Effective Nonprofit Governance: Lessons Learned

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Great articles on good governance have appeared for years, comparing how the governance and operations of nonprofit and for profit organizations are closely similar or very different, depending on the author you follow. For example, renowned management consultant, Peter Drucker, said effective use of the board is an area in which business can learn from the nonprofit sector ("What the Nonprofits Are Teaching Business," *The Essential Drucker*, pp. 39-44) while Harvard Professor F. Warren McFarlan said the governance of nonprofit organizations is very different from the governance of for-profit businesses in several critical areas, including missions, measurements, and board composition ("Working on Nonprofit Boards: Don't Assume the Shoe Fits," *Harvard Business Review*, Nov.-Dec. 1999, p. 64).

Given that a high proportion of NACD members serve both for-profit and nonprofit boards, what is your experience? Are they similar or different, and in what ways? Whether you spell it non-profit, nonprofit, or not-for-profit, let's look at some hot topics and lessons learned with great nonprofit organizations and boards today.

Comparison of the *NACD 2007 Leading Not-For-Profit Governance Survey* and the *NACD 2007 Public Company Governance Survey* finds leading issues and concerns for both public companies and nonprofits closely linked. (See the chart on page 7 for the comparison.)

Director Summary: The top issues for leading nonprofit and for-profit boards today are remarkably similar. The Sarbanes-Oxley Act of 2002 spurred corporate governance changes in many nonprofits and, since its inception, nonprofits have experienced greater government oversight. The authors present current trends and lessons for successful nonprofit boards.

Clearly, the leading governance issues and concerns are similar for nonprofits and for-profit organizations today. For both, the responsibilities and time commitments are substantial, with surveyed nonprofit trustees averaging 196.2 hours overall on board-related matters in 2007, a number that closely tracks for-profit director obligations.

A key difference involves the pay structure. If we look at the NACD Not-For-Profit Surveys for the past two years we can observe nonprofits seldom paying trustees or directors for service, although some do pay; nonprofits strongly favoring separation of the chair and CEO roles with about 85 percent of the respondents' nonprofit boards having this structure; and 83.5 percent of nonprofits favoring an independent chair.

Notably, executive sessions, a real hallmark of independence in the for-profit world, appear to be gaining acceptance in leading not-for-profits as 74.5 percent of surveyed boards met without the CEO present at least once in 2007, as compared to only 40 percent in 2006. Holding regularly scheduled executive sessions remains rare, however, with only 17.5 percent of respondents reporting this practice.

There are vast numbers of nonprofits that vary widely in size. Obviously, the governance practices of medium and large organizations with annual revenues in the tens of millions of dollars may differ widely from the innumerable and vital smaller nonprofits. The NACD surveys touch on some of these differences. For instance, 48.6 percent of large nonprofits reimburse trustee expenses but only 8.1 percent of small nonprofits do the same. Be aware of differences just as you would in comparing a public company governance survey to a private company survey.

Hot Topics of Great Nonprofit Organizations and Boards

This review of hot topics is presented in four atypical but relevant categories: "Amorphous Topics" covers several general trends that have emerged on the nonprofit scene. While these interesting topics are taking hold in some arenas, many find them ambiguous or untested; "Concrete Topics" covers basic reporting requirements for nonprofits that are being elevated yet again; "Funding Topics" covers the vital fundraising trends that so many in the nonprofit world heavily rely on; and "Ownership Topics" covers unique transactions of a nature to provoke one to ponder the fundamental governance question, "Who really owns or controls the nonprofit organization?"

Amorphous Topics: Capacity Building, Sustainability, and New Models of Governance

Capacity building and sustainability are related concepts that revolve around the ideas of increasing organizational effectiveness and long-term financial sustainability. Capacity building is typically a board-driven plan and approach to strengthen key areas of the nonprofit with targeted investments of talent and resources. Recently, a number of foundations have changed their giving from granting average-sized gifts to many nonprofits to making a number of large gifts to a smaller number of nonprofits with the specific mandate to strengthen key capacity-building areas like leadership, fundraising, or infrastructure in select nonprofits. One example is the Unity Foundation of Maine, which has been a leader in the concept of board-focused capacity building for nonprofits.

