Tactics for Leading Through a Financial Crisis

An Essay for the Noyce Leadership Institute at the End of a Week
During Which the Major World Markets Fell Every Day, Big-time

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There will be financial crises during the lifetime of just about any non-profit organization. By crisis, I mean an unexpected, short-term duration (a few months to a year or so) financial deficit. Below are notes on how science centers, children's museums, and related institutions have handled such crises in the past.

These notes are not intended to describe solutions to predictable deficit issues which go on for a long time, unusually until the organization restructures its business model or goes out of business. Having an unsustainable model for income, expenses, and budgeting can make an organization more vulnerable to temporary financial crises, but the measures described below are short-term fixes, and not systemic approaches to realigning an institution with economic reality. The longer term solution will be making the institution stronger by creating a new business plan, building up a working capital reserve or endowment, reducing permanent running costs, etc.

How severe a crisis is depends not only on the percentage of the budget involved, but also on the other key aspects of an institution's sustainability, such as the strength of its programs and the way it was viewed by its audience and stakeholders, pre-crisis. [For a discussion of the sustainability proposition more broadly, see Alan Friedman, "The Great Sustainability Challenge," *Visitor Studies*, Vol. 10, No. 1 (2007) 3–12.]

Handling the crisis depends on the particular situation, of course. The notes which follow describe a variety of tactics our institutions have used as short term fixes, to buy time for the longer-term improvements. First a word about causes of short-term financial crises.

The Causes

A typical crisis is created with the sudden loss of income:

- a local government subsidy, which arrived faithfully for years, is cut in half or disappears entirely because of some regional problem totally beyond the organization's control. Examples are the property tax reform initiative in California some decades ago, or the election of a new mayor or governor who has different priorities;

- the failure of an annual fundraising gala because of a collapse of the stock market (chillingly possible at the moment);

- the bankruptcy of a major funder or funding sector (also a currently scary potential);

- the ending of a major multi-year project, and the unexpected failure of a similarly-sized grant proposal which had been expected to replace it.

- A dramatic cut in earned revenue because an expected blockbuster exhibit or film fails to draw, or higher gas prices keep visitors at home, or all the bridges are closed because of a terrorist threat (the latter happened to the New York Hall of Science in 2001).

A deficit can also be created by a sudden expense, such as the need to replace the building's air conditioning system because of a catastrophic breakdown or accident. These causes of financial crisis seem to be less common in our world, but they do occasionally happen.

The Solutions

Solutions fall in two categories, reasonably enough: cut spending and/or increase revenue. The devils or gods are in the details, of course.

Cut Spending

<u>Across-the-board cuts to all departments</u>

Pluses: this sounds fair (democratic?). Simple to announce and mechanically simple and quick to administer. Immediate impact, visible response to the crisis, everybody knows what's happening. If the cuts are small (say in the one to four percent range) the impacts can be minimal.

Minuses: Every department has its share of fat and inefficiencies, but some have more than others. In addition, some services are impossible to cut while maintaining mission. If you cut security below a minimum of one guard being present 24 hours a day, you may have problems with insurance and experience a serious security problem, with subsequent new losses. Contracts and union agreements may be violated, with financial and other penalties.

The impact of these cuts, particularly if the percentage is 5% or larger, will likely be seen by the institution's constituents everywhere they look. The floors will be dirtier, lines longer, exhibits stay broken longer, etc., depending on just how the cuts are implemented.

If the expense budget for a "profit center" like the gift shop is cut, the result may be reduced inventory, followed by reduced sales and reduced revenue, cancelling out the savings and increasing the institution's deficit (I stupidly did just that once in a crisis).

Across-the-board salary cuts to all employees

Pluses: again, it sounds fair, is simple to announce and administer, and the improvement on financial picture starts immediately. If you are lucky, this tactic will also result in no short-term impact on mission or how the institution serves its constituents. A key is making sure everyone realizes this is a way to save the institution, their own jobs, and the jobs of their colleagues and that the cuts will be restored at a fixed point in the future. See Rick Maurer work 's on leading institutional change through creating a sense of urgency and bringing all employees along in the solution (http://www.beyondresistance.com/index.htm).

