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THE Nonprofit QUARTERLY

Special Double Issue

A New Day Dawning: Contemplating 2012

Barr and Bell on Financial Leadership

Buchanan and Bradshaw on Stakeholder Resistance

Cuesta on Building a Mission-Delivery Engine

Schmidt on Sustaining Community Capital

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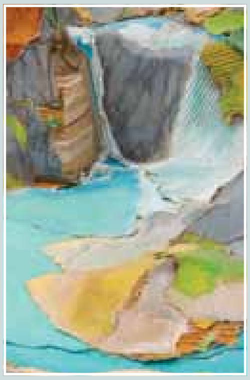
Features



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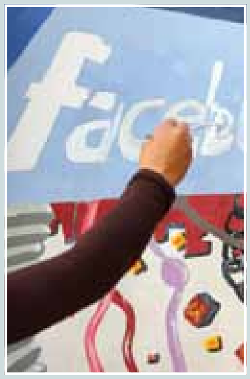

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Welcome

Dear readers,

Welcome to the combined fall/winter issue of the *Nonprofit Quarterly*. With this we close out one year and open the next.

As for 2011 . . . wow! It has been a barn burner, what with the disagreements between the top one percent and that bottom ninety-nine. At *NPQ*, where our intention is to promote active democracy, we have been excited by what is obviously a major resurgence of citizen action. The fact that it has taken place in an explicitly connected yet loose global network is more than fascinating. There is a breaking away from tradition here that reflects an era change in no uncertain terms.

So what portends for 2012? Within the sector we have heard many calls for new ways of doing business, for innovation—but (and please take the following musings as my own) none of them respond accurately to the core shift we think we observe in OWS, which can be likened to one of the architectural principles behind the Internet—that is: *We reject: kings, presidents and voting. We believe in: rough consensus and running code.*

This quotation, attributed to one of the Internet's primary architects, David Clark, was referred to in a recent *New York Times* article by Joichi Ito, "In an Open-Source Society, Innovating by the Seat of Our Pants." We think it is an interesting counter to the notion that social innovation is best promoted through the heavy capitalization of a few "high performers" rather than through the enabling of networks.

The article is well worth reading for the simple but profound lessons it imparts. Even the first paragraph is worth its weight in gold: "The Internet isn't really a technology. It's a belief system, a philosophy about the effectiveness of decentralized, bottom-up innovation. And it's a philosophy that has begun to change how we think about creativity itself."

Later in the article, Ito talks about the Internet's early standards, saying they were "uncomplicated, consensual—were stewarded by small organizations that resisted permission or authority. And they won: The Internet Protocol on which every connected device relies was a triumph of distributed innovation over centralized expertise." Ito believes this has resulted in driving the locus of innovation to the edges, where it is less controllable.

This issue of *NPQ* is most notable, then, for its timing—coming at a point where we must basically choose a belief system about how promising and sustainable change occurs. Is such change designed and implemented by the few for the many, or is it more a collectively held project with a set of unifying principles and intentions but many and diverse implementers? It is an interesting question, and one we will be wrestling with in the coming year.

The Nonprofit Ethicist

by Woods Bowman

According to our trusty Nonprofit Ethicist, "when it comes to ethics, if it *looks* bad, it *is* bad." Does it look okay for the director of a social services organization to raise funds for other organizations through a side business? How about if a board chair puts himself in the running for the executive director position but doesn't step down as chair? It looks, in the Ethicist's words—"Bad. Bad. Bad."

DEAR NONPROFIT ETHICIST,

I've been contracting with nonprofits for years as a writer and communications director. I presently find myself questioning the ethics of a director I've recently begun to work with. He is the executive director of a social services organization but he has a side business—a development company that raises money for organizations. Is it a conflict of interest for him to raise money for others through his business, since he is the chief fundraiser for the social service organization that employs him?

Suspicious

Dear Suspicious,

It looks bad all right. And when it comes to ethics, if it looks bad, it is bad. He is ethically tone deaf. However, the Association of Fundraising Professionals' Code of Ethics is not explicit on this point—probably because it is a rare arrangement. In principle, he could manage all of these business relationships ethically, but it would be tricky. The more his clients' interests overlap with those of his employer, the trickier it gets. At a minimum, he should disclose the identities of all of his clients to each of his clients (and his employer), but most self-employed persons are reluctant to publicize their client roster. The Ethicist would love to see his conflict-of-interest statement. He should focus all of his productive efforts on his day job.

Dear Nonprofit Ethicist,

Immediately following Hurricane Katrina, in 2005, many companies and donors were quite generous in gifting nonprofits—furniture, automobiles, computers, rebuilding supplies, etc.

Now that many of the items have either met their gifted purpose or become obsolete, how does a nonprofit move them along without creating the whisper of impropriety or greed? One statewide NPO received a large gift of furniture, and after a series of reorganizations, simply sold it without mentioning that it had been donated.

When questioned by individuals who knew the furniture had been donated, the senior staff stated the furniture had met its purpose of assisting in hurricane recovery and now the organization needed the funds to continue its mission; the organization was downsizing and, not needing the furniture, decided to sell it instead of donating the furniture to other nonprofits.

BTW, it was good stuff: full office suites of solid mahogany and cherry.

What is the ethical way to deal with donated goods after their intended purpose has been completed? That explanation just sounded greedy.

Just Wondering

Dear Just Wondering,

Not to worry. It is quite all right for organizations to sell donated goods. Think of the Salvation Army and Goodwill Industries and all the hundreds, or maybe thousands, of donated vehicle programs throughout the country. However, such transactions should not be manipulated to create a tax scam. The IRS is alert to this possibility, and has rules that I hope this organization followed.

This is a good opportunity to remind everyone that 501(c)(3) nonprofits must acknowledge gifts with a market value in excess of $250, including donated goods. The acknowledgement should state that the nonprofit is a charity recognized as tax-exempt by the IRS under Section 501(c)(3), and further state that "No goods or services were received in return for this gift." It should include the date of receipt and a description of the property donated. However, the nonprofit should not attempt to assign the cash value of the property—that is the donor's responsibility. The last point is very important: a nonprofit runs the risk of being implicated in a tax scam if it accedes to a donor's demand to attest to a gift's value.

As for your specific issues: a 501(c)(3) organization should keep donated property for at least three years. If an organization sells, exchanges, or disposes of property worth more than $500 for consideration within three years, it must file Form 8282, *Donee Information Return*, with the IRS within 125 days. (There are special rules for vehicle donations that use Form 1098-C.) The organization must give the donor a copy of its Form 8282, and failure to file may incur penalties. Donees are not obliged legally or ethically to disclose the fact that such goods were originally donated, but obviously they should not try to pass the goods off as new.

Dear Nonprofit Ethicist,
I am on the board of an organization that assists persons with disabilities. Our executive director left suddenly to take another position. The board established a search committee to find a new ED. Meanwhile the executive committee is closely supervising the interim staff. I am not on the search committee, but one of the members told me that the current chair of the board of directors has stated that he will apply for the executive director position, adding that he has no intention of stepping down as chair, let alone resigning from the board.

This person has been the chair of the board for several years. He is very hardworking and well respected by other board members, the staff, our clients, and our funders. I do not think that this guy has the chops for the job, but I also pretty much know that saying so would create emotional havoc in the boardroom. Am I right to be troubled by this development?

I suggest proposing an amendment to the bylaws prohibiting the CEO, or any candidate for an organizational position for that matter, from serving on the board. In this way, you can avoid the much more awkward and premature discussion of the board chair's capabilities through a perfectly legitimate and badly needed uncoupling of interests. If you lose on either issue, get out before the roof falls in.

I think that this issue has the potential to spin out badly even to the interim arrangement, since I know we have at least one internal candidate on senior staff. What to do?

In a Sticky Situation

Dear In a Sticky Situation,
Bad. Bad. Bad. First bad: it is disingenuous for the chair to pretend that his presence in the employment pool is not going to muddy the waters. Second bad: the fact that this guy does not know he should get off the board during a search process should automatically disqualify him, and the fact that the board does not demand it makes the whole organization look hinky. Third bad: if he really doesn't have the chops for the job and fails, good luck getting rid of him without a lot of blood on the walls. This is a terribly obvious no-no. The CEO and the board chair should not be one and the same. Francie Ostrower and the Urban Institute surveyed five thousand nonprofits, and discovered that organizations with CEOs on their boards followed fewer accountability best practices and had less board engagement (*Nonprofit Governance in the United States*, 2007). If he is serious about the CEO position, he should leave his chairship and get off the board, because he cannot, and should not, serve in both roles.

What to do? I suggest proposing an amendment to the bylaws prohibiting the CEO, or any candidate for an organizational position for that matter, from serving on the board. In this way, you can avoid the much more awkward and premature discussion of the board chair's capabilities through a perfectly legitimate and badly needed uncoupling of interests. If you lose on either issue, get out before the roof falls in.

Woods Bowman is a professor of public service management at DePaul University in Chicago, Illinois.

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Ask the Ethicist about Your Conundrum
Write to the Ethicist about your organization's ethical quandary at feedback@npqmag.org.

Welcome to 2012 and Our New World

by the editors

This past year marked the beginning of Occupy Wall Street, which is emblematic of a rising tide of citizen action unconnected to formal institutions. Disturbing to some and exciting to others, the ability of people to self-organize—and their evident preference for it—is the overriding meaning we take from this past year into the next. What does it mean for institutions even in this sector. Do we need to change, too?

As we head into 2012, there is a sense that the world has shifted in a powerful way.

The nature of this shift is still emerging, but we see the increasingly pointed demands for institutional accountability. People worldwide are less than happy about their treatment at the hands of the institutions they have supported in one manner or another, or about whose overall influence or operations they have simply had no say in determining. This has led people to break away from or otherwise call to account such institutions.

Occupy Wall Street, a loosely networked series of protests focused on crony capitalism and its progeny popped up around the country this fall—like a bunch of fractals of a generalized discontent about the structure of our economy and the relationship of the "one percent" with government. Encampments emerged overnight both here and abroad. Associated with that movement were other occurrences—such as the group called Anonymous's hacking into the Boston Police Department server after the BPD had arrested some protestors, to retrieve and publish the names of 1000 police personnel. (As far as we know there was no formal relationship between OWS and Anonymous.)

One grassroots effort quickly caused Bank of America to retract its brand-new $5 monthly fee for debit cards, and another led to millions in savings being withdrawn from big banks and deposited into noncommercial, and often nonprofit, credit unions. At the time of writing this (December 5), these Bank Transfer "Day" transfers have driven up deposits in new credit union accounts by more than $22.8 million each week since October 1. This story has a number of interesting components to it, including the fact that credit unions are run as cooperatives focused on member well-being rather than profit. The transfers are a concrete expression of discontent signaling a will to reinsert personal choice making in the kinds of contracts we are willing to tolerate between we the people and the institutions in our lives.

In this issue Buzz Schmidt, founder and former CEO of GuideStar, discusses the need to develop constructs to hold private enterprise accountable for its contributions to various forms of the productive capital needed for societal progress in the next era. This aligns well with where we are all headed.

New energy and tools are emerging for a more broad-based, fluid movement for global sustainability—a movement for accountability and fairness largely devoid of any central institutional presence. Leadership is staying in loose rather than firm alliances—bound by common conviction rather than organization.

Other boundaries are shifting, too, including the wielding of large private charitable dollars and attached conditions to public institutions from the global to the local level. The new development is the willingness to exert specific control, as in the case of Facebook founder Mark Zuckerberg and his $100 million for the Newark schools, making visible the influence of the "one percent" in the public agenda setting.

Clearly, this new "class" rebellion and the further extension of billionaire influence through charitable dollars are two trends in potential conflict, but who is to know how the tension will be resolved?

Within this context, nonprofits do not get a pass on institutional disassociation, and later in these pages you will see an article on nonprofit stakeholder rebellions that run the gamut in terms of issues and categories of stakeholders. Some of these cases have been very interesting and well covered, such as the online donor revolt about a merger between Operation Smile and Smile Train. The donors petitioned the attorney general of New York to disapprove the merger, which was subsequently called off. Other cases involve staff, members, or constituents who feel that their contracts with a given nonprofit have been violated in some way. One of our favorites is the case of two girl scouts who, upon discovering that palm oil plantations were displacing orangutans from their natural habitat, went on a campaign to get the Girl Scouts to stop using palm oil in their cookie recipes. We like that case because, along with any number of other stories we have been watching over the past year, it speaks to a new, strong wave of emerging young leaders complete with energy, analysis, and strong moral conviction.

Meanwhile, as these trends increase and develop, we are watching some of the leadership of the sector not quite getting the point about this new world whose rise we are privileged to watch, and perhaps even participate in, in the spirit of the moment. Here is a snippet from a *New York Times* article by Joichi Ito on innovation: "The Internet isn't really a technology. It's a belief system, a philosophy about the effectiveness of decentralized, bottom-up innovation. And it's a philosophy that has begun to change how we think about creativity itself."

NPQ would argue that we are headed into an era of enormous creativity and possibility, but that it may be a time of enormous tension and outright conflict, as the as yet loosely formed will evidenced in OWS becomes more insistent and others struggle to find their respective places. All of which puts us in mind of the poem "Escape," by D. H. Lawrence.

> When we get out of the glass bottles of our ego,
> and when we escape like squirrels turning in the
> cages of our personality
> and get into the forest again,
> we shall shiver with cold and fright
> but things will happen to us
> so that we don't know ourselves.
> Cool, unlying life will rush in,
> and passion will make our bodies taut with power,
> we shall stamp our feet with new power
> and old things will fall down,
> we shall laugh, and institutions will curl up like
> burnt paper.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 180302.

New energy and tools are emerging for a more broad-based, fluid movement for global sustainability—a movement for accountability and fairness largely devoid of any central institutional presence.

There is a world of difference between financial management and financial leadership, and refocusing your approach from fiscal management to fiscal sustainability gets you there. Outlined in this expert guide are such essential steps as: transforming your annual budget analysis; deciding whether or not income diversification is the way to go; achieving a robust reserve; and equipping your board for effective financial governance.

An Executive Director's Guide *to* Financial Leadership

by Kate Barr and Jeanne Bell, MNA

There is an important distinction between financial management and financial leadership. Financial management is the collecting of financial data, production of financial reports, and solution of near-term financial issues. Financial leadership, on the other hand, is guiding a nonprofit organization to sustainability. This is the job of an executive director. He or she is responsible for developing and maintaining a business model that produces exceptional mission impact and sustained financial health. To do that successfully, the executive director has to be ever mindful of essential nonprofit business concepts and realities. The following is a guide to this way of thinking for an executive—a summary of what we see as the eight key business principles that should guide financial leadership practice.

1. Activate Your Annual Budget

Strong annual budgeting is an essential element of financial leadership. The best annual budgets align to an annual plan—a written narrative that all staff and board understand about the core activities the organization will undertake in the coming year and how they will be financed. If the budget includes as-yet-unidentified income, which is standard for many organizations, that amount should be clear to all board and staff along with the plan to raise the funds during the year.

Achieve a net financial result. A classic mistake executives make is allowing staff to spend all year on budget when income is not coming in as expected. In fact, it is critical to emphasize to your staff

Kate Barr is the executive director of the Nonprofits Assistance Fund; Jeanne Bell, MNA, is the CEO of CompassPoint Nonprofit Services, a nonprofit leadership development organization.

 "VOYAGE" BY SANGJUN ROH

that an annual budget is a plan to reach a *net financial result*—to yield a specific surplus or to invest a specific amount of the organization's reserves through a planned deficit. Whichever the financial goal for the year, if the organization is not running on pace to achieve that net financial result, then even budgeted expenses should be questioned and reconsidered. The budget is never permission to spend when income is not coming in as planned.

Anticipate the future. Given that many organizations raise funds and encounter new risks and opportunities throughout the fiscal year, it is important not to stay overly focused on *budget variance analysis* to the exclusion of rolling analysis of your anticipated financial position. Budget variance is the difference between budgeted and actual results for a given period. While it is useful to understand why predictions were off, it is just as important to be actively anticipating the future. We see too many executives and boards focused on "hitting the budget" rather than anticipating and intentionally shaping their financial futures beyond the current fiscal year. Fiscal years are arbitrary units of time; in reality, the decisions we make—and the consequences of deferred decisions—live on well beyond the fiscal year. For this reason, we recommend that organizations build the habit of rolling financial projection.

Fiscal years are arbitrary units of time; in reality, the decisions we make—and the consequences of deferred decisions—live on well beyond the fiscal year. For this reason, we recommend that organizations build the habit of rolling financial projection.

Commit to financial projection. At least quarterly, the management team should evaluate what they are learning about current and possible revenue streams, shifts in programming, and strategic opportunities, and there should be a means to capture that up-to-the moment thinking in a financial projection. Midway through the fiscal year, we recommend adding a projection column to the income statement, so that for the rest of the year it includes year-to-date actuals, year-to-date budget, and a column for management's current projection of where the organization is likely to end the year. Even better, the projection can roll into the "fifth quarter"—that is, across the arbitrary finish line of the fiscal year and into the first quarter of next year.

2. Income Diversification . . . or Not

Income diversification is often touted as a tenet of sustainability—the idea being that having all of your eggs in one basket is by definition riskier than having them in multiple baskets—or in this case, multiple revenue streams. In fact, nonprofit business models vary considerably by field or service type.

Determine the degree of diversification you need. Income diversification is more possible and more necessary in some models than in others. For instance, community mental health services are likely to be heavily government funded, and once a nonprofit has established a successful track record of providing these services, that government funding may remain in place for years. Even though the organization is technically dependent on one set of government contracts, it may not be in a riskier position than another kind of nonprofit struggling to raise small amounts of money from individuals, corporations, and foundations, for instance. The reliability and competitiveness of your revenue streams dictate the degree of diversification that you need.

Determine risk. Income diversification carries some real risks. Evidence shows that more revenue streams don't necessarily mean greater annual surpluses or organizational scale. To attract new revenue streams, an organization has to develop and sustain new capacities. As nonprofit finance expert Clara Miller has noted, "Maintaining multiple, highly diverse revenue streams can be problematic when each requires, in essence, a separate business. Each calls for specific skills, market connections, capital investment, and management capacity. Only then will each product attract reliable operating revenue, pay the full cost of operations, and deliver results."[1] And a recent analysis of high-growth nonprofits by the consulting firm Bridgespan Group found that 90 percent had a single, dominant source of funding. Bridgespan concluded that organizations get to scale by specializing in a certain type of funding, and that diversification, and thus risk management, happens by "securing multiple payers of the same type to support their work."[2]

3. Make Cash Flow Your Priority

Most financial reports are historical documents, useful to verify what has already happened and compare to budgets and plans.

Develop a cash flow projection. For looking forward, one of the most important tools is a cash flow projection. Executive directors need to know how the organization's cash flows, and what to do if the cash doesn't flow. Unless your organization has built up a substantial base of operating cash, any nonprofit can run into cash flow problems. What causes them? A variety of factors, including seasonal fundraising, annual grant payments, reimbursement-based contracts, and start-up costs for new programs.

Anticipate—and resolve—cash flow issues. Cash flow projections require knowledge and judgment that the accounting department may not have. Because of this, executive directors need to have a direct role in developing useful cash flow projections, agreeing on the assumptions to use, and reviewing the projections carefully. The earlier you anticipate cash flow issues, the easier it is to address them. As a first step, assess whether the cash flow shortfall is a problem with timing or is an indication of a deficit. The strategies used to solve the cash flow problem should match the cause of the shortfall.

Manage your shortfalls. Timing problems can be prevented by managing the timing of payments and receipts, improving internal systems, or arranging for a line of credit. Shortfalls caused by deficits need to be solved by budget adjustments or strategic choices to absorb a near-term shortfall. All of these options need the input and support of senior management. Managing cash flow is not a one-time activity. Insist that projecting and discussing cash flow every month or quarter become routine practice.

Wishing you had reserves is not the same as planning for reserves. But where do reserves come from? For most nonprofits, reserves are built up over time by generating unrestricted surpluses and intentionally designating a portion of the excess cash as a reserve fund.

4. Don't Wish for Reserves—Plan Them

"Building a reserve" is on the top of the financial wish list of just about every executive director. It's an understandable goal—just read the preceding section about cash flow and you'll understand why. Having a cushion of cash that can absorb an unexpected delay in receiving funds, a shortfall in revenue for a special event, or unbudgeted expenses can stabilize an organization. Nonprofits that have built up a good cash cushion have had options and opportunities during the recession that have allowed them to respond to reduced income and increased demand more strategically and carefully than those organizations with few extra dollars in the bank.

Achieve a surplus. Wishing you had reserves is not the same as planning for reserves. But where do reserves come from? For most nonprofits, reserves are built up over time by generating unrestricted surpluses and intentionally designating a portion of the excess cash as a reserve fund. On rare occasions a nonprofit will receive a grant to create an operating reserve fund. So step one in planning for reserves is to develop realistic income and expense budgets that are likely to result in a surplus. Step two is to make sure that achieving a surplus is a priority that is understood and supported by staff and board members. For some organizations, there is an earlier step, too. They have to stop operating with deficits before they can even dream of having a reserve.

Determine your reserve goal. How much should you have? While there are some rules of thumb, generic target amounts don't take some important variables into account, such as the stability of ongoing cash receipts. A commonly used reserve goal is three to six months' expenses. At the low end, reserves should be enough to cover at least one payroll, including taxes.

Manage your cushion. Once a nonprofit has been able to build a reserve, using it must be intentional and strategic. Using reserves to fill a long-term income gap is dangerous. A cash cushion allows you to weather serious bumps in the road by buying time to implement new strategies, but reserves should be prudently used to solve temporary problems, not structural financial problems. To maintain reliable reserves, it's also important to have a realistic plan to replenish them from future surpluses.

5. Rethink Restricted Funding

There is an ongoing debate among grantmakers about whether general operating funds are a better investment strategy than programmatically restricted grants. And frustration with funding restrictions is a common refrain among nonprofit executives. But at times this debate gets oversimplified to a notion that all restricted money is bad and inherently compromising of organizational sustainability, when this is not the case. As an executive, what you need to be concerned with is not whether a grant is restricted but what it is restricted *to*. A restricted grant for a program central to your desired impact and that covers a robust portion of that program's cost is functionally the same thing as general operating support—it is funding a core piece of the work that you do. The two qualifiers are key, though: you are doing something that the organization would do anyway, and you are getting paid fairly to do it. What you need to avoid is chronic reliance on grants and contracts that pull the organization in unaligned directions or that refuse to pay fairly for the promised outcomes.

Develop effective grant proposals. Your development of sophisticated grant proposals is essential to incorporating restricted funding in your business model effectively. Take a very broad view of any program you are proposing for funding by including as direct costs such elements as hiring program staff, marketing and outreach to clients, staff professional development, and program evaluation. These are the kinds of organizational expenses that directly benefit programs but for which we too rarely charge our investors. If you believe that program evaluation is essential to monitoring effectiveness of outcomes, it's your obligation to force the issue with funders who classify the cost as "overhead." Incorporating sophisticated language in your proposal narratives that links staff development to program design to strong program outcomes sets the stage for a budget that includes these critical expenses. Restricted funding from foundations and corporations that genuinely understand and value your organization's work can be a very sustainable revenue stream if you are very selective about which funders to pursue, and if you pursue them with well-conceived programs and accompanying budgets.

As an executive, you seriously jeopardize your organization's funding and reputation if you maintain inadequate systems for tracking contract and grant dollars—it's a true nonnegotiable.

6. Staff Your Finance Function

Put simply, too many executives have not staffed their finance function properly, and they pay the price with chronically underdeveloped financial systems, low-grade financial reporting, and the lack of a trusted partner with whom to do analysis and projection. In *Financial Leadership: Guiding Your Organization to Long-Term Success*, co-authors Jeanne Bell and Elizabeth Schaffer describe three functional aspects of the finance function: *transactional*, *operational*, and *strategic*. The transactional are the clerical tasks that support the accounting function, such as copying, filing, and making bank deposits; they require someone with excellent attention to detail and exposure to basic accounting principles. The operational are the range of accounting functions, such as paying bills and producing monthly financial statements; they require someone with strong nonprofit accounting knowledge, including managing grants and contracts. And the strategic are the systems development, financial analysis, planning, and communication about the organization's financial position; they require what we think of as CFO-level knowledge and skills.[3]

Determine your optimal staffing approach. Every organization needs all three functions, but organizational size and complexity will determine how much time each requires *and* the optimal staffing approach. In general, it is income that makes nonprofits more or less complex. A $10,000,000 organization that gets all of its money from individual donors requires a very basic accounting system, while a $2,000,000 organization with government contracts and restricted foundation grants requires a very robust accounting system. As an executive, you seriously jeopardize your organization's funding and reputation if you maintain inadequate systems for tracking contract and grant dollars—it's a true nonnegotiable. If you have these funds in your business model, you should assume that you will need to fund a very experienced, senior finance staff role.

Invest in contract consultants. So how does an organization with limited resources adequately attend to all three finance functions? Increasingly, we are seeing executives pair contract consultants with staff in the finance function. For instance, a small or midsize nonprofit might invest in an excellent full-time staff accountant who can handle the operational functions expertly and provide oversight to an administrative generalist—such as an office manager, who handles the transactional functions during the 50 percent of her workweek that is directed to the accounting function. Then the executive contracts with a CFO-level consultant who spends fifteen hours per month answering any questions the staff accountant may encounter, doing financial analysis for the management team and board finance committee, developing budgets and projections, and so forth. This way, the executive has a strategic financial partner without creating a fixed staffing cost that she can't afford. Board members, including the treasurer, have a role that is distinct from the staff finance team. The executive needs an uncomplicated relationship to her finance team so that she can direct them in developing the analysis and reporting she needs as the organization's financial leader.

Boards have a governing role in assessing and planning an organization's finances. In too many cases, though, executive directors expect their boards to stay high-level and strategic without equipping them for the role.

7. Help Your Board to Help You

Boards have a governing role in assessing and planning an organization's finances. In too many cases, though, executive directors expect their boards to stay high-level and strategic without equipping them for the role. It is the executive director's responsibility to provide the board with information that is appropriate to members' roles and responsibilities.

Design your financial reports thoughtfully. The board is responsible for short- and long-term planning of the organization, and its members must ensure that systems are in place for effectively using resources and guarding against misuse. The board has legal responsibility for financial integrity but board members are not the accountants, so don't inundate the board with pages of detailed accounting records and then wonder why the board can't see the "big picture." Boards need analysis and interpretation more than they need the numbers. There is no one-size-fits-all financial report. Reports must be designed to communicate information specific to the organization's size, complexity, and program structure in a format that matches the knowledge level and role of board members.

Understand how boards use financial information. The format and content of reports for the board should be determined by their intended purpose. Boards actually use financial information for four distinct purposes: compliance with financial standards, evaluation of effectiveness, planning, and immediate action.

Compliance. Most nonprofits do pretty well with providing the board with financial reports that comply with the board's legal fiduciary role to know how much the organization has received and expended. Historical financial reports, audits, and 990s are the common reports.

Evaluation. For the board to evaluate how well the organization has used financial resources, different information is needed. Comparisons are needed to measure progress toward goals, assess the financial aspect of programs, and consider financial strategies.

Planning. When the board is engaged in planning to project future needs and changes or to develop budget guidelines, they need a big-picture understanding of the organization's history and of the external environment and financial drivers.

Taking Action. Sometimes the board needs to make a key financial decision to implement a strategic plan, react to a sudden change, or respond to an opportunity. In order to make a wise but timely decision, the board needs to understand the background and situation and scenarios based on one or two possible actions. And form should follow function: before developing financial reports for the board, ask what type of actions or decisions the board will need to make, and provide them with the right amount of information and analysis in a format that fits the purpose. Don't ask your board to maintain a top-level focus on strategy while submitting financial reports better suited to the auditors.

8. Manage the Right Risks

To reduce and manage risks, most nonprofits develop policies and procedures for each area of the organization. The facilities manager maintains controls over keys, access, and insurance coverage. The finance director assures appropriate segregation of duties, internal controls, and checks and balances. Program managers compile information and data to run background checks, keep licenses up to date, and maintain required reporting. If we put them all together in a binder, these policies make up the organization's risk management process.

Assess your organization's risks holistically. If each area assesses and formulates its own risks, who is responsible for deciding which risks have the most magnitude and impact on the organization? Put another way, if a nonprofit decided that at least one of its policies had to be eliminated for some reason, how would you decide which one the organization could do without? For example, which of these possible events pose the greatest risk to the organization's ability to achieve its mission, programmatic, and financial goals: theft of a laptop computer, loss of confidential client data on that computer, or damage to the organization's reputation if client data were made public?

Consider enterprise risk management. Many nonprofits do a better job of managing the risk of a small theft than they do of identifying and reducing these other two, much greater, risks. Enterprise risk management (ERM) is a term that your auditors may have brought up recently. ERM is essentially the process of assessing all of the risks that the organization faces with a comprehensive, enterprise-wide view and making decisions about managing risk in the same way. An ERM process considers both risks that are evident today and those that are will emerge as operational and strategic plans are implemented. Some organizations need to complete a formal, extensive internal assessment with a staff team and outside consultants. Smaller organizations can complete their own organization-wide review of risks through brainstorming and discussions. The most important step is to start thinking about all the parts as a whole. In the case of the stolen laptop, for example, too much emphasis on limiting access to the office on weekends might have led a program staff member to store confidential data to take home to complete a needed report. Balanced together, these risks would probably have been managed differently than if looked at separately. With the big-picture view of the organization always in mind, the executive director is the right person to advocate ERM by asking members of his or her team to think beyond their own area to the wider enterprise.

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What's old is new again. These principles are both longstanding practices and emerging trends for nonprofits. Some of these business principles are undoubtedly familiar to you. Others may run counter to what you may believe to be a "best practice." Executive directors learn that leading a nonprofit requires a constant balancing of current needs, external demands, and long-term vision. Financial leadership is fundamental to the role and cannot be fully delegated. These principles will help executive directors adapt to the demands of the changing environment and maintain the balance needed for mission impact and sustained financial health.

