Slaying the Financial Dragon: Strategies for Museums

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Developing an Arsenal: Strategies for Slaying the Financial Dragon

By John E. Rorer, COO and Executive Vice President, The New York Botanical Garden

The New York Botanical Garden is located on 250 acres in the north-central Bronx that encompass 50 acres of New York City area’s original forest, a wetland, display gardens, and the Enid A. Haupt Conservatory. In early 1990, the Garden’s leadership took a comprehensive approach to institutional planning that required the integration of planning for the institution’s site, programming, and finances. Since then a series of three distinct but unified planning efforts have guided the Garden’s activities.

The first, a modest, short-term plan launched in 1990 and completed in 1992, focused on visitor services and amenities and building the public’s awareness of the Garden as a museum of plants. The second, “A Plan for the Garden 1993-1999,” was an institution-wide initiative that guided nearly a decade of investments in capital infrastructure and program development. During this same period the Garden’s leadership raised more than $200 million in capital, operating, and endowment funds. The third, “Plan for a New Era, 2001-2007,” which began in 1998 and was completed in 2000, was designed to build upon earlier advancements and define the institution’s ongoing role as a nexus for plant science, conservation, and public education.

Understanding Trends Can Clarify Institutional Problems

How many cultural institutions are facing financially uncertain and potentially difficult times? It is likely that most of the people reading this essay are employed by organizations facing troubling financial circumstances. How can we solve this problem? The first step is to understand what the problem is. To do this, key decision makers must understand the long-term financial trends that impact the institution’s financial position.
A major goal of the New York Botanical Garden's long-range planning process was to build a clear understanding among staff and board of the institution's financial structure. Most institutions begin long-range planning with program needs or facilities planning. Financial planning often is dealt with last or, in some cases, ignored completely. This delay or oversight is one of the major reasons that strategic planning efforts among nonprofit cultural and educational institutions so often fail.

The Garden's planning efforts were tied to a detailed review of financial trends.

As the chart on page 91 shows, beginning in the late 1980s, government support began to decline as a percentage of the Garden's annual operating budget. The next line, private support, had been obviously fairly volatile during the latter part of the '80s but by the early '90s it was heading in the right direction. The question was, How much higher could fund raising go after such a significant leap?

The third line was earned income. It basically was staying within a narrow range. The last line was endowment income. As the chart indicates, endowment as a percentage of operating support moved up and then declined. The reason it peaked is because the institution started raiding its endowment, taking double-digit draws. When this problem was corrected in the late 1980s, endowment income became more consistent, but it also left the Garden without the same level of revenue that had been put into the operating budget in the previous several years.

As the Garden reviewed its situation, it looked not only at the trends in the short term, but also at what they meant for the long-term. Looking again at the government trend line; it is important to remember that most of the Garden's government support came from New York City, and city support was declining. At that time the city was in a very deep recession, and it was cutting back government funding in all sectors. As the Garden examined this trend line, the question was, Once New York City comes out of its recession, will funding return to previous levels or will it remain at reduced levels?

The Garden's financial planning team also looked at revenue from another point of view: Were its major sources of revenue vulnerable to the same economic conditions? For that purpose the Garden analyzed its four major revenue streams: government support, private support, endowment income, and earned income.

It was at this point in the planning process that the real problems fac-
The institution began to come into focus. As the chart below shows, most of the Garden’s revenue came from private support and government support. If something happened to either revenue stream, the Garden’s financial survival would overshadow new programmatic and capital initiatives that had been on hold for many years. There was also the concern about what would happen to both those sources of income in a time of recession. Government support would go down. Many segments of private support would also go down, especially corporate support and, over time, foundation support, since private foundations’ investments would suffer in a down market. It became clear that not only was the institution too heavily dependent on those two sources of income, but it was vulnerable to some of the same economic dangers in both.

The New York Botanical Garden
Components of Revenue
Fiscal Year 1992

Government Support 30.3%
Private Support 36.8%
FY 1992 Actuals $20.7 Million
Earned Income 23.9%
Endowment Income 9.0%

As noted earlier, the Garden’s assessment of its past and present financial position and forecast of its future was a prelude to a comprehensive institution-wide planning effort, an effort that required virtually all key managers and department heads to dream big about the Garden’s future and the advancement of their own programs. They were asked, “What would you like to see your area become in the next five to seven years?” It was at this point that the Garden’s leadership realized it might not be able to sustain its current operations much less fund the ambitions and dreams that people had.

The problem had been defined and the strategy became clear: How could the Garden increase its level of earned income to a more appropriate level? How could it increase endowment income? How could it reduce its reliance on private support and government funding?

