make a decision, but yeah – myself and the Finance committee look at it quite often.

I: Ok, yeah and do you quantify the risk exposure of the organization in general?

T: We do, uhm – I think, we have never been to risky in general. We invest in a big capital company that only works for non-profits, so I think they are not making huge risks and possibly, you know, they are watching not to make a big turn and loosing thousands of dollars a day, you know and I think you know, we- we definitely like to have and, lately, we have had a three to five percent average of return on our investment, but that is not huge…

I: Ok, to sum up, we will get back to the topic of ethics. We have already understood in the beginning, that mission plays a big role, so I assume also ethical considerations play a big role in the non-profit world. And, which role do you think do ethical considerations play in your everyday work routine?

T: Oh, I mean, huge. (laughs) I have to take it very seriously and you know, I think it is a huge part of my role. It is a huge part of the CEO-role, of the executive team, I think it is a huge part of the whole staff but I would say we are probably more responsible for that and accountable for it.

I: and, how do you ensure that Financial Management activities specifically are carried out in compliance with ethical standards? Is there any mechanism, anything that you developed over years for yourself, that works?

T: Yeah, I mean, we go by the simple rules of Accounting with – you know, we have controls in place, to make sure that we do not give the opportunity to make unethical things somehow but – you know, I worked in fraud for many years and the top of the fraud-triangle is opportunity, so I feel like, we can control that. So we do not give someone the opportunity to do something unethical, we have controls in place, we, as much as we can – non-profits, it is really hard, you do not have a lot of staff, so you cannot do things in all directions but, we do get audited every year – so, they kind of come in and make sure we have controls in place. So, uhm – yeah!

I: Good, so I am actually done with my questions and want to say thank you again. That was very insightful and will be a big part of my work.

ANNEXE III

Interview with Andrea Vigevani, secretary general of the Istituto per la Cooperazione Universitaria ONLUS (ICU)

Thank you very much Mr. Vigevani that you are available for an interview. As you might already know, I am doing my Master-Thesis on Liquidity Management in non-profit organizations. So thank you very much to take your time for the interview.

A: Yes, Yes of course, that’s great, look – I have about 30 Minutes time, is that enough?

N: Yes, Yes, if we go fast, we can do it. So let’s start right away.

Which position do you hold in the organization?

A: I am the secretary-general, which is in principle the director.

N: Ok, so, does mission attainment play a role in your daily business? Do you review potential projects regarding their fit to mission?

A: Yes absolutely, as our competences are strongly linked to our mission. So, if a project does not fit our mission, it does not fit our competences and we cannot do it.

N: Do you have the feeling that Financial Management Requirements can sometimes be in conflict with mission attainment?

A: No, no – in our case, Financial Management is very technical, so I do not see any conflict and no – no, we do not see that…

N: Ok, that were two general introductory questions and now I would want to talk to you about cash crunch crises. So, did the organization you are in experience a cash crunch crisis since you are part of it and if yes, when and how did you confront it?

A: We did not experience that. I mean, before I joined… I joined in 2006 and I know that before that, the organization went through a crisis and got some support from a foundation. So yeah, that was just that one moment to need an external support.

N: So the Financial crisis of 2007 and 2008, you did not feel that at all?

A: No, maybe our donors felt that, but we as an organization… we did not have a problem at all.

N: Mhm, ok, ok, I see.

Then, about liquidity in your organization. How do you define liquidity?

A (laughs): That is quite practical, so, for our organization, liquidity, in operational terms is the amount of money we have in our, our bank account.

N: Mhm, ok… and what would you say is the main goal of our liquidity management?

A: I mean, for us it is having enough liquidity to finance our projects and not too much, in order to avoid having a bulk of liquidity in long-term, which would be just a waste of Financial

Performance. We have our threshold for liquidity, if we do not have enough liquidity, we do take some funds from our endowments and if we are above the Threshold, we send funds to our endowment. This is more or less the way we manage.

N: Ok, this is good, because endowments will be part of one of my next questions. Ok… mhm… do you analyze the level of revenue and expenses against budget.

A: Yes.

N: Ok, and do you do cash forecasts?