Notes

1. *The Chronicle of Philanthropy*; *Money and Mission*; "Shattering the Myth about Diversified Revenue," blog entry by Clara Miller, September 2, 2010, http://philanthropy.com/blogs/money-and-mission/shattering-the-myth-about-diversified-revenue/26652.
2. William Foster and Gail Fine [Perreault], "How Nonprofits Get Really Big," *Stanford Social Innovation Review* (Spring 2007): 46.
3. Jeanne Bell and Elizabeth Schaffer, *Financial Leadership: Guiding Your Organization to Long-Term Success* (New York: Turner Publishing / Fieldstone Alliance, 2005), 21.

The Executive Director's Finance Cheat Sheet

A SUMMARY OF THE EIGHT MUST-DO'S FROM THIS ARTICLE . . .

1. Develop your annual budget with a commitment to its net financial result—whether surplus or planned deficit—and then adjust spending during the year if income is not coming in on pace to yield that net result. Then, complement your annual budget with rolling financial projections that incorporate your most current information about probable future financial results.

2. Diversify your income cautiously, ensuring you have the capacity to develop and sustain the programmatic and operational requirements of attracting each new resource type well.

3. Develop cash flow projections along with the budget and rolling projections so that you can anticipate any cash flow problems well in advance, when you have more options.

4. Plan goals for financial reserves based on your typical cash flow cycles and risks and incorporate reserves into all financial plans and policies. Be sure to foster a financial culture for staff and board that promotes the importance of a regular operating profit or surplus.

5. Pursue restricted funding from those foundations and corporations that understand and value your organization's mission and particular strategies for achieving impact. When pursuing restricted funding, develop proposal narratives and accompanying budgets that link staff development to program design to superior outcomes, including all related costs as direct.

6. Ensure that your finance function is always properly staffed; if necessary, use a mix of staff and expert contract consultants to achieve this.

7. Discuss expectations for financial roles and responsibilities with board leadership to create accountability and information flow that matches the size and life stage of the organization. Make sure to invest time in developing meaningful financial report formats for the board that reinforce organizational strategies and goals and support the board in fulfilling their responsibilities.

8. Introduce the concept of enterprise risk management to your team and initiate an internal assessment of a full range of risks.

The Voice from Outside: *Stakeholder Resistance in Nonprofit Organizations*

by Sean Buchanan and Patricia Bradshaw

There have been a number of instances recently where various groupings of stakeholders—including donors, members, staff, and constituents—have staged a revolt against a decision made by nonprofit leadership. Although social media may have aided the revolts, we think they are emerging from a changing attitude toward institutions.

A BOARD-APPROVED MERGER BETWEEN TWO nonprofits is quashed due to pressure from donors. Two Girl Scouts mobilize opposition to the use of palm oil in Girl Scout cookies and get the nonprofit to change the recipe. A recreation center on the verge of closure is prevented from doing so by the work of community members. A labor dispute between musicians and management in the Detroit Symphony Orchestra leads to the creation of an advocacy group that becomes a powerful voice in the negotiation process. These examples highlight an emerging

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"MONARCH BUTTERFLY COLONY IN FLIGHT"

phenomenon that is gaining momentum worldwide—that of what we are calling "stakeholder resistance," but what some executive directors may experience as "stakeholder rebellion."

Stakeholder resistance, we are suggesting, falls in the space between workplace resistance and civil society resistance.

What Exactly Is Stakeholder Resistance?

What is interesting about stakeholder resistance is that it originates with individuals who are not "insiders" in organizations, and that these "outsiders" are at times engaging in acts that challenge, disrupt, and even change organizational policies, practices, and actions. These individuals can actually limit the autonomy of organizational decision making, yet they are not legislators, lobby groups, or key funders. Generally speaking, an organization's stakeholders are those who are linked to an organization in ways other than a formal contract.[1]

In the case of nonprofits, stakeholders often include donors, members, and community members who engage with the organization either directly or indirectly.[2] Frequently, a strategic planning process includes a *stakeholder analysis*—an exercise that involves identifying key stakeholders as well as their interests and sources of power. The really influential, or those whose interests are perceived to be a threat, are then attended to, and the rest are mostly ignored. Clients being served or small, widely distributed individual donors are examples of those who have traditionally been seen to have interests in alignment with those of the organization or as having diffuse power bases and hence not necessary to include in a strategic planning process.

The term *resistance* was originally used with a negative connotation, as in "resistance to planned and top-down change," and it implied that compliance with the dictates of the leadership was expected and positive.[3] Since then, the term has been reclaimed by more critical scholars as an act of purposefully undermining the status quo and the taken-for-granted ways things are always done, and resistance is celebrated as an act that pushes back on established power relations.[4] Within the second tradition, studies have focused primarily on two types of resistance: workplace resistance and civil society resistance. Workplace resistance focuses on how workers resist employer practices, actions, and rules. This resistance consists of both overt actions such as strikes, whistle blowing, and sabotage and more covert actions of resistance through rhetoric, shirking, cynicism, and humor.[5]

Research on civil society resistance, on the other hand, has focused well outside the domain of the organization and examines social movements and the processes by which groups form resistance against dominant rules, norms, or practices in society.[6] Environmental NGOs have received particular attention for their acts of resistance. For example, the actions taken by Greenpeace to prevent Shell Oil's decision to dispose of an oil-storage buoy in the deep sea eventually resulted in Shell's overturning its initial decision.[7] Civil society resistance differs from workplace resistance because it emerges from an external source, whereas workplace resistance emerges internally.

Stakeholder resistance, we are suggesting, falls in the space between workplace resistance and civil society resistance.[8] These stakeholders are not employees of an organization but are likely more closely connected to the organization than the broader civil society. Take the case of the failed merger between Smile Train and Operation Smile—two organizations that repair cleft palates of children across the world. The resistance to the merger planned by the two boards of directors emerged primarily from the Smile Train *donors*, who mobilized opposition to the merger though an online petition.

In the case of the resistance enacted against the Girl Scout organization for its use of palm oil in cookies, it was two *members* of the girl scouts who engaged in the resistance. Fifteen-year-old Rhiannon Tomtishen and sixteen-year-old Madison Vorva learned through a Girl Scout project that the habitat of orangutans in Southeast Asia was diminishing because rainforests were being cleared for palm oil plantations. Palm oil, as it turns out, is a key ingredient in all Girl Scout cookies. After a failed attempt at sparking change with the Girl Scouts directly, Rhiannon and Madison began mobilizing support from other activist groups such as Rainforest Action Network.

Stakeholder resistance can also emerge from community members who interact with an organization. When a YMCA in Elmira, New York, was on the verge of shutting down due to a lack of funds, over two thousand community members signed an online petition urging local officials to find a solution to keep the YMCA operating. Meanwhile, grassroots groups of students from a local university and local elders met to discuss how the Y could be saved. This resulted in the adoption of the YMCA by a local senior center, allowing it to continue to operate.

On other occasions, stakeholder resistance might emerge from several groups simultaneously. The dispute between musicians and management in the Detroit Symphony Orchestra led to the creation of an advocacy group called Save Our Symphony, composed of several stakeholder groups including donors, audience members, and the local community. As the above examples illustrate, stakeholder resistance is unique in that it emerges from individuals and groups who are connected to an organization but often don't have the immediate access of an employee.

What Is Causing These Acts of Resistance?

While the specific causes of stakeholder resistance differ from organization to organization, it appears that underlying almost all the acts is a deep dissatisfaction with the organizations' responsiveness to their stakeholders. Specifically, in each of the examples highlighted in this article the acts of resistance against the organization resulted from a lack of voice given to their stakeholder groups in organizational decisions. This marginalization of the stakeholders may stem from the fact that they were considered to be *secondary stakeholders*, which afforded them less of a direct influence on organizational decision making than *primary stakeholders*, such as board members.[9] Furthermore, these secondary stakeholders are less organized than other broader stakeholder groups such as social movement organizations like the environmental NGOs mentioned earlier.[10] Thus, with less assumed importance to the organization and less formal power, these stakeholders are often not given adequate attention by their focal organizations.[11] Under these conditions of little formal voice and low organizational responsiveness, stakeholders who have a particular interest that they feel strongly about are more likely to engage in the types of resistance this article describes. It may also be the case that there may be a triggering event that activates resistance and that these events are difficult to anticipate. As the resistance mobilizes and the emotional subtext gets more heated (these acts are often accompanied by anger or anxiety), there is an amplification of a collective voice among what are normally diffuse actors.

Although these stakeholders are often in marginalized positions vis-à-vis the organizations, the organizations often attempt to communicate with them. Traditionally this has been through publications such as newsletters, which represent one-way communication mechanisms. The collective voice of stakeholders would traditionally be at a membership meeting, and while revolts have taken place in such forums, they could also at times be anticipated and managed. Nonprofit leaders recognize that these stakeholders have a critical role in the success of the organization, and failure to meet the needs of stakeholders can have many negative consequences.[12]

What Is Enabling These Acts of Resistance?

What has caused this apparent surge of stories of stakeholder resistance? Why now? One commonality to all these examples is the presence of social media as a tool for stakeholder communication, mobilization, and engagement. As recent examples in Egypt and Libya have demonstrated, social media sites such as Facebook and Twitter can play a large role in activism and resistance. There are several reasons for the effectiveness of social media in resistance; primarily, the direct, efficient, and low cost of Internet communication provides a powerful tool to engage a wide variety of stakeholders who may be isolated from traditional forms of collective action.[13] Interestingly, the interactivity of social media facilitates an unprecedented degree of two-way communication between organizations and stakeholders. Increasingly, nonprofits are using social media to engage their stakeholders through information provision, disclosure of performance, fundraising, and two-way communication.[14] This communication provides an avenue for organizations to

There are several reasons for the effectiveness of social media in resistance; primarily, the direct, efficient, and low cost of Internet communication provides a powerful tool to engage a wide variety of stakeholders who may be isolated from traditional forms of collective action.

engage stakeholders; however, it also provides a means for stakeholders to resist organizational actions or practices.

The generative dialogic communication between organization and stakeholder that is facilitated by social media offers an opportunity for these organizations to openly and effectively engage stakeholders and build a greater sense of community.

For example, the dispute in the Detroit Symphony Orchestra was made very public through social media, with the Save Our Symphony advocacy group creating a Facebook page where stakeholders could communicate with each other and the organization. Opposition to the Smile Train and Operation Smile merger and the closing of the Elmira, New York, YMCA gained momentum through the use of social media platforms. And when a group in Minnesota started a campaign to boycott the annual Basilica Block Party to protest the Archdiocese of St. Paul and Minneapolis's support of a constitutional amendment banning gay marriage, it was done through the group's Facebook page, which gained over six thousand followers.

Stakeholder resistance can also occur right on the organization's own social media sites, albeit in a more disorganized fashion. For example, one way in which stakeholders voiced support for a ban on palm oil in Girl Scout cookies was to post negative comments on the Girl Scout Facebook page.

In all the above cases, previously diffuse actors came together virtually and thus shifted their power base.

Strategic planning processes that include stakeholder analysis of stakeholders' respective interests and power must include a more critical appreciation of the power of these previously relatively powerless actors and take into account the impact of social media. Ironically, as with the Girl Scouts example, the sites that are often used in these resistance actions are ones established by the nonprofits themselves; when these are not managed well or monitored, there is no one to respond to concerns that are expressed or to catch the trigger events, and before long strong emotions—and then actions—escalate.

Challenges and Opportunities for Organizations

Stakeholder resistance presents a number of challenges for nonprofits. As a result of the increasing two-way communication between organizations and stakeholders, there is greater opportunity for formal resistance on the part of stakeholders than ever before. Moreover, the actions of organizations are becoming more transparent and publicly available, leaving little opportunity for organizational actions, practices, and policies to go unnoticed by stakeholders.

Another challenge for organizations with respect to stakeholder resistance is that it takes place on a public stage. In the cases of the Detroit Symphony Orchestra dispute and the Smile Train and Operation Smile merger opposition, the debates occurred in a very public way on company websites and Facebook pages. In some cases the debates can get very heated and, in some cases, reflect negatively on the organization as a whole.

Studies have shown that while most nonprofits have a social media presence, it tends to be underutilized as a communication tool. One study examined the Facebook pages of 275 nonprofits and found that relationship building with stakeholders was virtually nonexistent.[15] Another study of nonprofits suggested that these organizations appeared to view the mere creation of social media pages as active engagement with stakeholders.[16] Thus, it appears that while social media is providing more of an opportunity for organizations and stakeholders to communicate with each other, the bulk of interaction occurs during periods when stakeholders are unhappy with the organization.

Of course, the increasing engagement and power of stakeholders need not be viewed as a negative for nonprofits—especially considering how many of them are actively trying to increase stakeholder engagement and how many are committed to democratic participation. The generative dialogic communication between organization and stakeholder that is facilitated by social media offers an opportunity for these organizations to openly and effectively engage stakeholders and build a greater sense of community.

In the cases of stakeholder resistance outlined in this article, the organizations under scrutiny appear to have lacked a clear and open line of communication with their stakeholders. By closing themselves off, the organizations, perhaps inadvertently, created a barrier between themselves and their stakeholders. We suggest that these are the conditions under which stakeholder resistance will most likely occur.

Acts of stakeholder resistance are unlikely to disappear anytime soon. As the examples in this article indicate, stakeholders have been quite successful in their acts of resistance. Mitchell, Agle, and Wood note that organizations are likely to be most responsive to stakeholders with high levels of power, legitimacy, and urgency; and when stakeholders actively resist, they increase the power they have in relation to the organization by mobilizing opposition and resources.[17] This increased power then works to heighten the urgency and enhance the legitimacy of their grievance in the eyes of the organization and the world at large. The increasing power of social media provides an important tool as well as a potential weapon for stakeholders, and the trend in stakeholder resistance will likely continue to grow in importance as more stakeholders begin to make their voices heard—making it essential for nonprofits to put serious time and effort into their active engagement with their stakeholders.

Notes

1. We think it is interesting to acknowledge that the term *stakeholder* is a metaphor. (We were once asked in a workshop why we talked about a plate with a steak on it!) It appears the metaphor originated with land claims, such as in the gold rush, when gold diggers "staked" claims to land they believed contained gold by erecting an actual stake in the ground. Today "stakeholders" too are differentiated by their interests and power.

2. Madeline Toubiana and Patricia Bradshaw, "Why Won't You Advocate for Us?: Exploring the Disruptive Institutional Work of Marginalized Stakeholders" (working paper, 2011).

3. James C. Scott, *Domination and the Arts of Resistance: Hidden Transcripts* (New Haven: Yale University Press, 1990).

4. David Knights and Darren McCabe, "Ain't Misbehavin'?: Opportunities for Resistance under New Forms of 'Quality' Management," *Sociology* 34 (2000): 4221–4436.

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11. M. B. E. Clarkson, "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance," *Academy of Management Review* 20, no. 1 (1995): 92–117.

12. de Bakker and den Hond, "Introducing the Politics of Stakeholder Influence."

13. Gregory D. Saxton, Chao Guo, I-Hsuan Chiu, and Bo Feng, "Social Media and the Social Good: Facebook as a Stakeholder Engagement Tool for Nonprofit Organizations" (working paper, 2011).

14. Ibid.

15. R. D. Waters, E. Burnett, A. Lamm, and J. Lucas, (2009). "Engaging Stakeholders through Social Networking: How Nonprofit Organizations Are Using Facebook," *Public Relations Review* 35 (2009): 102–106.

16. D. S. Bortree and T. Seltzer, "Dialogic Strategies and Outcomes: An Analysis of Environmental Advocacy Groups' Facebook Profiles," *Public Relations Review* 35, no. 3 (2009): 317–319.

17. R. K. Mitchell, B. R. Agle, and D. J. Wood, "Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts," *Academy of Management Review* 22, vol. 4 (1997): 853–886.

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With just one concrete example of Social Impact Bonds in action—in the United Kingdom—and pilot projects only just starting to take off nationally, how do we measure the outcomes? At this early stage of practice we must take something of a "wait and see" approach, but what is clear is that Social Impact Bonds may very well come to represent a new step in the evolution of philanthropy toward an outcomes (rather than outputs) focused effort.

Social Impact Bonds:

A Conversation with Simon Jawitz

by Jon Pratt, JD, MPA

Editors' note: *Social Impact Bonds may be the latest and newest instrument for drawing private investment into entrepreneurial social programs. But with only one major example of Social Impact Bond financing,—from the United Kingdom—and efforts to gin up Social Impact Bond initiatives in Boston and the Twin Cities having only just begun, there are as yet too few results to trumpet.* NPQ *contributing editor Jon Pratt sat down with Simon Jawitz, board member of and senior advisor to Growth Philanthropy Network, to discuss the concept's prospects.*

Jon Pratt: *To introduce this topic to our readers, I would like to set the table with a working definition of Social Impact Bonds lifted from the Social Finance website. Here is how one of the early players describes them: "Social Impact Bonds provide up-front funding for prevention and early intervention services, and remove the risk that interventions do not deliver outcomes from the public sector. The public sector pays if (and only if) the intervention is successful. In this way, Social Impact Bonds enable a reallocation of risk between the two sectors." There is no doubt that this is an interesting concept, and some people see enormous potential for Social Impact Bonds to bring for-profit investment money to the nonprofit space for everything from health care and education to affordable housing and human services. Where do things stand now?*

Simon Jawitz: I think your characterization of people seeing huge potential is accurate. There is a lot of energy and enthusiasm for the concept of the Social Impact Bond. Somebody I spoke to recently, who is very actively involved, characterized the current level of interest as undergoing exponential growth.

But the level of actual transactional activity is a very different story. So far only one transaction

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"UNTITLED" BY AMY JOY WATSON

One can draw the conclusion that the Social Impact Bond has been hyped beyond anything that's reasonable; or alternatively, that people look at this and see huge potential, even if they recognize that there's a very long runway, and it's probably going to be a slow takeoff.

has occurred, and it was overseas—the U.K. Social Impact Bond (at HMP Peterborough) between the Ministry for Justice and Social Impact Partnership. And this was a very small transaction in the scheme of things—$5 million pounds sterling. One can draw very different conclusions from that. One can draw the conclusion that the Social Impact Bond has been hyped beyond anything that's reasonable; or alternatively, that people look at this and see huge potential, even if they recognize that there's a very long runway, and it's probably going to be a slow takeoff. There is a tremendous amount of dedication out there, not only to getting individual transactions completed but also to being very transparent about them. So I think one of the strategies the players are focusing on—folks like Third Sector and Social Finance—is to make sure that as these transactions get completed and information gets out very broadly to the public so that a base of knowledge builds up, making it easier for additional deals to get done.

JP: *So in the case of the British example, where the Ministry for Justice is expecting their service provider to reduce recidivism by, say, 7.5 percent, have you heard about how it's actually going?*

SJ: Not yet. It may be too early.

JP: *Who are the investors in the Peterborough Social Impact Bond?*

SJ: The only one that is a matter of public record is the Rockefeller Foundation. Other than that, I'm not aware that the investors have been identified. What I do understand is that if you wanted to characterize them, you would characterize them as, like the Rockefeller Foundation, not your traditional financial investor looking for a return; they're more the "impact investors"—people who are looking for both social impact and, potentially, a financial return.

JP: *So maybe the same types of institutions that might fund these types of services as a project, but here they're using their assets rather than their grants.*

Could Social Impact Bonds increase pressure on client relationships?

Social Impact Bonds are expected to change the relationship between service providers and government, but that's not the only relationship they may change. By increasing the stakes to achieve performance goals based on changes in their clients' behavior, with direct financial consequences for failure, organizations have stern incentives to make sure their clients perform as agreed.

The particulars of how this innovation might affect service providers is unknown, but an early example might be in Minnesota, where the 2011 Minnesota legislature approved a $10 million pilot project called Pay for Performance Bonds, which share some of the goals of Social Impact Bonds.

Minnesota's Pay for Performance legislation was championed by Steve Rothschild, founder of Twin Cities Rise!, a job training and placement organization. Twin Cities Rise! initiated a funding agreement ten years ago with the state's Department of Employment and Economic Development, whereby it would only be paid—after the fact—if it could document successful job placements.

To underscore the seriousness of its approach to clients, Twin Cities Rise! requires clients to sign a participant agreement in which they pledge to remain actively engaged in the program or else must repay the cost of the program, not to exceed $7,500. For one young woman, who found a job on her own and left the program, that meant receiving an intimidating letter that concluded, "Consequences of non-response to that invoice could also include TCR! bringing your account to conciliation court, where an unfavorable judgment would negatively impact your ability to gain credit with lending institutions." On April 11, 2011, Twin Cities Rise! filed suit against the client for $3,338 plus a $70 filing fee.

SJ: That's exactly right. I think that part of it is that the Rockefeller Foundation—and I don't want to speak for them, but I've had many conversations with them on this point—are one of the many institutions in this country that see great potential in this product. They would like to see the field develop, and hence—and, again, I don't want to speak for them—I think that was at least a part of the reason for their participation in the U.K. deal and a part of the reason why they have given grants to Social Finance and Third Sector Capital Partners. Other organizations have made similar grants. The Boston Foundation has also made a grant to Social Finance, as did the Pershing Square Foundation, established by the hedge fund Pershing Square Capital Management.

JP: *Is the underlying premise of the Social Impact Bond that there's to be a cost savings for government and this is why government would want to participate in this?*

SJ: Yes. The underlying premise is that these interventions will, if successful, result in hard-dollar savings to the government. And, since the government pays only if, in fact, the interventions are successful, at the end of the day—so long as the government doesn't end up paying out more than 100 percent of its realized savings—it comes out ahead financially and has also avoided taking on the risk up front. So, there are really two benefits for the government: avoiding taking on the risk that the intervention will be successful and only paying out of savings that it actually receives.

JP: *So, potentially, say, in the British example, if there was no change in recidivism, it's possible that the bondholders would just completely lose out.*

SJ: It's not a possibility—it absolutely would be the case. In fact, if they don't hit certain benchmarks there is no payout whatsoever.

JP: *It's kind of this combination of new money, private money, and then demonstrable results. . . . So what are the actual savings? For example, one area this has been promoted in is job training. Take, for instance, people leaving prison. If you could help them get employed they would be paying taxes, and this would reduce cost to the state. But is the state receiving money it would not otherwise have received if this employed person who pays taxes had not been trained by this organization? What if the employer had hired someone else? The state would have captured the same tax payments. So, after all, employers are hiring not out of charity but because they need a body to be doing the work. They're satisfying a need that they have in the marketplace.*

SJ: Right. If you wanted to focus on a group of unemployed people—and I'm just thinking about this as we talk—and you want to give them job training, the theory being that they would then go on to get a job and increase tax revenues . . . I think you *might* be able to develop something, but it would be extremely difficult, partly for the reason that you just identified: What's the control group? What would have happened absent the intervention?

Let me use another example—supportive housing for the homeless. There are many studies and a great deal of data that demonstrate that homeless people are extremely high maintenance in terms of visits to hospitals, use of emergency rooms, and incarceration. So the theory there is if you can provide an alternative in the form of some kind of supportive housing, you can potentially avoid all these other high costs that go along with having to take care of that population on the street. Numerous studies have demonstrated the ability to quantify those savings.

JP: *Right. But isn't this the argument that's commonly made for appropriations? That it is in the community's interest to undertake this expenditure because there's some other benefit that may well be an economic one?*

SJ: You're right. But the difference here is that in this particular case we're not just arguing that we should do this because it *may* have this result—we're saying, let's put this structure in place. We believe that we can get the results, and we're only going to pay if, in fact, we do get these expected outcomes and the resulting actual savings.

JP: *Do you see any possibility that by creating this new stream of revenue, support—including political support—for current appropriations could be decreased?*

The underlying premise is that these interventions will, if successful, result in hard-dollar savings to the government. And, since the government pays only if, in fact, the interventions are successful, at the end of the day—so long as the government doesn't end up paying out more than 100 percent of its realized savings—it comes out ahead financially and has also avoided taking on the risk up front.

[W]hile I think the concept of new money is certainly important, the more salient aspect is that we are taking another step along the road of moving philanthropy more generally in the direction of focusing on outcomes, and not outputs, and putting higher value on those programs and nonprofit organizations that have proven results.

SJ: Absolutely. You talked about two things earlier. You identified new money coming into the system. So that would be your third-party investors. But the other big thing is evidence-based programs and outcomes. Those are the two key components of the Social Impact Bond structure. I think the second, quite frankly, is more important than the first, meaning that yes, perhaps we can find new sources of capital to cover the up-front cost of these programs. Maybe initially it will be impact investors. Potentially, down the road, if the Social Impact Bond becomes established enough and well understood enough, you might find real, pure financial investors putting in the money for these programs up front. But, ultimately, you're still limited by the amount of money that the government is going to be willing to pay out.

So while I think the concept of new money is certainly important, the more salient aspect is that we are taking another step along the road of moving philanthropy more generally in the direction of focusing on outcomes, and not outputs, and putting higher value on those programs and nonprofit organizations that have proven results. I believe that a lot of the people involved in Social Impact Bonds see a shift down the road where—whether governments are using this structure or not, whether they're taking the risk themselves or not—governments are going to prefer to fund those programs with proven outcomes.

If I'm a nonprofit organization, and I'm hearing about this structure for the first time, what should I be thinking? Forget about all the structural complexities and the details. I should be thinking at the very least that here is yet more evidence that philanthropy is moving in the direction of funding evidence-based programs. I would want to start thinking more seriously about my own program, and what data I had and what data I could get, and position myself—whether for a Social Impact Bond or not—to be able to propound my program versus alternative programs that are out there. And, I think there's going to be increasing pressure in that respect as we go forward. We all know about the current financial and economic situation and the budgetary constraints at all levels of government.

As a governmental official I would have thought that the idea of making sure that my dollars are being utilized effectively—more precisely, that the taxpayers' dollars are going toward programs that actually generate results—is logical and compelling. Now, those results don't always have to be dollar savings for me—as opposed to lots of other benefits and results that the government wants to support—but at least I know that with regard to money being spent, I'm getting the results that I'm looking for.

JP: *This goal was part of the idea behind No Child Left Behind—that we should be able to measure the results and reward them. Is it possible, though, that the increased attention on payment conditions on meeting specific targets could have the effect of increasing pressure on the providing organization, and also result in a change in the nature of the relationship between the service provider and the person served? In other words, do we want nonprofits choosing only the easiest clients so that they're more likely to succeed, and avoid the most difficult populations?*

SJ: The contracts have to be structured very carefully. . . . One of the most important things is to make sure that the service provider is not cherry-picking, because then you're really defeating the purpose. It comes down to the negotiation and the structuring of the contract between the state and the service provider. I think another very important aspect of all this is transparency.

My own view is that it's absolutely critical that all aspects of this transaction be clear and well understood by all the parties. And that would include the relationship between the service provider and the recipient of those services. That has to be out in the open. That has to be vetted. That has to be understood. I think that will go a long way towards making sure that we don't inadvertently create perverse incentives that push organizations or people towards conduct that we don't really want to encourage.

JP: *What advice would you give to government officials developing these pilot projects? What should they pay most attention to getting right?*

SJ: Oh boy, there's a long list. In no particular order may I just try to give you some thoughts? Well, one is—as we've just discussed—making sure that all the incentives are lined up, that the transaction is properly structured. You have to make sure that you can measure the outcomes properly, which means some kind of control. You want to make sure that the service provider is not cherry-picking, so that you're getting improvement in the population as a whole. If all goes well, and the deal is structured properly and the targets are met, the government will make a payout that will go to investors. That payout will by its very nature be greater than what the government would have paid if it had just contracted for the services up-front.

That should be clear to anyone. Investors are putting up the money that covers the cost of the program interventions. They will be looking to get that money back plus an appropriate return based upon the risks they are taking. So the equity kicker, so to speak, that the investor receives, is an incremental cost to the government that it would not otherwise be required to pay out. The government is paying out more than it would have paid out if it had done this the traditional way, which is basically just entering into a contract and paying for the services.

Now, the benefit of doing that—and it has to be weighed—is that the government is avoiding taking the risk that the program doesn't work. But how valuable is that? How much real uncertainty is there in the program? If there's so much uncertainty, then you have to ask why any investor is going to be willing to take the risk. So it requires a careful balancing of risk and an intelligent assessment of pricing in light of each party's incentives and priorities. Obviously, the government will want to be able to assure taxpayers that their money is not being wasted—that while the government is actually paying a premium, it is getting real value in exchange.

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There are many other considerations for the government. Are the necessary data available and reliable? Are the agreed outcomes measurable? Is there a clear agreement on how those outcomes translate into savings? Now, as currently conceived, the Social Impact Bond is structured with

[O]n October 21, the White House Office of Social Innovation and Civic Participation co-hosted an event with the Nonprofit Finance Fund to bring together representatives of state and local governments from around the country to share information regarding the potential of Social Impact Bonds and efforts currently under way.

an intervention and then a measurable outcome. So, for example, in the case of the U.K. Peterborough deal, there is an ongoing intervention, and the outcome that's being measured is recidivism. The payments, if any, to be made to investors will be determined by the reduction in recidivism. In a way, that is the end of the transaction as far as investors are concerned. Of course, they will have an interest in understanding how the government computes its savings, if only to assure themselves that they are getting a fair share.

But determining how a reduction in recidivism translates into actual cost savings is very likely to be the thorniest problem of all. It's an extraordinarily complicated question, because you're going to start getting involved in budgetary issues and allocations and overhead and who captures the savings and where it goes. . . . But it's obviously something that governments need to be focused on. I would advise governments looking to do this to make sure that they work with or hire advisors or intermediaries—people versed in how Social Impact Bonds work—and make sure that all the conflicts of interest inherent in putting these deals together are understood.

JP: *What is the current level of Social Impact Bond activity in the U.S.?*

SJ: Domestically, most of the current activity on Social Impact Bonds seems to be taking place in the Boston area. As you know, a few months ago the state issued a request for information, asking people in the field to educate them about their potential applicability. They received, I think, more than twenty-five responses—from academics, intermediaries, and nonprofits. I have not been involved in those discussions or meetings, but from what I have been told they have been working diligently since then to try to understand exactly what the concept is and how it could be used in Massachusetts. I think I'm not saying anything that's not a matter of public record when I tell you that Professor Jeffrey Liebman from Harvard University, who is one of the driving forces in pushing this along in Massachusetts, has been engaged by the state to help them with that process.