Having to go through the process of identifying its underlying financial position and understanding how to reverse what would have been inevitable trends of declining resources was crucial to the Garden’s survival. Had the institution not been able to devise the necessary strategies to change those trends, it would have gone out of business. Instead, in just over a decade, the Garden completed and implemented a seven-year plan that guided the institution through an era of unprecedented growth and development. It was renewed by nearly a decade of ambitious investments in capital infrastructure and program development. During this same period, it enjoyed an unprecedented financial resurgence, balancing annual operating budgets each year, expanding earned income opportunities to support program growth, and increasing the institution’s endowment by more than 300 percent.

Why Financial Planning Is Essential
In all institutions, financial planning provides a real context for current financial decisions and commitments. When organizations focus only on annual budgets and do not project their annual budgets into the future, they make decisions that work well now, but may not be good for future years. Financial planning helps institutions make sound decisions not only in today’s terms but also in terms of sustainability for the future.

Sustainability is particularly critical in the context of a major fundraising or capital campaign. Organizations often do their financial planning and projections when new campaign funds are flowing in. But what happens after the campaign is completed? At the Garden, that end
of campaign period was referred to as “steady state.” Can the institution sustain its new level of operations without the momentum or visibility of a major campaign? If an organization cannot look beyond its capital campaign to a steady state budget, then probably it will end up in significant financial trouble.

At the New York Botanical Garden, projecting post-campaign revenues and expenses tempered a lot of decisions about priorities and commitments and how the institution would use campaign funds. That meant recognizing that some funding was a one-time commitment. Beyond the question of sustainability, a sound, long-range financial plan also creates a framework for seeking new opportunities. Finally, financial planning provides essential information to potential donors at a time when they are being asked to share a vision for the future.

When and why does an organization launch a capital campaign? There are two reasons for a capital campaign, one of which is good and one of which is not. The first, which is not good, is, “we are in trouble and we need to go out and raise money to survive.” A much better reason to mount a capital campaign is to build something for the future. If you can demonstrate to your donors that this is the reason you’re engaging in the capital campaign, you will have strengthened your argument substantially.

Now, it is one thing to look at and define financial trends based on past performance and actual expenses and revenues. But how do you predict future trends? You don’t. But you must make informed assumptions about the future and forecast what you believe will be the outcome of your capital campaign. Will it increase the expense base? Will it expand the endowment? Will it increase annual giving or earned income?

As it turned out, private support continued to go up. The Garden put significant effort and resources into building its development office and building its annual fund. Could the organization increase fund raising? The answer was it could. From 1993 to 2001 private support rose in excess of 40 percent. Could it continue that kind of upward trajectory indefinitely? The answer was no, it could not, and so the trend line slowed and began to plateau.

Another question asked was, “When New York City comes out of its recession, would government support improve?” It did not. If anything, the Garden proved it could survive steep cuts. That was probably a mistake, but at the time, there was no other choice. Now, particularly with large museums, the City of New York is providing substantial capital dol-

ars but continuing to hold down operating support. The Garden’s concern back in the late 1980s about being too reliant on government support has proved to be entirely accurate and entirely correct.

Endowment income went up because of two things. The first was that the Garden made a concerted effort in its capital campaign to raise endowment principal. Although still woefully inadequate when compared to other major New York museums, the Garden was successful. Over time, the institution was able to generate greater endowment income using a reasonable draw rate as opposed to the double-digit rates described earlier. That trend was bolstered by the market appreciation that occurred in the 1990s. Endowment remains a concern, however, and is now a major area concentration in the Garden’s current capital campaign, which was launched in 2001.

**Business Plans Are Critical**

So you’ve done your projections and you’ve developed a financial plan. What do you do next? Well, doing projections is not enough, especially when it comes to increasing earned revenue, because revenue growth is not self-executing. Business plans are critical.

For those of you who think, “I’m not good at business plans or numbers,” hopefully the section that follows will provide a different point of view. Developing business plans is really about answering some questions. If you can figure out the answers to these questions, you probably can do a business plan. Most of the questions do not involve a lot of numbers. They involve looking at what your product is, what your audience is, and what you want to achieve financially.

**Eight Essential Questions**

1. What are the products (i.e., a visitor experience, a group tour, a catered event, etc.) the organization has available or wishes to develop to generate income?
2. How much can you charge for a product and still be competitive?
3. How large is the potential market for this particular product?
4. Are there segments in the broader potential market more likely to want what you are offering and more inclined to pay for it?
5. How can the product be made appealing and compelling to targeted market segments?
6. How do you communicate with your market effectively and efficiently about what you have to offer?
7) What are the revenue/expense projections for the initial years of operation and what, if any, investment capital is required?
8) How do you track progress in meeting stated goals?

