The Impact of Inflation On Nonprofits

7 min read

The target inflation rate which is usually regarded as normal or acceptable is 2%, according to the Federal Reserve [1].

Key Takeaways

- **What Is Inflation?:** Inflation is a rate that expresses the decrease in a currency's purchasing power over a set period of time. The decreased purchasing power of currency results in…

- **Employees Struggle Without Pay Increases to Match Inflation:** During inflationary times, nonprofits have an exceptionally difficult time holding onto employees and keeping turnover rates low…

- **Cutting Costs and Super-Charging Your Back Office Abilities:** To gather the financial data you need and generate timely and accurate financial reports that enable you and your nonprofit board to make smart, data-driven decisions to lead your organization through these uncertain financial times, you are going to need a…

Last year, inflation rates hit record highs. In fact, at of the end of May 2022, the 12-month inflation rate in the U.S. was at 8.6% [2] – a 40-year high with no real signs of deceleration. In fact, the inflation rate was so alarming the Federal Reserve raised its key benchmark interest rates by 0.75%, a rate hike that hasn't been seen in almost 30 years [3].

As we continue through 2023, Inflation rates have simer slightly- reaching about 6% in February- but are still considered above the Federal Reserve standard. [4]

In any uncertain economic climate accompanied by high inflation, nonprofit organizations are bound to be affected- just like businesses and civilians. Typically, NPOs see an increase in demand and and a decrease in donations. But we'll dive into that later.

What Is Inflation?

Inflation is a rate that expresses the decrease in a currency's purchasing power over a set period of time [5]. The decreased purchasing power of currency results in price increases. In other words, a single unit of currency cannot purchase as many goods as a result of inflation.

Countless factors can lead to increases in inflation, but generally speaking, inflation occurs when the growth of a nation's currency supply outpaces the growth of the economy. This excess cash then drives demand, and inflation can be further worsened when supply chain issues make it difficult for the supply to meet the demand growth. This causes scarcity which further drives up prices and devalues the dollar.

As individuals, we all feel the effects of inflation in our investment portfolios, as the purchasing power of our savings accounts diminishes, and in our monthly budgets when we visit grocery stores, gas pumps, or pay for services. Nonprofit organizations feel the effects of inflation in several ways, too.

Read More: The Nonprofit Guide to Outsourcing Your Back Office - Bookkeeping and Accounting

With the alarming inflation rates we are currently experiencing, the implications of inflation should be a challenge that every executive director and nonprofit board of directors is immediately concerned with identifying and addressing.

Challenges for Nonprofits During Inflation

Your Funds Don't Go as Far

The primary challenge of inflation is that your limited funds lose value. As a result, your budget is forced to shrink, even if the actual dollar amount of funds you have to work with has remained the same. This means you're able to do less with the same amount of funds. You'll encounter the need to start slashing items from your budget and aggressively reducing expenses wherever possible.

Additionally, inflation can present future challenges regarding the value of grant money that you have already been awarded but have not yet received. For example, if you have a $200,000 grant that is being paid out over the course of five years, the money will continue to lose value over that period if inflation rates continue to rise.

Your Savings and Portfolio Could Suffer

No matter what size of organization you are running, your savings and investments will lose value as a result of inflation. This effectively means your reserve funds cannot shelter you from financial hardship or be used to grow your mission nearly as effectively as they could with normal inflation rates.

During the Great Inflation, the period of steep inflation rates that occurred through the 1970s and into the early 1980s, significant wealth value was lost. Cash savings accounts lost more than 50% of their spending power, and investments in 60/40 portfolios lost 20% of their spending power. During this period, a 60/40 portfolio with no incoming reserves, that was also being spent at a 4% rate throughout the period would have lost at least 75% of its value during the period [6].

Read More: [Top Donor Management Software Solutions & Why Your Nonprofit Needs Them]

Employees Struggle Without Pay Increases to Match Inflation

During inflationary times, nonprofits have an exceptionally difficult time holding onto employees and keeping turnover rates low.

In addition to the financial struggles that directly affect your organization, your employees will also be experiencing increased financial hardships and budgeting challenges in their own, personal lives. If your organization can't offer raises to keep up with inflation rates, then your employees are effectively experiencing pay cuts.

Your Donor Base Has Less Free Cash

The spending power of the donations you receive not only diminishes with inflation but the amount you receive from donors likely will too. Your donor base (individuals and corporations) will have less free cash available for charitable causes. This means you might need to deal with reduced revenue in addition to the reduced value in funds.