A: This no, uhm because I mean, our activity is cash positive. So, I would say, 100% of all projects are funded in advance from our donors. We receive the money in advance, before we do the project. So we are not really concerned about all of this… uhm…

N: Okay, and – okay- you said before that you worked with a threshold for your liquidity and I was wondering, since that corresponds to a theoretical concept I came across, called the Appropriate Liquidity Target (ALT) – how did you determine this Threshold.

A: I mean I would say, that its is – the threshold is an amount that should cover 2 months of operational expenses.

More or less… mhm..

N: Mhm, ok, that's clear. In my next question I would want to talk a bit about economic indicators and how they impact your work. Are their certain indicators that you use to monitor to inform your liquidity Management?

A: Yes, so, I mean for liquidity – No. I mean, not Financial indicators. For monitoring liquidity, I mean… the ones are operational, such as, I mean, uhm, I mean progress in project implementation against the budget and forecast of expenditures in a specific project – so, let's do an example, let's say a project has an immense expenditure planned in the next month- let's say, it will buy an equipment, that is 300.000 worth and – I mean, this is not an indicator, but more operational informations from the project.

N: Ok, so and… external from the organization.

A: oh, sorry, there is an indicator as well, I mean I am not sure if it is an indicator, but – I said before that our work is cash-positive.

N: Yeah.

A: ok, except the case that we arrive to the end of the project. So, I mean, the project cycle is like this: At the beginning when the project starts, the donors gives us 50% of the budget. We spend, let us say 50% of the budget and then we ask for a second tranche and the donor gives us, let's say 40% of the budget, so at this point, we have received 90% of the budget, so at this point, with this 90% of the budget, we are asked to spend to arrive at the 100% and after that, we do a Financial report and received the missing 10%. So there is a moment in the end of the project, where we are cash-negative and this an indicator we monitor, how much we are in advance in payments in a project. Maybe this is the only real indicator, financially defined that we monitor. The others are rather operational.

N: Ok, Ok. So, could I just give you if that is ok a list of Financial Management Ratios and you tell me if you monitor them, or not?

A: yes, yes.

N: Quick Ratio?

A: No.

N: Ok. Current Ratio?

A: No, I do not even know what that is.

N: Net working capital?

A: Yes.

N: The assets ratio?

A: You mean the ratio of the assets you have on your balance sheet?

N: Yes.

A: I mean, we monitor it, but more for operational reasons.

N: So, you monitor it, but more for operational purposes?

A: Yeah, yeah…

(small pause)

N: Ok, cash ratio?

A: No.

N: Cash Flow from operations and the cash-flow statement in general?

A: No.

N: cash conversion efficiency?

A: No

N: Net Liquid Balance?

A: Uhm, that I would say yes.

N: Okay. Is there anything, I mean apart from what you mentioned before, when you have that special point where you have cash negativity – is there something that you monitor, that I did not mention? That comes to your mind and that you compute?

A: No, I would say no.

N: Ok, the next thing, economic indicators and the impact on the organization. If it is ok, I would like to list some, and you tell me if you monitor them or not?

A: Yes, yes. Regardless if we monitor them for Financial Management or other purposes?

N: Yes, yes, This is – if you monitor it in general for the organization?

A: ah, external, yes, yes, of course – sorry, yes.

N: Growth rate?

A: Yes.

N: Unemployment rate?

A: Yes, yes.

N: Ok. Consumer confidence?

A: No..

N: tax rate?

A: No.

N: Inflation?

A: No, I mean – yes, yes. We work in countries, where the inflation is completely out of control. I mean, this is in both cases the issue – before or after.

N: Mhm, ok – charitable giving index?

A: No.

N: Stock indices?

A: yes.

N: Ok. Forecasted increase in temperature, meaning climate change?

A: No.

N: Elections?

A: Yes.

N: demographic changes like birth – and death rates.

A: Yes

N: Ok, so of those, which are more important? Do you remember which are more important for what you do? You mentioned, inflation is important?