I'm told that within the next month it's likely that Massachusetts will be asking for a second round of information, and this will probably be closer to a request for proposals. Once they get that, they may identify and choose two pilots: one in the area of criminal justice (similar to the deal that was completed in the U.K.) and the other likely in the field of homelessness. At that point they'll get down to the hard work of actually finalizing the deals to get these two pilots done. These are expected to be very complex, time-consuming transactions involving many parties, and necessitating involvement by the legislature, because most of these transactions will require some kind of enabling legislation that will allow the state to enter into pay-for-performance contracts as well as to allocate funds for a multiyear purpose, which generally is not the way funds are allocated. So a lot is going on in Massachusetts.

I'm also told that other states around the country are looking into Social Impact Bonds; I know less about this, but I'm told that Virginia and California are also taking a hard look, and we know that something similar is being explored in Minnesota. New York City has been studying this for some time. And then of course there's something in the proposed 2012 federal budget allocating up to $100 million for seven pilot programs in five different areas. But we will have to wait and see how that all plays out, obviously. Also, on October 21, the White House Office of Social Innovation and Civic Participation co-hosted an event with the Nonprofit Finance Fund to bring together representatives of state and local governments from around the country to share information regarding the potential of Social Impact Bonds and efforts currently under way. This is certainly a clear indication that while development of Social Impact Bonds is still in the early stages, their potential has caught the attention of both public and private sector players, all of whom are working hard to make Social Impact Bonds a significant and meaningful part of the U.S. landscape.

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Cautionary Tales . . .
Nonprofit Style

by the editors

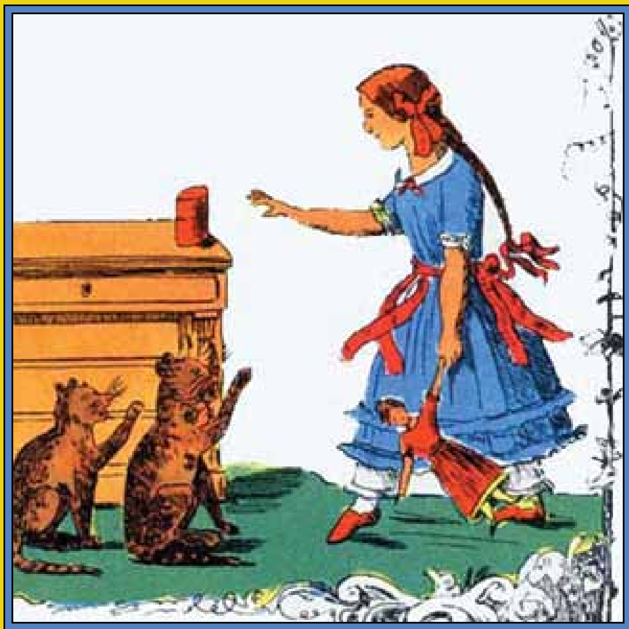
Why do so many of us insist upon learning from our own mistakes rather than those of other poor souls? Here we give you one more chance. Take heed of these tales of nonprofit organizations—large and small—that wander down the wrong path and embarrass themselves.

There is an old cautionary tale, made most famous by Hilaire Belloc, that warns the reader of the dangers resulting from bad choices. The consequences are usually related in grisly detail—a child bursts in half as a result of gluttony or is eaten by a lion when he runs away from his nurse, and so forth.

We at *NPQ* have our own versions of such tales. Because *NPQ* surveys the news each day, producing newswires from the stories we feel will be most instructive, we have a bird's-eye view of some of the more repetitive behaviors—those that embarrass not only the groups named but their unassailable colleaguest, too, who suffer from the public's sometimes broad-brush judgments based on tales of mild to acute incompetence that snowballed into scandal.

We thought to highlight some of the more archetypal stories we found to have been most prominent in the last year, so that they might help your organization avoid some of the pitfalls described therein. But we suggest that you keep an eye on our daily newswires, because below represents merely a fraction of the instructive fables to which they give you access.

"THE DREADFUL STORY OF HARRIET AND THE MATCHES" BY HEINRICH HOFFMAN



Now, on the table close at hand,
A box of matches chanced to stand;
And kind Mamma and Nurse had told her,
That, if she touched them, they would scold her.

But Harriet would not take advice:
She lit a match, it was so nice!

And see! oh, what dreadful thing!
The fire has caught her apron-string;
Her apron burns, her arms, her hair—
She burns all over everywhere.

And when the good cats sat beside
The smoking ashes, how they cried!

I. Court Your Stakeholders as If You Love Them

One of the most under-discussed skill sets in nonprofit management lies in the area of identifying, prioritizing, and properly addressing stakeholder interests. In some cases, this blind spot has led to the default valuing of one set of stakeholders over another, even when no clear decision was made to do so. Recent stories we have covered indicate that this practice has become increasingly dangerous in the age of social media, a platform from which those stakeholders—whether constituents, donors, or staff—have a greater capacity to organize themselves to embarrass or oppose the formal power structure of nonprofits. We have seen so many instances of such revolts over the past months that we were moved to include a feature about stakeholder revolts in this issue—"The Voice from Outside: Stakeholder Resistance in Nonprofit Organizations," by Sean Buchanan and Patricia Bradshaw.

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Community Volunteers Step In to Save a Y

May 9, 2011; *Club Industry* | In early 2011 in Elmira, N.Y., the Chemung County YMCA decided it could not go forward any longer. Owing $8,000 in rent, it had agreed to volunteer all of its fitness equipment to the county, when the community stepped forward and proved that it fully "owned" the endeavor. More than two thousand local residents signed a petition asking local officials to help find a solution, while small grassroots groups of elders and young people from a nearby university met and considered what might be done to save the Y.

All of this paid off, with the Y being adopted by a local senior center. A number of former Y members have made donations and have taken on annual memberships. A committee made up of some of the former members of the Y and some senior center representatives have devised a new budget, including new fees and programs. They have also gotten started on the facility's refurbishment.

This is an interesting and profound situation. Did the Y know that this support was present? Did it not consider how it might be mobilized? And did it take a crisis to convince local people that they truly needed to "own" this community resource? Lots to ponder here as we consider what wasted resources in the form of people might be present around our own organizations.

These kinds of conflicts are often most acute when the organization has advertised itself as doing more consultation with stakeholders than it has actually done. . . .

Lesson from the Trenches: Don't Sugarcoat Conflicts While Doing Strategic Planning

August 17, 2011; *Philadelphia Inquirer* | The Philadelphia Orchestra has been working on a strategic plan to address financial problems resulting from a reduction in revenue. But on the eve of a three-week European tour, eighty of the company's one hundred musicians formally rejected the plan's recommendations in a letter to orchestra president Allison B. Vulgamore and board chair Richard B. Worley.

As reported by the *Philadelphia Inquirer*, the musicians said in the letter that "[t]he document and its suggestions have serious flaws, and we do not believe it will do what a strategic plan is supposed to do: create a plan for the future that protects the music we create and builds on our legacy as one of the world's greatest orchestras."

The musicians say that they do not have an alternative plan at this time, but they think that the process needs to be started over from scratch. What is confusing about the situation is that the process has been touted as one that involved the musicians and was an expression of institutional cohesiveness. The musicians, however, say that they were involved only in the early stages of the process and were then left out when the organization's financial crisis became more severe.

"That's why we were surprised by repeated public statements that we were somehow involved in the drafting" [of the association's plan], the letter says. It goes on to say:

> As Ms. Vulgamore said in July on CBS, "The conversations with the musicians started in October. So we've been working together for a long time." No,

> we worked together "a long time ago." As you know, we did not even see a draft of the plan until just before it appeared in the newspaper at the end of May—more than six months after our involvement in the planning process ended.

If this is true, of course, then this earthquake was inevitable. You cannot turn engagement in decision making on and off without making the process crystal clear. These musicians, like those in many other companies, have now evidently been turned into activists. Though they had been silent about the strategic plan, they did oppose the orchestra's decision to file for bankruptcy in April, so there was every reason to believe that leaving them out of the last stage of the strategic planning process would result in their opposition.

Of course, as with every labor-management dispute, there is probably a lot more here than meets the eye. But a good lesson we might reiterate is to advertise only as much engagement as actually exists.

Many of these stories come down to a question about how much say various stakeholders should have in the direction of an organization. More and more, we see people collectively declaring "not in my name you don't!" and, alternatively, organizations opening up to new forms of democratic involvement in decision making. NPQ *believes, of course, that the power and influence of this sector is in the engagement of its stakeholders, but this is not the only sector considering such stuff. . . .*

Iowa City School Board Looks at Models of Democratic Governance: Listen Up Nonprofits and Philanthropy!

September 14, 2011; *Iowa City Press-Citizen* | There are sometimes odd and surprising ways in which the nonprofit sector demonstrates its influence in other realms of our society. A guest editorial in the Iowa City newspaper addresses questions of how the seven-member Iowa City Community School Board functions.

The writer is Sarah Swisher, herself a member of the school board. She takes to task people from the corporate world who have been drawn to the board-governance model developed by John Carver. Swisher suggests that this model has drifted from its origins in the for-profit sector into the nonprofit sector because so many corporate types now serve on nonprofit boards. She notes that the Carver board-governance model emphasizes "strong executive leadership that is minimally limited."

But Carver went too far in marketing his trademarked consultant-attracting "Carver Model of Policy Governance" to a publicly elected school board, Swisher says. To provide a CEO with "a false carte blanche providing he doesn't fail to succeed" (double and triple negatives litter the language of the Carver model) is simply not what voters want when they elect school board members. As an alternative, Swisher suggests a "deepening democracy" model called "Empowered Participatory Democracy . . . [in which] committees and task forces have real voices and authority." That means involving parents, teachers, students, and union members in very active, hands-on tasks—such as interviewing and hiring school principals—that strong CEOs might see as injecting too much citizen intrusion into the process.

Board governance models are topics of active debate in nonprofit and philanthropic circles, but the mechanics of publicly elected boards are usually rooted in past practices that few people are wont to question, much less change. To see the nonprofit sector's debates brought into the public sector is a testament to the increasing influence of nonprofit-sector principles of good governance, as well as a reflection of the demand of many people to improve the workings of American democracy. But nonprofits might also want to take this moment to reconsider their own governance processes—and if you have not read it already, we would suggest the *NPQ* article "Community-Engagement Governance™: Systems-Wide Governance in Action."

Moral of the story: Honor your stakeholders lest they embarrass the pants off of you and also because it is the right and powerful thing to do.

Moral of the story: Honor your stakeholders lest they embarrass the pants off of you and also because it is the right and powerful thing to do.

II.
The Mystery of the Disappearing Execs

Many organizations go through awkward leadership transitions, but something you do not want to create is an information vacuum into which the public can insert its own speculations. For one thing, there are some people who just *will not rest* until they find out the story behind the story.

Continuing on the topic of nonprofit accountability, we have noted during the past year many stories of nonprofit leaders on duty one day and gone the next without explanation. This appears to us to be a practice tailor-made to raise questions and speculation in the minds of the public, along with a general sense of distrust. The larger issue here is the lack of understanding these organizations exhibit about the value of their reputations. Because, if they understood that value, they would take the time to figure out what their communication strategy needs to be. Below are two such cases that occurred within days of each other.

How to Raise Sticky Questions in the Minds of Your Public: Clam Up

August 26, 2011; *Appleton Post-Crescent* | Many organizations go through awkward leadership transitions, but something you do not want to create is an information vacuum into which the public can insert its own speculations. For one thing, there are some people who just *will not rest* until they find out the story behind the story.

Earlier this week, the board of the Emergency Shelter of the Fox Valley in Wisconsin abruptly dismissed its executive director of thirteen years, Debra Cronmiller. The only comment on the dismissal came from John Russo, the board vice president, who told the *Appleton Post-Crescent*, "We felt a change of leadership was appropriate at this time. While timing of these decisions is a matter of judgment, we felt the time was appropriate to make this change." Somewhat mysteriously, Russo also said that the board had had no problem with the executive director's performance.

Board president Kurt Eggebrecht was equally vague. Speaking about the search for a new director, he told the *Post-Crescent*, "We recognize some of the core responsibilities that that position has. I think that's something the executive committee will be finalizing and bringing to the board for final approval."

Hmmm. Russo says he hopes that donors will continue to be generous to the shelter. We would be willing to bet that some will have questions they want answered. Again, and we say this repeatedly, consider your message carefully in a crisis. (Great guidelines can be found in the classic *NPQ* article by Kim Klein, "Mission, Message, and Damage Control." Keep this in your permanent file!)

The next story is interesting because the departure of the co-executives seemed to have happened abruptly, though there had been questions circulating about the organization's leadership for years. Still, the communications plan did not get ahead of the incident. Of course, the organization was also the source of a good deal of money flowing into the community—an awkward power mix. . . .

Abrupt Departure of Leadership at High-Profile San Diego Nonprofit

August 30, 2011; *Voice of San Diego* | The neighborhood served by the high-profile Jacobs Center for Neighborhood Innovation was surprised this week by the sudden departure of its two leaders, Jennifer Vanica and Ron Cummings. According to the local news website *Voice of San Diego*, the married couple have acted as CEO and COO respectively for the past sixteen years. It is not clear if they resigned or were asked to leave. *NPQ* is interested in the story behind the story on this mysterious turn of events.

The project has been relatively controversial from the start. The organization was founded and funded by Joseph Jacobs, a Los Angeles entrepreneur, and it has become a major developer and landowner. But there have always been questions, some raised by Jacobs himself, about whether the program's leadership was unrepresentative of the low-income southeastern San Diego neighborhoods the program is aimed to improve.

Board chair Valerie Jacobs said only that this turn of events means that the organization is on track to meet its long-term founding goal of transitioning leadership to better reflect the community in which it operates. According to *Voice of San Diego*, the nonprofit says that approximately 90 percent of the residents in communities served by the Jacobs Center are "ethnic minorities," while both Vanica and Cummings are white, as are most of the senior team and the board, who are all members of the Jacobs family.

Roque Barros, who has been associated with the Center's efforts to build relationships with the community, has been named interim president. "I'm from the community, I've been here a very long time," Barros told the *Voice of San Diego*. "It is part of what we've been talking about, transitioning our leadership. For us this is really an exciting moment, resident ownership of leadership change."

The constancy of these types of stories led us to take note when the CEO of Yahoo let it rip about the exact circumstances of her own transition. We thought the straightforward nature of the communication was quite instructive. . . .

Nonprofits Could Learn a Thing or Two from Yahoo When It Comes to "Executive Transition"

September 08, 2011; *All Things Digital* | To all,

I am very sad to tell you that I've just been fired over the phone by Yahoo's Chairman of the Board. It has been my pleasure to work with all of you and I wish you only the best going forward.

Carol

So went the e-mail—today's equivalent of a break-up by Post-It Note—sent out to staff by the then-CEO of Yahoo, Carol Bartz. Why would *NPQ* cover this? Only because we have been tracing a recent rash of disappearing CEOs at nonprofits, like the Jacob Center for Neighborhood Innovation last week—stories of leaders who are standing up at the Kiwanis Club podium one night and then—poof!—are gone the next morning, with no indication of the reason or even whether they were fired or resigned or had made off to the Cayman Islands with half of what remains of the endowment.

This is occurring even at the very highest levels, with a case in point being the mysterious vanishing act of Patrick Corvington at the Corporation for National and Community Service. We hear that people are still looking behind the curtains to try to figure out what happened. Talk about a board practice designed to erode confidence: the now-the-wonderful-CEO's-here-and-now-he's-not trick has to be one of the lowest.

At least in this case we are all clear about how the dirty deed at Yahoo occurred, who did the deed, and what the reaction was of the CEO in question. A refreshing change. And actually the market cheered Bartz's forced walk off the gangplank. Yahoo's stock rose at the news. It would be nice if communities could get such clear information about the nonprofit/philanthropic world; that way, donors and communities would be able to pick their horses with some sort of confidence.

This section concludes with a refreshing alternative in an example of what appeared to be reasonable executive transition–related communication on the part of a nonprofit. . . .

A Community-Based Organization Shows How to Communicate Clearly about a Crisis

September 13, 2011; *San Antonio Express-News* | Last week *NPQ* wrote approvingly about Yahoo CEO Carol Bartz's having been unexpectedly and summarily fired. We suggested that the often-secretive behavior of nonprofits at times of abrupt executive transition is off-putting, and erodes confidence and connections with stakeholders.

That's why this story about Project Quest, a workforce development program in San Antonio, is notable for the communications steps the agency undertook during a recent crisis, including a meeting with the editorial board of the local newspaper, the *San Antonio Express-News*. The organization recently found itself in "debilitating debt"; facing another large deficit this year, it had come to the conclusion that it needed a new leader—someone who could spend more time doing the kind of high-profile political work the agency needed at this crucial time.

Incumbent director Mary Peña openly admitted that she was not the right person for the task ahead and decided to step down. "This has always been a high-profile job," she told the *Express-News*. "It's always been political. I have personal responsibilities that I didn't have back then. I've taken the organization as far as I can." The forthrightness of the executive transition at Project Quest appears to have impressed local government officials. "They have demonstrated to the city staff after an analysis that any shortcomings in the past are being remedied immediately," San Antonio Mayor Julian Castro told the *Express-News*, adding, "Project Quest has a track record of success with its students."

Talk about a board practice designed to erode confidence: the now-the-wonderful-CEO's-here-and-now-he's-not trick has to be one of the lowest.

Here a candidate for state senate plays fast and loose with the conflict of interest policies of the organization he founded. Silly man! Did he not realize that the press would be interested?

The full story is probably more complex than a routine change in leadership. The Texas state comptroller's office is perhaps partly to blame for the agency's slide into debt. And we are sure there were some horribly painful moments. But all in all, this publicly funded agency appears to have comported itself with openness and dignity during a difficult time. Yahoo!

Moral of the story: Act like the public is intelligent and has a legitimate vested interest in your operation, and maybe they will want to invest in you.

III.
The Tragedy of the Sedated Board

A lack of board oversight is well known to have potentially disastrous effects, but in an organization that appears to be flourishing under stable and productive leadership, an abrupt fall off the unseen cliff constructed by inattention can be especially shocking, and sometimes fatal. Such nonprofits can have excellent relationships with power brokers and a good reputation for service and still be on the verge of public humiliation. Take the following two cases, where the leaders were well known and respected but the boards were evidently asleep at the controls.

N.Y. Organization That Sparked Review of Nonprofit Pay Begins to Reform Itself

September 13, 2011; *Crain's New York Business* | Young Adult Institute (YAI), the large state-funded organization in New York State that serves adults with developmental disabilities, was taken to the public woodshed last month regarding its outlandish executive compensation packages, among other problems. A *New York Times* investigation found that brothers Philip and Joel Levy, who had led YAI since the 1970s, were each being paid just under $1 million per year. In addition, the Levys billed taxpayers for luxury cars and the costs of their children's college education and living expenses. The story was quickly followed by a declaration by Governor Andrew Cuomo that he was authorizing a review of executive pay at all nonprofits that receive state Medicaid funds. *NPQ* took the position at that time that such a review should be focused not only on nonprofits but also for-profit vendors serving people in need.

Now YAI, which runs 450 programs serving 20,000 people a year, has come forward to announce the steps it is taking to reform its faulty governance system. Among other changes, approximately half of the nineteen trustees on the board will be replaced within the next year, and the replacements will include representatives of the developmental disability community. The compensation and pension committees will be completely reconstituted by the end of the year. Additionally, the pay of the chief executive will be keyed to the 50th instead of the 75th percentile among a peer group of executives, and the bonus system has already been overhauled.

In a September 7 letter to the acting deputy commissioner of the New York Office for People with Developmental Differences, YAI board chair Eliot Green said, "It has been a painful time as YAI has dealt successively with the fallout from the recent government investigation and settlement, followed by critical articles in the press and the understandable concerns of [state] officials . . . We are not wasting a moment by being defensive or rehashing the past."

Even the most seasoned public figures apparently have enormous capacity for self-delusion when it comes to the rules for mere mortals. Here a candidate for state senate plays fast and loose with the conflict-of-interest policies of the organization he founded. Silly man! Did he not realize that the press would be interested?

But even if you do not decide to try to replace an Edward Kennedy / Scott Brown lineage, can't we all agree that these policies are there to protect us all? And that the people leading the organization are responsible for modeling the right behaviors?

Khazei Admits Error in Hiring Brother, Says He Has Learned from the Experience

August 30, 2011; *Boston Globe* | Four days after the *Boston Globe* scolded him for hiring his brother to do marketing work for his latest nonprofit venture without first getting board approval, City Year co-founder and Democratic U.S. Senate candidate Alan Khazei admitted that he made a mistake. In a letter to the editor of the *Globe*, Khazei writes:

> The editorial "Brotherly love and denial" (Aug. 25) contained valid points. I made a mistake in not seeking the board's approval at Be the Change when hiring my brother, and I apologize for the error. Regardless of my confidence in his skills, his hiring should have been reviewed and approved in advance by the able board there. I deeply appreciate

the support that Be the Change has received and what it has been able to accomplish as a result. I have learned from this experience, and I remain a strong advocate for accountability for decisions made by leaders across the public arena.

Presumably Khazei hopes that his apology will close the book on a bad couple of weeks of publicity for him concerning his nonprofit organization. As *NPQ* reported previously, both Boston newspapers had looked into the hefty consulting fees Khazei was earning from Be the Change now that he had left the organization to run for Senate. Then came the news that Khazei had failed to get board approval before he hired his brother to do marketing work for the organization, paying him $40,000 over three years. But Khazei's worst moment was when he initially tried to justify hiring his brother by invoking family loyalty and his brother's talents as a writer. That response exposed something troubling about Khazei's character, and prompted the *Globe* to publicly scold him in an editorial. The rebuke from the newspaper that endorsed his run for Senate in the 2010 special election apparently got Khazei's attention, prompting the apology letter that ran four days later.

Politics repeatedly attracts hard-charging figures from the for-profit and nonprofit sectors, who believe that they can bring to government a no-nonsense energy to "cut through the red tape" and "get things done." But sometimes, as with the board-approval requirement that Khazei skirted, that red tape is there for a reason. And the level of scrutiny one receives heading a private organization is no match for the microscope of politics. Khazei is not the first businessperson or social entrepreneur to find that out, and he won't be the last.

IV.
Opportunities for Self-Service Is Trouble for Nonprofit Boards

As long as we can remember, the question of whether or not an organization should do business with its board members has been on the table as a discussion point. It has long been *NPQ*'s position that the practice is pure folly. If a board member thinks he or she can bring value as a contractor, get off the board and support it in other ways—but do not both inhabit a top decision-making position in a

Politics repeatedly attracts hard-charging figures from the for-profit and nonprofit sectors, who believe that they can bring to government a no-nonsense energy to "cut through the red tape" and "get things done." But sometimes . . . that red tape is there for a reason.

public benefit organization and arrange to be hired by them unless you really want to risk eroding all confidence in the organization's integrity.

Museum Founder and Former Trustee Adrift in Dangerous Waters

May 30, 2011; PressofAtlanticCity.com | This story is so convoluted that it is hard to really get one's arms around it, but we think the adage "don't try this at home" is apt. Apparently, Deborah Whitcraft, founder and curator of the New Jersey Maritime Museum, sold a property to William Burris, one of the trustees of the museum, but with a caveat: payments on the mortgage, which she held, were to be used to support the operating costs of the museum. The annual payments would have amounted to $90,000 over a twenty-year period, or $1.8 million altogether.

Way too close for comfort.

Anyway, Whitcraft is now suing Burris in Ocean County Superior Court, alleging that Burris stopped paying on the loan after he eliminated the security for the loan through a series of transactions, and left the museum high and dry. Says Whitcraft, "I have spent a lifetime building this museum, and it is completely disheartening to see a former member of our board of trustees causing such great damage to this beautiful place. . . . We carefully set up this loan to ensure a steady flow of income to the museum, and now Burris has ripped that apart."

Burris defended himself by saying that he had had to reduce the museum's call on him because he needed the money to defend himself in other lawsuits. No doubt.

Moral of the story? Even if you are the most charismatic and passionate founder on earth, that does not protect you from scoundrels and bad press when you cut corners and engage in such stuff as business transactions with members of your board.

Moral of the story? Even if you are the most charismatic and passionate founder on earth, that does not protect you from scoundrels and bad press when you cut corners and engage in such stuff as business transactions with members of your board.

Massachusetts AG Goes to Legislature to Ban Board Pay at Nonprofits

September 28, 2011; *Boston Herald* | On September 27, Massachusetts Attorney General Martha Coakley went to the state legislature's Joint Committee on the Judiciary to ask for its help in banning the practice of paying nonprofit trustees. The issue surfaced in the Bay State when an $11 million salary and severance package was awarded to Clive Killingsworth, after he resigned from Blue Cross Blue Shield of Massachusetts. When it was revealed that the trustees themselves were also being paid handsomely, a penny dropped for Coakley. She told the *Boston Herald* that trustees should serve on a board like BCBS's because they want to look out for the best interests of the insured (who, by the way, have seen their rates climb on a fairly steep trajectory of late). Coakley said, "As a general rule, the historic reason that people volunteer to serve at public charities is because they have a fiduciary duty to the mission, not their own profit. . . . This bill would restore what has always been the practice, up until the last few decades."

We can still remember the verse: "There was a Boy whose name was Jim; / His Friends were very good to him. / They bought him Tea, and Cakes, and Jam, / and slices of delicious ham". . . . Thus starts one of Belloc's cautionary tales, where a boy ends up eaten by a lion. Would that you might recall so clearly even a month from now the lessons of these stories about the consequences of inattention to your nonprofit principles.

Fundraising Study: Closeness of Connection Should Drive Type of Appeal

July 18, 2011; *The Daily Texan* | The findings of a recent study suggest that if a donor is already close to a nonprofit, it should be approached one way—and a less-close relationship should suggest a different type of appeal. The study, which is due to be published in the *Journal of Experimental Psychology: General*, is based on five studies performed by researchers at the University of Texas, Sungkyunkwon University in South Korea, and the University of Chicago.

"Individuals who think of the beneficiaries in psychologically distant terms contribute more when you can find a way to signal to them that the charity's cause is important," Marlone Henderson of the University of Texas wrote the *Daily Texan* in an e-mail. "When you make people focus on what other people have already contributed versus what's still missing, people feel like the cause is more important and thus feel more motivated to give."

On the other hand, when donors feel more closely identified with the group they contribute to, the group meets its goal. These findings seem rather obvious, but we are looking forward to reading the study, because the way it was done was through "manipulating" the usual "us and them" style of appeals to a "we and us" style. It's an interesting point for those who write appeals and think about the value of a good engagement strategy.

The question of the decade: How do online, direct mail, and face-to-face contact integrate to make a fundraising program that really sticks?

Don't Dump That Direct Mail Program! The Limitations of Online Fundraising

June 1, 2011; AdvisorOne | According to a recent study by Blackbaud, online fundraising is useful for acquiring donors, but less useful in retaining them—a valuable piece of information for hardworking fundraisers. Particularly interesting is the degree to which direct mail still plays a major part in retaining even those donors who give their first gift online.

According to Blackbaud, the findings were derived from the most recent transactional data available for the twenty-eight organizations participating in Target Analytics' donorCentrics online benchmarking service. The nonprofits in these online benchmarking groups are "prominent national nonprofits covering a range of sectors, including animal welfare, the environment, health, human services, international relief and societal benefit."

Other key findings about online donors:

- The majority of gifts are still received through direct mail, although it has become increasingly common for new donors to give their first gift online.
- Online-acquired donors are significantly younger, and tend to have higher household incomes than mail-acquired donors.
- Online-acquired donors tend to give much larger gifts, but have slightly lower retention rates than mail-acquired counterparts.
- In aggregate, online-acquired donors have much higher cumulative value over the long-term than traditional mail-acquired donors. However, long-term value varies depending on the donor's origin gift level, and the substantially higher gift amounts given by online-acquired donors can mask issues with retention.

[O]nline fundraising is useful for acquiring donors but less useful in retaining them—a valuable piece of information for hardworking fundraisers. . . .

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Beyond Sustainability:
Identifying the Right Resource Mix for Growth

by Woods Bowman

The long-term success of an organization depends on sustainability, but sustainability is not sufficient for maximizing the impact of an organization. The key to growth, explains the author, in large part lies in finding "the right revenue mix," which, depending on the organization, may involve multiple funding sources or concentration on one source type.

Editors' note: *This article is excerpted from chapter 10 of the author's new book,* Finance Fundamentals for Nonprofits: Building Capacity and Sustainability *(John Wiley and Sons, Inc., 2011) and used with permission.*

On the Upper West Side of Manhattan, across Central Park from the Metropolitan Museum of Art (the Met), stands the New-York Historical Society. It was founded in 1804 as both a museum and a library sixty-two years before the Met and ninety-one years before the New York Public Library (NYPL)—like the Met and the Society, also a nonprofit.[1] The combined expenses of these much younger institutions are now thirty times greater than the Society's.

Sustainability is a necessary condition for long-term success, but it is not sufficient to optimize the impact of an organization. The Society is over two hundred years old, so obviously it is sustainable, but long ago it ceded its preeminent role among New York's museums and libraries to younger rivals. This article explains how an

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"CLOUD NINE" BY KARA MARIA

Figure 1: **Characteristics of Common Revenue Sources**

	Predictability	Autonomy
Endowment Income	high	high
Government Contracts*	high	moderate
Earned Income (3rd Party Payers)	high	low
Federated Gifts and Grants	high	low
Individual Contributions (small/ many)	moderate	high
Membership Dues	moderate	high
Earned Income (Individual Payers)*	moderate	high
Individual Contributions (large/ few)*	low	low
Foundation Grants	low	low

Adapted from Pratt (2004) and *Froelich (1999)

organization should manage its revenue composition to go beyond sustainability and maximize its growth potential.

Diversification or Focus?