Sustainability is the idea of developing innovative methods of growing new revenue sources for the nonprofit. Much thought in this area can be traced to the January 1997 *Harvard Business Review* interview with Monsanto public company CEO Robert Shapiro on growth through global sustainability.

What does sustainability really mean? The issue for nonprofits is about confronting the tension between the short term versus the long term. The challenge that nonprofit brands must address is how to articulate a time horizon that is not focused squarely on the short term. How are they to ensure that the work of the nonprofit is meaningfully sustainable in the long term?

Defining new models of governance is the Holy Grail

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that catches the attention of those passionate about good governance, nonprofit or otherwise. In the recent past, there has been a steady stream of new concepts, articles, and books on nonprofit governance and boards. Much of the work is formative. Published in 2005, *Governance as Leadership: Reframing the Work of Nonprofit Boards* by Chait, Ryan, and Taylor, promotes the interesting, thought-provoking concept of "generative governance."

Concrete Topics: Government Scrutiny, More Regulation, and Taxation

Government scrutiny of nonprofits has been highlighted in recent months with a number of high-profile requests for information, including U.S. Senator Charles Grassley focusing an investigation on a number of TV evangelists such as Kenneth Copeland, Creflo Dollar, and Joyce Meyer. Basically, the allegations involve governing boards that are not independent and whose members enjoy lavish lifestyles that include private jets and luxury cars. And, in a moment of campaign-year irony, the IRS has notified the United Church of Christ (UCC) that it was investigating U.S. Senator Barack Obama's speech at the UCC's 2007 General Synod, questioning political activity that could jeopardize its tax-exempt status. You have got to love the poetry of it all!

More regulation and regulatory awareness has grown since SOX kicked off governance and compliance reforms that have now reached the nonprofit world with enhanced record retention requirements, specific whistleblowing

Comparison of Respondents' Top Governance Issues

NACD 2007 Leading Not-For-Profit Governance Survey	*2007 NACD Public Company Governance Survey*
– Strategic Planning & Oversight	– Strategic Planning
– Organizational Performance	– Corporate Performance
– Board Leadership	– CEO Succession
– CEO Succession	– Relations with Shareholders
– Board Effectiveness	– CEO Compensation
– Board Culture	– Information Management/Decision Making

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standards, and far more rigorous reviews by auditors. A number of state attorneys general appear more vigilant—some would say activist—following numerous actions against nonprofits like recent college financial aid settlements, charitable solicitation matters, and the publicized Dick Grasso (former head of the NYSE) pay package litigation costing multiple millions to pursue. One of the most fascinating regulatory requirements we have seen recently concerns the case of a nonprofit that is required to maintain a board majority of persons with significant disabilities. As you might expect, this nonprofit's core mission is serving persons with disabilities.

A 2004 Grant Thornton LLP study reported that nearly half of nonprofits have made corporate governance policy changes in the wake of SOX. Grant Thornton's Larry Ladd summed it up: "Many not-for-profits believed that Sarbanes-Oxley was a passing fad or bubble. Today, however, awareness of the Act and actions based on the provisions of Sarbanes-Oxley are on the rise. Board members and regulators are now pressing for reform."

More taxation includes new IRS requirements for nonprofits like enhanced Form 990, Return of Organization Exempt from Income Tax. The revised 990 grew from two to ten pages with up to fifteen new schedules. The form digs into governance practices, composition of the board, compensation practices, and much more. Another Form 990 focus is employment and related tax reporting. In the past thousands of charities withheld taxes for Social Security and Medicare from employees' pay but did not send the money to the IRS. It's a concern for the IRS and any diligent nonprofit director from a liability perspective. (Pay those taxes when due!)

Many nonprofits have substantial business income from activities unrelated to their tax-exempt purpose, for example, a large charity owning commercial real estate. Often, large charities have large real estate holdings. Few nonprofits pay taxes on these revenues, prompting review. In another trend, many large ministries, healthcare providers, and prominent education organizations are effectively being asked to pay more taxes through voluntary or negotiated state and local tax-type payment programs often known as PILOT (Payments in Lieu of Taxes) Programs. A handful of nonprofits have had their tax exempt status threatened outright, like the Midwest nonprofit hospital system charged by tax collectors with not being "charitable enough" or deserving of tax exemptions for alleged failure to provide adequate charity care to the poor. The hospital system is prevailing.

