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Philanthropy Can Do a Lot to Help Hard-Hit Small Businesses and Nonprofits

By Philip Gaskin and John Tyler

The Covid-19 pandemic knows no boundaries. Its effects on health and the economy are profound.

From an economic standpoint, the pandemic does not discriminate between nonprofit or for-profit organizations. Nor does it discriminate by the characteristics of who owns a business or what size it is — so all types of owners and managers of businesses, whether national, regional, or local, find themselves at risk.

But some businesses are far more vulnerable than others, and many will be unable to withstand the pandemic.

Startup small businesses are especially fragile. Nearly half of small businesses have little more than two weeks, and often less, of cash liquidity. Those based in low-income areas tend to have half that. And that was when the economy was soaring.

That's why we need foundations and other organizations with endowments to act now to help the hardest-hit businesses, especially those based in communities with large numbers of people of color.

Minority-owned startup businesses are susceptible in ordinary times and are particularly at risk during this pandemic because of their historic lack of access to capital. What's more, they are struggling more than other businesses to benefit from the federal stimulus program.

Small and startup businesses are the lifeblood of many communities, across demographics. They provide jobs, anchor neighborhood cultures, fulfill demands for goods and services, help bring innovations to market, advance standards of living, and, are a gateway to economic self-sufficiency.

Heroic efforts are underway to keep small businesses operating to the extent safely possible and to get cash to employers so they and their people — employees, customers, and communities — can weather this storm and emerge ready when the time is right.

But philanthropies, donor-advised funds, and other entities can do more. They have opportunities to use new and too frequently neglected approaches for getting funds to vulnerable businesses and their personnel, particularly now as the pandemic has sharply expanded the definition of "vulnerable" from even a few weeks ago.

In addition to shoring up these companies, here are some approaches worth considering — and they might also be used to directly help those who provide supplies, services, testing, vaccines, personal protective equipment, and other efforts to combat, treat, and curb the spread and return of Covid-19.

Recognize the value of buying goods and services now.

Typically, we aren't going to pay for many that aren't being used while our offices are closed, and we can't crowd into farmers markets, theaters, bowling alleys, and so many other public places. But we can pay ahead for goods and services we'll need when physical distancing is no long necessary.

Of course, that anticipates that a business will be around to deliver goods or services — but advance purchases might help enable its reopening. Gift certificates and other options that can be redeemed later inject cash into businesses, and it's easy to buy those in large quantities and donate them to others, although there may be tax consequences depending on who is receiving the donations.

Prepaying for goods and services to be used later means that eventually those companies will face cash-flow issues. However, there's a way around it: Say you prepay now for three months' worth of goods and services to be delivered later; spread delivery over six, nine, or 12 months, and keep up regularly timed payments in between. That cashflow amount will still be less than normal because of the prepayments, but we aren't dealing with "normal."

Keep in mind that many charities deliver goods and services, such as education, day care, health screening, and cultural performances. They can also be prepaid. You can pay charities for what they might later deliver to you or to others. Contributions to charities that prepay them to deliver to beneficiaries might qualify for a charitable deduction. For instance, you could help such charities set up or expand pools of funds to help pay tuition or other expenses for those who have been laid off or incurred unexpected health-care costs. That way they can continue receiving the charities' services even though they can't currently pay for them.

Under the right circumstances, charities and foundations that are landlords and lenders to small businesses and startups could allow them to skip payments without penalty and either forgive the payments or extend the loan or lease terms so payments would be recouped later. Whether for-profit or nonprofit, these steps could make the difference between surviving and shutting down.

Make capital infusions by investing or lending.

Consider creative ways to approach loans and extensions of credit. Microlenders, community-development financial institutions, and others that focus on support for small and startup businesses can be a huge help in this process. Maybe base loan-repayment terms on a portion of revenue rather than set, flat amounts: That is, use revenue-based financing. Evaluate alternatives that have a multiplier effect, including pooling funds to guarantee loans, secure debt, or expand loan loss reserves. In this way, your dollar might contribute to making two, five, or 10 additional dollars available.

More complex options include making equity investments in companies to help them and their employees stay afloat. That might involve seeking out angel investors or private-equity firms that deploy non-traditional models, such as revenue-based investing. Maybe take preferred, nonvoting positions in a business — possibly with buy-back options that allow the entrepreneur or small-business owner to buy back the shares at the principal amount, an agreed-upon small premium over set periods of time, or the lesser of those options or fair market value (which might be challenging to compute).

These approaches can be used by both charitable and noncharitable sources of capital. For noncharitable providers, charitable deductions may be available for contributions to charities and foundations that operate these types of programs. Also, to the extent there are capital losses and loan forgiveness, other deductions might be available.

Charitable organizations must undertake additional analysis to ensure their actions are consistent with charitable purposes and don't involve "sweetheart" deals or other benefits to nonprofit insiders. That work sometimes scares off charitable organizations, but in the current environment, the great need and potential impact might make these approaches worth the effort.

Watch the rules for charitable endowments.

When charities and foundations make money available to for-profit businesses and tax-exempt groups that are not charities, they must take several steps to stay within the law.

- They should prepay for goods and services or spread out payments only for items they would have bought anyway as part of pursuing their charitable purposes.
- Investments designed to increase a charitable organization's endowment can be positioned to accomplish the above as "mission-related" investments. The prudent-investor standard in nearly all states now allows charities and foundations to consider their programmatic, charitable missions and the "social" and financial returns on those investments when making investment decisions. That certainly does not mean they can be reckless, but it loosens the focus on risk and financial returns and supports thinking and acting differently whether investing directly or through funds.

- Investments in programmatic activities that advance foundation or endowment missions can be acceptable. For foundations, this means they can make grants to organizations that are involved in supporting small startup businesses. Or they can go through a careful process the Internal Revenue Service calls "expenditure responsibility" to support businesses directly. Or they can use program-related investments to provide low- or no-interest loans and other investments with certain for-profit companies that directly advance their charitable missions.

Given Covid-19's ravaging of society and the economy, charities and foundations might apply more expansive filters to the way they determine what activities and investments fit their missions. Among these could be:

- Supporting economically disadvantaged neighborhoods (including the entrepreneurs that operate and serve in them).
- Funding entrepreneurs and their companies denied capital because of their race, ethnicity, or gender.
- Lessening the burdens of government as currently expressed in this crisis.
- Combating community deterioration by shoring up companies that anchor neighborhoods.
- Providing disaster relief.

What's more, the rules that foundations and charities must follow to protect against any individual or company getting undue financial benefits from a transaction might be a little more flexible now given the contribution to the public good that could come from generous, but strategic, investments now.

That said, Covid crisis or not, organizations pursuing these approaches need competent, thoughtful, and reasoned analysis and appropriate documentation of it.

What may be unusual is the need — perhaps even responsibility — to think and act more expansively about the tools and tactics available to charities and foundations as sources of cashflow and capital to small and startup businesses in this pandemic. This different way of thinking and acting might help with survival of not just vulnerable enterprises but also the people, families, and communities they serve and in which they live.

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