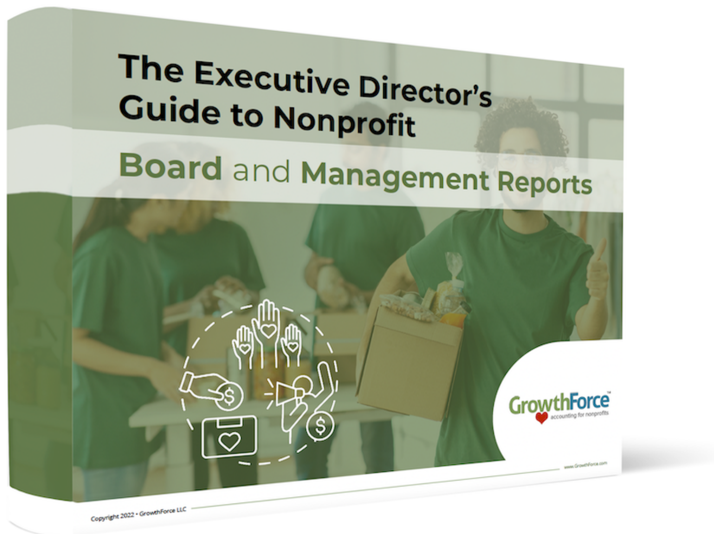
There Might Be Increased Demand for Your Services

As most nonprofits know, difficult financial times often lead directly to an increase in demand for nonprofit services. So, while you're operating on a tighter-than-ever-before budget, you are also going to have your community asking you to do more. This means you'll need to think extremely carefully about how you allocate your funds to ensure you are able to have the greatest possible impact while incurring the least amount of expenses possible.

Data-Driven Decisions Are Crucial for Nonprofits to Survive Inflation

During inflationary times, careful spending is essential to your nonprofit's ability to continue providing your services in addition to your survival. The consequences of inflation mean you're likely going to need to reckon with the reduced spending power of your funds by cutting costs and reworking your budget. Every expense should be scrutinized, and every decision to spend should be backed up with a real, data-driven reason to do so.

For example, when making budget cuts and taking measures to reduce spending, you should be using unit economics and careful expense allocation in order to look at profit and loss statements by program, event, beneficiary, department, employee, etc. This can help you to devise a data-based method for stack ranking your programs by ROI. You can then determine which programs generate the largest and most useful/impactful ROI for your organization. Focus on those and cut the ones that are not performing as well.



The Top 7 Most Useful Reports To Run Your Organization

An Executive Director's Guide to Board & Management Reports

Nonprofit Forecasting During Inflationary Times

In addition to using unit economics to spend more wisely, your nonprofit should also adopt regular financial forecasting practices with regard to cash flow statements and budgeting. You should regularly update and look at your cash flow forecasts to determine what your cash flow looks like and evaluate how ongoing inflation might be affecting your ability to cover costs as they continue to increase.

Additionally, create a normal budget (with stable inflation) and a worst-case scenario budget that factors in worsening inflation rates so that you can have contingency plans in place to safeguard your organization from worsening financial struggles.

Cutting Costs and Super-Charging Your Back Office Abilities

To gather the financial data you need and generate timely and accurate financial reports that enable you and your nonprofit board to make smart, data-driven decisions to lead your organization through these uncertain financial times, you are going to need a solid bookkeeping and accounting department. Financially savvy employees, however, come at a high cost that your organization likely cannot currently afford, especially if your nonprofit is small or medium-sized.

You can, however, still access the expertise, technology, and tools of a highly experienced financial team through the power of outsourced accounting services. With outsourced accounting services, your organization has access to all the benefits of an in-house back-office team but at a fraction of the cost.

Choosing an outsourced accounting provider to meet your back-office needs can save you money and time, while also ensuring you have the financial reports and insights to make good strategic decisions that will successfully see your nonprofit organization and its mission through these exceptionally inflationary times.

[1]https://www.federalreserve.gov/faqs/5D58E72F066A4DBDA80BBA659C55F774.html

[2] https://tradingeconomics.com/united-states/inflation-cpi

[3] https://www.cnbc.com/2022/06/15/fed-hikes-its-benchmark-interest-rate-by-three-quarters-of-a-point-the-biggest-increase-since-1994.html

[4] https://www.kiplinger.com/economic-forecasts/inflation#:~:text=The%20slowing%20economy%20is%20likely,target%20of%202.0%25%2D2.5%25.

[5] https://www.investopedia.com/terms/i/inflation.asp

[6] https://www.bernstein.com/our-insights/insights/2021/articles/an-inflation-guidebook-for-nonprofits-and-foundations.html