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THE Nonprofit QUARTERLY

Influences *on* Nonprofit Management

McCambridge on External Influences on Nonprofit Management

Saxton on the Participatory Revolution

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Volume 19, Issue 2

THE Nonprofit QUARTERLY

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The Nonprofit Quarterly

www.npqmag.org

The *Nonprofit Quarterly* is published by Nonprofit Information Networking Association, 112 Water St., Ste. 400, Boston, MA 02109; 617-227-4624.

ISSN 1934-6050

The Nonprofit Quarterly

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Subscriptions: Order by telephone (617-227-4624), fax (617-227-5270), e-mail (subscriptions@npqmag.org), or online (www.nonprofitquarterly.org). A one-year subscription (4 issues) is $49. A single issue is $14.95.

Welcome

Dear readers,

Our summer 2012 issue looks at the external influences on nonprofit management—so let's talk about those governing the *Nonprofit Quarterly*. *NPQ* went out to its community this past month with an appeal that was urgent on many levels. We are one of many publications laboring in the often cash-poor laboratory toward a new future of journalism. All of us are experimenting to find the right fit between our publications and those we serve; and for us this fit has changed—both because the sector has changed and the gap we fill has grown.

We have seen an erosion of reporting power vis-à-vis the sector for a while now, and this erosion has been particularly depressing of late. Stephanie Strom was taken off the *New York Times* nonprofit and philanthropy beat months ago, and now Todd Cohen is gone from the Philanthropy Journal, with serious cost cutting going on there.

But this is occurring at a time when the civil sector is expanding and changing in just about every way imaginable. People working on critical social issues need a place where they can go to for "business intelligence" about their working environment—the experiments being tried, the policies proposed, the investments made.

NPQ is experimenting with a form of journalism that is uniquely suited to the civil sector. We love the quote from Jay Rosen, spoken during a May 1, 2012 roundtable discussion on the future of journalism: "I emphasize the good that comes when old institutions fall apart. What happens is that frozen conceptions of journalism and what it can be suddenly become unlocked and we can rethink them. That's how American institutions evolve."[1] That this can happen in the civil sector through *NPQ* is hugely exciting.

In print, *NPQ* looks much the same—if still unique—in that it delivers world-class articles about nonprofit management and governance and fundraising and stakeholder engagement. But online, *NPQ* is bringing the making and writing of history together by engaging practitioners in documenting the growing diversity of activities and actors in civil society. Collaborative journalism engages multiple contributors to identify and work on stories as they develop over time, with both individuals and institutions sometimes acting as contributing partners on a single story. The method is well suited to making practical sense of a complex and evolving environment.

So think of us laboring in our laboratory/newsroom at *NPQ*, and consider making an investment in our future with some cash support today—and regularly, from now on. We will all be the better for it!

Note

1. Capital New York; "It's the year 1472 in journalism, a fact some people like and some don't," blog entry by Jed Lipinski, May 3, 2012, www.capitalnewyork.com/article/media/2012/05/5827045/its-year-1472-journalism-fact-some-people-and-some-don't.

The Nonprofit Ethicist

by Woods Bowman

Even if you agree that desperate times call for desperate measures, under no circumstances is it okay to "make it look as if Project A made purchases that really applied to Project B." As the Ethicist succinctly sums it up: "Cooking the books is lying."

Dear Nonprofit Ethicist,

Is it sufficient for a board member who plans to apply for the CEO position to take a leave of absence for the search period, or should he or she resign from the board? I've found many references online that suggest a serving board member shouldn't apply, but I can't tell if a leave of absence is acceptable (let alone a best practice).

Unsure

Dear Unsure,

Taking a leave of absence is the minimum acceptable behavior. However, this person should resign and take his or her chances on not getting the job. Resigning sends a message to the board that says, "There's no doubt that I'm the best person, and I'm willing to put my future in your hands." On the other hand, taking a leave of absence sends a signal to the rest of the board that says, "If you don't pick me, you'll have to live with me and my seething resentment." The board can always vote to reinstate an unsuccessful candidate if everyone is cool with it.