All dollars flowing into nonprofits are not equal. Every revenue source has specific characteristics. There is no shortage of theories of revenue management; the best known of these, however, is resource dependency theory, which posits that "the activities of nonprofit organizations are influenced by their outside funders . . . the nonprofit organization and its funders reach agreement [often implicitly] on a set of goals and, in turn, negotiate a stable source of revenues to accomplish those goals."[2] This section focuses on two contrasting theories about how such stability is achieved: *portfolio theory* and *normative theory*.

From *portfolio theory* comes the idea that revenue diversification can reduce financial vulnerability to recession and other external economic shocks. It is counterintuitive, but two highly volatile revenue sources from different lines of business may be more predictable than either one would be separately.[3] But each line of business also requires a system to support it, making the organization's administration and development more costly.

Normative theory suggests that nonprofits should concentrate on sources that are uniquely associated with the benefits to be afforded to a particular population group or groups. In other words, it recommends *focus*. The downside is having greater vulnerability to disruption in a particular revenue source. (For characteristics of common revenue sources, see figure 1, left.)

What Do the Mixes in Nonprofit Organizations Look Like?

Every reader of this article knows that income mixes in nonprofits can be highly diverse, but the mixes will often look similar over a field of practice, and many fields show a preponderance of one type of income over another.

For instance, approximately 70 percent of nonprofits use a funding model heavily dependent on philanthropy. Dependence on philanthropy is greatest in the categories of the arts, animal-related services, youth services, advocacy, and philanthropy. The fraction of nonprofits in each of these groups exceeds 90 percent, and gifts make up between 45 and 55 percent of their total revenues.

Nonprofit health care providers are particularly reliant on earned income (90 percent of providers have some, which on average accounts for 74 percent of their total revenue). Arts and housing are close behind in terms of the fraction having earned income (89 and 88 percent respectively). Earned income accounts for 40 percent of the total revenue of the average arts organization and 61 percent of the total revenue of the average housing organization. The nonprofits least dependent on earned income are in the philanthropy category (11 percent). Advocacy is not far behind (16 percent).

Many large nonprofits that have experimented with multiple funding sources in the early stages of development have become large by embracing one particular source type. Out of 200,000 nonprofits that obtained exempt-status recognition since 1970, only 144 currently have at least $50 million in annual revenue. Most raise the bulk of their money from a single type of funding source, and "created professional organizations that were tailored to the needs of their primary funding sources."[4]

Thus, the key to growth may be in finding the right revenue mix, which may in fact largely comprise a single, well-suited source. "Sources of income should correspond with the nature of benefits conferred on, or of interest to, the providers of those resources."[5] (For revenue types, see figure 2, above.)

Figure 2: **All Money Is Not Created Equal**

Every income type is appropriate to a different provider/recipient combination. A good income portfolio reflects the mix of benefits it provides in addition to responding to "basic organizational challenges."[6] Normative theory is a sophisticated variant of resource dependency rooted in public finance, a branch of economics. The key is identifying the beneficiaries and matching them to revenue types:

- *Private benefits* accrue specifically to individual consumers or clients who recognize the benefits and are willing to pay for the goods and services. Nonprofits producing private benefit goods should set a market price to cover cost of production; if mission dictates a price that does not cover cost, they should seek cross-subsidy or endowment income. (Example: the Met's admission fees and its gift shop net income.)
- *Group benefits* are collective goods that benefit a subgroup of society and are valued by donors interested in helping that subgroup. Values-centered management influences the *choice of group* and defines the benefits conferred. These types of goods and services are most likely to find support from specific groups of donors and organization partners. Endowment income and some targeted government funding programs are possibilities. (Examples: the Met's appeal to art lovers and the NYPL's appeal to researchers.)
- *Public benefits* are collective goods that accrue to a sufficiently large segment of the general public such that government financing is politically supported. Unlike with group benefits, no particular group is favored. Widespread benefits attract government funding. (Example: the NYPL's service to the community as an archive.)
- *Trade benefits* are private goods acquired by institutions or groups. The key to growth may be finding the right income mix, which may in fact be a single source.

Back to the Example

The New-York Historical Society is a museum *and* a library. Although both divisions are dedicated to the preservation of artifacts, the revenue-raising potential of each division is very different. Most museums are private, whereas most libraries are publicly owned and operated, which suggests that it is difficult to support a library on either earned income or private philanthropy. (See figure 3, following page, for composition of revenue comparison.)

Museums can generate revenue from admissions fees and gift shop revenue. Libraries would probably wither if they tried to charge admission fees, and they rarely have gift shops (bookstores). Both institutions may have dues-paying members, but these so-called members do not have the privilege of electing the board of directors, so their role is more akin to donors.

The key to growth may be in finding the right revenue mix, which may in fact largely comprise a single, well-suited source.

Normative theory explains the growth trajectories of the organizations in the opening vignette. The Met and the NYPL tailored their revenue structure to the groups they served. The New-York Historical Society relied too heavily for too long on philanthropy.

Figure 3: **Composition of Revenue Comparison**

	The Society	Met & NYPL
Current Support for Budget	71 %	18 %
Government Contributions	8 %	36 %
Program Service Revenue	8 %	10 %
Membership Dues & Assessments	3 %	5 %
Endowment Support (estimated)	9 %	31 %
Total	100 %	100 %

Source: Author. Data from IRS 990 reports for 2007; numbers may not add up to 100 because of rounding.

The data reflect these differences: total expenses of the Met and the NYPL are approximately equal, but the museum's program service revenue is eight times larger, its membership income is ten times larger, and its net income from sale of inventory is forty-five times larger. On the other hand, government support for the NYPL is over six times that for the Met.

The Society, meanwhile, is almost entirely dependent on gifts. Its competitors derive approximately one-third of their combined revenues from government support and another third from endowment income. Its philanthropic support is under stress, paying for activities that competing institutions finance with different sources of income.

During most of its existence the Society had no government support. Even today, government covers only 8 percent of reported expenses, so apparently the Society's museum is cross-subsidizing its library. In reaction to successive budget crises, the Society historically cut the budgets of the museum and library in tandem.

Although the Society's inner workings are private, one imagines this even-handed policy reduced the museum's subsidy to the library, aggravating the overall budget problem.

Further, the library has negligible program service revenue, and therefore it has first claim on unrestricted gifts, which likely leaves the museum inadequately funded. Without government support, the library division of the Society never achieved its growth potential. With the museum division cross-subsidizing the library division, the museum was deprived of resources it needed to achieve its own growth potential.

Conclusions

Normative theory explains the growth trajectories of the organizations in the opening vignette. The Met and the NYPL tailored their revenue structure to the groups they served. The New-York Historical Society relied too heavily for too long on philanthropy. Normative theory suggests the Society defined its constituency too narrowly for its own good over the long-term.

This broad-brush examination is an example of peer-group analysis that answers the question, "Which sources of revenue are compatible with the kinds of goods and services we produce?" An organization can identify possibilities for revenue development by comparing how much of its revenue is derived from each source, and comparing the percentages with comparable information from other organizations with a similar mission and service-delivery method. This information is publicly available through GuideStar, and updated annually.

Notes

1. The NYPL was formed by the merger of the private Astor and Lenox libraries, and received the bulk of Samuel Tilden's estate at the onset. The Astor's founding date is obscure, but its founder died in 1848. The Lenox was founded in 1871. (The Society's name is indeed hyphenated.)
2. Kevin Kearns, "Income Portfolios," in *Financing Nonprofits: Putting Theory into Practice*, ed. Dennis R. Young (Lanham, MD: AltaMira Press 2006), 299.
3. This magic trick only works when changes in one volatile source are unrelated to changes in the other, or better yet, when they vary in opposite directions—that is, when one is up the other is down.
4. William Foster and Gail Fine, "How Nonprofits Get Really Big," *Stanford Social Innovation Review* (Spring 2007), 46. Their study used the *NonProfit Times* list for 2006 to identify the largest nonprofits.
5. Dennis R. Young, "Toward a Normative Theory of Nonprofit Finance," in *Financing Nonprofits: Putting Theory into Practice*, ed. Dennis R. Young, (Lanham, MD: AltaMira Press 2006), 341.
6. Ibid.

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The Wherewithal of Society:
An Accountability Challenge to Private Enterprise

by A. W. "Buzz" Schmidt

In this article, the author argues that any and all enterprises need to be held to account for their contribution to—or depletion of—those things that are necessary to sustain a healthy society. He calls these, "elements of community capital." This article is meant as the beginning of a conversation.

***Author's note:** This article entreats investors and philanthropists to hold enterprises of all kinds accountable for their net (positive or negative) contributions to society's wherewithal. I use the word "wherewithal" throughout to characterize the collection of resources, competencies, knowledge, systems, and facilities that a healthy society must possess to move forward. The word derives from "wherewith," which is used extensively in early English classical literature to indicate the "means with which" one might take on or complete a prospective challenge or transaction. Some believe the suffix "al," also archaic, meaning "all," reflects inclusion, or—in my construction—all the means required for a healthy society to advance.*

OUT-OF-CONTROL BUDGETS, DYSFUNCTIONAL legislative decision making, and perceived bureaucratic ineffectiveness have driven citizen faith in government solutions to social problems to an historic low.[1] And, while public faith in virtually all "traditional" institutions wavers, we are seeing an explosion of "innovative" strategies designed to increase the productivity and propensity of private nonprofit and hybrid (mission-driven for-profit) enterprises to solve social problems. Over the past decade, these strategies—mission-related investing, social venture capital, social impact bonds, philanthrocapitalism, impact assessment schemes, and the like—have captured a surfeit of policy-maven mindshare, digital ink, and seed funding. But despite their innovativeness and theoretical potential, these private strategies remain generally unproven, disconnected from one another and cohesive public policy, and—strangely—proprietary. More importantly, they are largely silent with respect to what may be the main event—*traditional commercial enterprises and the fundamental implications of that work for social progress*. After all, it is commercial enterprises, both large and small, that employ most of us, generate the great preponderance of our financial and intellectual capital, and impact our environment, communities, and governance in ways—both positive and negative—too numerous to count and too great to ignore.

The objective of this article is to motivate citizens and philanthropic institutions to think broadly in their dealings with the full range of private enterprises, to understand how each enterprise contributes, or not, to the long-term resources of society, and to deploy those resources accordingly. The article first offers an explanatory schema for seven core components of capital—*financial*, *human*, *intellectual*, *civic*, *systemic*, *natural* and *physical*—that comprise what I am calling society's "wherewithal." It next touches upon the historical/legal context and practical

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"DNA SHAPED LIKE ANIMALS" ©IMAGES.COM/CORBIS

Contributions by enterprises directly and through their employees can do much to support civil society, cultural advancement, and sustainable/ fair employment expectations, all of which are important elements of sustaining social capital.

distinctions among nonprofit, hybrid, and commercial enterprises before turning its focus to specific consideration of the impact commercial enterprise has on social progress. The article then makes a case for investors to take full and conscious responsibility for decisions to invest their funds in specific enterprises, while noting the institutional impediments that have arisen to direct investor cognition and action. Observations about the contributions to society's wherewithal made by nonprofit and hybrid enterprises, and their relationships to those made by traditional commercial enterprises, follow this analysis.

The Seven Capital Components of Society's Wherewithal

Society's dependence upon private enterprises to build or preserve a robust complement of competencies, knowledge, facilities, systems, and natural conditions conducive to society's well-being is a central thesis of this article. These competencies comprise the core capital of society, the wherewithal it must have to sustain economic opportunity, enable human progress, and ensure future peace, democracy, and prosperity. The seven capital components described below represent a first attempt at establishing a helpful framework for analyzing the net contributions of our enterprises to society's wherewithal. Each component is necessarily an amalgam of related capital elements, and the groupings of elements and component names are preliminary and hardly definitive.[2]

- **Financial Capital:** Financial capital is the universally necessary ingredient for the care and feeding of all enterprises. Our enterprises' long-term contributions of financial capital are necessary to build or restore society's store of lubricating capital. Any enterprise that loses money, over time depletes (negatively contributes) society's store of financial capital. Nonetheless, a negative contribution of financial capital may satisfy expectations, given an enterprise's contributions of other forms of capital.
- **Human Capital:** A prepared, productive, healthy, and motivated population is critical for the future wherewithal of society. The propensity of enterprises to "turn out" great people constitutes a huge contribution to society's store of sustaining capital, but respective contributions of human capital vary tremendously among enterprises. Enterprises contribute to society's store of human capital directly in the form of educational products and services and indirectly through development of their own employees.
- **Intellectual Capital:** A society cannot progress or compete, especially in a global economy, without continuing production of intellectual capital, such as production/technological know-how, hard science, art, and social science. Enterprises can make contributions to society's intellectual capital through products and services that are intended to advance the society's knowledge, as well as through the intellectual content in their own internal operating methodologies. One of the ways enterprises contribute is through formation of spin-off enterprises that further exploit the intellectual capital of the original enterprise.
- **Civic Capital:** A healthy, engaged, trusting citizenry is an enormous source of wealth for every society. Enterprises can have enormous, but not always positive, impacts upon society's civic capital. Contributions by enterprises directly and through their employees can do much to support civil society, cultural advancement, and sustainable/fair employment expectations, all of which are important elements of sustaining social capital. Enterprises can also do great damage to the fabric of civil society through inconsistent practices in these areas as well as through practices that compromise the integrity of our political systems.
- **Systemic Capital:** Society's functional health requires a healthy component of capital in the form of its physical (roads, bridges, waterways), communications, health, legal, and economic systems. Enterprises are often formed to construct elements of society's systemic capital—it is their business purpose. Further, through their operating practices, enterprises can make positive or negative contributions to these systems (for example, positively, through fees that support roads for everyone, or negatively, through exploitation of common physical infrastructure or erosion of the integrity of economic or financial systems).

- **Natural Capital:** Access to a plentiful store of natural resources—clean air, clean water, stable temperatures, minerals, energy, timber, fertile soil, and other resources—comprise society's fundamental store of productive resources and are a precondition for the existence and success of all enterprises. Through both the substance of their products and services (for example, passive energy products) and their ways of conducting business, enterprises have the potential to have enormous impacts (positive and negative) upon society's store of natural capital.
- **Physical Capital:** Society's inventory of fit-for-purpose production facilities, operating technologies, and distribution systems, most of which reside within its collection of enterprises, is a critical component of its collective wherewithal. The quality, productivity, and condition of an enterprise's facilities and systems are a substantial determinant of its contribution to society's physical capital.

Legal Context and Practical Distinctions among Enterprise Types

As we contemplate the wherewithal-building role of enterprises, it is important to remember that there is nothing ultimately sacred about their existing corporate and tax statuses. Tradition—both red and blue polity—and the current law of the land hold that society benefits when citizens are permitted to organize their work across a range of distinct enterprise forms. In turn, each form is defined by a discrete combination of fiscal attributes such as limited liability, perpetual life, tradable securities, earnings retention, corporate personhood, tax exemption for "public" purposes, etc. Theoretically, the available range of enterprise forms helps society deploy of its resources effectively, offer incentives for long-term performance, meet unmet needs, and pursue strategies to generate society's wherewithal. However, if at some point via our democratic (constitutional) process we determine that our current enterprises are failing to do the job for society, then their rights of formation and existence are fully revocable.

Further, with respect to the net implications of its work for society's wherewithal, a random private enterprise will not fit automatically into one of three tax-status-defined—nonprofit/good, hybrid/mixed, and for-profit/agnostic—buckets. And when we look at what private enterprises—nonprofit to commercial—contribute to society's wherewithal, we are likely to see as many differences within as between categories. The tax status of organizations is not necessarily the best predictor of an enterprise's substance or social value.

Because we seldom think holistically about commercial enterprises, it is useful to focus directly upon the vast divergence in the net contributions to society's wherewithal made by our commercial enterprises. The financial bottom line hardly begins to explain an enterprise's net value to society. Citizens must do a far better job of understanding the respective net contributions of commercial enterprises and direct investment and consumption to those enterprises that truly advance the ball for society.

Assessing the Role of Commercial Enterprise

It's not that commercial enterprise has been given a full analytical free pass. For thirty years, negative-screened mutual funds have directed significant public and maybe more limited investor attention away from companies that produce tobacco, firearms, and alcohol or do business in rogue countries. More recently, increasing awareness of climate change has led to establishment of green corporate behavior indices and funds designed to exclude the worst-behaving corporations or include the best-behaving ones. The latter, more positive screening approach has been used recently to identify corporations that by some method are judged to advance stronger communities. Other surveys identify the best companies to work for and those with the best overall public reputations. Porter and Kramer's "shared value" conception promotes corporate strategies to connect "companies' success with societal improvement" by "reconceiving products and markets, redefining productivity in the value chain, and building supportive clusters at the company's locations."[3]

But, at the end of the day, we don't need more analysis documenting the exploitative qualities of commercial enterprise nor a new corporate epiphany about their potential to build lasting societal

It's not that commercial enterprise has been given a full analytical free pass. For thirty years, negative-screened mutual funds have directed significant public and maybe more limited investor attention away from companies that produce tobacco, firearms, and alcohol or do business in rogue countries.

value. There are already thousands of truly great wherewithal-creating commercial enterprises out there. These are enterprises that build a globally competitive work force; enhance the quality of civic life and opportunity for citizens; strengthen our economic, physical infrastructure and political systems (and, just as importantly, public faith in those same systems); generate our store of intellectual property; impact neutrally or positively the quality of our climate and natural environment; and generate long-term financial wealth.

Likewise there are companies that through their policies corrupt our political and financial systems; erode public faith in the fairness of economy; market products that seriously diminish the health and welfare of the population; and rip communities apart, generally dissipating society's wherewithal, despite "healthy" reported earnings.

Before we spend any more time building new corporate forms and collaborative constructions, we must recognize the vast differences in the net contributions these enterprises make to society's wherewithal and put our money where our values are.

Investor Responsibility and Institutional Impediments to Progress

In the final analysis, *how* an enterprise operates is fully as important for our productive future as what it produces or what it earns. For society's purposes, the so-called externalities that result largely from the "hows" of enterprises doing business are intrinsic, inseverable components of their core activity. Before we spend any more time building new corporate forms and collaborative constructions, we must recognize the vast differences in the net contributions these enterprises make to society's wherewithal and put our money where our values are. This recognition is especially critical in an era in which everyone understands the limitations of government. We can no longer cavalierly ignore the net positive or negative contributions that our enterprises make to society's wherewithal and effectively abdicate our voting rights in this resource allocation process to financial intermediaries, the interests of whom, it would seem, diverge significantly from our own.

Seizing the voting franchise will require of us a far greater understanding of the impact, positive or negative, enterprise policies and activities have upon society's wherewithal and progress. But first we must overcome two entrenched systemic barriers to society's wherewithal investment. The first barrier is the prevailing "best practice" dogma that demands that investors recognize only historically assessed financial risk and reward when putting corporate securities into their portfolios. As a consequence, investors are conditioned to ignore the fundamental work practices, corporate policies, and even products and services of the companies in which they invest. The second barrier is the prevailing and conscious practice of commercial enterprise managers to maximize short-term earnings at the risk of damaging long-term corporate and society's wherewithal, with the incidence of that risk falling entirely upon shareholders or taxpayers.

No doubt many of these behaviors are fostered by a mushrooming industry of financial intermediaries. Over the past thirty years, the finance industry's share of GNP has doubled from roughly 4 percent to over 8 percent.[4] Given that finance exists to facilitate the provision of financial capital to the operating enterprises of the economy, the finance sector's growing share of GNP now effectively comprises a large tax on a relatively diminishing productive sector.

This direct tax on the economy is accompanied by a further dysfunction. This steadily increasing share of the economy enjoyed by financial intermediaries constitutes not only a pictorial but also an actual immense wedge between investors and their investments, resulting in the faster turns of holdings and short- rather than long-term investment horizons, risk-generating derivative trading instruments, substance-neutral asset allocations, etc.

While a handful of activist shareholders will confront the highly public and egregious behavior of a News Corporation or a large-cap company's failure to extract full shareholder value from its collection of assets, these initiatives arise only sporadically, affect a very small number of corporations in the moment (and then only at annual meetings), and miss the point of society's wherewithal generally. While investors struggle to understand the numerical machinations of the experts, they lose sight of the fundamental work of the underlying entities to which their investment dollar, after the intermediary's cut, finds its way.

It wasn't always like this. To be sure, it would be a mistake to over-glorify a past conception of "Greatest Generation" investor sensitivity to the values of the companies in which they invested.

Nonetheless it is instructive to remember that fifty years ago mutual funds held stocks an average of six years rather than today's one, and institutions owned only 8 percent of equities versus 68 percent today.[5] Stocks held in mutual funds in the 1960s could be expected to change hands every six years. Today, on average, they turn over annually.[6]

Implications for Categorizing Enterprises and "Social Investment" Strategy

If we as citizen investors overcome these barriers and find the means to assess the relative contributions our commercial enterprises make to society's wherewithal, we would expect to realize a greater connection between our values and commercial enterprise outcomes. We would also achieve a more complete understanding of how citizens do their work and how the wherewithal-advancing attributes of vast numbers of commercial enterprises intersect with the manifold activities of nonprofit and self-described "hybrid" social enterprises.

What about the holistic contributions of these entities? I would expect to find a similar, if not quite as vast, divergence in the respective net contributions of nonprofit and hybrid enterprises to society's wherewithal. Some nonprofit and hybrid enterprises would make materially greater contributions than others, well beyond their financial and specific mission results.

The category of enterprise (nonprofit, hybrid, commercial) ultimately may not tell us very much. Theoretically, viewed through this contribution to society's wherewithal lens, the enterprises of society inhabit a wide continuum from low to high net contributors, with enterprises of various types and tax statuses mixed together across the array. Anyone who believes in the importance of private enterprise in fostering social progress must endeavor to understand the net contributions that these enterprises, regardless of tax status, make to the cumulative wherewithal of society and invest, consume, and donate accordingly.

* * *

A full understanding of enterprises' contributions to society's wherewithal will allow us to define enterprises by their intrinsic contributions to social progress. If adopted, this holistic perspective will have substantial implications for philanthropy, investment portfolio theory, public policy, corporate law, and business model definition and strategy for all enterprises. Ideally, such a schema should compel socially sensitive investors, citizens, and institutions to identify and invest resources in those enterprises that contribute most positively to society's cumulative store of sustaining wherewithal, as well as encourage leaders of all private enterprises to pursue business policies to optimize their own contributions.

Over the past thirty years, the finance industry's share of GNP has doubled from roughly 4 percent to over 8 percent.[4] Given that finance exists to facilitate the provision of financial capital to the operating enterprises the economy, the finance sector's growing share of GNP now effectively comprises a large tax on a relatively diminishing productive sector.

Notes

1. Gallup's September 2011 poll found that the percentage of those polled responding "not very much" or "none at all" with respect to their trust and confidence in Congress had risen to 69 percent, from 25 percent in 1972.
2. Of course, once components are selected for analysis, additional issues arise. For example, how do we measure an enterprise's contribution to each capital component, and how do we weigh respective contributions to calculate an enterprise's net contribution? Rather than dwell now on these complicating factors, the purpose here is in this first instance to focus only on a list of capital components in order to facilitate serious consideration and/or criticism of the general proposition.

3. Michael E. Porter and Mark R. Kramer, "Creating Shared Value," *Harvard Business Review*, January–February 2011, reprint page 7.
4. "Kauffman Foundation: Consequences of Financialization," April 18, 2011, *The Investments Blog*, http://theinvestmentsblog.blogspot.com/2011/04/kauffman-foundation-report-consequences.html.
5. Marshall E. Blume and Donald B. Keim, "Changing Institutional Preferences for Stocks: Direct and Indirect Evidence," University of Pennsylvania, Social Science Research Network. (Posted March 18, 2011.)
6. John C. Bogle, *Don't Count on It!: Reflections on Investment Illusions, Capitalism, Mutual Funds, Indexing, Entrepreneurship, Idealism, and Heroes* (Hoboken, New Jersey: John Wiley & Sons, Inc., 2011), 148.

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Four Reasons Why NOT to Use Social Media . . . *and Why to Use It Anyway*

by Christine Durand and Kristen Cici

Social media can eat up a lot of energy to little effect, and may even open us up to public criticism. So not only is the return on investment in question, but we may actually lose support. The authors here acknowledge these concerns, but also proffer some excellent reasons to use social media and a short, logical model for how to use these tools and methods.

These days, a nonprofit communicator must be quick. Quick to learn new tools, new technologies—and how to appropriately apply them to his or her organization. But over the past eight years, we've seen the rise and fall of social media giants like MySpace, Google Buzz, and Delicious. Those that invested their own and their organization's time and resources into these tools may have felt burned by the social media bandwagon.

Social media can be confusing and overwhelming. At the same time, there is a lot of pressure for nonprofits to embrace social media and engage

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facebook

with donors, volunteers, and supporters using tools like Facebook, Google +, and Twitter. In this article we explore why, why not, and how to use social media to the best advantage of your organization.

Many people think that organizations should use social media because it's free. But social media management is free like a puppy is free.

To Use or Not to Use . . . That Is the Question

Nonprofit communicators are often skeptical—and rightly so—of the new tools out there. Why should organizations shift resources away from what has proven to be successful to this vague concept of the social web? Below are the four most frequent points raised as to why organizations should think twice before heading down the social media path . . . and reasons why those points don't necessarily hold up.

1. It's a fad—it's going away soon anyway. . . .

When the Causes application pulled out of MySpace, in 2009, it effectively removed any ability for nonprofits to fundraise using the tool. There were 40,000 nonprofit organizations with profiles on the social networking site at the time. Early nonprofit social media adopters had flocked to MySpace as a way to further connect with their audiences and raise a few extra dollars. They spent time figuring out what Causes meant for their organization, how to use it, and how to raise money on it. And then the tool up and changed, leaving them in the lurch.

What's to prevent that from happening to other tools, like Facebook, Twitter, or YouTube? Well, nothing, really. Tools come and go. Their population may soar and then plummet without notice. They may change the rules midcourse. That's the scary part of the fast-moving world we live in today.

That said, we can say with some certainty that social media is here to stay. It will evolve and likely turn into something barely recognizable from the social media we know and use today. The growing mobile culture is already changing the way individuals interact with organizations; nonprofits, in addition to for-profits and public sector groups, must evolve with it in order to keep up with their audiences.

Still, no one, not even Mark Zuckerberg, can guarantee that Facebook will be around in fifteen, ten, or even five years. Nonprofits should invest in the *concept* of being social organizations rather than becoming stuck on a single tool—or even group of tools—that they use to make that happen. Be open to engaging in online conversation, whatever the tool may be. Use tools that make sense in the moment, and don't feel that the organization needs to make a long-term commitment to that tool. If the situation changes, be flexible.

2. What's the ROI? I can't see that it's worth it. . . .

Many people think that organizations should use social media because it's free. But social media management is free like a puppy is free. While setting up a profile on Twitter sites may cost zero dollars, its management requires constant care and feeding. And, unlike a puppy, as you train social media it needs *more and more*—not less and less—attention. There is a huge opportunity cost: smart managers understand that if they dedicate one or more staff to manage social media, those resources will be diverted from existing work.

So if you know that your e-mail campaigns and your website are working for you, why would you move away from the tried-and-true tools to others that may come and go?

As our communications toolbox grows, it is becoming more and more difficult to determine cause and effect of particular messages and methods. If a homeless shelter posts a photo and a link to donate on Facebook, sends an e-mail, and sends a direct mail donation appeal, it becomes difficult to determine which method will have motivated donors who received all three campaign methods. We can easily see the results of our efforts when a potential donor returns a donation envelope that was mailed to them, clicks on a link in an e-mail, or lands on a donation page on a social media website. And we know the statistics, as demonstrated in figure 1 (right). But what we can't tell from those statistics is how these messages may build upon one another. A decision made after reading a Facebook post may be acted on when an e-mail reminds a donor.

A return on investment may also be skewed during the building period of a social media strategy. As a nonprofit builds its social media presence it must start at zero followers and fans.

An organization must expend considerable effort just building its numbers. An organization's Facebook fan page with only 100 fans compared to the same organization's e-mail list of 10,000 can seem like wasted effort. But social is as social does. Any social profile must reach a sort of tipping point before its fan base can be leveraged. In order to reap the rewards of social media, every nonprofit must put in its time building a base. That can be a difficult pill to swallow, because during that time you may have little participation and low outcomes with respect to your goals. The time it takes an organization to leverage its base depends on how much time and effort it chooses to put into it.

Figure 1: Various Media Averages

Advocacy e-mails	13% open rate 3.7% click-through rate 3.3% response rate
Fundraising e-mails	12% open rate 0.6% click-through rate 0.08% response rate
Nonprofit e-newsletters	12% open rate 2% click-through rate
Facebook	15,053 fans
Twitter	4,632 followers
Letter-size direct mail	3.42% response rate

Data is from the 2011 *eNonprofit Benchmarks Study*, by M+R Strategic Services and NTEN, except direct mail, which is from the Direct Marketing Association's *2010 Response Rate Trend Report.*

[S]ocial is as social does. Any social profile must reach a sort of tipping point before its fan base can be leveraged. In order to reap the rewards of social media, every nonprofit must put in its time building a base.

3. People will say bad things about us. . . .

The argument here is that if you build it, the naysayers will come. Providing a Facebook page invites those who don't think too kindly about your organization to post their negative comments for all to see. There have been some very public examples of this in the for-profit world. Comcast, American Airlines, Southwest Airlines, and Dominos Pizza have all found themselves in a PR crisis because of social media posts. Some of these companies have fared better in the social media world than others, but one thing they all learn is that people—donors, volunteers, supporters—are already talking about them. In other words, the social media *tools* are not the issue.

A donor may tell a friend about a great mentoring group that she donated to, or a volunteer may take a picture of himself packing grocery bags for a local food shelf, or a client may talk about participating in an English-as-a-second-language class. Social media is merely a tool each one may have selected as a means of expressing his or her feelings. The uniqueness of social media is that it allows organizations to be part of the conversation and respond in ways that it would not be able to do in other forums.