Funding Topics: Big Giving and Big Donors

Americans as a whole remain among the most charitable people in the world, and our giving continues to grow in record amounts. For example, *The Chronicle of Higher Education* reports there are currently 28 American universities seeking to raise at least one billion dollars each, and in the past year they collected over nine billion in gifts and pledges.

In past decades, nonprofit directors knew or learned that a primary duty of nonprofit governance was to quietly raise lots of money. Recent decades have seen a large fundraising industry develop and supplant much of the experience and work of directors in fundraising. Thus, for many nonprofits, the fundraising role of the director or trustee has become unclear. Add to this the very real influences and distinctions of generational values and attitudes in the marketplace and workplace today and you have some very real, new challenges for nonprofit leaders and directors to sort through in maintaining record fund- and friend-raising for nonprofits across the board.

Penelope Burk, of Cygnus Applied Research, has conducted some of the best research out there on setting new standards for fundraising success as it relates to nonprofit directors. Another great fundraising source is Chuck Underwood, founder of The Generational Imperative. He has done great research on generational values and differences.

Whether it is millions of average donors using the rapidly growing donor advised funds to set aside hundreds of millions of dollars each year for charitable giving, or large donors setting up their own charitable foundations, or mega-donors like Buffett and Gates making stunning gifts, big-time philanthropy is growing unabated. Effective boards, both nonprofit and for-profit, are the ones that stay knowledgeable on current charitable giving techniques and new corporate philanthropy tools and trends.

In what may be a unique charitable giving transaction for a U.S. company, *Fast Company Magazine* (December 2007) reported on a highly profitable luxury skin-care company placing their operating company in a Massachusetts nonprofit corporation. Money is made and taxes are paid, but in a nod to the concept of sustainability mentioned above, and with no owners to collect dividends, profits ideally will be sustained into the long-term future. Interestingly, board members are prohibited from financial gain.

It's fascinating to watch a number of major U.S. corporations refine and redirect their corporate philanthropy plans and programs. A case in point is Minneapolis-based Target Corporation. The nation's second largest retailer moved the Salvation Army bell-ringers out of its stores. Salvation Army revenue had averaged $9 million at those outlets nationwide. Target made a $1 million donation to the Salvation Army's online version of the Angel Tree program, donated all proceeds from the sale of a limited-edition ornament and placed a link on its corporate website for Salvation Army donations. Target met its goals and continued to strongly support many causes, including the Salvation Army. We have seen similar changes effected at other large retailers—Home Depot, Lowe's, CVS Pharmacy, and Best Buy.

Ownership Topics: Contemplating Nonprofit Governance

Who really owns or controls the nonprofit organization? Is it the key donor(s), the top fundraiser, the active volunteers, or trustees who rise through the ranks and grab control? Is it a strong chairperson? A powerful executive who controls the nominating committee? The banker who owns the mortgage or line of credit loans? The plaintiffs in litigation seeking control? The state attorney general taking action, or any other options you can imagine or have experienced? One good way to consider and answer this question of who really owns and controls the nonprofit organization is to simply ask, "Who has any real chips or skin in the game?"

These are interesting times for legal and financial transactions that make one ask real questions about the nature of ownership, control, and governance and the intersection with the nonprofit and for-profit worlds. Think of the recent conversion in 2007 of the NYSE from nonprofit to for-profit and its listing now as a publicly traded company (stock symbol NYX).

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Last fall, nonprofit Oral Roberts University in Tulsa changed presidents after a spate of bad press and accepted a $70 million gift from one generous family. The gift was conditioned upon a number of governance reforms and actions including shared governance under a new set of bylaws; new trustees, including a number of slots confirmed by the donor family; and a donor family member as chairman of the board. One higher education blogger wrote, "Wow! Talk about buying a university. Is this a hostile takeover?" and another wrote, "I wonder when the name changes to the donors?" With all due respect to the bloggers, $70 million sounds like some real chips and skin in the game. Is this, in effect, setting a precedent, and how far can we expect this to go?