Dear Nonprofit Ethicist,

While prospect research companies have become an accepted nonprofit tool to learn more about major donors, where do we draw the line of ethics versus competitive edge? On a recent visit with one major donor, I felt a twinge of guilt, having pulled a report from "XYZ Online Company" the week prior to prepare for the meeting. (This company only uses public information for the analytics it provides.)

It is one thing to utilize all the public information available on a person, but at what point does it become too invasive when some charities use private information as well? Call me old-fashioned, but doesn't the word "private" mean it should remain private? This person personifies the word "philanthropy" to me. I respect and admire her tremendously. I found out much of the same information in the two hours I spent with her, plus so much more just in talking with her. At the end of the day, fundraising is still going to be about relationships and building trust. I don't know how much trust you can build if a donor finds out that you have been spying on his or her personal habits, hobbies, and political affinities.

To quote my favorite line from the film Jurassic Park*: "Just because we can, it doesn't mean we should."*

Troubled

Dear Troubled,

As long as the information harvested and repackaged by XYZ is from generally available public sources, it is legal and ethical. I suggest having a conversation with XYZ over how they collect the information. The key is "generally available"; if they won't disclose their sources, maybe it is time to look for a new vendor. However, ethical principles are very personal. (Arguably, they define us.) If it doesn't feel good, then *don't* do it. Whenever the brave new world we now live in troubles you, follow your own lights.

Dear Nonprofit Ethicist,

Several weeks ago, my boss, the agency's executive director, made a racist statement in front of two board members, a community volunteer, and a vendor *(the vendor happens to be donating half the cost of services so I consider them a donor). I tried to stop the conversation by saying in a syrupy, feminine voice, "Now, now, we don't need to go there." To my horror, the volunteer and board members took it further, with jokes around the table. The vendor and I were dumbfounded. I interrupted everyone and moved the conversation to the topic of the meeting.*

I have lost respect for each and every person in the room yet must still work with them. I must also project an image of acceptance in our communications and relationships with donors. Apart from actively seeking a new job, what do you suggest is the best way to handle my daily interactions with people who are closet bigots? What is the best course of action for future situations?

Disgusted

Dear Disgusted,

Ouch! So much for living in a post-racial society. There is no easy way to deal with bigoted associates. You must find some way to communicate clearly and firmly that such comments are out of line. Everyone must find his or her own voice. One way that appeals to my natural puckishness is to say, "Did I ever tell you that I am one-quarter black [or whatever]?" Then, savor the looks on their faces before confessing the truth and saying that it would still be best not to continue in the same vein (for example, "Some people would misunderstand and take offense").

Dear Nonprofit Ethicist,

Our executive director set an agency policy of charging unrelated expenses to grants. For example, say Project B was woefully underfunded, with no money to pay for anything. If Project A had a lot of money for office supplies, food, and mileage, she would change the Quickbooks ledger and backup documentation (purchase orders, etc.) to make it look as if Project A made purchases that really applied to Project B. This did not sit right with me. Sometimes these would be large purchases, like hundreds of dollars spent on incentives. It seemed to me that the funder had in good faith awarded money to Project A, and only Project A. Advice? Does this happen a lot? How should a staff member proceed? I raised my concerns only to have them shot down with the excuse, "This is how we always do things."

Distressed

Dear Distressed,

Cooking the books is lying. Your auditors should have caught it, but, of course, most nonprofits do not have regular financial audits. "Too expensive," they say, but that can also conceal nasty stuff. I don't have any statistics on how often it happens, but nothing would surprise me, because it is so easy to pull off. I do know that your donors deserve better.

What can a lone staff member do? Federal law requires nonprofits to have reporting avenues for whistleblowers, backed up by protections against retaliation. However, an organization as lax as yours probably flouts that law, too. If the restricted funds were provided by the government, such behavior as you describe is a crime, and you should report your organization to the appropriate authorities. It would serve them right.