While negative comments *are* a concern, a bigger concern is lack of participation. Social media is inherently about conversations. If you sit down for the conversation and no one joins you, it can make you feel silly. Participation takes being an active listener and contributor to the broader conversation. Nonprofits that post on social media only about their upcoming events or where to purchase supporter T-shirts and mugs will have a tougher time breaking through the social barriers. Consider the friend who always turns the conversation back to him- or herself. Savvy nonprofits will learn to use social media to engage with people in a two-way or group conversation.

4. Our supporters don't use social media. . . .

Really? Many organizations are happy to find that their donors, volunteers, clients, and supporters are interested in connecting with them on social media sites—but it is true that not all will be interested.

When exploring a new medium, an organization should evaluate its audience. When communicating with an audience, any good marketer will learn to go to where the audience is and not try to entice them to a whole new space. Just as successful retail stores are located on busy intersections with easy access, nonprofits should position themselves on busy social media sites if that is where their desired audience is spending its time.

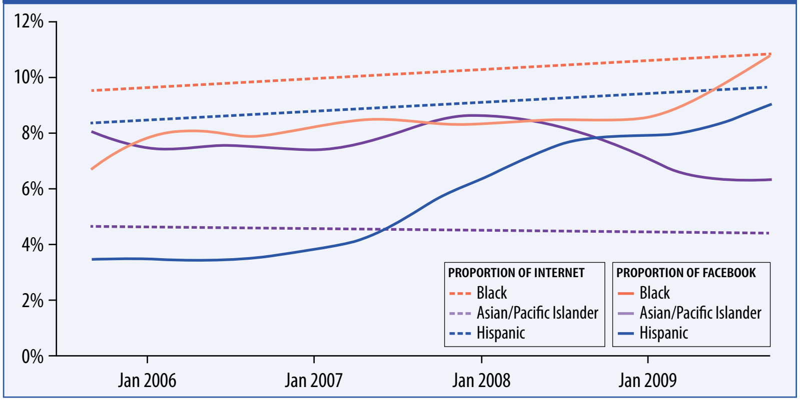
Currently, Facebook has more than 800 million active users. Women make up 60 percent of those users (see figure 2, following page). In the United States, in 2009, African Americans made up about 10 percent of Facebook users, Latinos about 8 percent, and Asian/Pacific Islanders about 6

Figure 2: **Facebook Users by Age and Gender**

Age	Total Users	Male	Female
13–17	14,402,580	6,646,820	7,719,380
18–25	50,679,700	23,004,960	27,048,020
26–34	29,703,340	13,588,320	15,577,380
35–44	23,596,860	10,216,440	12,775,140
45–54	17,425,520	6,915,900	10,176,980
55–64	10,459,580	3,982,340	6,301,480

Source: Facebook

Figure 3: **Facebook Users by Race**



Source: Facebook

percent (see figure 3, above). This matches proportionately with all Internet users in the U.S. The smallest group of Facebook users, those between the ages of 55 and 64, is also one of the fastest growing. So though an organization's audience may not at first use social media, they very well may later on—something that is worth reassessing every year.

It's important to think about the root purpose your organization has for considering social media as a tool. Is it to help raise money? To recruit volunteers? To educate the public about a problem?

How to Do It Right

Organizations that have been using social media for years—and those that are just beginning to use social media—would do well to pay careful attention to its impact. Social media should be viewed as a tool that can be used toward reaching an organization's overall strategic goals, and the only way to measure the impact that social media is having on your organization is to come up with an evaluation method that best suits your particular objectives.

Most nonprofits indicate that they are tracking their social media use in some way. Counting the number of fans, followers, visits, or likes are the norm. Knowing that you have 1,378 followers on Twitter is great, but what does that actually mean? Nonprofits need to ask themselves, "Why are we using social media?" The answer probably isn't to have a thousand likes on Facebook.

It's important to think about the root purpose your organization has for considering social media as a tool. Is it to help raise money? To recruit volunteers? To educate the public about a problem? Once you have defined your purpose, you should connect that to your evaluation of social media use. What does it mean to have a thousand likes? Is that translating into more volunteers, more donations, more education about your mission or your issues?

Evaluating social media can be tricky. Organizations should follow three steps in beginning to measure their efforts: determine the reason (and create a logic model) for your organization's social media use; lay out some concrete outcomes for social media use (you can take these from the logic model if you have one); and match the evaluation methodology to your needs.

1. Determine the Reason for Social Media Use

The first step an organization should take is to create a logic model for its social media use. Sit down and really think about your social media strategy. Who will manage your Facebook page? How will you keep people interested and involved? Will you invest in custom-designed features or branding? Determining your inputs is the first step in putting together a logic model.

The next step is to outline your activities and outputs. These are things like staff time to update your social media tools, the number of fans, likes, or followers you have, and the discussions that take place on social media.

The last step is to determine your short-term and long-term outcomes. For this, you will likely refer back to your organization's mission or strategic plan. This is what your ultimate goal for using social media will be. Having a logic model

LOGIC MODEL

Organization: Animal rescue

Social Media Use (Outcome to Measure): Uses Facebook to recruit new foster homes for dogs and cats. Would like to measure whether Facebook is an effective means for this.

Budget: $0–$250

Recommended Approach for Evaluation: With the budget and information need this organization has, a survey would be recommended. A monthly membership in an online survey service would cost less than $50. The organization should develop a survey to ask questions getting at two main focuses: (1) How did people first hear about the opportunity to foster? (2) How do current fosterers get their information about new dogs/cats coming in? Survey questions should be developed with these two focuses in mind, which will provide information relating to whether people are first hearing about fostering through social media, whether the organization is saving staff time because potential fosterers are hearing about incoming dogs/cats through Facebook (versus staff having to call/e-mail all the potential fosterers), and more.

will allow you to refer back to why you are doing what you are doing and will help in determining whether using social media is a worthwhile investment for your organization.

2. Lay Out Concrete Outcomes for Social Media Use

Pick the outcomes you want to measure for your social media use. These should be concrete, such as raising money for a new homeless shelter, getting five thousand people to lobby in support of legislation, or bringing ten new volunteers on board.

3. Match Evaluation Methodology to Your Needs

Evaluation can consist of anything from a poll on your Facebook page to a dozen focus groups with your target audience. Once you have determined the outcomes you plan to measure, you can match a methodology to fit your needs. Picking a methodology will depend primarily on two things: (a) budget and (b) information needed.

If you have a small budget (or no budget) you likely won't be conducting focus groups, which require incentives, food, staff time, transcription, and analysis. Similarly, if the information you are looking for is numbers-based (for example, the percentage increase in the number of youth staying in school), you will probably not be conducting interviews that won't provide the necessary breadth of data.

Conclusion

Social media is often quickly damned for being of little substance. While that can be the case, the widely available tools offer nonprofits a world of opportunities. There are many exciting and creative ways nonprofits are using social media to advance their missions:

- A human service organization may use a blogging tool to help teach English to ESL students.
- An animal shelter may post pictures on Facebook of animals available for adoption.
- An advocacy group may use Twitter to mobilize a gathering at the Capitol in support of their issue.
- A senior support group may use a variety of social media tools to market new services to families and friends of seniors in need of Medicare form assistance.
- A theater may post photos on its website of production crew backstage to create buzz for a new musical.

Accountable organization leaders are smart to question the value of new technologies, especially those that have not stood the test of time. But social media is far too useful—and ubiquitous—a tool to dismiss out of hand. The question shouldn't be, "Should our nonprofit use social media?" Rather, the question should be, "How can we strategically use social media to further our mission?"

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Accountable organization leaders are smart to question the value of new technologies, especially those that have not stood the test of time. But social media is far too useful—and ubiquitous—a tool to dismiss out of hand.

"I Thought We Were Friends!"
Can Nonprofits Terminate Employees for Their Social Media Posts?

by Emily Chan

The intersection between social media and labor and employment law is an uncharted road that the legal system has only recently started navigating. This article provides a guide to the legal principles on which recent decisions have been made, but also makes the point that this area of law is still very much in development. A must-read for executive and HR directors.

An employee comes home from work feeling frustrated and annoyed, as many of us often do, and logs on to Facebook. While on Facebook, she posts comments accessible by her hundreds of Facebook "friends" detailing all the reasons she dislikes her job—from incompetent management to annoying co-workers to lackluster benefits and low pay. The next day, the employee's supervisor addresses her Facebook comments and takes disciplinary action. Was this lawful?

This is a simplified version of what currently faces many employers and employees using social media, and the best answer available is that it depends. As social media continues to gain in popularity and usage at unprecedented rates, employers are seeing an ever-increasing blurring of professional and personal lives online. It is not uncommon today to see individuals discuss work-related issues, complain about their jobs, or engage in conversations on social media sites with co-workers and non–co-workers alike that traditionally have been confined to work break rooms. But for every action there is a reaction. Understandably, employers may be concerned about their organizations' image, potential exposures to liability, and the nature of certain conduct. Sometimes this leads to employee disciplinary action.

Terminations due to actions on social media sites, commonly referred to as "Facebook firings," have been gaining widespread attention over the past year, including from the National Labor Relations Board (NLRB), the federal agency charged with enforcing the National Labor Relations Act (NLRA). Facebook firings may implicate an NLRA provision that protects employees' rights to discuss matters affecting their employment in certain situations. However, the intersection between social media and labor and employment law where these cases meet is an uncharted road that the law has only recently started navigating. While posting every minutia of our lives to networks that potentially tap into millions of people online seems commonplace today, it is hard to imagine such behavior could have been predicted

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Despite the recent abundance of social media cases, only minimal guidance exists, because relatively few charges make it very far. Generally, most charges are either withdrawn or dismissed, and the majority of those with probable merit settle.

even in the mid-2000s, when social media began to alter more than just our digital lives.

News of the first Facebook firing case occurred only last October 2010, in *American Medical Response of Connecticut, Inc.*[1] An NLRB regional office filed a complaint against American Medical Response (AMR), when an employee was terminated after she, along with co-workers, posted negative comments about her employer and supervisor on her Facebook page—comments that included expletives and references to her supervisor as a "psychiatric patient" and "a scumbag as usual." Although the case ultimately settled, it was widely publicized because it signaled the NLRB's position that a Facebook firing may be a prosecutable violation of the NLRA.

Despite the recent abundance of social media cases, only minimal guidance exists, because relatively few charges make it very far. Generally, most charges are either withdrawn or dismissed, and the majority of those with probable merit settle. An informative U.S. Chamber of Commerce report released in August 2011 found that of 129 cases before the NLRB involving social media, 117 were charges, 7 were complaints, and 5 were settlements.[2] This U.S. Chamber of Commerce report and a highly publicized NLRB General Counsel Office report released the same month (detailing 14 social media cases reviewed by the agency within the last year) are the only comprehensive summaries to date on NLRB social media cases.[3]

Attention to Facebook firings hit its greatest peak in early September 2011, with the case *Hispanics United of Buffalo, Inc.*[4] In this case, an employee posted a co-worker's criticism of other employees' job performances on her Facebook page. She and four other employees defended themselves on the page, and expressed frustration with working conditions, including workload and staffing issues. The employer, Hispanics United of Buffalo, Inc. (HUB), discharged the five employees, claiming their actions constituted harassment of the critical co-worker mentioned in the post. An NLRB Administrative Law Judge (ALJ) ruled that the Facebook firings were in violation of the NLRA, and ordered HUB to reinstate the five employees.

The *Hispanics United of Buffalo, Inc.* case did not change the rules of the game, but it certainly raised the stakes. Most noteworthy, it was the first case involving Facebook to result in an ALJ decision after a hearing. It also provided a wake-up call to any employers only minimally concerned about Facebook firings, given three recent Advice Memorandums released in July 2011 dismissing such charges.[5] Additionally, in an odd twist of fate, because the employer, HUB, is a nonprofit, it provided a fortuitous wake-up call to the nonprofit sector. Accordingly, this case was an important reminder to employers, including nonprofits, that they should pay attention to the ongoing conversation about social media and the workplace.

What Is the NLRA and Why Should Nonprofits Care about It?

The NLRA is the federal statute protecting most private-sector labor management in the United States. It was enacted in 1935 to reduce industrial strife resulting from a lack of appropriate channels for employees' collective efforts to improve workplace conditions. The Act therefore includes a body of provisions aimed at addressing the "inequality of bargaining power" between employees and employers.[6] Section 7 of the NLRA is the provision generally implicated by Facebook firing cases, and states, in relevant part:

> Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and *to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection*, and shall also have the right to refrain from any or all such activities. . . .[7]

Surprising to many is that Section 7 protects both union and non-union employees because it protects not only the right to join a union but also to make other steps toward taking group action. This means about 108 million workers[8] and as many as 6 million private employers[9] are potentially subject to the NLRA. Among those excluded from the NLRA are public-sector employees, agricultural and domestic workers, independent contractors, workers employed by a parent or spouse, and supervisors.[10]

Nonprofit leaders are typically unaware that the NLRA applies to their organization. This is especially troubling because nonprofits may be particularly susceptible to situations that lead to Facebook firings.

First, nonprofits are the front-runners across all sectors in adopting social media use. It was recently reported that 92 percent of nonprofits, regardless of their size, use at least one commercial social network.[11] Accordingly, nonprofit employers are more likely to use social media connected to their employees' networks or have employees connected to each other's networks.

Second, many nonprofits fail to invest in strong organizational governance structures, particularly in addressing developing areas of the law such as those related to technology. The priority may be on programs, not infrastructure, often resulting in a trial-and-error approach to developing sound policies and practices in these areas.

Third, employment-related claims are already a major source of exposure for nonprofits, accounting for 90 percent or more of all claims against boards of directors.[12]

Fourth, given the current economic climate, nonprofits are facing particularly difficult times, which contributes toward higher stress levels, greater job dissatisfaction, and other adverse consequences that negatively affect employees at their places of employment.

Finally, public trust is a fundamental component of any sustainable nonprofit. Thus, nonprofits are particularly vulnerable to events that might negatively affect that trust—for example, by tarnishing their goodwill or relationships with clients, donors, and other constituents.

What Is and Is Not Protected under Section 7 of the NLRA?

Three elements generally need to be established in determining whether an activity is protected under Section 7: (i) whether the activity was "concerted"; (ii) if it was, whether it is protected; and (iii) even if it is protected concerted activity, whether it lost that protection.

Concerted Activity

The phrase "concerted activities" is generally understood in terms of "individuals united in pursuit of a common goal."[13] This does not however require that two or more individuals "act in unison to protest, or protect, their working conditions."[14] The test is whether the activity is "engaged in, with, or on the authority of other employees, and not solely by and on behalf of the employee himself."[15]

Concerted activity generally occurs in two forms:

1. The actions of individual employees as logical outgrowth of concerns expressed by the employees collectively;[16] or
2. Individual employees (a) "seek to initiate or to induce or to prepare for group action"[17] or (b) bring "truly group complaints" to management's attention.[18]

Social media does not necessarily make activity "concerted" simply by virtue of occurring on social media platforms. However, it can certainly facilitate the possibility of concerted activity. The analysis looks primarily at the collective nature of the activity, irrespective of the merits of the content. For example, an employee's Facebook comments to his stepsister regarding his low salary and lack of tips in response to her question about how his night went did not amount to concerted activity, because they did not grow out of a prior conversation with a co-worker about the tipping policy.[19]

Furthermore, comments by co-workers are not alone sufficient and must also be evaluated for context.[20] For example, an employee's Facebook post about poor performance by co-workers and management—in response to which his co-workers left comments such as "hang in there"—was found to be individual griping, not concerted activity, because the post was "solely by and on behalf of the employee himself," and did not attempt to engage group activity.[21]

These cases can be compared to the "textbook example" of concerted activity, in which, in preparation for a meeting with her boss, an employee initiated a discussion on her Facebook page that in essence was an appeal to her co-workers for

[A]n employee's Facebook post about poor performance by co-workers and management—in response to which his co-workers left comments such as "hang in there"—was found to be individual griping, not concerted activity, because the post was "solely by and on behalf of the employee himself," and did not attempt to engage group activity.

assistance on the issue of job performance—resulting in comments posted by co-workers.[22]

Protected Activity

Protected activity refers to actions addressing terms and conditions of employment, such as pay, work hours, or supervision. The NLRB has recently made it clear that the "finding of protected activity does not change if employee statements were communicated via the Internet."[23]

Given that individuals disclose a wide range of information—from the very serious to the trivial—on social media, the NLRB social media cases have been quite revealing as to the reach of "terms and conditions of employment." For example, an automobile dealer employee's mocking and sarcastic Facebook posts regarding his and other co-workers' displeasure over hotdogs and bottled water being served at a BMW event were considered protected, because the employees worked entirely on commission and "were concerned about the impact the Employer's choice of refreshments would have on sales, and therefore, their commissions."[24]

Although many work-related comments will fall within "terms and conditions of employment," not every work-related comment will be protected. For example, an employee of a residential facility for homeless people with mental health issues was not protected for her Facebook posts about the facility being "spooky."[25]

Has It Lost Its Protection?

Protection under Section 7 is not absolute. In very limited cases, actions may lose their protection.[26] Examples include:

- Actions so opprobrious and egregious as to render the employee "unfit for further service."[27] This four-factor test is most often applied where an employee has made public outbursts against a supervisor.[28] The use of obscenities is generally not sufficient to lose protection;[29] and
- Actions that are so disloyal, reckless, or maliciously untrue as to lose the NLRA's protection.[30] This test is usually applied where an employee has made allegedly disparaging comments about an employer or its product to outside or third parties.

Employers should be aware that these exceptions rarely apply. Even if an action seems inappropriate or insubordinate, the activity will not lose its protection unless it reaches certain levels of outrageousness and disparagement.[31]

When Does an Unfair Labor Practice Occur?

It is an unfair labor practice in violation of Section 8(a)(1) of the NLRA for an employer to interfere, restrain, or coerce employees in the exercise of their Section 7 rights.[32] Most allegations of unfair labor practices in social media cases arise from unlawful discharge or disciplinary action and overbroad policies.

Unlawful Discharge

Employers are prohibited from terminating an employee for engaging in Section 7 activity. This does not preclude a termination based on activities not protected by Section 7.[33] However, the grounds for termination are critical, especially when an employee has engaged in both protected and non-protected activity. The General Counsel generally has the initial burden of showing a *prima facie* case that the protected activity was a motivating factor in the termination or adverse action; if met, the burden shifts to the employer to show that it would have taken the same action, even in the absence of the protected activity.[34] Thus, employers must proceed cautiously when Section 7 activity has occurred, even if that is not the grounds for termination.[35]

Overbroad Policies

Although Facebook firings get much of the spotlight, these cases often involve overbroad policies. The underlying rationale is to prevent employers from imposing a work rule that would "reasonably tend to chill employees in the exercise of their Section 7 rights."[36] The social media cases have evaluated any policy that restricts Section 7 activity on social media, not just those labeled "social media policy."[37] Additionally, an unfair labor practice can be found based on an overbroad policy even if no disciplinary action has been taken.[38]

A policy is generally unlawfully overbroad in two situations:

Although Facebook firings get much of the spotlight, these cases often involve overbroad policies. The underlying rationale is to prevent employers from imposing a work rule that would "reasonably tend to chill employees in the exercise of their Section 7 rights."

1. The rule explicitly restricts protected activities; or
2. If not:
   a. The employees would reasonably construe the language to prohibit Section 7 activity;[39]
   b. The rule was promulgated in response to union activity; or
   c. The rule has been applied to restrict the exercise of Section 7 rights.[40]

Prohibiting the discussion of wages among employees, for example, explicitly restricts protected activities.[41] Other explicitly restrictive policies include prohibiting employees from providing information to outside sources or participating in interviews with outsiders (for example, reporters) regarding employees or the company.[42]

Looking primarily at policies that could be reasonably construed to prohibit Section 7 activity, common patterns of problematic policies have emerged, including:[43]

- Prohibiting disparaging, discriminatory, or defamatory comments when discussing their employer or superiors;
- Prohibiting employees from posting pictures of themselves in any media that depict the employer in any way (for example, company uniform or corporate logo) without approval from the employer;
- Prohibiting inappropriate or generally offensive language; and
- Prohibiting rude or discourteous behavior to a client or co-worker.

Such policies are often problematic because they encompass a broad spectrum of activities but contain no limiting language or context to clarify or inform employees that they do not restrict Section 7 rights. Because context is key, the same policy can have different outcomes depending on other circumstances.[44] For example, a policy prohibiting "negative conversations" was unlawful when it stood alone,[45] but a similar policy that prohibited "statements which are slanderous or detrimental to the company" was not unlawful, in part because it appeared on a list of prohibited conduct including "sexual or racial harassment" and "sabotage," and therefore could not be reasonably understood to restrict Section 7 activity.[46]

Takeaways and Tips

Although there is still much to be desired regarding formal guidance from the NLRB, there are several takeaways and tips that can be gleaned from current information.

Policies

- Avoid overbroad language; narrow conceivably overbroad terms by providing specific examples or imposing limitations that would prevent such terms from excluding Section 7 activity.
- Avoid ambiguous or unclear language when possible; provide definitions when appropriate.
- Use a disclaimer, especially where multiple bodies of regulations overlap (for example, "none of the policies are intended, or should be interpreted, to discourage or interfere with employees' rights under NLRA").
- Provide a policy purpose statement or explanatory language for general context of the policy (for example, the purpose "is not to restrict the flow of useful and appropriate information but to minimize the risk to the company and its associates").[47]
- Regularly review any policies that may affect social media activity with an appropriate expert (for example, an employment law or HR expert).

Balancing Protections

With so much attention on Facebook firings, it is important for employers to remember that the NLRA is only one of many bodies of regulations employers should know and encompass in their policies. For example:

- The Federal Trade Commission requires employees to disclose themselves as employees of their employer whenever providing endorsements or testimonials in employer advertisements.[48]
- Employees are prohibited from disclosing certain confidential or private information (for example, health care employees have obligations under HIPAA not to disclose a patient's protected health information).

[A] policy prohibiting "negative conversations" was unlawful when it stood alone, but a similar policy that prohibited "statements which are slanderous or detrimental to the company" was not unlawful, in part because it appeared on a list of prohibited conduct including "sexual or racial harassment" and "sabotage". . . .

We may have only seen the beginning as to how social media questions will be resolved under the NLRA. Employers are best advised to get aboard and buckle up. There may be a long and bumpy ride ahead.

- Employees are prohibited from disclosing trade secrets or copyrighted or trademarked information (for example, employees must have prior permission to republish their employer's copyrighted materials on their own sites).

Other laws to consider include those related to harassment, workplace bullying, conflicts of interest, anti-discrimination, and computer usage. The kaleidoscope of laws is varied and undoubtedly challenging, and employers are encouraged to seek the help of knowledgeable experts and professionals.

Continued Education

Many employers have an understandable fear that informing employees about Section 7 rights may result in increased unfair labor practice charges or participation in protected but generally unwelcome activities such as striking. This fear however should be weighed against the risk of ignorance not, in the end, being bliss and maybe leading to greater liability exposure and future headaches for the employer. Better education for both employers and employees about Section 7 or social media in general could prove beneficial for all parties. One can surmise that at least some employees would think twice before engaging in online behavior they knew would not be protected and might be sufficient grounds for termination.

Additionally, the NLRB has recently expressed concern about the lack of awareness regarding NLRA rights. Starting next year, the NLRB will require employers to post a copy of a notice advising employees of their NLRA rights and provide information pertaining to the enforcement of those rights.[49] This new requirement may also be a sign that the NLRB will be increasingly unsympathetic to employer policies that fail to reference NLRA rights or provide a Section 7 disclaimer.

One Year Later . . . Are We Older and Wiser?

This article only begins to scratch the surface of Facebook firing cases before the NLRB. It is apparent now, more than ever, that things are changing, and organizations would be doing themselves a great disservice if they fell behind on these developments. We may have only seen the beginning as to how social media questions will be resolved under the NLRA. Employers are best advised to get aboard and buckle up. There may be a long and bumpy ride ahead.

Notes

1. *American Medical Response of Connecticut, Inc.* (Case No. 34-CA-12576).

2. U.S. Chamber of Commerce, Labor, Immigration, and Employee Benefits Division, *A Survey of Social Media Issues Before the NLRB*, August 5, 2011, 2–3; see also NLRB website (www.nlrb.gov), Cases and Decisions.

3. NLRB Office of the General Counsel Division of Operations-Management, *Report of the Acting General Counsel Concerning Social Media Cases*, memorandum OM 11-74, Aug. 18, 2011; Office of the Federal Register, National Archives and Records Administration, 76 *Federal Register* 54006, no. 168 (August 30, 2011). Cited hereafter as Memorandum OM 11-74 and *FR*, respectively.

4. *Hispanics United of Buffalo, Inc.* (Case No. 3-CA-27872).

5. See *JT's Porch Saloon* (Case No. 13-CA-46689), *Wal-Mart* (Case No. 17-CA-25030), and *Martin House* (Case No. 34-CA-12950).

6. 29 U.S.C. §151.

7. 29 U.S.C. §157; emphasis the author's.

8. See Bureau of Labor Statistics, "Employment Situation Summary: Table B-1: Employees on Nonfarm Payrolls by Industry Sector and Selected Industry Detail," economic news release, last modified December 2, 2011, http://www.bls.gov/news.release/empsit.t17.htm.

9. See 76 *FR* 54042.

10. See 29 U.S.C. § 152(3).

11. NTEN, Common Knowledge, and Blackbaud, *3rd Annual Nonprofit Social Networking Benchmark Report* (2011), 6. See also The University of Massachusetts Dartmouth, Center for Marketing Research, *Social Media Usage Now Ubiquitous among US Top Charities, Ahead of All Other Sectors* (March 2011). The latter publication reported that 97 percent of the largest U.S. charities surveyed have a Facebook profile, 96 percent have a Twitter presence, and 64 percent have a blog.

12. Nonprofits' Insurance Alliance of California (NIAC) and Alliance of Nonprofits for Insurance, Risk Retention Group (ANI-RRG), *Nonprofit Directors and*

Officers: Key Facts About Insurance and Legal Liability (2009), 2.

13. See *Meyers Indus., Inc.* (*Meyers I*), 268 NLRB 493 (1984).

14. *Karl Knauz Motors, Inc.* (Case No. 13-CA-46452).

15. *Meyers I*, 268 NLRB at 830–831.

16. *NLRB v. Mike Yurosek & Son, Inc.*, 53 F.3d 261, 265 (9th Cir. 1995). It is not required that there be "express discussion of a group protest or 'common cause.'"

17. *Owens-Corning Fiberglass Corp. v. NLRB*, 407 F.2d 1357, 1365 (4th Cir. 1969). "[A]ctivity of a single employee in enlisting the support of his fellow employees . . . is as much 'concerted activity' as is ordinary group activity."

18. *Meyers II*, 281 NLRB 882, 887 (1986); see also *Lutheran Heritage Village–Livonia*, 343 NLRB 646, 647 (2004).

19. See *JT's Porch Saloon* (Case No. 13-CA-46689).

20. Memorandum OM 11-74.

21. See *Wal-Mart* (Case No. 17-CA-25030).

22. Memorandum OM 11-74; see *Hispanics United of Buffalo, Inc.* (Case No. 3-CA-27872).

23. Memorandum OM 11-74.

24. Ibid; see *Karl Knauz Motors, Inc.* (Case No. 13-CA-46452).

25. *Martin House* (Case No. 34-CA-12950).

26. *Salon/Spa at Boro, Inc.*, 356 NLRB No. 69 (2010), citing *Honda of America Mfg., Inc.*, 334 NLRB 751, 752 (2001), enf. 73 Fed. Appx. 810 (6th Cir. 2003). "[A]ctivity may become unprotected if . . . the employee uses sufficiently opprobrious, profane, defamatory, or malicious language. Nonetheless, the most repulsive speech enjoys immunity provided it falls short of a deliberate or reckless untruth."

27. *Atlantic Steel Co.*, 245 NLRB 814 (1979).

28. The four-factor test set forth in *Atlantic Steel Co.*, 245 NLRB 814, is: (1) the place of the discussion; (2) the subject matter of the discussion; (3) the nature of the employee's outburst; and (4) whether the outburst was, in any way, provoked by an employer's unfair labor practice.

29. See *Felix Industries, Inc.*, 339 NLRB 32 (2003).

30. See *Jefferson Standard Broadcasting Co.*, 346 U.S. 464 (1953).

31. See *Timekeeping Systems, Inc.*, 323 NLRB 244, 249 (1997). "Unpleasantries uttered in the course of otherwise protected concerted activity does not strip away the Act's protection."

32. 29 U.S.C. §158(a)(1).

33. See Memorandum OM 11-74.

34. *Wright Line*, 251 NLRB 1083 (1980), affd. 662 F.2d 899 (1st Circ. 1981), cert. denied 455 U.S. 989 (1982).

35. See *Karl Knauz Motors* (Case No. 13-CA-46452).

36. *Lafayette Park Hotel*, 326 NLRB 824, 825 (1998).

37. See *Karl Knauz Motors* (Case No. 13-CA-46452).

38. See *American Medical Response of Connecticut* (Case No. 34-CA-12576).

39. *Double D Construction Group*, 339 NLRB 303 (2003) (footnote omitted); see also *Salon/Spa at Boro*, 356 NLRB No. 69 at 73. The test is "whether the words could reasonably be construed as coercive, whether or not that is the only reasonable construction."

40. *Lutheran Heritage Village–Livonia*, 343 NLRB at 647.

41. See *IRIS U.S.A., Inc.*, 336 NLRB No. 98, citing *Lafayette Park Hotel*, 326 NLRB at 825, 829 (2001). Prohibiting employees from communicating about wages and conditions is unlawful in the absence of justification by significant employer interests.

42. See *American Medical Response of Connecticut* (Case No. 34-CA-12576).

43. See, for example, *American Medical Response of Connecticut* (Case No. 34-CA-12576). For instance, it prevents an employee from posting a picture of "employees carrying a picket sign depicting the Company's name, or wearing a [T]-shirt portraying the [C]ompany's logo in connection with a protest involving terms and conditions of employment."