Minuses: in general, a 10% cut for a highly paid employee is much less painful for that individual than a 10% cut is for a minimum wage employee. This can be somewhat mitigated by having a higher cut for senior staff, but that may not eliminate a feeling of unfairness. Even with fixed percentage cuts and unanimous good intentions, some senior staff (the very ones you really want to keep) may find themselves irresistibly drawn to greener pastures elsewhere. If it proves impossible to restore the cuts as scheduled (say the economic downturn lasts many years) then the likely loss of key staff and high turnover of disappointed employees can cause more long term damage. Loss of a great fundraiser, for example, can cause much more harm to income than it saves costs from lower salaries.

Hiring Freeze

Pluses: another easy to understand and easy to implement way to save money.

Minuses: savings only start when somebody leaves. There is no way to set the amount or rate of savings. This tactic, in my experience, rarely works well. Some roles are critical, and if the individual performing that role leaves, nobody else in the institution may have the skills to fulfill the role. Savings may happen, but they may not respect any of the institution's core needs or priorities, and may place an insupportable burden on people whose departments happen to have multiple departures.

Selective cuts to departments, salaries, programs, or operations

Pluses: creates an opportunity to make changes you have eyed for a long time, with less resistance than would be the case in good times. It can be a way to reward high-performers, by protecting them from cuts or minimizing those cuts, and to ease out people and programs which are not pulling their weight. Programs which attract smaller audiences can be sacrificed to maintain the most popular offerings.

Minuses: without the apparent (if imaginary) shield of "fairness" in an across-the-board cut, this route will lead to much internal and some external unhappiness. The leader's wisdom and judgment will be attacked, and enemies, both visible and invisible, will be created.

There are also tricky dilemmas created by most choices of what to cut. If you cut highly visible things, like hours of operation and numbers of public contact staff, the audience and stakeholders may conclude that the institution is headed downhill, and reduce their patronage. If you reduce the number of traveling exhibits you book, attendance declines and cancelation fees may wipe out any savings. If you cut only behind the scenes activity, like systems maintenance or research and publications, you may damage long term prospects for growth and (especially in the case of deferred maintenance of the building) make financial crises even worse in the future. And there is this nasty turn: if it appears to outsiders that the institution is holding up fine with minimal visible cuts, some funders may conclude you had a lot of fat and they should never restore funding all the way back to previous levels.

A variation on the selective cuts option is to keep most programs whole, but completely eliminate other programs. The reasoning is that weakening everything will damage the reputation of the institution and the morale of everyone, but keeping most things whole and ending just one or more programs will limit the damage to manageable proportions. What makes this choice hard is that everything your institution is doing has *some* constituency, both internal and external, and they will fight hard, and make good cases, to keep at least a skeleton program in place so it can be rebuilt later. My own experience is that for single digit percent cuts, spreading the damage around is better, but when the overall budget cut is well into double digits, it is usually better to isolate the damage by eliminating one or more programs.

Increase Revenue

<u>Increase unearned revenues</u>

Pluses: little or no impact on most staff and programs, and much less pain for those inside the institution. New funding sources, and increased support from existing sources, can stick with the institution for a long time, especially if all perceive their support as having helped the institution avoid a crisis which damaged other institutions severely.

Minuses: it is really hard to do this, takes time, and most damaging of all, it may not work and the attempt may even make things worse. It is especially difficult when the financial crises is not just in one sector or local, but extends broadly (like, well, today!).

Do you increase the deficit at first by hiring more fundraisers, or having a second gala? If these don't produce significantly more new revenue than they cost, the end result may be further increasing the deficit rather than reducing it. It is hard to pull off success with this tactic because few funders really want to "rescue" or "bail out" an endangered cultural institution. We may not like it, but much philanthropy goes to strong institutions to make them even stronger, and little goes to those perceived to be weak or threatened. The challenge is to convince funders the problem is not of the institution's making, that the crisis is temporary, and that long-term prospects and quality of performance remain excellent—as long as we can just get through this rough patch.