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

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External Influences *on* Nonprofit Management: *a Wide-Angle View*

by Ruth McCambridge

Is management dead? Well, no. But it must become more fluid, open, reactive, and engaged with the shifting terrain, whereby the idea that institutions are separated by clear-cut boundaries is becoming less and less true, organizations are becoming ever flatter, and chaos has become more or less the order of the day.

Clouds are not spheres, mountains are not cones, coastlines are not circles, and bark is not smooth, nor does lightning travel in a straight line.

—*Benoît Mandelbrot* [1]

I WILL ASK READERS TO BEAR WITH ME AS I TRY TO TAKE a wide-angle lens to the external influences on nonprofit management. They are many and complex, but they also may be simplified—which I will try to do by looking for what, to my mind, is the core design principle we are facing.

Complexities "R" Us

All organizations are affected by the cultures and social structures from which they emerge. Dominant paradigms, shared belief systems, and personal politics create mental models about the way we want—and are sometimes blindly driven—to structure and manage our work.

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

Our organizational management styles and structures are affected by the following:

- The fields in which we work—in the arts, for instance, dual leadership models that place artistic and business leadership side by side are common.
- The regulatory environment in which we function—for instance, in Head Start programs, regular audits measure a specific and very long checklist of items, including the governance structure, accreditation standards for teachers, and the resources available in each classroom, among many others. Such stringent accrediting measurements administered directly by a funder tend to affect what management focuses on.
- Our communities' spoken belief systems—for instance, feminist organizations of the 1970s

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experimented with structures that were less hierarchical because they equated hierarchy with paternalism.

- Our communities' cultural norms and dynamics—for instance, our ethnic community relates in certain ways to other ethnic communities around it, much as our geographic community relates to its region, state, nation, and the world.

These are larger systems of which our organizations are a part. Of course, within organizations there are often also a set of norms and dynamics put in place by the epic stories we tell of, say, organizational birthing or near-death experiences, or by the model of leadership exhibited by culturally influential leaders or founders. The surfacing of the mix of these internal and external effects on organizational management has always been fascinating work for those who like the anthropological exercise of trying to figure out the assumptions beneath why people in organizations do what they do.

It is complex stuff, but stuff that may just have been made a little easier—paradoxically, by a major era change.

Because, with all of the ways in which external factors affect how organizations function, it has generally been assumed that organizations are systems separated from one another by clear boundaries. In fact, one of the definitional requirements of a system is that it have those boundaries to set it apart. So what happens to the notion of organizational culture when institutional boundaries become more porous overall, and the people associated with the system are working virtually, or are transient or contracted? And what happens to the nexus of management? Does our estimation of where leveraging and management actions are taken change significantly? Might it neutralize differences between organizations to some extent and move the loci of change and cultural influence both up into larger systems and down to much more local levels?

About Dominant Paradigms

In this life, those of us who are actively involved in trying to make complex systems work are always dealing with contradictions—or dialectics, which, according to philosopher Georg Wilhelm Friedrich Hegel, is the constant conscious playing out of those contradictions to create progress. So, for instance, even as individuals or organizations we are at once attracted to the control of a situation *and* the active exploration of the possibilities and limits contained in the situation—in other words, to stability and chaos.

Encroaching chaos is uncomfortable for many managers, who by definition tend to like predictability. We are comforted by "I do *this*, and *that* happens." When that kind of predictability begins to be hard to come by and we are beset with disequilibrium, we are challenged to step outside of the system as we have been living in it and try to take a longer view: Has something big changed for good? Is this the system we need? Is it doing what it is meant to do? What ideas can I try? Who else should we be talking to who can be partners in a change bigger than the usual? How do I intervene, and at what level? These are the questions that many of us are faced with now.

Thankfully, often what at first appears to be chaotic because it is still finding its order, later becomes increasingly familiar—game rules, underlying assumptions, and all. Once we have had a chance to observe and experiment with the essence and the patterns of something new, and to realize where practical and ethical questions emerge, we may become surer of our footing even if we cannot yet answer these questions.

But what if we are far from that kind of semistasis? What if we are facing a generation or more of greater than usual change?