44. See, for example, *Sears Holdings (Roebucks)* (Case No. 18-CA-19801).

45. See *Salon/Spa at Boro*, 356 NLRB No. 69 at 83.

46. See *Sears Holdings (Roebucks)* (Case No. 18-CA-19801), citing *Tradesmen International*, 338 NLRB 460, 462 (2002).

47. Ibid.

48. See Federal Trade Commission, Bureau of Consumer Protection, Division of Consumer and Business Education, FTC Facts for Business, *The FTC's Revised Endorsement Guides: What People Are Asking* (June 2010).

49. See 76 *FR* 54006.

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Building a Mission-Delivery Engine:

Moving Your Website beyond the Web

by Carlo Cuesta

This past year marked the beginning of Occupy Wall Street, which is emblematic of a rising tide of citizen action unconnected to formal institutions. Disturbing to some and exciting to others, the ability of people to self-organize—and their evident preference for it—is the overriding meaning we take from this past year into the next. What does it mean for institutions even in this sector. Do we need to change, too?

The first thing you see on the website www.caringbridge.org is the statement "Free, personal and private websites that connect people experiencing a health challenge with family and friends," followed by a call to action: "Create a Site"—a button that, when clicked on, allows visitors to make their own personal CaringBridge website. The approach is direct, and it immediately

Carlo Cuesta is managing partner of Creation In Common, a consulting firm specializing in strategy and participation building for nonprofits, foundations, and government agencies.

"HOWDY COME IN" © JACK HOLLINGSWORTH/CORBIS


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explains why you are there in the first place. More important, it engages you in an experience that exemplifies the organization's mission: to "amplify the love, hope and compassion in the world, making each health journey easier." The site has a point of view that extends a promise to meet your needs, and then it delivers and something unexpected happens. You become engaged with a friend's or family member's battle with cancer. You give voice to his or her journey by creating a website around it. You help people remain connected during a very difficult time, sharing stories and laughter, and even praying together. All of a sudden, bits of digitally compressed data streamed to your computer become transcendent.

When the web emerged, in the 1990s, it was a seminal moment for the nonprofit community. The possibilities of enabling communication, interaction, and transaction around mission seemed endless. Then reality set in. Organizations came face-to-face with technical, operational, and content barriers that were far more difficult to overcome than anyone expected. We quickly learned that our two-dimensional marketing materials did not translate to the web; that a thousand page-views did not necessarily lead to deeper mission engagement; and that "if you build it" did not always mean "they" would "come." Add to this the advent and growth of social media, which overturned notions of how we communicate and shattered the myth that pushing a message to a captive audience will ultimately create a relationship. On the web, audiences have come to expect a different kind of experience—one where they get to generate and shape content, playing an active role. What we discovered was that a nonprofit website could be more than a communication tool or repository for information and data; when a website is fully embedded in the life of the organization, it becomes a mission-delivery engine, simultaneously creating public value and promoting an intuitive understanding of what the organization is about.

When the web emerged, in the 1990s, it was a seminal moment for the nonprofit community. The possibilities of enabling communication, interaction, and transaction around mission seemed endless. Then reality set in.

Building a mission-delivery engine requires a process; KERA, the public radio and television station in North Texas, discovered a way forward. Early in the last decade, KERA faced the threat most media outlets were dealing with at the time: figuring out how to remain relevant to audiences looking to the web for their news and entertainment. This required organizations not just to repackage what they were producing but also create new ways to transform how audiences receive, process, and interact with content. Serving millions of listeners and viewers a week, KERA knew from the start that its greatest resource was its deep understanding of what its audience wanted and the ability to create award-winning content to meet those needs. At the same time, a cultural renaissance was taking shape in Dallas, led by the development of a multimillion-dollar arts district. KERA, in collaboration with a forward-thinking philanthropist and local arts leaders, saw an opportunity to use the web to connect its audience to, and deepen its participation in, the cultural vitality the region offers.

KERA sought to determine the scope of its value proposition by meeting with a variety of external stakeholders. Conversations with arts leaders led to new partnerships to build content, and potential audience members were engaged to provide insight into what they would look for and how they would want it delivered. Early on, it became apparent that there was a great need for enhanced arts coverage, but there were also calls for active participation in the creation of art. Synthesizing the results of its stakeholder outreach, KERA instinctually knew that creating a larger stage for the arts was only part of the equation. In order to engage and inspire users to take full advantage of what the arts have to offer, KERA had to take full advantage of the web's ability to encourage interaction and dialogue. In other words, creating ways to tear down the boundaries between artist and audience was as important as offering high-quality arts criticism and in-depth information on arts events and activities.

Like CaringBridge, KERA forged a point of view about what it wanted to deliver. By meeting with its stakeholders, building partnerships, and garnering support for the effort, KERA was able to create a dynamic new offering—Art & Seek (artandseek.net)—that is more than just a website. With over three thousand community partners, the site has become the region's central means of finding out what's going on in the arts. And it has enriched the conversation by offering in-depth reporting and critical insight into the North Texas arts scene as well as opportunities to participate and share one's own ideas and creativity.

When building a mission-delivery engine, it is important to recognize its centrality to organizational development. At its core, a mission-delivery engine is a complete rethink of a nonprofit's programming strategy, and it should enhance the relevancy of the organization for those who directly benefit as well as those who invest in the organization's ability to deliver value. It requires a cross-functional effort that engages all facets of the organization—where program, finance, development, and marketing are fully integrated, creating an engine that sustainably delivers and communicates value, and, in return, captures support for its efforts.

Like most large-scale programmatic efforts, engine development requires that the organization reach out to stakeholders, leading to active partnership building and the securing of long-term engagement and support. And, by putting stakeholders at the center of the process, the organization not only ensures that stakeholders' needs are met but also, through the organization's approach to meeting those needs, ensures that the organization's mission is communicated.

Critical to the effort is building a frame of reference that allows for the creation of experiences expressing the particular promise an organization makes to its stakeholders. This frame of reference comes from a melding of multiple points of view of users and supporters, draws its purpose from the organization's strengths, and results in the formation of something new. It forges a bridge between the stakeholders' wants and needs and the organization's perspective of what is truly valuable, elevating the experience and expanding the impact stakeholder and the organization can create together.

Organizations put their web strategy at risk when mission is only a statement that is on their home page. What both CaringBridge and KERA teach us is that the web is central to how we enable, activate, and resource our mission. After all of these years, we need to get back to the possibilities that originally inspired us about the web. And so, more important than the drive to make sites more user-friendly, attractive, and easier to navigate is the intention to remain relevant and meaningful to our stakeholders.

We need to give them a space in which their needs are met and they can respond however they wish. They may laugh, cry, or take action. They may wish to offer a helping hand or share their own creativity. A collective prayer might be in order. In the end, the website is about them, not us.

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The largest proposed program cut in the omnibus budget bill is to Medicaid. But even if the bill doesn't eventually pass, we can still expect to see the program cut little by little via reductions in benefits to patients and pay to doctors and hospitals—as well as tighter eligibility standards. What, one wonders, is to become of lower-income patients, seniors, and the long-term disabled if the program is slowly but surely eviscerated?

The State of Medicaid:
A Conversation with Ron Pollack

by Ruth McCambridge

***Editors' note:** The importance of Medicaid dollars in the nonprofit sector cannot be underestimated. Specific numbers are hard to come by, but a 2007 study from the Rockefeller Institute of Government suggests that Medicaid disbursed between $42 and $44 billion to nonprofit hospitals; $11 billion to nonprofit nursing homes; as much as $16.9 billion to nonprofit substance abuse and mental health providers; as much as $13.8 billion to nonprofit managed care organizations; and up to $20.9 billion to nonprofit home health care providers in FY2004. That means roughly one-third of Medicaid expenditures went to nonprofit health care providers. Steven Rathgeb Smith, Waldemar A. Nielsen Chair in Philanthropy at the Georgetown Public Policy Institute, describes Medicaid as a significant driving force behind the increase in government funding for nonprofits in recent decades.*

With $334.2 billion in expenditures in FY2008 (accounting for 14.2 percent of all national expenditures on health and 27.9 percent of all public sector expenditures on health), Medicaid is the primary health care program for lower-income Americans. The strength of the national and local nonprofit infrastructure is inextricably bound up with the state of Medicaid funding. As the founding executive director of Families USA, the national organization for health care consumers, Ron Pollack is well positioned to help nonprofits make sense of the importance of Medicaid and to give us a picture of the current state of play for the program at the national and local levels. Recently, NPQ *editor in chief Ruth McCambridge sat down with Pollack to map out the critical policy issues that will affect Medicaid over the next few years and beyond.*

Ruth McCambridge: *What do you think is most at risk, at the national and the state levels, in terms of the Medicaid program now? What are the policy issues that are up in the air?*

Ron Pollack: Well, the most significant risk is that there are efforts, both at the national level and at the state level, to cut the Medicaid program because of fiscal concerns, and we've seen a variety of manifestations of this. The most obvious manifestation that occurred at the federal level was when Congressman Paul Ryan, a Republican House member from Wisconsin who is chairman of the House Budget Committee, introduced a proposal that was an omnibus budget bill—but the biggest program cut in his proposal was to Medicaid.

Ruth McCambridge is the *Nonprofit Quarterly*'s editor in chief.

"THE SQUEEZE" BY JILL HUDSON

[T]o make matters worse, childless adults—singles and couples—in forty-two states can literally—not rhetorically, *literally*—be penniless, and they're ineligible for Medicaid.

He proposed to convert Medicaid to a block grant, with $771 billion less in funds provided to the states over the course of the next ten years. And, in succeeding decades, the reduction would be even worse, because with each passing year the federal government would be paying a smaller and smaller share of the costs of the program. Now, that proposal passed the House of Representatives on a partisan vote supported—essentially—by all Republicans, and opposed by Democrats. It did not pass in the Senate. It's not *likely* that the proposal will be adopted, at least through the calendar year 2012; however, depending on what happens during the elections in November 2012, it could very well pass [in 2013]. It would have a much greater chance of passing if there were a different president in the United States—if a Republican took President Obama's place, and the Republicans had control over both Houses of Congress.

Failing that, I think we will see incremental proposals that are not as draconian [as the Ryan plan] to cut back the program, and if the states receive less money, the states that are already concerned about their own fiscal situation will substantially cut back the program. Right now, they can cut back by reducing the benefits that are provided as part of someone's Medicaid coverage, and they can reduce the payment levels to health care providers that serve Medicaid patients—people like doctors, and hospitals. And, doctors and hospitals already get paid much less by Medicaid than they do by Medicare, which in turn pays less than private insurance. And, as a result, there are many providers of health care who refuse to see Medicaid patients because they feel they're getting paid too little. So, if you pay them even less, then you're exacerbating an existing problem.

What also could happen is that right now, under existing law, the states are prohibited from changing eligibility standards for Medicaid. There are some exceptions to that rule, but by and large there is a prohibition against states doing that. If the federal government provides less money to the states, I think that current provision in the law would likely be repealed. And, so, in addition to cutting benefits for those eligible, and reducing payment levels to providers, we would likely see changes in eligibility standards that would mean fewer and fewer people would be eligible for coverage.

To complete that picture at the federal level, under the Affordable Care Act—the health reform legislation that passed last year—eligibility for Medicaid is supposed to significantly expand for adult populations. Right now, eligibility in the Medicaid program is miserly for adults. We have very different eligibility standards for children, as opposed to the parents of those children, as opposed to adults who are not parents. Children in virtually every state are eligible either for Medicaid coverage or the Children's Health Insurance Program (CHIP) if their parents' annual incomes are below 200 percent of the federal poverty level. Now, 200 percent of the federal poverty level is somewhere close to $37,000 for a family of three. In some states, the eligibility standards [allow for] higher than that—New York goes up to 400 percent, New Jersey goes up to 350 percent. But in all but a few states [there are no] eligibility standards for either Medicaid or CHIP below 200 percent of poverty.

Now, on the other hand, for parents, eligibility is not predicated on their children's being eligible. And the income cutoffs are considerably lower. And, so, instead of having eligibility as it exists in virtually all states at—at least—200 percent of the federal poverty level, parents have a median income eligibility standard that is approximately 69 percent of the federal poverty level. So it's about one-third of what it is for the children. And, just to give you a sense of this (and this differs from one state to another): in Arkansas, the parents in a three-person household are ineligible for Medicaid if they have annual income above $3,150, and in places like Indiana and Missouri if they have income above $4,600; in Texas, $4,800; in Pennsylvania, $6,300. And, so, the income cutoffs for parents are a mere fraction of what they are for children. But, to make matters worse, childless adults—singles and couples—in forty-two states can literally—not rhetorically, *literally*—be penniless, and they're ineligible for Medicaid.

What the Affordable Care Act—the health reform law—does is, starting in January 2014, all adults nationwide will be eligible if their household income is below 138 percent of the federal poverty level. So this is a huge improvement. Now, when you ask what's at risk and what's the danger, obviously there are a significant number of members of Congress on the Republican side who want to repeal the Affordable Care Act. And, so, this very important expansion could be eviscerated depending on what happens in the November 2012 elections.

RM: *In terms of the draconian measures that may be taken at state levels, are there strategies that have been taken by the states to reduce their Medicaid load?*

RP: Well, what I mentioned before—right now with some exceptions. I can go over the exceptions, but by and large states may not reduce eligibility, nor are they allowed to place impediments in the way of getting people enrolled beyond the impediments that existed before the health reform law was passed. So, they can't do that, but that provision of the Affordable Care Act is very much in jeopardy, and Republicans are very much attacking it. Governors would like to see that changed, and if that were changed then we would see one state after the other reducing eligibility.

RM: *You were talking about how the Ryan plan is trying to reduce the budget for Medicaid. How does that integrate with the repeal of the law? Can they do that when the law requires a certain level of funding?*

RP: Well, part of Ryan's Bill repeals the Affordable Care Act. But then he goes beyond that, and would cut back Medicaid from its current level. So it's not just eliminating the significant improvement and expansion that the Affordable Care Act establishes . . . it would also cause huge cutbacks from where we are today.

RM: *Can you name the populations that you think would be most at risk? I think you've done that in terms of income eligibility, but are there other populations you think are particularly at risk with that kind of policy moment?*

RP: Well, first of all, if the Affordable Care Act were repealed, adults would be at risk because, currently, they're affected by miserly eligibility standards. But if you ask overall which groups in the population are at greatest risk, it's of course people in communities of color, because they are disproportionately uninsured and they are less likely to have coverage through their employer, if they are employed. And, so, people in communities of color would be disproportionately harmed. Also harmed would be people—whether they are seniors or younger than seniors—who have major disabilities: people who need long-term care, people who need care in a nursing home or who need care at home or in the community.

What's important to understand, and what many people don't realize, is that the Medicaid program is by far the largest payer of long-term care. It pays for about half of the cost of nursing homes in the country. It is by far the largest payer for people who need care either in an institution like a nursing home or need care at home or in the community. And, so, if Medicaid were cut, it would obviously put seniors and people who have major long-term chronic disabilities very much at risk.

What's important to understand, and what many people don't realize, is that the Medicaid program is by far the largest payer of long-term care . . . And, so, if Medicaid were cut, it would obviously put seniors and people who have major long-term chronic disabilities very much at risk.

RM: *Are there ways that people should be involved right now—things that you would like to recommend?*

RP: With the "supercommittee" failing to reach a deficit reduction agreement, Medicaid is spared for the moment. However, deficit reduction will continue to be high on the Congressional agenda, and Medicaid will be a target for cuts. The fight to protect Medicaid is far from over. People need to keep telling members of Congress that Medicaid is important to citizens in their state. It provides critical health care and long-term care to seniors, children, and people with disabilities; it creates jobs; and it keeps state health care systems strong.

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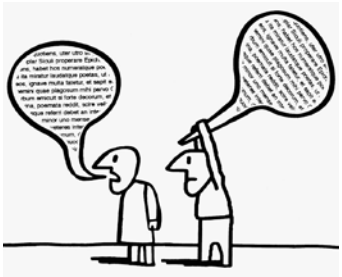

Dr. Conflict

by Mark Light, MBA, PhD

When a new employee asks for help handling the office gossip, Dr. Conflict advises first against upping the conflict by putting said gossip on the defensive, and second to check out the office culture before leaping into the fray. Perhaps surprising to some, he also reminds the frustrated employee that while one should not pay attention to every detail of what goes on in the workplace, it is never a good idea to stay disconnected, either, as "today's gossip may be tomorrow's fact."

Dear Dr. Conflict,

I recently started working for a local nonprofit, where I had been volunteering since they opened their doors twelve years ago. I am sold on their mission and feel that it provides a very valuable service to our community. I took a significant pay cut from my previous salary, but I am trying to make it work. I enjoy most of my co-workers, and I definitely enjoy what I am doing.

I do have one co-worker who is a challenge. The most unfortunate part is that she is the person that I work with most closely. We have similar philosophies about our jobs, but she is a very big gossip and is constantly talking about the business of our staff and our volunteers. To a certain extent, the information that she provided me when I started was helpful in getting to know the volunteers and how and when they like to work, but it has gone way beyond that now.

We work in cubicles, and she sits next to me. Every time I am on the phone, she listens to my conversations and then quizzes me about who I was talking to and what I was talking about. It does not matter if it is a business or personal call. She then shares what she heard or gleaned from my telephone conversations with other staff people and volunteers.

I am the new kid on the block, so I am trying not to make too many waves, but I am at my wit's end. I have told all of my friends and family not to call me at work. On the occasion when I have to take a call from a doctor or someone else like that, I have to deal with her questions as soon as I hang up. I have started walking away from my desk if I get a cell-phone call, but I cannot walk away if I get a call on my work phone.

I am trying not to snap, so I need a tactful way to approach her and try to put a stop to this. I know that I cannot stop her gossiping completely, but I would at least like to be left out of her daily "town crier" editions. What should I do?

Frustrated in Florida

Dear Frustrated in Florida,

If you're looking for a tactful way to deal with your gossip vulture, start with Dr. Conflict's rule of engagement: "Conflict begins with 'you' and ends with 'I.'" Want to get your colleague lathered up, angry, and defensive? Simply say to her, "You are inconsiderate for eavesdropping on my conversations and then taking it on the road." Then stand back for a preview of her next Gossipalooza.

Want a smoother ride? Start with "I," as in, "I am angry" or "unhappy" or "upset." This will usually elicit a response like "About what?" and open the door to describing her behavior, its effect on you, and the specific behavioral changes she needs to make. Keep it in the first person and stay neutral on the language. To keep your emotions in check, do what Dr. Conflict does: breathe deeply and fold your hands loosely as if silently praying "Dear Lord, deliver me from strangling her."

But before taking this tactful approach, ask yourself whether she's a gossip troll or just a goof. Some gossip is utterly harmless and actually strengthens the social fabric of the workplace. "Gossip" is an umbrella term that includes everything from workplace discussions to hearsay. Friendly conversation is a long way from malicious gossip that cuts to the bone. You're not supposed to pay attention to every detail in the workplace chatter, but don't be completely disconnected, either. Remember management guru Henry Mintzberg's warning that "today's gossip may be tomorrow's fact."[1]

Dr. Conflict knows that some readers will gasp in shock to hear that you should keep your ear to the rail, and that not all gossip is bad. Here's a news flash for you: there are some nasty types swimming around out there who couldn't care less about your purity. They're sharks, and they swim to eat. Ignore the feeding frenzy at your peril; you could be tomorrow's fish dinner.

Though the idea of talking directly to the gossipmonger is first choice for most people, you could be pulling the trigger too soon. You've been on the job for just two months, and where did you end up? That's right, the cubicle next to gossip girl. Coincidence? Maybe, maybe not. Was it the only space left? Who was there before you? Did he or she quit in haste, get fired, change cubicles?

Before you approach your gossipy colleague, Dr. Conflict asks you to step back and determine the culture of your organization. Are you working in a collegial environment hospitable to a tactful conversation, a minimally politicized place where teamwork and openness are celebrated? If so, you're good to go. But if it's a dog-eat-dog culture, you need to gear up for a street fight.[2]

One way to get at the culture is to touch base with some of your co-workers. Ask them how they handle conflict, what people should do when they have problems, who are the heroes and villains in the agency. You have to use this approach carefully so that it doesn't seem like you're one-upping your gossipist.

A quieter method is to look for artifacts—pictures on the walls, the layout of the office, things that you can see—to get a first impression of the culture. Next, look for a code of conduct or values statement that tells folks how to behave. Finally, try to put all the clues together to understand how you should "perceive, think, and feel"at the agency,[3] and "'how things are' in the organization rather than how individuals feel about them."[4] Knowing your workplace's "unique way of doing things" is key to deciding how best to deal with your colleague.[5]

In the meantime, shut down the personal stuff. Don't give out your work number; learn how to say, "I'll call you back." When that unavoidable call comes in on your cell phone, hop up from your desk and take it elsewhere. Who wants to hear you talk about that fungus problem anyway? And those work calls that you have to take? Try to keep your voice down and stay on topic.

A newbie doesn't approach a conflict-laden situation without doing some homework. In a collegial environment, you can collaborate to your heart's content. But in a pathologically politicized workplace, you have to be one tough cookie to survive, a skilled political maneuverer to win. The bottom line is simple: "Don't bring a knife to a gunfight." And you won't know what to bring until you first understand who's going to be there and what they're packing.

Notes

1. Henry Mintzberg, "The Manager's Job: Folklore and Fact," *Harvard Business Review* 68, no. 2 (1990): 166.
2. Workplace typologies are common. Kim Reardon (*The Secret Handshake: Mastering the Politics of the Business Inner Circle*, Currency/Doubleday, 2001) offers the four-frame politicized workplace model from low to pathological. Amitai Etzioni (*A Comparative Analysis of Complex Organizations*, Free Press, 1975) observes three types of organization types: coercive, utilitarian, and normative; Goffee and Jones (*The Character of Corporations*, Harper Business, 1998) find four: fragmented, mercenary, communal, and networked. Different conflict-handling styles are effective for each of the types.
3. Edgar H. Schein, *Organizational Culture and Leadership*, 4th ed. (San Francisco: Jossey-Bass, 2010), 18.
4. Kim S. Cameron and Robert E. Quinn, *Diagnosing and Changing Organizational Culture: Based on the Competing Values Framework*, rev. ed. (San Francisco: Jossey-Bass, 2006), 147.
5. Gerald E. Driskill and Angela Laird Brenton, *Organizational Culture in Action: A Cultural Analysis Workbook* (Thousand Oaks, Calif.: SAGE, 2011), 5.

Dr. Conflict is the pen name of Mark Light, MBA, PhD. In addition to his work with First Light Group (www.firstlightgroup.com), Light teaches at the Raj Soin College of Business at Wright State University and the Mandel Center for Nonprofit Organizations at Case Western Reserve University. His most recent book was published by John Wiley & Sons, in 2010. Along with his stimulating home life, he gets regular doses of conflict at the Dayton Mediation Center, where he is a mediator.

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Philanthropic Equity: Promising Early Returns

by Craig C. Reigel

Practitioners agree that regulatory support is essential to Philanthropic Equity's survival, but even if common standards and IRS guidance are put into play, PE is not for everyone. As the author explains, "Philanthropic Equity is about making sizable bets on plans and teams whose success is uncertain." But he continues: "If only 1 percent of the funds currently flowing to U.S. nonprofit organizations were in the form of Philanthropic Equity, it would be sufficient to radically alter the growth trajectories of many of the highest-potential organizations in the social sector." What do you think?

We have just come through a wrenching economic downturn. Those on Wall Street seem to have largely recovered. Many on Main Street seem to be on their way. Some, however, are still in dire straits. Among the most dramatically hit are young urban adults emerging from economically challenged households without the advantage of a college education. While the headline rate of unemployment has fallen from its October 2009 peak, for young adults between the ages of sixteen and nineteen unemployment has remained around 25 percent throughout the alleged recovery.[1] For young adults in inner cities, particularly individuals of color, the story is worse. In fact, their chances of finding durable, skills-based employment are below their chances of being incarcerated.

In 2000, an organization was founded in Boston to address this very issue. Year Up is a one-year intensive training program that provides urban youth with professional skills, college credits, and corporate internships. Year Up has proven to be an effective program, and the formerly Boston-focused operation that once served a couple of hundred local kids a year now serves nine communities. It is growing rapidly and with fidelity, and employs a model that sustainably funds operations without dependency on major grant funding. This year, more than 1,300 students will participate in this program. If past performance is indicative, nearly 1,100 of them will likely wind up either with permanent, full-time technical jobs or enrolled in college. How Year Up grew from a local program for at-risk Bostonians to a national solution to a chronic problem is, at least in part, a story of Philanthropic Equity.

What Is Philanthropic Equity, and Why Does It Matter?

Philanthropic Equity is an emerging practice whereby a nonprofit raises grant money to play the role that equity financing would normally play in a for-profit organization. Philanthropic Equity acts as an early-stage investment in an organization, paying the bills while waiting for the business model to kick in.

Unlike for-profit equity investors, Philanthropic Equity investors seek social rather than financial returns, and grants are invested to provide a one-time infusion of capital. And investors have the expectation that the recipient will use that capital to further its business model (rather than to serve its constituents).

How does Philanthropic Equity differ from any other grant? For virtually any nonprofit, there is a revenue "bar"—the amount of money the organization needs to bring in to pay for operations. Philanthropic Equity doesn't help an organization hit that bar. Instead, it *raises* the bar.

Ordinary revenue, as associated with an organization's business model, is money received to deliver the service (or product) a nonprofit provides. It represents a payment to the organization by someone who cares, and can take many forms—a pledge to a local public radio station, federal funds for neighborhood stabilization, a foundation grant to provide services to homeless families, proceeds from the sale of Girl Scout cookies—but in all cases it represents the funding integral to the business model of the nonprofit. These types of ordinary revenue are also known as "buy money," in that they "buy" the programs and services that nonprofits deliver to the clients they serve. *Sustainability* is having sufficient buy money to cover the full costs of doing business on an ongoing basis.[2] The amount of buy money an organization needs each year sets the bar. Every dollar it raises or earns helps to meet that bar. The height of the bar is the full cost of conducting the business for the year.

For Year Up, this buy money comprises government funding for jobs programs, locally raised contributions, and funds from the businesses that employ the interns that come out of the program. This business model can pay for a program on a local scale, but just barely. And these types of revenues can never be sufficient to expand the program into new cities, pay for start-up costs, or create the sort of infrastructure required to manage a national operation. This is where Philanthropic Equity comes in.

Philanthropic Equity is expressly *not* buy money. It is part of a second category of money that can be characterized as "build money." Build money builds the enterprise from which buyers buy services. By raising build money, a nonprofit creates the expectation that it will build, which almost always requires increasing the amount of buy money it generates each year. Build money raises the revenue bar.[3]

VolunteerMatch.org: The Promise of Compelling Social Returns

VolunteerMatch (VM), an early adopter of Philanthropic Equity, operates an eBay-style online database of volunteer opportunities. Individuals log on and search for meaningful ways to pitch in, looking in their communities, in their field of interest, or for ways to use specific skills they possess. Like all marketplaces, the value increases as the number of participants on both sides grows.

VM is also a social enterprise, supporting itself with a combination of fees from corporate participants seeking access to the volunteer opportunities, fees from nonprofits seeking add-on tools for managing volunteering, individual and corporate contributions, and programmatic grants supporting specific aspects of their work. In 2007, these revenue streams collectively funded 58 percent of VM's expenses.

In 2007 VM began a $10 million campaign to fund the expansion and improvement of its volunteer database and associated services. VM's plan sought to both improve the general user's experience and provide tools required to increase the participation by fees-paying corporate and nonprofit customers. The promise was that by the end of investing the campaign proceeds, the business-model revenues would support 100 percent of the enterprise. In March 2011, VM reported that business-model revenues covered 99 percent of expenses in the prior quarter, and the organization continues its path toward sustainability.

How has the investment done? Like all social investments, that is in the eye of the investor. What is clear is that VM is becoming an enduring institution. VM reports that in 2009 over $472 million worth of volunteer services were arranged via VM's service—$178 million more than before the campaign launched. Any way you choose to calculate SROI, that's impressive.

Raising the Revenue Bar

So why would a nonprofit manager want to raise this "bar-raising" money? Often, the scale of a nonprofit is not up to the scale of the problem it seeks to address; sometimes an organization's business model only works when it reaches a certain scope or scale; sometimes a new business model would be more appropriate, and the transition cannot be funded by the proceeds of the existing model; and sometimes it is simply hubris. But whatever the case may be, there are certain freedoms that come with raising both the bar and the money to help reach it. And Philanthropic Equity, in particular, plays an important role in circumstances where other forms of build money cannot deliver the desired transformation. For instance:

- **Long-term investments:** Nonprofit organizations are often reticent to make long-term investments in their capacity. Oft-deferred investments include such things as developing a modern, integrated IT system, hiring a CFO appropriate to oversee the organization they seek to be, hiring fundraisers not likely to pay dividends for a year or two, or developing a modern, sophisticated brand. Each of these requires that the organization's leaders have confidence in the financial strength to pay for them over time. By pre-raising the capital for transformation (Philanthropic Equity), such investments can be undertaken with confidence.
- **Trial and error:** Edison tried over 1,000 ways to make a light bulb. Had he been funded $2,000 by a foundation to make 1,000 light bulbs ($2 foundation dollars per bulb), he would have made 1,000 quick-to-burn-out bulbs with the available technology. By exhaustive experimentation, however, he discovered a combination of filament and design that

Performances to Date of NFF-Supported Philanthropic Equity Adopters					
Campaign Start	Organization	Program Delivery			
		Metric	Baseline	Current	Growth Multiple
2006	GlobalGiving	Project Resources Delivered	$1,684,000	$8,577,494	5.1x
2007	DonorsChoose.org	Student Resources Delivered	$2,600,000	$10,117,000	3.9x
2007	VolunteerMatch	Volunteer Referrals	441,000	677,000	1.5x
2007	Year Up	Youth Served	352	793	2.3x
2008	Ashoka's Changemakers	Direct Innovation Funds Seeded	$7,000,000	$39,400,000	5.6x
2008	VisionSpring	Eyeglasses Sold	35,000	201,000	5.7x
2009	Root Capital	Loans Disbursed	$41,200,000	$56,900,000	1.4x
2009	Stand for Children	Education Reform Victories	15	17	1.1x
2009	YES Prep Public Schools	Students Enrolled	2,008	2,638	1.3x
				Average Growth Multiple	3.1x
				Average CAGR	57%

changed the world. Whether trying to invent a new service model or exploring new business models, we would be well served if nonprofits were able to experiment more. Most grants are so restrictive that they leave little or no room to experiment.