There are some essential questions to ask and answer. What is it you're trying to sell? What's the product? That's a dirty word in the museum world, but museums are selling a product and they need to figure out what it is. It may be a visitor experience, it may be group tours, it may be continuing education, it may be a catered event. Whatever it is must be clearly defined.

Now you must look beyond your own institution and enter the competitive realm. You need to figure out how much you can charge. This will vary greatly depending on location and what other institutions are around. You must decide what price is still competitive.

You also need to figure out how large the potential market is for your product. In the case of a museum, that will vary greatly depending on what is being sold. It is critical to define how large a potential market is because a product that has no real market, or a very thin market, will not be successful.

Another question which must be answered is, “Are there segments in this market that are more likely to want what we are offering and are more inclined to pay for it than other segments?” If so, how do we reach them?

Next, the institution must determine how to make its offerings compelling to its target market segments. Many museums feel that, of course, we have quality programs, and, of course, we do quality exhibitions. Therefore, people should want to come and see them. Well, maybe. However, if you are depending on admissions to build your level of earned income, it’s not enough to say we have a quality product. It must be compelling to somebody else. How do you encourage people to get off the couch and come into your museum and actually see what you’ve got to offer? Developing that type of motivational component within your marketing scheme is extremely difficult.

Then there’s the question of how to communicate with your potential markets. Often the kind of mass communication that museums tend to undertake, like advertising, is enormously expensive. It will not be possible to do that for each product in the museum. Figuring out how to communicate effectively at much less cost is a critical component of the business plan.

Yes, you will have to get to the numbers at some point. You will have to do revenue and expense projections, and you will have to see what, if any, investment capital is required. Keep in mind the payback issue. If it takes a very long time to pay back that initial investment, it’s probably not worth doing.

Finally, it is just as important to know how to track the results. Most organizations fail to do this. They think, “Okay, we’ve got it. We’re excited about it. We can go sell it. We can do this.” But they never verify whether they did it or not. Determining whether stated goals are being met is absolutely critical.

Doing financial projections or creating business plans is a lot of work, and you may need some help to do it. But if you really want to understand your financial position and the potential threats it faces, if you really want to improve your chances of navigating potentially treacherous waters and take advantage of the opportunities before you, then you are going to have to do the work. You are going to have to understand it. You’re going to have to be comfortable with it. And you’re going to have to have specific strategies to deal with the issues and problems that will inevitably occur.

**An Arsenal of Strategies**

In your experience, is it true that when most people are confronted with a problem, they tend to stay focused on the problem rather than on the opportunities that problem may present? What follows is a series of problems and the financial strategies they inspired. Every one is real. Every problem seemed desperate at some point. But every one presented an opportunity.

The first group of strategies is leverage strategies and the second is bridge strategies. The goal of describing these strategies is not so that you can necessarily duplicate them in your organization. Some of these will be far afield in terms of what your organization is doing. But all should offer a way of thinking about the financial challenges that organizations sometimes face.

The first problem may not sound like a problem at all, but it actually happened at the Garden. A major donor who had been an important contributor for a number of years approached the president and said, “We would like to give you $10 million for your endowment.” That sounds pretty good, right?

Of course, the Garden most certainly needed the $10 million for its endowment, but it had gone through a long planning process that showed
rather conclusively that it also needed a new food service facility for visitors. The Garden is a large place and about 75 percent of its audience focuses its visit on a 40-acre section near the Enid A. Haupt Conservatory. At the time of the donor’s generous offer, food service was on the opposite side of the 250-acre site. That meant, of course, that most people didn’t eat at the Garden. If people come to a museum and they don’t have a place to eat, they will shorten their visit. Planning confirmed that the only option was a new building. Research conducted during the planning process indicated that if a catering operation could be developed in a facility suited for that purpose, the Garden could generate a substantial amount of earned income. But it needed a new building for both public and catered food.

So, the challenge became how to build a new food service facility and create an endowment with a $10-million gift. The Garden developed the following plan for the allocation of the $10-million gift.

**Restructuring a Major Gift**

- Donor’s intent  
  Give $10 million to endowment

- Institution’s needs  
  Build a food service/catering facility
  Increase endowment and earned income

- Income stream from  
  $10-million endowment,  
  assuming a 5.5% draw rate

The $10 million was divided into two parts. The larger part was used to build the food facility. Now, according to a feasibility study undertaken at the time, the new facility would generate between $600,000 and $800,000 in income a year. A 5.5-percent draw on an endowment of $10 million would be $550,000 a year. The food facility could potentially earn more than that. So, the Garden redefined the catering facility as a “living endowment.”