If we were to assume that organizations mimic the assumptions and operating dynamics of the overall environment, and that these change from economic era to economic era, you would expect the dominant paradigm we have for forms of organizations to change, too. This does not happen overnight, even in today's sped-up environment. There has been a generation or two of time during which the industrial era has slowly been crumbling—with its artifacts and archetypes becoming almost cruelly comic in their extremity.

But the seeds of this transition to a technology-driven, knowledge-era economy have long been present as the ascending pole of the dialectic.

Encroaching chaos is uncomfortable for many managers, who by definition tend to like predictability. We are comforted by "I do *this*, and *that* happens."

> "The changes . . . were so far-reaching and profound, so tragic in their strange mixture of good and evil, so dramatic in their combination of material progress and social suffering that they may well be described as revolutionary."
>
> **Arthur Birnie,**
> *An Economic History of Europe, 1760–1930*

The industrial era, too, was driven by advances in technology, which allowed for the large-scale production in big factories—through the use of machines—that we have come to identify as the rise of industrialization; and the factories needed large amounts of capital to establish themselves, thus consolidating the means of production, and also needed large numbers of wage earners, who made themselves relatively dependent in return for a measure of security.

But every revolution carries within it the seeds of its opposition, so—

What Formula Is Driving the Era Change?

If we were to see this economic era as a fractal—"a rough or fragmented geometric shape that can be split into parts, each of which is (at least approximately) a reduced-size copy of the whole"[2]—the basic form being replicated might be stated as follows: "We reject: kings, presidents, and voting. We believe in: rough consensus and running code."

We refer to this short statement—attributed to David Clark, who is often called the founder of the Internet—because it succinctly expresses the formula by which this era is defined. As Lawrence Lessig wrote in "Open Code and Open Societies: Values of Internet Governance," what is being described here is not chaos but rather a bottom-up control of development based on an open systems orientation.[3] Within this concept, he goes on to say, is the idea of "open forking": "Build a platform, or set of protocols, so that it can evolve in any number of ways; don't play god; don't hardwire any single path of development. Keep the core simple, and let the application (or end) develop the complexity."

Lessig goes on to say, "Good code is code that is modular, and that reveals its functions and parameters transparently."

But before we all cheer about the image we are building of networks of locally based action connected on a global stage working for human rights and sustainability, remember that there are still significant issues to work out in the form of reinforcements and defenses of the old way of consolidation. Growth capital still tends to flow to large systems in the nonprofit as well as the for-profit sector; this ghost may haunt us for some time. Many nonprofits are limited by siloed funding as well as funding that does not necessarily lend itself to constant reevaluation and change.

And then there are those pesky, unintended consequences of the new era, which is likely to be equally as good and tragic as the previous one.

But before we all cheer about the image we are building of networks of locally based action connected on a global stage working for human rights and sustainability, remember that there are still significant issues to work out . . .

Our Networked World and What It Does to an Era Change

There are a number of factors that are distinctly of this age and conspire to reinforce the sense that we are actively evolving a new economic era:

- *There is an ever-greater push for transparency and a growing assumption of need for institutional accountability.* We now have iconic events—epic stories that anchor the need for and possibility of greater transparency in the public consciousness and imagination. Enron and the mortgage crisis, among a number of other scandals, anchor the need, and WikiLeaks anchors the inevitability.
- *There is the ever-more-rapid ability of one group of stakeholders to mobilize quickly to influence another.* This allows stakeholders without direct resource control over an organization to affect those with resource control. It is not that this was impossible before, but it took much longer and required more central control. There are any number of stories *NPQ* has been tracking that describe this kind of spontaneous stakeholder alliance-building online. The unbelievable and wildly diverse power bloc that sprang up overnight to oppose Susan B. Komen for the Cure's defunding of Planned Parenthood is one example—Komen's losses have been enormous, rolling out in a series of broken relationships and cash losses.

The Internet is perhaps *the* influential operating system of the era—acting as a model to grow and develop a field on the margins and incremental embroidery on a basic protocol that is near-universally accessible.