- **Focus on execution:** Building businesses is hard. When executive directors are required to continually fundraise to close the year's budget (or worse, meet the month's payroll), they are unable to focus on the critical challenges of building and running the operations. Abraham Lincoln said that if given six hours to chop down a tree, he'd spend the first four sharpening his axe. Nobody would spend the first four hours raising money to buy a dull axe, but that is exactly what many social entrepreneurs do. Philanthropic Equity allows them to both sharpen their organizational axes and get to work chopping.
- **Simplifying funder relations:** By aligning a group of funders' support with a common plan, shared expectations, consolidated financial output, and outcome reporting, the time and expense of interacting with those funders is greatly reduced.

In the case of our exemplar, Year Up, build money was needed to pay the one-time expansion costs, fund the first few years of each new region's operations until they reached sustainable scale, and invest in the talent and systems required to run a national operation. The hope was that after expansion, the regional sites would be self-sufficient and provide a small amount of money to fund ongoing support from the home office. They are unlikely ever to be sufficiently prosperous to repay the start-up funding, and requiring them to do so would both cast an unhelpful burden on them and create a story not conducive to their ongoing fundraising needs. For these reasons, Year Up raised $19.3 million in Philanthropic Equity to fund their expansion costs.

Does Philanthropic Equity Work?

The appeal of Philanthropic Equity notwithstanding, we should ask whether it works. Does raising and deploying large amounts of growth capital in this manner transform organizations into more effective service deliverers? While early evidence suggests that it does, like so many questions concerning philanthropic efficacy this is hard to answer with certainty.

For most grants, an organization is expected to deliver a specific set of services, or spend money in a particular way, or invest in building very specific capacity. Answering the question of whether an organization has done so is fairly straightforward. Having concrete objectives and completing those objectives during the term of the grant make for generally measurable results. In the case of Philanthropic Equity, however, the funds are substantially unrestricted, and the desired result is a sustainable organization supported by other revenue over long periods of time, making results rather harder to measure.[4]

Nonprofit Finance Fund (NFF) Capital Partners has been working since 2006 with a small number of organizations to raise and deploy formal Philanthropic Equity, and they have tracked their results (see table, above). While these organizations do not represent the entire universe of Philanthropic Equity, they are probably the most clearly defined group using the methodology. In our last annual survey of their results, we found remarkable outcomes since the application of Philanthropic Equity:[5]

- 57 percent average annual growth of each organization's primary program delivery metric;
- 36 percent average annual growth of business-model revenue (which excludes Philanthropic Equity);
- 100 percent of participating organizations expansion of both service and business model revenue.

These results are even more remarkable when seen in the context of the broader environment. The time frame of the analysis (2006–2009) spans the most dramatic economic downturn in our careers. During this period, 30 percent of all nonprofits reported declining revenue, and 98 percent reported growth below their mean.[6] Also worth noting is that these are early days—none of the nine organizations in our cohort has completed its growth plan or depleted its growth capital.

Will they all reach sustainability and deliver on the promise? Probably not. But no venture capitalist would expect all investments to pan out as planned—in fact, only a small minority typically do. Philanthropic Equity is about making sizable bets on plans and teams whose success is uncertain. As it turns out, better than half of this cohort are tracking very well against their respective plans, with six of the nine having a higher level of sustainability than at the beginning of the period; the other three had a drop in their sustainability. As most of the nine had planned for an interim dip, however, even for those three this may not necessarily be a sign of weakness.

Anecdotally, other Philanthropic Equity investments seem to be delivering similarly well. Citizen Schools (see following page) is one of three organizations in a cohort that the Edna McConnell Clark Foundation (EMCF) calls the Growth Capital Aggregation Pilot. While these three organizations' funding relationships, terms, and grant structures are distinct, their investments bear hallmarks of Philanthropic Equity. As with the NFF group, these organizations are, according to their recent reporting, transforming themselves to great effect.[7] The other notable success story is the $60 million of early-expansion capital Wendy Kopp raised for Teach For America. There are likely other examples, both of success and failure, of which we are not yet aware.

Adoption Challenges

So, if Philanthropic Equity is so promising, why isn't it being adopted everywhere? There are four primary challenges to building support for Philanthropic Equity among grantmakers:

Orthogonal strategic and tactical demands. Giving away money turns out to be complicated. Most grantmakers are extraordinarily attentive to a handful of dimensions of their grantmaking and have thus far shown little appetite for adding yet another. They each focus on a subset of an organization's theory of change, its size or stage of growth, its geographic footprint, participation in various groups, etc. Then, they layer on their internal considerations (timing, payout, precedent setting, etc.). Thinking through the question of which grants are about buying and which are about building seldom trumps (or rises to the level of) these other issues as a priority for program officers, foundation presidents, or their boards. And so it will remain until the transformative potential of Philanthropic Equity investments ignites grantmakers' imaginations as a tool for closing the gap between "What are we trying to do with our grants?" and "What are we trying to accomplish in our community?"

Comfort with the norm. Ingrained habits are persistent. Grantmakers and grantees have developed a sort of muscle memory around their cycles of giving and asking. In the high-stakes realm of a primary funder relationship, grantees are reticent to upset the applecart. Grantees have learned to speak the language their program officers want to hear about the transformative impact of their grants. It is an effective fundraising approach to cast an organization's program as a critical cog in the strategy of each funder, encouraging funders to think of the organization as an extension of their strategy. Philanthropic Equity turns the tables, putting the operating nonprofit in the center of the solution and asking funders to align in support of a single strategy. One can readily imagine how reticent an executive director might be to ask a large potential funder to come along on this shift; it is far easier to dance the dance that has worked in the past.

Aversion to collaboration. Collaboration is hard. Effective Philanthropic Equity requires investments on a scale individual funders are seldom equipped (or willing) to provide. Most foundations are unaccustomed to relying on other funders' participation for achieving success.

George Overholser of Third Sector Capital Partners describes what is required to solve these second and third challenges as a "Copernican shift," whereby funders cease to be the center of the system, instead coalescing around a well-anchored program. The consequences for the grantor–grantee relationship are challenging enough; the perhaps less-obvious consequence is that among funders. This shift becomes powerful only when multiple funders align their support toward common ends. This sort of collaboration is yet another challenge for the adoption of Philanthropic Equity. At the very least, the collaboration can be uncomfortable—going through the process of discovering with whom to collaborate, assessing the collective needs and objectives, and reconciling the various timelines is a potential nightmare. With so many other pressures, the payoff would need to be both obvious and substantial.

Citizen Schools: Syndication in Action

Citizen Schools has long been a grantee of the Edna McConnell Clark Foundation. In 2007, EMCF organized a coalition of funders including ArcLight Capital, The Atlantic Philanthropies, Bank of America Charitable Foundation, Josh & Anita Bekenstein, John S. and James L Knight Foundation, Koogle Foundation, The Lovett-Woodsum Foundation, The Picower Foundation, Samberg Family Foundation, Skoll Foundation, and the Citizen Schools Board of Directors to collectively fund Citizen Schools' $30 million growth plan. This program is one of three such collaborations EMCF calls the Growth Capital Aggregation Pilot (GCAP).

Defining characteristics of the GCAP are: (1) upfront, unrestricted funding; (2) support for a business plan designed to provide sustainability after the end of the grants; (3) common terms and conditions; (4) shared approach to performance measurement; and (5) transparency and shared learning.

Why the grand coalition? As EMCF reports, "Successful grantees require more support than EMCF alone could provide if they were to solve at sufficient scale some of the nation's most intractable social problems." By 2012, Citizen Schools plans to annually serve over 6,700 middle-school students from low-income communities, bringing volunteers' real-world experiences into their classroom.

Inappropriate accountability tools. Accountability conventions run contrary to Philanthropic Equity. The current standard of funder accountability requires regular reporting of the outputs of individual grants, with ongoing support contingent upon those results. Philanthropic Equity requires a commitment in anticipation of results over much longer time horizons, and with much different measurability. Foundation professionals are under considerable pressure to ensure their grants' effectiveness. In attempting to do so, conventions for grant accountability have arisen, including highly restrictive grant conditions, performance-tracking regimes (often wishfully described as outcome tracking), and processes for making further support dependent upon initial results. While any of these conditions might be well intended, they are incompatible with the notion of providing a team and a plan with flexible, committed resources required to foster success. In the for-profit analog, equity funds are provided irrevocably for "general corporate purposes" and in very large rounds of financing. Venture capitalists know they cannot hedge their risks by overly constraining or managing investments once they have decided in whom to invest. Foundations frequently attempt to do just that.

The Future of Philanthropic Equity

What would it take to overcome these challenges and for Philanthropic Equity to really take off? The short answer is, we don't know. In 2006, as we were laying out the objectives for NFF Capital Partners, we set a goal of witnessing $300 million in Philanthropic Equity investments. We thought such a volume would create an array of success stories that would induce the field to take off with a life of its own. At the time of this article, we have seen more than $340 million, and yet no unstoppable movement is in sight.

Along the way we have also learned a fair bit about how hard all of this is. For all participants, Philanthropic Equity is a high-stakes endeavor. Even now, after several hundred investments have been made in a dozen and a half deals, each feels like a one-off experiment. The vast majority of funders require specific support to participate. Terms are becoming more standard for the deals NFF supports, but still require tailoring to each situation. Measurement and comparison are complicated and challenging.

Perhaps most surprising, only a very few funders have become actively engaged in working out the process challenges of Philanthropic Equity investments. Similarly, with the exception of the EMCF-led Growth Capital Aggregation Pilot, investments have been coordinated by the recipients rather than by a syndicate-leading foundation. Widespread adoption will require that a collection of funders periodically play leading roles, and that more formal syndicates become the norm.

To the extent that a consensus is building around Philanthropic Equity practices, those practices reside with only a small cadre of practitioners. Perhaps the best potential for easing the process and standardizing the practice lies with the adoption of appropriate reporting standards. Today, GAAP accounting standards for nonprofit organizations do not provide for measurement of equity investments. Tools have been created to work around those constraints, and they are successful. They are not, however, uniform. For real transparency and comparison between applications, common standards are required. These should not be expected to emerge organically; regulatory support is required. Imagine how much less resistant foundations and the nonprofits they support would be were they able to rely on standards from FASB and guidance from the IRS about how to handle such investments.

What would a vigorous market in Philanthropic Equity look like? Would all grants become build-money investments? Absolutely not. In all of the examples we've seen, the total need for equity investments is small relative to the ongoing buy money each organization needs. Given the desire for organizations to be sustainable after the investments are consumed, it could hardly be otherwise. Further, many nonprofits do not have significant need for equity investments—either they are not seeking significant transformation, or the economics of their plans do not require significant capital beyond their own means. Of those that do, a significant portion have economics so predictable and strong that debt is an easier path to funding. If only 1 percent of the funds currently flowing to U.S. nonprofit organizations were in the form of Philanthropic Equity, it would be sufficient to radically alter the growth trajectories of many of the highest-potential organizations in the social sector.

What impact might that change have? Asking that now is perhaps akin to asking Wilbur Wright what impact the now ubiquitous jet-powered flight might have. He couldn't possibly have known, but it's fairly certain he thought it was worth finding out.

As for Year Up—having used up most of their $19.3 million in Philanthropic Equity, they now have active programs in nine cities. Sustainability on business-model revenue is near, although the economic environment has been less than helpful. Demand for the program is stronger than ever. Did Philanthropic Equity help? At the time of this article, Year Up was well under way, with a $55 million campaign to fund further expansion and program improvement. Among the anticipated funders are several participants from the first campaign. Having both Year Up and their equity funders choose to double down is about the strongest endorsement I can imagine.

Notes

1. Bureau of Labor Statistics (www.bls.gov), September 2, 2011.
2. Note that buy money includes both earned and contributed revenue. The distinction between the two, while important to accountants, is unimportant to our characterization of buy money, or its counterpart, build money.
3. Other types of build money include more conventional forms that anticipate repayment of the funds somewhere down the road. These are financial-return-seeking investments. Debt is in this category, as are recoverable grants—esoteric instruments intended to behave like for-profit equity, deferred compensation of staff, and, in some dire circumstances, receivables factoring.
4. Among the prerequisites for the propagation of Philanthropic Equity is the practice of systematically measuring results. NFF conducted a study monitoring the progress of its clients adopting formal Philanthropic Equity treatment (called the SEGUE methodology). The study does not purport to provide a comprehensive view of all Philanthropic Equity currently deployed in the field. Such a comprehensive view would require both widely accepted standards and an impartial third party to monitor progress. At this point, both accepted standards and an impartial monitor enjoy a high ratio of talk to action.
5. *NFF Capital Partners 2010 Portfolio Performance Report* (http://nonprofitfinancefund.org/capital-services/portfolio-performance-report) reports on the progress of nine Philanthropic Equity users for whom multiyear data are available. Results represent the mean of data collected from these organizations.
6. Based on an NFF analysis of GuideStar 990 data.
7. The Edna McConnell Clark Foundation, "Growth Capital Aggregation Pilot," http://www.emcf.org/how-we-work/growth-capital-aggregation-pilot/

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Social Entrepreneurship and Social Innovation: Are They Potentially in Conflict?

by Ruth McCambridge

When implemented wisely, social innovation is a positive approach to nonprofit growth; but most current practice falling under that rubric tends to invest primarily in one organization or program. Wouldn't investment in infrastructure be far more valuable to development of the sector overall?

The phrase "No matter who you are, most of the smartest people work for someone else," is known in the high-tech industry as "Joy's Law." It articulates "the essential knowledge problem that many enterprises face today—that is, that in any given sphere of activity, most of the pertinent knowledge will reside outside the boundaries of any one organization, and the central challenge for those charged with the innovation mission is to find ways to access that knowledge."[1]

In a political, social, and economic environment that is in enormous flux, it is right and necessary to look for new ways to address social problems. When the context shifts this decisively in so many ways, it creates dynamic complexity, and we have to remain nimble and intellectually curious enough to make wise choices about the structure, content, and direction of our work. The fields of health, housing, education, and senior care—to name a few—are being challenged by profound external factors. And that very disruption provides burning platforms all around us and opportunities to organize ourselves and our work differently—in other words, to innovate.

NPQ would like to make the case—not for the first time—for questioning the arguments for scaling "innovation" via support of a single organization, and promoting, instead, systematic innovation and field advancement through strong field networks. That is, a system that promotes distributed innovation with an overarching architecture that captures, develops, and advances promising new ideas across a whole field of practice rather than just one group.

But first we should clarify our terms. We see the terms social innovation and social entrepreneurship used somewhat interchangeably, or at least in ways that are linked; but we believe they are not *inextricably* linked, and we would like to uncouple them in order to address the idea of promoting innovation separately from the idea of entrepreneurship.

Because, really, you do not necessarily need a new idea to be an entrepreneur—you just need to figure out the packaging that will sell a product to the buyer in a way that builds an institution. The most common definition of an entrepreneur is "one who organizes, manages, and assumes the risks of a business or enterprise." We believe that this is the way most Americans understand the term. Entrepreneurs open up pizza places and spas, and build carpeting emporiums—none of which is especially innovative; and even when they do base an enterprise on a new idea, that idea can have questionable value for the world at large. For instance, entrepreneurs sometimes figure out ways to build a business based on monopolies and overpromising results, which do of course have an element of innovativeness—at least as far as marketing is concerned. And even if the consumer's desired results can be seen in the short term, the unanticipated consequences are often acute, like those diet pills that begin in weight loss and end in a heart attack, or the fast food that starts with cheap tasty meals and ends in national obesity levels unprecedented in human history.

Thus, as Fredrik Andersson notes in his article "Social Entrepreneurship as Fetish" (published in *NPQ*'s summer 2011 issue), "While certain forms of entrepreneurial activity are undoubtedly very positive and productive, there are other activities that tend to be unproductive—and some are even destructive. Consequently, this plurality of forms 'reminds those engaged in the research, practice and policy planning of entrepreneurship that entrepreneurial activities are not fundamentally "good" and should be examined in their entirety.'"

Entrepreneurialism is entrepreneurialism—it is about packaging and promotion, and not necessarily the promotion of a new or inherently good idea. Conversely, innovation is not just different from entrepreneurialism—it can be entirely unrelated. Take, for instance the artist that starts an entirely new school of painting but ends his or her life in obscurity—this is innovation, but the artist may not have had an entrepreneurial bone in his or her body.

Innovation basically results from experimentation, and it can come from just about anywhere in a system. The urge to experiment occurs when we see that something might work better if approached in a way that is either slightly but strategically different or radically reframed. Sometimes, innovation occurs when you look at things in a different environment than you have previously, or when you bring different disciplines to bear by talking to colleagues in other fields.

And it is the nature of the beast that many innovations will eventually be supplanted by others. They will be embroidered upon for a while, integrated into a new environment that changes our perspective on them, measured and found wanting against some other new approach, challenged for an unanticipated consequence, and then sometimes scorned as antiquated. The environment, however, may or may not be supportive of those additional iterations.

That is what innovation is all about—progress is rough stuff.

NPQ has run a number of articles over the past year that push back at the idea that the best method for advancing social innovation is to invest heavily in one organization in order to "scale up" its work. Specifically, we question whether that model of "closed innovation" is the best one for advancing more effective responses to social issues, and suggest that it might even be antithetical to advancing innovativeness in the sector. Perhaps ensuring that the aggregation of distributed knowledge and ideas into a curated "marketplace of genius," as one business entrepreneur termed it, would make more sense.

[W]hat we observe to be happening in the funder approach to social entrepreneurship in the U.S. sector right now, is that already well-funded organizations with great marketing capacity and social capital to spare have been perhaps overcapitalized—arguably well past the real value of what they add.

In this changing landscape of nonprofit finance, we would like to see funders investing in local experiments and infrastructures for some of the fields in rapid development right now. We would like them to ensure that research is being done about all types of interesting experiments that have been tried, that the research is circulated, and that practice is then built out of the learning of many projects in many diverse settings rather than just a few. This is occurring notably in some fields but not in others. And even in fields where there is strong research, it would be useful to have more.

Where good networking is occurring between local entrepreneurial groups, you not only can derive good enabling policy outcomes at the federal and state levels—because you have local examples and relationships—but can also continue to develop the field over time with challenges to status quos, because change in the field can happen on the margins first and then flow into the center, as well as the other way around. You have more autonomy, and that is what you need if you value innovation. Social entrepreneurship scholar William Gartner sees this type of broad-based investment as a kind of "critical mess," where you have some trash from which you learn as well as some treasure that you keep. But what we observe to be happening in the funder approach to social entrepreneurship in the U.S. sector right now, is that already well-funded organizations with great marketing capacity and social capital to spare have been perhaps overcapitalized—arguably well past the real value of what they add. This has then "crowded out" the other approaches being tried by less well-funded and sometimes very local organizations.

And once tens of millions of dollars have been invested in one organization, what will the willingness be to reverse that course, even if it is clearly falling short or failing or causing unanticipated harm to communities or community infrastructures?

Note

1. http://www.mitpressjournals.org/doi/pdf/10.1162/itgg.2007. 2.3.97.

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Habitat for Humanity: The Evolution of a High-Performing Nonprofit Network

by Rick Cohen

Habitat for Humanity International struggles to find the right balance between staying true to its mission and surviving—and even thriving—in the years ahead. But the network's thrust to sustain and improve upon performance has meant rethinking its brand, cautiously exploring social innovation and entrepreneurialism, and even (more cautiously) trying out government funding. Despite the challenges, Habitat affiliates agree that in order to move forward they must evolve. As one affiliate opined, "We cannot allow the grass to grow too long under our feet."

High-performing organizations do not all look alike. The measure for one might be output; for another, impact; for a third, synoptic leaps in efficiency. Missing from most literature is the turbulence surrounding the political and economic environment that compels truly stellar nonprofits to continuously adjust, adapt, and change. Habitat for Humanity International is an example of an unusually high-performing organizational network facing the challenge of constant learning and adaptation to the complexities of operating in diverse cities and nations, while holding true to an identity at the nexus of their faith-based mission of creating affordable homeownership for those in need.

Like many of the largest nonprofit organizations in the United States, Habitat is actually a network of organizations. The Habitat groups are unified to the extent that they share a common operational model, but the diversity of the network allows for individual groups to generate new ideas and hone new techniques, which then spread throughout the network. Successful nonprofit networks capture innovations that develop within affiliates on the periphery. Vibrant nonprofit networks like Habitat learn from their members and capture and diffuse innovations developed and tested in the field as opposed to those generated and disseminated through top-down dictates.

Earlier this year, some sixty executive directors of local Habitat for Humanity affiliates responded to a half-dozen questions on the political and economic challenges they face. Their answers were hardly uniform but they reflect how the constituent members of a geographically far-flung network try to sustain and improve upon their performance.

Not Your Daddy's Habitat

Remember that volunteer Habitat effort in your town, mobilizing church members and potential home purchasers to roll up their sleeves and build a modest, affordable home (sort of like a modern, frequently urban barn raiser, except that instead of a barn the product was a home for a family in need)? While still volunteer and faith based, the Habitat network is large, international, and influential. And most of the public—and perhaps even much of Habitat's internal constituency of board members and staff—may not fully grasp Habitat's reach. As one Habitat affiliate CEO told us, "When I moved to my current affiliate eight years ago, I had to put on a little show I called 'We're not your daddy's Habitat' to get people's attention that we were willing to embrace change."

As members of a strongly grassroots network, Habitat's local executive directors are grappling with how to remain true to Habitat's mission of service to the poor while adjusting to policy challenges such as the home mortgage foreclosure debacle that vaulted to the top of the nation's consciousness in 2008, as well as rethinking their brand, adapting to a new charitable language and syntax of social innovation and entrepreneurialism, and exploring new funding options. According to one affiliate executive director, "The double-edged sword is the reality that we're thirty-five years old and still building new houses with volunteer labor. The new houses are great and we know how to do them well, but it's hard to keep that process shiny."

Modern Habitats

Habitat for Humanity is rather more complex, multifaceted, and dynamic than its usual description as a simple, local, volunteer-oriented and sweat equity–dependent homebuilder for those in need. Some may recall that the Habitat organization is tied to a faith-based mission, but that mission, often translated in the public's understanding into a vision of tiny, local, one-house-at-a-time faith-based builders, fails to convey the size, scope, and complexity of the Habitat for Humanity International network.

For one thing, although the active involvement of former president Jimmy Carter and his wife, Rosalynn, gives Habitat something of an American cast, the Habitat network is global, with the bulk of its construction work in FY2010 occurring outside the United States and Canada. Of the total 74,960 families served by Habitat in 2010 around the world through new construction, rehab, or home repairs, only 6,707 (8.9 percent) were in the United States and Canada, as opposed to 29,617 (39.5 percent) in Asia and the Pacific, 24,939 (33.3 percent) in Latin America and the Caribbean, and 10,888 (14.5 percent) in Africa and the Middle East.

For another, Habitat has moved from localized volunteer construction to responding to regional and national issues. For example, Habitat made a major effort in responding to Hurricane Katrina. Five years after Katrina, Habitat had built 2,219 new homes in the Gulf Coast region, repaired another 994, and helped clean out an additional 2,500 in preparation for rehabilitation. Within a few years of Katrina, Habitat had turned its focus elsewhere: to the nationwide mortgage foreclosure crisis, building on its incipient funding relationship with the federal government (Habitat had received $35 million in HUD Section 4 capacity-building funds between FY2001 and FY2009) to volunteer for a major national role in carrying out Neighborhood Stabilization Program efforts to rehabilitate bank-foreclosed properties.

In 2009, with 5,294 housing closings, Habitat joined the ranks of the top ten homebuilders in the United States, just behind Hovnanian Enterprises and just ahead of the Ryland Group. It may be that Habitat's rise reflects the recession slowdown in the market for commercial builders, but it also mirrors the growth in Habitat productivity and effectiveness in responding to the continuing need for affordable owner-occupied housing.

As a complex network of grassroots organizations, Habitat is likely to face continuing challenges in the years ahead, particularly as charitable and government funding shrink in the face of a national economic recession that is hardly disappearing. But the network seems to have adapted to the environmental turbulence of the national and international housing development market, suggesting not only that it is here to stay but also that it may very well thrive.

A Valuable Brand

In 2009, Habitat for Humanity ranked as the seventh most valuable nonprofit brand in the *Cone Nonprofit Power Brand Top 100* list. The arcane methodology placed a value of $1.768 billion on the Habitat brand. The Cone report described Habitat as "an organization with great momentum due to the tangible opportunity it provides for people to roll up their sleeves and take part in the construction of one of life's basic necessities . . . [plus] a far-reaching network of ambassadors and advocates including celebrities, politicians and companies who provide support and help it earn extensive media coverage and recognition."

Habitat actually ranked even higher—fourth—in brand image, the mix of inchoate factors such as public perception, consumer familiarity, media coverage, and volunteer base. It adds up to an image (or brand) that is basically one of somewhat faith-based, volunteer do-gooders, epitomized by the Jimmy and Rosalynn Carter Work Projects in places as diverse as Birmingham, Alabama; the Twin Cities in Minnesota; Seoul, South Korea; and Durban, South Africa.

But Habitat brand's being well-known and valued sometimes counts against it. An overseas affiliate's executive director noted that "one significant funder . . . believes our balance sheet is too strong to warrant their support and commented that we would be the envy of many of the charities they do support. Others do realize that we are asset rich and cash poor and continue to support us. . . . [But some] trusts and foundations . . . feel that we assist too few people for the dollars involved to justify their support, i.e., our 'bang for the buck' is not big enough." Habitat's faith-based language resonates with charity, with slogans over the years that motivate individual donors and tithers but not necessarily government and foundation investors: a "hand up, not a hand out"; "Habitat builds homes"; "building community, one house at a time"; "building hope, one family, one home at a time." According to another affiliate director, some donors, businesses, and foundations just hear "charity" even if the Habitat product is one of fighting poverty, creating assets, and building community.

At the same time, it is difficult to get government officials, foundations, and the public to adjust their perceptions. An executive director comments, "I am always amazed at the number of people who think they know what the mission of Habitat is only to be surprised when they find out families put in sweat equity and assume a mortgage." At the same time, foundations and government agencies hear about the sweat equity and additional volunteer labor and do not grasp the fundamental economics of property acquisition and construction costs that make the housing costs expensive, notwithstanding the "free" labor components—economic factors that should spur foundation and government subsidies to reduce unit construction costs.

Habitat's being a faith-based network is an additional factor that counts against it, even though, like many providers that are faith-based in their origins, Habitat affiliates are increasingly secular—or at least nondenominational—in their operations. Foundations typically give little to religion, not just because of the foundations' missions and restrictions but also because of a belief that religious groups are relatively well supported by individual contributions, with upward of a third annually going to religious groups. As one executive director put it, "the 'ministry' and Christian concept can be hard for some to buy into."

Another stumbling block for foundations is the perception of Habitat's narrow focus on housing. According to one Habitat director, "the common argument that we hear is that we spend $65,000 'helping one family,'" though when Habitat gets beyond its role as a housing organization and talks about family outcomes and family assets, the rationale has to change from a per-house subsidy to a support for families and community building. These are the programs—and the measures—that Habitat is exploring through its Neighborhood Revitalization Initiative (NRI).

The Habitat program appears to be an attempt to reposition governmental agencies and foundations—and the members of the Habitat network themselves—to see Habitat for what it really does: build and transform neighborhoods. Habitat's NRI brings the network's message up to date with what Habitat actually achieves for the families and communities it assists through its Build Louder advocacy campaigns, its efforts to strengthen security of tenure for poor families (a huge issue for Habitat families in developing countries), and its emphasis on the housing and poverty problems of women and children.

Social Innovation and Entrepreneurship

Habitat's aspirations to high performance are based on the adaptation and replication of its small-scale volunteer model fitted to multiple cities and countries with different political and economic contexts and systems. The mission and model are still there, but the challenges are constantly emerging.

Habitat executive directors see themselves as continually adjusting to a world that requires change and adaptation. When asked where they saw themselves fitting with respect to the language of social innovation and social entrepreneurialism—and what might be the obstacles that social innovation and social entrepreneurialism present to Habitat—one of the respondents summarized the challenge of social entrepreneurialism in a broader framework:

> We are changing with the times, no matter what you label it. . . . [W]e are organizing neighborhood cleanups, and we are organizing service clubs to go out and change light bulbs/smoke alarm batteries/furnace filters so that elderly homeowners don't fall. This was necessitated by the downturn in the economy and to make sure we honor the "safe, decent, and affordable" mantra we repeat every day. If we don't adapt, we die. The question for us then is, what is the best new path? But adapt how?

For some, it is a matter of changing Habitat's business model from its historically low-pay, volunteer base to a more modern nonprofit operation: "The NGO sector needs to think more commercially when it comes to hiring staff, for example. Rather than paying peanuts and hiring monkeys, the sector needs to be smart in hiring appropriately qualified people to get the job done efficiently and effectively."

For others, it is a matter of pushing at the boundaries of Habitat's program definition and asking whether the model and the resources can accommodate certain kinds of change: "I think we have no choice but to embrace social marketing, etc. It is very hard for many of us to begin to even understand how it works. It's important to segment our population into those groups that respond differently to new media. . . . The older we are the harder it is for us to see the potential and value of social entrepreneurship."

But to some, "entrepreneurial" is in fact an apt description of the reality of nonprofit Habitat community developers, though Habitat tends to do little or no entrepreneurial self-promotion. For example, one Habitat affiliate director said, "I think Habitat has been [made up of] entrepreneurs since the beginning. What else do you call real estate developers, mortgage companies, and retail establishments?" Another added, "I strongly believe that the ability of nonprofits to quickly respond to environmental changes makes us social innovators . . . which should be highlighted more than it is now."