The second part of the gift, $3.1 million, would be invested as endowment with no withdrawals taken until the value of the investment reached $10 million. A presentation to the donor revealed how his proposed gift could mean even more to the Garden in the long-term.

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**Additional Benefits:**

- Institution gets visitor amenities and current income.
- Catering business builds awareness and visitation using caterer’s marketing dollars.
- Institution gets a $10-million endowment over time.

The donor became convinced that this approach would yield more for the institution financially and help meet several other goals at the same time. The Garden would get its food facility, important current income immediately, and, eventually, the $10-million endowment.

The next example is about small investments that pay big dividends. One of the issues that emerged for the Garden during its long-range planning was the number of volunteers that it had relative to the number of paid staff. The Garden was going through severe cutbacks in New York City funding at the time, which meant that it had to cut staff positions. The
question became, "How can the organization get everything accomplished with fewer staff members? Can volunteers do some of these things?"

To answer these questions, the Garden did benchmarking with other museums to understand how many trained volunteers they had and how they used them. It became clear that the ratio of volunteers to paid staff was very low as compared to other institutions. The Garden saw an opportunity to create a first-rate volunteer program and invested in the cost of a professional to build the program.

The institution now has a volunteer program that contributes more than 80,000 work hours a year. If those hours are valued at minimum wage, the new program represents a contribution of approximately $400,000 a year at a cost of a little over $100,000. The institution may never have made this important investment if it hadn't been faced with cutting staff. The volunteer program became a real solution to staff reductions.

Another example of a leverage strategy is taken from the strategic planning efforts of an urban university in downtown Brooklyn. The university's campus was interspersed with marginal or deteriorated properties. There were burned out buildings and vacant parking lots in the midst of its campus buildings, which were spread over several blocks. This blighted setting was particularly serious since a substantial part of the student population consisted of part-time evening graduate students. They had to come to the campus at night. Just picture yourself as a student driving into what I just described. Would you want to pay competitive tuition rates to be in that type of environment? Probably not.

The university had a small endowment and no cash reserves. In fact, it was in the process of paying off a deficit and had limited access to credit. Furthermore, the competition for students was extremely strong because there were a number of other technology-oriented universities in the metropolitan area. If you worked at this university and you had this series of problems, what would you do? Look for another location? That was explored and determined not to be feasible.

Another possibility was improving the environment, but the university did not have the financial resources to accomplish that on its own. So the solution had to be to get somebody else to pay for improving the university's environment. The issue for the university was, "What do we have to offer to third parties that would convince them to make such a huge investment?" Or, put differently, could it find people who would benefit by partnering with an urban university in downtown Brooklyn? The answer was yes.

This was the mid-1980s, when many New York City firms—brokerage houses, the stock exchanges, etc.—had huge back office technology components. They were located on Wall Street and in midtown Manhattan, and most were paying extravagant rents to house their computers.

The university told these potential partners, "You can come to Brooklyn for a fraction of the cost and it's 10 minutes away from your executive offices. It is not necessary to house your computers next door or on the floor below. You can house them in Brooklyn and cut costs significantly. And we're a technology university so we can do research for you in computer science and communications, and we can train your employees as part-time graduate students." Several companies thought that made very good financial sense and said, yes, they were willing to relocate to downtown Brooklyn.

The university and two commercial companies began to build three new buildings and in doing so launched the core development that would begin to transform the area. Ultimately, the university and its commercial partners developed a 16-acre site. At its core was a 3-acre park. All the buildings faced the park which helped to create a security barrier that made the whole environment safe. Finally, the university was able to attract significant economic development funding from the city and state governments for the project.

In the end, the only funding the university put into the project was for the buildings that it built. The final outcome was 16 acres developed at a cost of about $1 billion.

This next leverage example focuses on using other people’s money to meet an institution’s needs. It concerns a nonprofit organization that owns multiple parcels of real estate. Its flagship holding is land that is diagonally across from Saks Fifth Avenue and on the edge of Rockefeller Center in Manhattan. Unfortunately, a substantial portion of the organization’s endowment is tied up in that one piece of property, which is now valued at about $70 million. It is also under a long-term lease, and the amount of rent will not change for 20 years no matter how valuable the property becomes.

The challenge was to improve the yield on this piece of property. The solution came in the form of two possibilities. The first was to sell it and invest the proceeds in some other way. The property had been in the organization’s possession for over 50 years, and the group was not at all interested in selling. The second option was to get more money from the property without selling it. That is the strategy the organization chose to follow.
Because this is such a valuable piece of land, it is possible to obtain a loan at a very attractive rate, using the land as collateral. The organization found that if it borrowed $25 million against this $70-million property, even with the cost of borrowing factored in, the effective rate of borrowing would only be 5.75 percent. That gives the group $25 million to use for other investments with a higher potential return.