A: Yes, yes – because we work a lot with foreign currencies. I mean… sorry, there is an indicator, which is the foreign exchange – FX-rates and that is linked with inflation. This, we monitor and that also frequently and that is linked more or less with inflation. Because the issue is that we work a lot with foreign currencies and so we need to pay a lot of attention, so we need to pay a lot of attention that we do not hold too much liquidity in other currencies than the Euro. Especially since we work in developing countries, that have a high exposure to inflation and foreign exchange volatility. Those are of utmost importance in our Financial Management. I mean, the risk is, experiencing enormous foreign exchange losses – which had not been happening so far.

N: Mhm, ok. And how do you hedge for that?

A: Oh, I mean, we cannot afford paying for hedging, that is to costly. What we do is, keep the liquidity in Euro, until 5 minutes before we spend it. So what we do, even in countries without Euro, is that we keep the liquid resources in Euro. So let's say Tunisia or Jordan, or whatever, even if Euro is not the currency, it is often accepted, so we try to use Euro. But if that is not possible, we keep the money in bank accounts in Euro, even in the countries and we do the conversion to Euro just at the moment of the payment.

N: I see, thank you. Very interesting…

Would you say that there are any risks to your liquidity, apart from the ones that you just mentioned, that you would say is very specific to your type of organization?

A: Mhm, no, I mean – that could be something linked to the banking system of the countries we operate in. I mean, if it is a bank failing, let's say in Burundi or Rwanda. That might be a risk. But apart from that, no.

N: Mhm, ok. Thank you. Than, about the Financial Management personnel. How does your Financial Management department look like? I mean, how many people are there, working in Financial Management and which educational background do they have? Which educational background do you look for?

A: Yeah, so we have one Financial Manager in our headquarter and one in every country where we work. So, lets simplify it, for 10 countries.

N: Mhm, and, is there one educational background that you specifically look for or need in personal for that area?

A: For the headquarter, absolutely yes, in the countries – I mean, we prefer to have people with the educational background, but it is not strictly mandatory, I mean, it is very difficult to find Financial Managers to abroad in developing countries. I mean, we prefer if they have formal qualification, but we also accept it if they don't. I mean, this is for expatriate people – sorry, something sorry- I would add to what I said right now – in every country, we have one Financial Manager in our headquarter and in each country where we work, we have one Financial Manager Expatriate and an Accountant from the country itself and of course the accountant must have a somehow financial background as part of the education.

N: Mhm, ok.

A: But, I mean – not always.

N: Then, about your funding sources. I think you mentioned already that foundations are your main source of funding are foundations?

A: I mean, the majority of our funds come from governements, so international cooperation agencies. Like the European Union, or the Italian government or the US government or the UN system, the united nations and then also large foundations. I mean – mostly institutional donors. I mean, they can be public or private, but we do not have any fundraising by individuals and money out of their pockets.

N: Yeah, I see, ok. And the funding you have from the foundations – is it in the form of a grant or a donation?

A: Oh, uhm – how would you distinguish a grant and a donation?

N: So, from my understanding, a grant is mostly attached to certain conditions. Like you mentioned it before no – that after you fulfilled certain conditions you get the full funding, no?

A: Yeah, uhm, yeah – so in fact we do not receive any funding that is not linked to a specific project or activity. Or general donations for our general budget now.

N: Mhm, ok, ok, that is good, thank you. Did this donor structure grow over time or was it strategically chosen like this.

A: Ah, uhm so – that is a very complicated question. So… it's, I mean – I would say, it came up over time. By the way, it is aligned with our mission – to projects that are technically quite complicated. I would say – it grew over time.

N: Mhm, ok. Then, regarding the funding sources. Do credit lines and loans sort of play a role in your considerations regarding liquidity management?

A: No.

N: Ok, then – endowments, (skype-connection broke)

A: what…

N: Sorry?

A: No, I could not get your sentence.

N: Ah, yeah, sorry – so- I was just saying that you mentioned already before that you use endowments and how you fill them or draw from them…

A: Ah, yeah, so the thing with the credit lines was also, that we do not have that because we have the endowments. So in the case we need liquidity, we take it from the endowments.

N: Ok, I understand. So in this case, you do not need credit lines. Ok, so – do you distinguish different types of endowment classes?

A: You mean, asset forms?

N: Yes, Yes, asset classes and if there is a prevalent form also.

