

Key Performance Indicators: Nonprofits Need Them, Too!

By Libby Bierman, Analyst, Sageworks, Inc.

When someone starts or joins the team at a nonprofit organization, it is likely the case that the individual was inspired by a passion or interest in furthering an idea or helping a cause. It is *not* likely the case that the individual did so because he or she wanted to mind the finances of the organization.

This disinterest in financial reporting may not be unique to nonprofit organizations (NPOs). But given NPOs' external sources of capital, financial stewardship and accountability is a theme not soon to disappear, and financial literacy goes beyond compiling receipts for year end review by your accountant or CFO. In addition to complying with tax law and grant covenants, there are certain proactive financial steps that NPO directors and manager can follow to take control of their finances before they have to report to a board, other staff, or donors.

Key Performance Indicators (KPIs) are a popular buzzword among the for-profit crowd, but they have their appropriate place among NPOs, too. KPIs are quantifiable measurements of an organization's health or success. And usually, these KPIs are benchmarked against peer organizations for context about what are good and bad positions to be in.

Determining what KPIs are important for your organization can be difficult if you don't have an accountant well versed in nonprofit finance or if you aren't a franchise in a larger collection of organizations. Liz Marenakos is Director of Product Management at Blackbaud, the leading provider of general ledger and other financial software for nonprofit organizations. Marenakos often speaks about KPIs and their place in nonprofit management. When selecting the metrics to watch over time, Marenakos suggests that NPOs keep them focused on the goal or mission of the organization and determine how to best quantify that mission. If the organization is a soup kitchen, consider the average number of lunches each day as a key indicator of performance. This will tell you the organization's reach into the community and how it has changed over time.

Some other important principles to remember when selecting KPIs for a nonprofit organization are:

1. **Have a definition or calculation to find the KPI**, and do not change it overtime. In order for your longitudinal analysis to be of value, you need to compare X today to X tomorrow and isolate other variables. If your "average cost per meal" includes the related overhead costs when you calculate it today, be sure to include the same costs when you calculate it in the future.
2. **Set a target for the year**, and back solve to determine what your KPI must be month after month to hit that annual target. For example, if your target "number of new memberships" is 500 for the year, recognize that you should be shooting for at least 42 new signups per month to successfully hit that goal.
3. **Set the target according to industry benchmarks.** As mentioned earlier, KPIs should be context-specific, so it is important to review how similar organizations are performing on each selected KPIs. Success is not guaranteed by matching or exceeding others, but keeping pace with your sector will lend more credibility to your organization in the eyes of stakeholders. Benchmark data can be difficult to find for nonprofit sectors, so speak with your accountant to determine a source for reliable and timely data. If necessary, you can always find the public copies of similar NPOs' Form 990s and find the averages among them.

Given Sageworks' experience with the accounting industry, there are three benchmarks which we recommend all nonprofit organizations calculate and use to compare to historical and peer data: program efficiency ratio, operating reliance ratio, and fundraising efficiency ratio.

1. **Program Efficiency Ratio**

This ratio is calculated as program service expenses (or money directly spent to further the nonprofit mission of the organization) divided by the NPOs total expenses. This information is significant to donors, board members, and managers because it quantifies how much the NPO is spending on its primary mission rather than administrative costs. How many cents of every dollar spent is dedicated to the NPOs goal or programs? Ideally, this ratio would be equal to one, but such success is unrealistic for most business models.

2. **Operating Reliance Ratio**

This ratio is calculated as unrestricted program revenue (or inflows from operations that can be spent at the discretion of the NPO) divided by total expenses. Calculating this number will enable managers to gauge whether or not the nonprofit could pay all expenses from program revenues alone. A good outcome for this measure is one, and in some cases more than one, but most NPOs must also rely on temporarily or permanently restricted revenues.

3. **Fundraising Efficiency Ratio**

This final ratio is calculated as unrestricted contributions (or incomes from donors who do not specify where it must be used) divided by unrestricted fundraising expenses (or how much money was spent by the NPO to collect those contributions). An important takeaway from this ratio is how many dollars the NPO can collect for every one dollar of fundraising expense—how efficient is the organization at raising money. The higher the ratio, the more efficient the fundraising efforts.

Use these three metrics—program efficiency ratio, operating reliance ratio, and fundraising efficiency ratio—as a starting point to select KPIs more specific to your sector and organization. Consider also having KPIs specific to certain campaigns in your organization, so you can compare roughly how one campaign performs over another. The information you gain from KPI analysis can help you make better decisions regarding resource management and can help you support those decisions when reporting to stakeholders.

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