- *There is much less reliance on cradle-to-grave relationships between people and institutions (no longer the standard).* And more free agency and greater reach of communications technology require stronger and more consistently engaging attractors. Maybe a core image here is that of the contracted and relatively unprotected worker—the worker with multiple short-term jobs, or the employee who commutes remotely. Socially concerned people are replicating these shorter term, more tenuous relationships—taking their energy to a Habitat for Humanity construction project one month, a race against hunger the next, and participating in a campaign against constrictive web legislation in between. If you want to compete for people's attention and money and names, you had better be giving them something that they can get very interested in and over which they can feel a sense of accomplishment and partial ownership. They do not always need to do the work themselves, but they do need to feel engaged at a spirit level.
- *Social media makes every "local" organization national and even international in certain ways.* A small local organization that tries something new can get noticed as a model: its strategies can be replicated and its mistakes avoided. The Internet also expedites realization and expressions of common cause across vast geographic and cultural boundaries. Small local work can build to big work in this way. Swarming may occur, as it did in the anti-landmine campaign. And the friction that occurs at the boundaries sparks odd new thinking—always good for innovation.
- *The Internet is perhaps* the *influential operating system of the era*—acting as a model to grow and develop a field on the margins and incremental embroidery on a basic protocol that is near-universally accessible.

But again, the consolidation of power and capital is extreme, even in this sector, as is the urge to stake out spaces where capital can be secreted. We are in the midst of an election that is characterized by the consolidation and secretion of election capital, and we are witnessing the truly phenomenal growth of charitable gift funds. The latter recently prompted Agnes Gund, president emerita of The Museum of Modern Art, New York, to comment, "We need to better comprehend this environment and learn how to participate in it. The arts are slow at developing donors online, where much fundraising now happens. We have been slow to attract the new money—the hedge fund and social-media crowds, the new inheritors of wealth. We need these people in the arts, but we are not getting their attention. Large amounts of money are going into donor-advised funds; we scarcely know how to reach those funds. We are late adapters of social media, of the interactive ways of dealing that are now common among the young.

"As fundraisers, we are not good at collaborating; we argue for one symphony or one dance company or one museum at a time—without appealing for the arts as a whole, significant sector in American life. And as institutions we haven't learned to combine tasks, to find common ways of solving problems, to enlist new thinkers in our business.

"We are trying to do business as usual, when—in fact—the usual is gone. There is a new usual. We need to make it work for the arts. Without the arts, we would be people without inspiration, without ideas, without ideals. That's why successful fundraising for the arts in the new economy is essential."[4]

What Does This Mean for Organizations? Is Management Dead?

If we cannot predict our variables in the near future, is all hope of effective management dead? Clearly not, but the style of managing must be so much more fluid, and the actors so much more diverse—and actively thinking and gathering information wherever they sit in and around the organization. The organization must be listening to these actors and processing information in a way that looks for patterns of the emerging order that will need to be addressed. And only then should they feed the scenario back out, so that the actors can help with the next steps of the design.

Thus, participants in and around the cause get the running code—which is likely nothing more than the purpose and vision and principles of the organization (or cause) as it is placed against the challenges of its environment, and rough consensus is reached and experimentation and innovation at the margins is encouraged to flourish.

The course is rough, not smooth. It cannot be sized up with a tape measure (though perhaps measured, at times, with a Geiger counter) as we fall while trying to scale new challenges on a new terrain with a new partner. But there is something exhilarating about it all. Benoît Mandelbrot said that "roughness" is a part of human life, and that there are many different kinds of mess but there is always order in that roughness to be found. And it is all very complicated and simple at the same time.

So here are some more questions:

Do we believe that a swarm of small things can bring down a big thing with any sort of regularity? Do we believe that it can be done "the right way," without being tightly and centrally controlled? Can we change our orientation from top-down to bottom-up? Can we shift our evaluation and planning practices to ones wherein active communities help define the outcomes that they want and provide data on the results?

And is organizational defensiveness an enemy of the state we want to be in? If our future is based on open networked systems that communicate toward greater effectiveness, are we managing and developing our work toward that end?