<u>Increase earned revenues</u>

Pluses: if higher admission prices or charges for more things work (I'm writing this on an airplane and have just been offered a pillow and blanket for $7), the deficit can be eliminated or reduced. In the long term, the audience may become used to the increases, after temporary grumbling and lower attendance, and return content to pay more for the indefinite future. You are almost certainly a bargain now, and will remain so after your price increases.

Higher earned revenue would allow the institution in better times to build its future reserves, endowment, or programmatic strengths, making future financial crises easier to handle.

Minuses: audience resistance or resilience in the face of higher charges or more charges may not be apparent soon, and long-term damage may result. It is hard to predict this; if you survey visitors they will probably (in their own reasonable self-interest) display a greater displeasure with fee increases than they feel deep down, but you will not know how much of that displeasure is lasting until months after a higher fee schedule is implemented. There can also be hidden damage: lower-income segments of the population may stop coming, reducing the diversity of audience and the image of the institution as serving broad populations. Some funders would find that critically important, and fund you less. It may also happen that while those people who do come to the institution pay more, fewer people overall come, so the net income is little changed or even goes down. [During one financial crisis at the New York Hall of Science we began charging for formerly free special exhibits. The result was that very few people decided to pay extra for the special exhibits, so gross income was not improved while the cost of having those exhibits remained fixed and fewer people enjoyed them.]

<u>Borrow from reserves</u>

Pluses: If you have working capital, or semi-endowment ("board designated funds"), or real endowment, it is possible in many (but not all) cases to maintain present income and expenses, and weather the crisis by draining those resources, with the promise of replenishing them later. This could get the institution through the crisis without causing any damage to staff, programs, fundraising or audience.

Minuses: Few organizations have enough reserves to get through a serious crisis. Even if they do, the promise to replenish may be hard to fulfill, and without reserves the next crisis could be worse or even fatal. Raiding true endowment is particularly hazardous, because even if it can be legally done, that it happened at all may discourage future donors from considering replenishment or new endowment support. A common agony in recent years has been institutions finishing a capital project which ran over budget (don't they all?) by borrowing and raiding reserve funds, expecting to repay the loans and replenish the reserves with increased income generated by the expanded facility. When that increased income fails to meet targets, the institution finds itself in a life-threatening crisis.

Conclusions

The science centers and children's museums I've watched have weathered a financial crisis with a combination of the tactics discussed above, with no one of the tactics taken too drastically. I don't have enough case studies and have not studied these instances sufficiently to determine what individual tactics or combinations work best, and I expect the individual situations are so different that it will be hard or impossible to generalize.

One mitigating tactic does seem to help reduce the downsides of nearly all of these approaches. It is simply this: in the midst of cuts and changes, very visibly *increase* support for one or two really popular and promising core activities. Perhaps involve the staff and trustees in selecting the activity, although you can imagine the pitfalls there. But for most of the institution's constituents, it is heartening to demonstrate that even in the midst of adversity the institution is sensitive to the needs of its audience, is innovating and recognizing quality, and has bright prospects to fulfill when the crisis is over. Examples are speeding up installation of exhibit prototypes, so visitors get a taste of wonderful new exhibitions to come; expanding programming with free science and science fiction films; sending a portable planetarium around to shopping centers and community groups, with free short shows.

A second overall suggestion is to have a high degree of openness about the problem and the strategy to get through it (if not necessarily the specific tactics to be undertaken). Rumors can seriously exacerbate a bad situation. In the absence of clear and frequent communication, it is likely that trustees, staff, and other stakeholders will exaggerate the seriousness of the problem. So let everyone know, as soon as you know, the dimensions of the financial crisis, and what your overall timetable is for dealing with it. Enlist their help, to whatever degree you really can use that help, in decision making. And be optimistic: nothing damages the prospects of success more than a perception that the CEO doesn't know what to do, or doesn't believe there is a way through the crisis.

The good news is that the survival rate of science and children's museums in the face of a crisis is over 99%. So you will in all probability get through it. How well the institution emerges from a crisis depends on your skill, openness, and luck.