What Is Strategic Capital Planning & How Can It Enrich Your Future?

By Ben Aase

This new way of looking at planning can make a huge difference.

Today, more than ever, capitalization and financial sustainability are vital for nonprofits. The key question is how to achieve the capitalization necessary to deliver services and grow, in addition to ensuring financial stability for the future.

"The key question is how to achieve the capitalization necessary."

Capitalization efforts may fall short due to such factors as:

- **underfunding** infrastructure and growth
- **penalizing** the accumulation of flexible cash.

As most nonprofits leaders know, capitalization and sustainability can be achieved in part by:

- **building** a stronger balance sheet
- **encouraging** liquidity
- **paying attention** to depreciation and debt
- **increasing** financial literacy, particularly with boards.

These financial basics rely on past practice, however. Considering the current economy and future forecasts, you can't move forward by watching the rear view mirror, particularly if past efforts have fallen short of sustainability goals. The basics alone aren't likely to lead to sustainability.

So what can you do to strengthen your financial footing? One answer is to more strongly link your strategic thinking to your organization's capital needs.

Is It an Art or a Science?

It's both. Strategic capital planning is the art and science of managing your capital. Capital can be defined as the funds you have available (a combination of your fund balance and your debts).

The Kresge Foundation defines capital planning as "the accumulation and application of resources — operating and working capital, operating reserve, risk capital, endowment and building reserve — to support achievement of an organization's mission over time."

Capital capacity is integral to your financial health. Strategic capital planning is the ongoing process of tying capital investment to strategic and operational plans. It requires your organization's board and staff to do the following:

- **Define** financial objectives.
- **Understand** the market and operating initiatives required to meet financial objectives.
- **Relate** these initiatives to a capital investment strategy.
- **Translate** the above considerations into organizational change.

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What Are the Key Steps?

A strategic capital planning process involves four key steps:

STEP 1: ESTABLISH EXPECTATIONS.

First, you need to develop consensus about overall financial expectations. Ask the following questions:

- **How large** should the operating margins and cash reserves be?
- **What debt coverage ratio** is appropriate?

Develop the answers to these questions at the outset. Be sure to involve the board in the process.

The purpose of this step is to provide a baseline understanding of the organization’s current debt and capital capacity. This will serve as a basis for evaluating strategies during the planning process.

When setting financial performance targets, keep the following in mind:

- **industry standards,** such as rating agencies, to determine credit quality
- **recent financial performance** and current financial health
- **capital “life cycle”** considerations.

In discussions about financial targets, emphasize how performance expectations drive the organization’s need for:

- **risk capital**
- **operating and working capital**
- **operating reserves**
- **facility reserves**
- **endowment.**

STEP 2: CALCULATE YOUR AFFORDABLE CAPITAL CAPACITY

Your “affordable” capital capacity is equal to:

- **your organization’s affordable debt capacity** (as determined by the performance targets you set in Step 1), *plus or minus*
- **any excess or deficit cash flows,** *plus*
- **any philanthropic** contributions.

In other words, your affordable capital capacity is the amount of money your organization can reasonably borrow, plus cash generated from programs or activities, plus contributed support.

Calculating your capital capacity will help you see the capital implications of key goals, priorities, and strategies in your current strategic plan.

STEP 3: CREATE AND ANALYZE PLANNING SCENARIOS

Adopt an interactive planning process that lets interested parties — board members, staff, and partners such as marketing firms — evaluate strategic options through modeling. Effective modeling allows all parties to assess the organization’s capital needs. Modeling also helps people understand the implications of different actions before they finalize decisions.

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How Can the Board Help?

Board members add value to the strategic financial planning process with the following steps:

- **Champion a culture** that expects and rewards strong financial performance.
- **Contribute insight** about planning and capital management from other industries.
- **Assess the underlying strategic, market, and operating assumptions** of capital investment projections in a systematic, objective way.
- **Recommend innovative capital financing sources** and vehicles.
- **Win the confidence** of creditors, rating agencies, contributors, and other investors.
- **Assure better performance monitoring** relative to the organization’s capital investments.

> **"Link your strategic thinking to your organization's capital needs."**

In "typical" financial planning, staff and consultants leave a meeting and independently "crunch the numbers" for discussion later — sometimes after weeks or months. Conversely, real-time modeling includes financial guidance during preliminary discussions. Stakeholders can evaluate a variety of options and make decisions efficiently and cost-effectively in a real-time setting.

Evaluate each planning scenario across four key drivers of future financial performance:

- **environmental impacts,** such as changes in market demands, competition, and program or service obsolescence
- **growth from operations,** by program or service
- **value** of strategic investments
- **impact of management actions,** particularly on revenue enhancement and cost savings.

STEP 4: ASSESS AND REVISE THE PLAN

Assess the plan's strategic initiatives and their underlying assumptions, based on their affordability. Remember that you calculated "affordability" in Step 2. Build ownership of the plan's goals to ensure that staff and board members are empowered and accountable.

This process will help you prioritize strategies that support the organization's mission. It will also identify resource or capital constraints that will require attention or investment in order to execute your mission.

What Will You Gain?

Strategic capital planning is a new, more focused approach to strategic planning. It more directly addresses the challenges and opportunities of connecting your capitalization needs to your plans.

To be successful, key stakeholders will need to agree on your organization's financial targets. This process emphasizes understanding the value of strategic and capital investment opportunities and financial tools. These tools will help you evaluate the future impacts of your capital investment decisions.

Meeting current and future challenges and opportunities head-on will increase your organization's ability to accomplish the following:

- **Translate strategic options** into financial terms.
- **Deepen board-level understanding** of risk and return on investment.
- **Align and integrate** strategic, development, operational, financial, and facility plans.
- **Foster organization-wide focus** on variables affecting financial success and capital access.
- **Address market changes** through an aggressive set of strategic actions.
- **Communicate the vision and plan** to external capital sources.

Ben Aase (benjamin.aase@cliftonlarsonallen.com) is a principal with CliftonLarsonAllen and leads the firm's nonprofit strategic, financial, and operational consulting and advisory services. CliftonLarsonAllen (cliftonlarsonallen.com) is one of the nation's top 10 certified public accounting and consulting firms. Portions of this article were adapted from Capital Asset Planning: An Integrated Approach, *Governance Institute (governanceinstitute.com).*

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