Is Habitat truly entrepreneurial? Many Habitat executive directors cited the ReStore resale outlets operated by Habitats around the nation as a tangibly entrepreneurial addition to the Habitat model. ReStore accepts donations of reusable and surplus home accessories, building materials, and appliances, and sells them to the public at very low cost. All of the sale proceeds fund local Habitat home construction. Because of the public's common misperception of "entrepreneurial" as "commercial," many affiliates look at the ReStore operations as Habitat's "main concept of social entrepreneurialism . . . [with a] niche market . . . [that] ensures we are different from Goodwill and the Salvation Army while meeting Habitat needs." And, "ReStore makes us entrepreneurs," according to another.

But Habitat clearly struggles with the idea of entrepreneurialism's being equated with self-sufficiency. "It is through our ReStore that we are self-sufficient. More emphasis needs to be made on ReStore advertising, donations, and making ReStores profitable," suggested one respondent. Taking a diametrically opposite view, another said, "Habitat can reposition itself by changing the language of ReStore without changing the business model. The downside is that donors may move our funding requests to the bottom of the pile because we have a successful revenue stream. We will need to be clear that the ReStores do not, and cannot, completely fund our mission."

In the Habitat network, innovation is emerging from the local affiliates within the network, like the ReStore model. The reality of social innovation is that when practiced as more than public relations, it bubbles up from the field and is not imposed top-down. Habitat execs described programs already under way with local Habitat affiliates, such as A Brush with Kindness, Apostles Build, and Women Build, as "new ways of addressing social problems with innovative approaches." And, as some respondents proudly noted, rather than being a program crafted and promulgated from Habitat's international headquarters in Americus, Georgia, the ReStore model was created, tested, and adapted by Canadian affiliates and then replicated widely throughout the Habitat network.

While the affiliates are innovating as a matter of function and survival, the challenge may be for the Habitat higher-ups to talk about social enterprise and do better external marketing of ReStore—broadening the concept of Habitat to include the "holistic outcomes" it achieves in addition to the core "Habitat builds houses" identity. National (or international, in this case) Habitat executives have to sell the message within the network that innovation and risk taking are to be encouraged. As a Toronto respondent said, "We need to top the wonderful Canadian idea of the ReStore. . . . We are due for another."

One affiliate executive director concluded, "Within the constraints of the ministry, we must view ourselves not only as creative problem solvers but also as risk managers and innovators, if we are to navigate our ever-changing seascape." The challenge is for the Habitat network to look for and encourage the generation of innovations and adaptations based on models being formulated and tested by local affiliates, particularly those affiliates that interact with other non-Habitat players in the housing and community development field and get to benefit from "adjacent possibilities." That is the value of a high-performing nonprofit network.

Government Funding

One area of change in the network has been Habitat's cautious but begrudging acceptance and utilization of government funding. Direct government subsidy was anathema in the early Habitat model, but that has changed over time. Habitat has become a mission-focused participant in federal programs to and through local governments, accepting and using direct subsidies, such as financing and grants, and indirect subsidies, such as the provision of tax-foreclosed and other government properties. One Habitat affiliate executive director described an example of a successful partnership with one specific government program:

> Our biggest success was in the Neighborhood Stabilization Program (NSP). Thanks to HFHI [Habitat for Humanity International], we were ahead of the issue and asking our State Housing Authority what the program would look like before they even got the money or the rules. This put us at the table during the formation of the program. We worked with our local grantee and sub-grantee, and together devised a plan where our role fit best as a "developer" and user of the funds. Being at the table during the program design process and being patient during the process were key steps to eventually using these funds to double the number of homes we could sell last year.

Unlike other comparable nonprofit housing and community development networks, however, Habitat doesn't appear to be beholden to government funding. A third or more of the respondents said that their affiliates do not use government funds, finding the strictures surrounding the uses of funds to be too constraining and inflexible. Even those that tap into federal programs expressed some dismay with the process, particularly the chaos that enveloped some of the new stimulus programs:

> [The] rules changed in the middle of the game—that was very frustrating! The amount of documentation for some funds is tremendous, confusing, and time-consuming. We have one person in our office who has become the local "expert" and is

> constantly checking with others to make sure we are interpreting information appropriately. This requires staffing that could be effectively used elsewhere, and there are some funds we do not pursue because they are just too time-consuming and the return is too small.

The Habitat model's high performance is based in large part on the fact that all of its affiliates, while sharing a basic, core model, do not have to march in lockstep to the tune dictated by national (or international) Habitat leaders. Rather, the affiliates assess the opportunities and make decisions about what works in their contexts, and so some can and do spurn opportunities for government subsidy. One affiliate director expressed the challenge in bold terms: "I steadfastly disagree that we 'have no choice but to make [government programs] work.' We do have choices, and one of those could be to not accept government funding. The increasing requirements are oppressive and at times impossible. It has become a return on investment exercise—are the requirements worth the money?"

For others, such as an affiliate director who uses HOME Investment Partnership Program funds for property acquisition, demolition, down payment assistance, and closing costs, the calculus is straightforward: "Quite simply, they have the funds, they make the rules, I give them what they want/need as far as paperwork to make the program work for all parties." Another affiliate director suggested that Habitat's added value is part of the government program calculus: "We'll use anything that is put in front of us, that is the simple truth. But we'll do it faster, better, and cheaper than any and all other programs because of the great leveraging ability we have to utilize volunteers and other funds."

Moving Forward

Clearly, Habitat is a much more dynamic network than the rather simplistic image its very valuable brand today conveys. As a result of its now decades of experience building owner-occupied housing for people with little other than their own sweat as a potential home down payment, Habitat confronts a situation where it is one of the few housing and community development networks with a reach into thousands of low-income urban and rural neighborhoods across the nation, and, as a result, is being turned to for much more than small, volunteer-led projects. In order to move forward, Habitat may have to resolve the challenge of whether it wants to mobilize the entire network toward larger-scale initiatives or fundamentally maintain its diverse current structure of varying kinds of local affordable housing efforts. Moreover, it has to address whether it wants to be viewed as, fundamentally, a producer of affordable housing, or think of itself and become perceived as having a broader, cumulative impact in fighting family poverty.

Habitat's own promotional materials, as one executive director said, portray Habitat as "more construction-centric and less family-centric than I'd prefer." And according to another affiliate executive director, "In many communities we are seen as a small player in the affordable housing world, and that it takes significant dollars per family served. The foundations who see Habitat as a movement that engages large numbers of people in addressing poverty housing are more willing to fund our work than those who simply see us as an affordable housing provider." A third executive director noted, "We have not successfully converted our image from something that helps individuals versus affecting system change. When we get to the latter, it's easier to attract funding."

To attract funding, organizations and networks have to evolve, adapt, and innovate, but does the language of social entrepreneurialism and social innovation accurately fit and describe the evolution of Habitat for Humanity? With a huge number of diverse affiliates, the issue may be a matter of understanding and living the social entrepreneurialism of a high-functioning nonprofit rather than cloaking the operation with new buzzwords that mean little to Habitat executive directors.

As a Habitat executive director from New Zealand, who may have been less than excited with what he called the social enterprise "catchwords floating around at present," suggested, "Habitat needs to search for additional ways of delivering its mission objectives with focus on these new ways of being financially sustainable—even better, profitable." As he put it, "I don't personally believe our affiliate region would associate very well with this verbiage as a 'marketing tool.' We are a Christian ministry, and our region is strongly supportive of that paradigm. At the same time, I believe that we as affiliates should constantly be pursuing an innovative and entrepreneurial approach to our ministry. We cannot allow the grass to grow too long under our feet. We have to be reinventing ourselves and keeping a fresh face on our work so that our community stays connected to what we are doing."

Rick Cohen is the *Nonprofit Quarterly*'s national correspondent.

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Does My Nonprofit Need to Pay Tax? Understanding Unrelated Business Income Tax

by Judah I. Kupfer, JD, LLM

While nonprofits are, generally, tax-exempt, they must pay income tax when operating outside the scope of their exempt purposes. But determining what are an organization's exempt purposes is not always as clear as one might think, and distinguishing between related and unrelated activities can be tricky. There are clear rules, as well as several exceptions to those rules, that can help guide an organization in the right direction. But, as Kupfer underscores, while this article outlines key concepts of UBIT, "specific advice should always be sought from a competent tax counsel."

Editors' note: *This article was originally published as a feature on* NPQ*'s website, on September 15, 2011.*

If there is one thing that people know about taxes, it is that tax-exempt organizations don't pay federal income tax. That seems simple enough. After all, if they had to pay tax, they wouldn't be "tax-exempt," right? Well, not always. While it is true that under most circumstances tax-exempt organizations are not subject to a corporate level income tax (as their taxable entity counterparts are required to pay), there are times that they *will* be subject to income tax—in this context known as the Unrelated Business Income Tax, or "UBIT" for short.

Much to the dismay of business owners, corporations and trusts pay income tax at the corporate/trust level. To ensure that tax-exempt organizations aren't given an unfair advantage over their corporate/trust counterparts, Congress added the UBIT rules to force exempts to pay their fair share when engaged in commercial activity outside the scope of their exempt purposes.

The laws surrounding UBIT are complex. This article is not meant to cover all scenarios but is intended to provide an overview and alert readers to potential UBIT issues. Competent tax counsel is recommended for further detailed questions. In addition, the IRS's *Publication 598*, which describes the UBIT regulations, is a handy resource.

When Will an Organization Pay UBIT?

UBIT rules require a tax-exempt organization to pay income tax when the organization regularly carries on a trade or business that is not substantially related to the organization's exempt purposes. Let's discuss each of these elements separately.

To be subject to UBIT, first, the organization has to carry on a trade or business. This is pretty self-explanatory, but to be clear: trade or business will usually involve the sale of goods or services in exchange for money or something else of value for the purpose of making a profit.

Second, the trade or business must be *regularly* carried on. This means it takes place frequently or on a continual basis similar to the way the activity would be carried on by a for-profit business. (Even a seasonal business can be considered regularly carried on, regardless of the large gaps of time between sales.)

Third, the trade or business must not be substantially related to the organization's exempt purposes. In other words, the activity must not contribute importantly to accomplishing the organization's exempt purposes. What are its exempt purposes? This gets a bit more complex, so let's take a step back and review some background.

At the time of formation, nonprofits file a certificate (or articles) of incorporation with the secretary of state in the state of incorporation (trusts execute a trust document). The founders of the organization choose from a short list of permissible purposes in which a nonprofit is permitted to engage, and include the purposes in the certificate. Whereas a for-profit business is generally incorporated with the ability to conduct all lawful activity, nonprofits may only carry on certain activities, and in exchange they receive certain benefits when they are recognized by the IRS as tax-exempt. Depending on the kind of organization, the benefits may include the ability to receive tax-deductible contributions, income tax exemption, a property tax exemption, and preferred U.S. postal rates, among others.

The most common exempt purposes for charities and houses of worship are religious, charitable, educational, and scientific. While the tax regulations defining the activities that fall within each of these purposes are lengthy, suffice it to say that a church's activities will fall within religious, charitable, and perhaps even educational purposes, and such purposes should have been listed in the church's formation documents. And while an exempt school's main purpose is educational, some of its activities will also fall within the charitable category. Finally, the activities of most charities will fall within the charitable category, but if they provide some educational element, such as educating communities regarding issues of concern to the broader public, those activities would be listed as educational. *The nonprofit, in short, may only engage in activities that contribute importantly to those exempt purposes it is authorized to conduct*—and it becomes authorized by including them in its certificate.

As an illustration, the charging of tuition by an exempt school is, no doubt, a *regularly* carried on business. But the charging of tuition is related to its *exempt* purpose, since parents are paying for the education of their children—education being the name of the game. The rule is that when a business activity is related to the exempt purpose, it may be carried on even substantially, with the organization never having to pay UBIT. Similarly, in the case of a church charging its congregants membership fees and dues, this is a regularly carried on business but it is related to its exempt purpose—admission for the purpose of prayer, which falls squarely within a church's religious function. From these examples we see an interesting point: *there is no prohibition for a nonprofit to make money, so long as it does so by carrying on an activity related to its exempt purposes.* Of course, the organization is restricted with regard to what it may do with that money; generally, it may only use the money to pay reasonable compensation and necessary expenses. It is subject to the restrictions on private inurement and excess benefit transactions.

In determining whether an activity is *related*, we look to the activity itself and not to where the profit from the activity may go. So, if an activity itself does not contribute to the organization's exempt purposes, the act of applying the proceeds to fund the organization's exempt purposes does not make the activity related.

For example, what if, in an attempt to raise funds, the school started a retail clothing business located across the street, where it sold clothing to the general public at market value? The retail sale of clothing does not fall within any of the school's exempt purposes, and so it is *unrelated* regularly carried on business activity. As noted above, it will be unrelated regardless of the fact that the proceeds go to benefit the school's core function of educating students.

Once we have a regularly carried on trade or business that is unrelated, the next question to ask is whether it is substantial or insubstantial compared to all else that, to stay with the above example, the school does. If it were *insubstantial*, the school would be required to pay UBIT to the Internal Revenue Service. This is a tax at the current tax rate for the net profits the organization earns by running the unrelated business. If, however, the school's business really took off and became *substantial*, as compared to the rest of the activity conducted by the school as a whole, then in addition to being required to pay the UBIT the school would be at risk for losing its tax-exempt status, since it would no longer be primarily engaged in its tax-exempt purposes as required by section 501(c)(3) of the Internal Revenue Code—the source for its tax exemption.

While weighing whether a trade or business is substantial or insubstantial is subjective and depends on the specific details of the case at hand, one may want to think of it in terms of which activity is *primary* and which is *secondary*. Taking the organization as a whole, the question to ask is whether—going back to the school example—this is a school that happens to have a small clothing business or whether it is really a clothing business that also has a school. This can be measured by many factors, including revenue, size, and extent of the various activities (because it varies based on the specific case, it would be prudent to make this determination in consultation with a tax counsel). Although it has never been clearly defined, many practitioners agree that, as a rule of thumb, an organization's net income generated from unrelated activity should not exceed 20 percent of its overall net income.

In addition to paying the tax, an organization with $1,000 or more of gross income from unrelated business is also required to file a Form 990-T (by the fifteenth day of the fifth month after the end of its tax year). Note that this filing is required regardless of whether the organization is otherwise required to file a Form 990 (so a church would not be exempt from this filing). If the organization anticipates paying $500 or more of UBIT for the year, it is required to pay the tax in quarterly estimated payments.

What are the Exceptions?

There are several exceptions where unrelated and regularly carried on business activity will not be subject to UBIT.

Convenience Exception

First, where the business is performed primarily for the convenience of its members, students, patients, officers, or employees, UBIT will not apply. For example, a nonprofit hospital's cafeteria is obviously a regularly carried on business. However, because it is there primarily for the convenience of the patients, employees, and guests, its net income would not be subject to UBIT. To the extent it is used by the general public (i.e., those who have no connection to the hospital), its net income generated by outsiders would be subject to UBIT. Additionally, if it did more than necessary such that it could no longer be called a simple convenience—if the hospital were to open a five-star restaurant, for instance—the net income attributable to anything more than what is necessary for the convenience of its patients, staff, and visitors would be deemed unrelated. A laundry run by a school is another example of a business operated for the convenience of its students, and, thus, its net income would not be subject to UBIT. A school's or hospital's vending machines would also fall within the convenience exception, and not be subject to UBIT.

Items sold at a tax-exempt organization's gift shop are scrutinized on an item-by-item basis to determine whether the sale of each item is related to the exempt purposes of the organization. For example, there is a museum—a tax-exempt organization—that has a gift shop and an online store, each of which does a substantial amount of sales, yet the museum only infrequently pays UBIT. Items possess an imprint of art images (which is seen as acting in furtherance of the museum's educational purposes by making works of art more familiar to a broader segment of the public), and, thus, are considered to be related to the museum's exempt purposes. However, such souvenir items as T-shirts or mugs featuring an emblem of the museum's location or the museum's logo would be viewed as not contributing importantly to the accomplishment of the museum's exempt purposes, and would be subject to UBIT.

Sale of Donated Property

UBIT doesn't apply to the sale of donated property. Thus, sales by thrift shops or bake sales by a tax-exempt organization—so long as the sale goods were donated—would not be subject to UBIT. Also falling within this exception would be a tax-exempt organization that receives donated used cars and subsequently sells them to earn money that is then applied toward the organization's mission—even though the sale of the donated cars would otherwise be regarded as unrelated trade or business.

Applying this rule to our school retail clothing store example from earlier, if the store only sold items it received as a *donation*, it too would fall within this exception. (Do keep in mind, however, that the organization's sale of donated property creates limitations to the amount the donor may deduct from his or her taxes.)

Work Performed by Unpaid Volunteers

Work performed by unpaid volunteers is not considered an unrelated trade or business. Thus, to continue with our example above, if substantially all of the work at the school's clothing store were accomplished through the work of unpaid volunteers, it too would fall within the exception.

Passive Investments

Income derived from passive investments, such as dividends, royalties, interest, and capital gains, is not subject to UBIT. Thus, if a tax-exempt organization invests in publicly traded stock and receives a dividend, or sells the stock and realizes a capital gain, such dividend/gain is not subject to UBIT. Similarly, if the organization earns interest on its bank account, the interest is not subject to UBIT.

Income derived from the rental of real estate is considered passive and falls within this exception so long as the organization only *rents* out the space and does not provide personal services. (Note, though, that passive income from the rental of personal property is subject to UBIT). Thus, if an organization derived income from renting hotel rooms, rooms in boarding houses or tourist homes, or space in parking lots or warehouses, this exception would not apply (and the net income would be subject to UBIT) because some element of personal service was provided in addition to the space.

So let's say an organization operated a parking lot for a fee (and assume it did not fall into the convenience exception)—this activity would be considered unrelated. If, however, the organization leased a sizeable plot of empty space it owned to a company for a fixed fee to operate a parking lot (and the company handled everything, and all the organization provided were the typical services generally provided by a landlord), this would be considered passive rental income, and would fall within the exception. If, however, the rental fee paid to the organization were tied to the success of the parking company, this would be a joint venture between the organization and the business. The rule is that a joint venture, where the rent or dividend is dependent on the success of the venture, is not considered to be passive. So if the amount paid by the rental company were tied to the success of the business, it would not fall within the exception and would be subject to UBIT.

It should be kept in mind that even if one exception is not available, another may apply. To illustrate, if the parking lot were operated primarily for the convenience of the organization's guests and employees, it would fall within the convenience exception or otherwise be considered related to the purposes of the organization, as it may contribute importantly to the use of the organization's facilities. If, however, it were used by members of the general public, who had no connection to the organization and simply sought to avail themselves of the parking facility, the net income generated by such members of the public would be subject to UBIT.

To illustrate the passive investment exception further, if an organization is a partner in a partnership (or LLC) engaged in unrelated business (even as a silent partner), or if it owns S Corporation stock (any S Corporation stock, regardless of whether or not the business of the S Corporation is related to the purposes of the organization), it would have to report the income from its partnership and S Corporation holdings as unrelated taxable income. If, however, the organization (or the partnership in which the organization is a partner) owns stock in a corporation and receives a dividend, such dividend would fall within this passive investment exception.

The tax regulations explicitly state that the rental of space in a warehouse or storage garage does not fit within the passive investment exception and would be subject to the general UBIT rules. Regulations also make clear that the income an organization generates by placing cell towers or antennae on its building's roof in order to rent space to cell-phone carriers does not fall within the passive investment exception, as this would be deemed the rental of personal property, which, as we have seen, does not get the benefit of the exception.

It is important to note, however, that this passive investment exception generally does not apply to any income from a passive investment that was acquired through debt financing—for example, borrowed funds, such as a mortgage. So, if an organization borrows in order to conduct unrelated passive investments, the net income earned from the investments would be subject to UBIT in proportion to the debt on the property—and, if substantial, could risk the exempt status of the organization. (The rules regarding the above exception are particularly complex, and a tax counsel should be consulted in the event of such a situation.)

Low-Cost Items

Some organizations send potential donors a low-cost item (such as a coffee mug or key chain) sporting the organization's logo to help induce them to donate. Under this exception, such a distribution will not be seen as a sale (when the donor ends up making a donation) if the donor did not request the distribution, the distribution is made without the express consent of the recipient, and the item is accompanied by a request for a charitable contribution to the organization, along with a statement that the recipient may keep the item regardless of whether or not he or she makes a contribution.

Some Additional Examples

The tax regulations make it clear that "income derived from the conduct of an annual dance or similar fundraising event for charity would not be income from trade or business regularly carried on." Thus, should an organization host an annual dinner or similar event solely for fundraising purposes, the net income derived therefrom should not be subject to UBIT, as such events would not be considered to be "regularly carried on."

If an organization sold its mailing lists or other data to an outside commercial entity, such sales would be unrelated and subject to UBIT. Similarly, if the organization maintained a website or periodical, the advertising revenue generated therefrom would generally be unrelated and subject to UBIT. A limited exception is available under certain circumstances for "qualified sponsorship payments," where the person paying receives no substantial benefit other than the use or acknowledgment of the business name, logo, or product lines in connection with the organization's activities.

State Requirements

Thus far we have discussed requirements to file and pay UBIT to the federal government. States also have their own requirements. For example, organizations that are subject to federal tax on unrelated business income are taxable under Article 13 of the New York State Tax Law if they pursue those unrelated business activities in New York State. To report those taxes, the organization must file Form CT-13, *Unrelated Business Income Tax Return*. The rules of states vary, so specific state laws should be consulted to determine your organization's state tax liability.

In conclusion, to ensure that tax-exempt organizations aren't given an unfair competitive advantage over for-profit commercial entities, Congress added the UBIT rules to force exempts to pay their fair share when engaged in commercial activity outside the scope of their exempt purposes. When that activity is substantial, however, organizations are at risk of also losing their tax-exempt status, since at that point they no longer operate primarily in furtherance of their exempt purposes, as required under section 501(c)(3). The rules surrounding UBIT are complex. This article has outlined some of the key concepts, but specific advice should always be sought from a competent tax counsel.

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How Social Media Transformed a Nonprofit Medical Professional Society

by Jennifer Young

Organizations in the area of health care have special concerns when it comes to incorporating social media into their communications strategy. But entering the conversation on Twitter and Facebook helped the American Society of Nephrology reach out to groups previously inaccessible to the society, broadening its global community.

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The American Society of Nephrology (ASN), founded in 1966, is a well-established 13,000-member professional organization. Highly regarded, it has long provided the best of all possible education opportunities in the field of kidney medicine. ASN was reluctant to enter the world of social media, however—a world that includes Facebook and Twitter but also encompasses the entire web-enabled culture of people sharing online content with people they know.

ASN hired me as an intern in May 2011, in part to help move the society toward a more dynamic social media presence. Social media had been part of my communications strategy while working for a campus society in college, and I had just finished my first year at Georgetown's Communication, Culture & Technology Program (CCT), which grounded me in an understanding of how social media is revolutionizing the way we communicate. My challenge at ASN: (1) research how to improve ASN's social media efforts, and (2) clearly demonstrate the benefits of social media for a nonprofit medical association.

Why Are Some Organizations Reluctant to Use Social Media?

Using social media represents a big change in communication style and method for many organizations. Instead of a unidirectional (top-down in most cases, including ASN's), highly controlled media and communications approach, social media focuses on "sharing," conversational engagement, and less centralized control. Before the Internet age, ASN's audience consisted of physicians and scientists studying the kidney, legislators interested in kidney disease, and the media. As electronic communication and the use of social media exploded, these "traditional" society audiences and others, including ASN members, began looking for information about the society via the Internet and on social networks like Twitter and Facebook.

As a medical professional society, ASN had another, more specific set of concerns. Medical professionals view patient confidentiality as paramount and inviolable. There are many aspects of work done in the care of patients that cannot be transmitted publicly. But social media encourages unfiltered speech. And while the use of social media by a medical professional organization presents few chances to breach patient privacy, in any health care–focused environment legitimate concerns exist regarding social media. To incorporate social media into a medical association's communications, it is essential to answer those concerns and show that social media can constructively benefit an organization's mission.

Medical professional associations are often academic organizations providing journal publishing, research funding, and conferences for their members. Academics are trained to engage in extensive debate and discussion (which often includes a rigorous peer-review process) prior to undertaking major decisions. In science and medicine a measured pace of change is important, but today's communication environment moves at lightning speed. Incorporating interactive, real-time communication can require a significant adjustment on the part of an organization's decision makers, many of whom may not have grown up in a world with e-mail, Facebook, Twitter, and YouTube. However, physicians and scientists are also trained to evaluate data and apply it in decision making. Staff members who want to increase use of social media in these types of organizations have many opportunities to demonstrate why social media is so important for the future of organizational communications and mission.

A Shift in Focus Needs a Shift in Media

ASN has long proved a reliable source of professional education and research support. In recent years the society has begun to play a much more active role in shaping policy. ASN advocates for improving patient care with respect to dialysis, chronic kidney disease, and transplantation in the new health care framework, as well as for increased federal funding for kidney research. Advocacy today requires a set of tools different from those ASN was using in the past, however. Many organizations whose main focus is issue advocacy, such as the Sierra Club, Change.org, and Amnesty International, have made social media a powerful tool in the fight for social good. So as ASN became more invested in public policy, it had to become more invested in social media.

ASN leaders also realized that an increasing number of patients and members of the general public were visiting the ASN website. As a medical professional organization with a very strong focus on education, ASN has a lot of interesting and valuable information on kidney health for all in the kidney community—including patients and family members. But again, for ASN to reach these new audiences, a shift in focus really required a shift in media. A strong social media presence would allow ASN to engage and inform new audiences looking for all available information on kidney health and disease.

Finally, the society recognized that younger members, already accustomed to social media, expected to find ASN communicating through social media. Additionally, ASN wanted to reach medical students (as well as undergraduate and high school students) who had not yet focused on a specific medical interest such as nephrology. In both cases, social media provides the connections and communication tools needed to engage younger members and reach out to students to present nephrology as a career choice.

How We Handled the Transition

In order to revamp ASN's social media, the communications team and I had to start small. ASN only sent out a few tweets or Facebook posts per day, all handled by one member of the communications staff. Starting out small gave ASN room to experiment with how it handled social media and time to explore new tools and practices—while maintaining a steady presence on Twitter and Facebook. As the communications team added investment into social media, we also added effort, expanding the number of staff posting on Twitter and Facebook.

Most important, ASN's communications team gathered as much data as possible. We began compiling statistics on ASN's own social media efforts while educating ourselves about social media best practices and the ways social media helped other organizations reach target audiences. The team gathered data on what other groups were doing, as well as statistics on ASN's own efforts. For example, we began using the URL shortener Bit.ly, along with a user sign-in, which meant that we could create unique shortened links to long website addresses and then track how many people clicked through our links to the content we had identified. This provided valuable knowledge on the kinds of information our audience on Twitter and Facebook wanted to see from us. Many of our best-performing links, surprisingly, were to a blog about the history of nephrology (historyofnephrology .blogspot.com). While we expected ASN's Twitter followers to be mostly interested in science and society news, our followers were also demonstrating an interest in a wider range of topics that reinforce their sense of community—such as the history of nephrology.

As our use of Twitter and Facebook increased, the statistics helped us learn what information our readers wanted from us. In an effort to build a nephrology community on Twitter, ASN's social media team tweeted more links to material that our statistics suggested would get high readership. The aforementioned blog is a perfect example of this—and one that can be built on as we learn more about some of the nephrologists in our own membership who are also bloggers.

The communications team also gathered data on what other groups were doing. We analyzed social media use in organizations both similar to and different from ASN to learn about the most effective ways of using Twitter and blogs. Comparing our own practices to those of organizations such as the Sierra Club taught us a lot about innovative ways to engage in conversations with multiple audiences. Following other professional societies' feeds provided examples of best practices for large professional nonprofits.

The communications staff also educated themselves about social media by reading such sources as Mashable and more health care–focused sources like Health Is Social. This benchmarking process helped us to develop a strategic playbook of best practices and things to avoid. From watching other organizations we learned that a great way to increase our presence and readership was to schedule tweets around the clock instead of just posting during normal business hours. This way, ASN could reach busy professionals who only check Twitter when they get home, as well as a more international audience of followers who might not be awake during the same hours as ASN staff. We learned, too, that as we bolstered our social media presence, we had to keep an eye on mentions and direct messages in Twitter, or risk losing followers. We began using tools like HootSuite to enable the communications team to easily track messages, followers, and interests.

By focusing on best practices and avoiding other organizations' mistakes, we were able to prove competence and demonstrate that we knew what we were doing. Because ASN is a member-driven association, it's always important for the staff to ensure that the leadership understands how specific tactics (such as social media) are advancing the society's mission. The communications team's benchmarking process provided a record of insights that could be presented to the leadership alongside the fact that, in just two months, we had tripled link access and seen the number of Twitter followers grow by 45 percent.

There were already plenty of nephrologists using social media before ASN began working on reevaluating its social media presence. The conversation on kidney disease issues was already well under way on social media venues such as Twitter and blogs. We had to show nephrologists that, as their representative professional organization, ASN was willing to join in that two-way conversation and foster a better nephrology community. Once ASN stepped beyond its traditional communication channels and entered the conversation on Twitter and Facebook, it quickly became clear that social media could help the society reach out to groups previously inaccessible but invaluable to ASN, such as nonmember nephrologists, students, nurses, pharmacists, dietitians, and the global nephrology community.

Look to the Future

Many communications experts have resurrected Marshall McLuhan's declaration, "The medium is the message." ASN's transition to social media displays this point beautifully. The American Society of Nephrology had to recognize that a shift to social media, with its conversational focus and disruptive ability to disperse messages from anywhere to anywhere, was both inevitable and good for the organization.

Social media is sustainable media; it helps to build and maintain communities, and it can be used in rich or lean times. Social media does require rethinking strictly hierarchical communication structures. Its ability to foster social innovation can bring in more energy, information, and connections. ASN's social media presence is growing stronger, and it will enable the organization to advance its mission of fighting kidney disease. ASN's experience shows that medical professional societies in particular can and should embrace social media, especially if they are to take on new advocacy and disease-awareness roles.

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