In the current market, there are attractive commercial properties to buy. This particular organization already manages commercial properties so they have the expertise to manage others. Buildings with tenant leases of 10 years or longer could generate about an 8.5 percent or better return. If the leases are longer than 10 years, and the loan is for 10 years, the leases are locked in for the duration of the loan. That provides leverage of 2.7 percent—the difference between what it costs to borrow the money and what the organization will get from its tenants in the commercial buildings.

A differential of 2.75 percent on $25 million translates into $687,000 a year, a reasonable improvement in current income. In addition to that, over the course of the 10 years, the organization will repay a nominal amount of principal as part of its debt service. This will create an opportunity to accumulate some value in those properties as well. Therefore, by leveraging the property through a loan, more current income is generated and there is potential for further appreciation in the endowment.

Now, you may say, “We don’t own any land. This is not an example that would relate to what we do.” I would ask you this question: Do you have assets that you’re not using sufficiently? You probably do. Therefore, the challenge is to develop some creative ways to derive more cash flow from those assets.

A final leverage strategy is tax-exempt financing for building construction. Let’s say your museum is contemplating building a building that will cost $12 to $15 million. I know this is not the situation for most museums, but if that applies to your organization, one of the things you should strongly consider is tax-exempt bond financing.

Most institutions raise the money to build a building. On the other hand, if the organization raises unrestricted money to build its endowment and thereby establishes the capacity to pay off debt, it can borrow money in the tax-exempt bond market to construct a building. For example, if $40 million is raised and invested for 30 years and earns historical returns in the stock market, at the end of the 30 years, the earnings will have been sufficient to repay the $40-million bond principal and all of the interest on the bond, and $62 million will be left over. That’s preferable to raising $40 million to build the building.

The second category of strategies is bridge strategies. Many organizations are confronted with short-term financial difficulties that are likely to improve over time. The objective is to create a short-term solution until better circumstances can materialize.

An obvious bridging strategy is spreading cost over time. However, this is something that must be done very carefully. There are certain arenas like leasing computer equipment that are very sensible. Currently, there are attractive packages for computer leasing that include the cost of the equipment, software, and even consulting time.

That is especially attractive if there is a reliable way of making the lease payments—for instance, a donor who has made a multi-year commitment and will allow it to be used for this purpose. The computer system can be acquired up front, and the donor’s annual payments can be put toward the lease. The institution gets its computer system immediately and is assured that over five years, for example, it will have a steady income stream from the donor to pay for it. Getting what you need now and paying for it over time is a strategy to consider.

Another strategy for institutions that need to demonstrate forward movement but are not ready for a major campaign is a mini-campaign. In the late 1980s, the New York Botanical Garden was in the final stages of an old campaign from the prior administration, which the new administration had to finish. As described earlier in this article, the institution was in dire financial straits and couldn’t balance its budget. Most of its buildings were in a terrible state of deterioration. The board was in need of revitalization.

The question was, How do you create a sense of excitement about this organization, given all the negatives? The answer was a mini- or advance campaign. It focused on much needed cosmetic changes and creating some excitement about the Garden as a public institution. The intent was not to undertake fundamental change, but to make the Garden a hospitable and fun place to visit.

The Garden created a year-long fund-raising effort called “Spring of ‘90.” It was a very modest campaign, less than $1 million. But the funds were used to make very visible site improvements aimed at improving the quality of the visitor experience. In many people’s eyes this mini-fundraising campaign created a more attractive institution and lifted the status of the organization in the eyes of visitors and donors. Those donors were
then approached to support the larger capital campaign launched in 1993. The mini-campaign became an early victory.

There is one more bridge strategy worth noting. When they are financially pressed, organizations often go through transition times that can last a few months or two or three years. But when confronted with budget deficits, many organizations view cuts as permanent reductions. These are hard decisions for organizations to make and often the actions are not taken because they are regarded as permanent. One strategy to consider, particularly if the financial recovery period is likely to be short, is to temporarily reduce expenses without making permanent cuts.

Recently, the City of New York began making fairly substantial budget cuts, and the Garden was not prepared at that point to eliminate positions. So the institution opted to delay filling certain positions. There are parts of an organization in which that can be done with modest impact. Delaying rather than eliminating is another way of saving costs without making permanent cuts that may be unacceptable to staff and, in some cases, to a board as well. ☐

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