A: Listen and not-listed, so I would say, one third in listed assets and two thirds in non-listed assets. And listed means, investment funds and not-listed means real estate.

N: Ok, Ok, I see.

And, did you ever have a case of abuse of endowments or an attempt of abuse of endowments?

A: No

N: Ok, and regarding the endowments but also exchange policy. Do you have something like an investment policy, or also something about risk mitigation – do you have that laid down somehow?

A: No, I mean, for endowments, certainly not. For liquidity and foreign exchange topics, we have this sort of Manual for our Finance Officers, with the most important rules.

N: Mhm, Ok – so, you just mentioned that already, that the endowment funds are managed by the Financial Managers?

A: No, I mean, the endowment is managed mostly by me.

N: Ok and they work with it, so they get the Manuals.

A: Yeah, but I mean, not for the endowment, but the operational Manual for the projects.

N: Ok, ok, I understand. Thank you – ok and do you carry out regular review of the status of the endowment funds?

A: Yes, I mean, I manage it and I share all the decisions and information with 3 people, of the executive level in the headquarter and then we review the investments with the… in the board meetings twice a year.

N: Twice a year…

A: Yes, yes, more or less.

N: Ok, and do you have operating reserves?

A: Uhm… I mean, we have operating reserves in our Balance Sheet. Uhm, uhm – for risks and so on, and the liabilities uhm – but I mean, that is more let us say, a paper-issue than an operational issue. I mean, in the operational life we see, I mean from one side liquidity and from the other side the endowments. But I mean, we cannot distinguish, let us say – I mean, one part of the endowments can be connected to the operating reserves that we have in the liabilities in the Balance Sheet, I mean that is not something to which we do not pay attention.

N: Mhm, I see, ok. And, ok – no, this is – sorry sorry. I was just doing something with my notes.

I would be already at the last three questions. One is more general an the other 2 are related to ethical considerations. Is that ok, do we have time?

A: Yes, yes.

N: Yeah – ok, if you would have to condense your organizations liquidity management in something, like to summarize it, what would be the long-term goal of your liquidity management? And what does long-term mean for you in that case?

A: Ahhhh, that is a very nice question – so, I would say like this and then feel free to ask or interrupt or add anything that is not clear – so, I mean, in our considerations, long-term does not apply to liquidity, so liquidity is short-term in our considerations. So, as far as long-term is arising as a word, we think to endowments, not to liquidity management. I mean, liquidity is just at the minimum and we try to keep it at the lowest possible level. So, our goal is to have the right liquidity and not one euro more, to cover our needs in the short-term but not one euro more, and that is our long-term financial strategy. All the excess liquidity will go to the endowments. And there, we have another consideration of long-term an Financial strategies, because – I mean, ok – does it makes sense?

N: Yeah, yeah, that is really interesting.

A: Ok, but then will you send us your thesis?

N: Yes of course (chatting continues for a minute)

N: The last two questions … are about ethics, I think we talked about it in the beginning when we talked about mission and the importance of mission for your work. Is there something specific that you try to ensure that ethics are respected.

A: I mean, that the ethical principles are always present and at the core of our thoughts, that is the question, more or less?

N: Yeah.

A: Yes, I mean – okay, ethical principles are actually at the core of our operational and daily work – the issue is that I do not see specific ethical issues in financial management or let's say liquidity management, I see much more ethical issues in our projects, that we manage.

N: Mhm…

A: I mean, from an operational point of view. So, if we buy and equipment, or if we use money to support the local organization and so on and so forth. This is hardly, I mean connected with Financial Management issues. I mean, if we do nothing forbidden by the laws and misuse money, I mean, which is, I mean – this is not the case – we do not see specific ethical issues. We do of course see ethical issues in the management of our endowments, there yes - I mean it is about investments and who is it we are investing in. I mean, it is a bout the ESG principles – environmental, societal and governemental.

N: I see, yeah.

A: Or the asset class and so on and so forth. So I mean, the answer is – yes, we take it into consideration and we take a look at it, but we do not see any specific issue in that topic.

N: Mhm, ok – alright, thank you, thank you very much. As I said, this is probably the most important part of the thesis. (more unrelated chattering)