In prior years, a prominent foundation with some $2 billion in assets faced public allegations of failing to follow donor intent, lack of oversight by the board of directors, and certain conflicts of interest. The state attorney general conducted a comprehensive review of the foundation. The back story appears to have been a number of long-term directors who personally knew the deceased donor and believed the current CEO and new directors were departing from the donor's desires and plans. We think this is commonly called a "power struggle." While producing many recommendations, the attorney general found current leaders free to change approaches while exercising discretion preserved to subsequent boards. In other words, the management and new directors prevailed by a close vote, and the attorney general took no real actions that impacted those in control.

National Benevolent Association completed one of the largest nonprofit bankruptcies ever by selling its retirement home assets to for-profit Fortress Investment Group for $230 million, following the trend of other large nonprofits in converting their operating assets ultimately into for-profit organizations. In a similar vein, private equity funds of late have been very active in buying the assets of some nonprofit colleges.

Financial analysts are currently debating whether the publicly traded Hershey Company can ever grow in value so long as a charitable trust is the controlling shareholder. In November 2007 the Hershey Trust voted out six of the Hershey Company board members apparently out of frustration with the company's declining performance.

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Now that we have looked at hot topics and current trends in the nonprofit world, let's look at a few of the top lessons learned from great nonprofit organizations and boards after years of good corporate governance. As you review these top lessons learned, think of how closely they relate to the top issues from the *NACD 2007 Leading Not-For-Profit Governance Survey,* including strategic planning & oversight, organizational performance, board leadership, CEO succession, board effectiveness, and board culture.

Many trends are prompting the search for new nonprofit board members in record numbers and the competition for talent is stiff. Reasons include:

- growth in assets;
- demand for talent;
- increasing complexity;
- maturing organizations;
- need for independence;
- term-limit requirements;
- good governance aspirations;
- generational changes and transitions;
- enormous growth in numbers of nonprofits.

Top Lessons Learned

Lesson #1: Effective Nonprofits Have Strong, Effective, Engaged Boards

Today, successful nonprofits have fully engaged boards who consist of diverse members, each bringing specialized leadership competencies to the board. The distinctive orientation ranges from financial accounting, legal strategy, and governance background. We are seeing gravitation towards talented individuals capable of working as a team and with the ability to strengthen the boards' capacity to grow, change, mature, and survive.

Lesson #2: Nonprofits that Thrive Have a Visionary CEO

"It's called the art of constructive impatience." That is the capacity to lead with a sense of conviction, strong will, focus, strategy, and courage—to lead from the front. The ability to see around the corner is paramount to being a visionary leader.

The challenge is that most nonprofits are led by their founders, individuals who were instrumental in creating the nonprofit, pioneers who were bold enough to take an idea and to make it a reality. The types of leaders that nonprofits demand today are team builders who are effective in bringing together diverse people from varying generational backgrounds.

Lesson #3: Nonprofits That Fail Have a Board Not Doing Its Job

Nonprofits that fail often have what L. Crutchfield and H. Grant described in their book, *Forces for Good: The Six Practices of High-Impact Nonprofits,* as "invisible boards." They see their role as limited to just fundraising. Even though this is an important function, other attributes, such as the ability to think strategically and the capacity to bring fresh ideas to the table, could enable the positive transformation of the nonprofit. The key ingredient is quality talent at the board level.

Lesson #4: A Key Nonprofit Board Test is the Ability to Attract and Keep a Top CEO

There is little doubt that successful nonprofits have a keen awareness of the importance of attracting and retaining top notch CEOs. They do it by not becoming overly dependent on search placements in newspapers and headhunters. They aggressively seek out leaders that are not necessarily looking for a job. Through their informal networks they are successful in identifying talented leaders and then pursuing them. What nonprofits need now are leaders with a sense of the value of leading themselves first and a real understanding of the ability to earn a buy-in from those whom they lead. ■

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