The course is rough, not smooth. It cannot be sized up with a tape measure (though perhaps measured, at times, with a Geiger counter) as we fall while trying to scale new challenges on a new terrain with a new partner.

Notes

1. Benoît Mandelbrot, *The Fractal Geometry of Nature* (New York: W. H. Freeman, 1982).
2. Ibid.
3. Lawrence Lessig, "Open Code and Open Societies: Values of Internet Governance," draft 3 (1999 Sibley Lecture, University of Georgia, Athens, GA, February 16, 1999). An earlier version (v1.0) of this was presented as the 1999 Greene Lecture, Kent Law School, Chicago, IL, January 26, 1999.
4. Agnes Gund, "Business as Usual? 'The Usual Is Gone,'" *Crain's New York Business*, July 9, 2012.

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The **Participatory Revolution** *in* **Nonprofit Management**

by Gregory D. Saxton, PhD

More and more, stakeholders are becoming active participants in individual and organizational-level decision making. As stakeholders continue to demand greater institutional democracy, nonprofits will feel the pressure to become, as the author asserts, "more flexible, horizontal, collaborative, and transparent."

Editors' note: *This article was originally published in* The Public Manager, *in spring 2005.*

The future that has already happened is not within [the organization]; it is outside: a change in society, knowledge, culture, industry, or economic structure. It is, moreover, a break in the pattern rather than a variation in it.

—*Peter F. Drucker* [1]

DRUCKER WANTS ORGANIZATIONAL LEADERS to focus on the opportunities and challenges presented by changes in the external environment that are ongoing or have already occurred but have yet to be widely perceived. I argue that just such a "future" is underway: In the cultural sphere, people now create and publish their own books, movies, and music; they eagerly customize orders on restaurant meals; and blogging, "podcasting," and other forms of targeted media are displacing mass media through satellite- and Internet-based communications. In the business world, shareholder revolts have skyrocketed; self-organizing teams, stakeholder analysis, and self-employment have steadily increased; organizational structures have flattened; and corporate democracy is beginning to take hold. In government, the devolution of power, public disclosure agreements, community score cards, public audits, and citizen satisfaction

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"BUTTERFLIES ON BLACK" BY LILY GREENWOOD/WWW.LILYGREENWOOD.COM

surveys are becoming ever more commonplace. And in politics, key elements of direct democracy, including citizen ballot initiatives, recalls, open primaries, and supermajority and voter-approval rules for tax increases have all become increasingly popular.

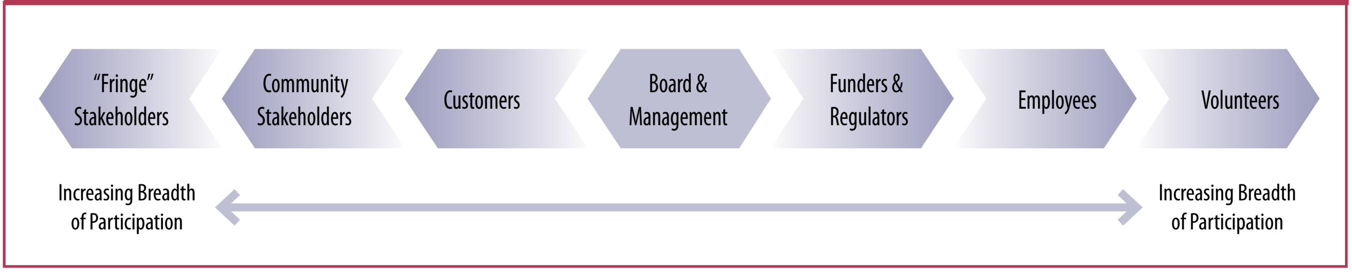
These seemingly unconnected developments collectively point to a generalized surge in participatory practices and values throughout society. Thanks to an array of ongoing large-scale social changes, stakeholders now increasingly possess the capacity, interest, and opportunity to play a key role in decision making at the individual, organizational, and community levels alike. This growing propensity for participation has, in turn, begun to change prevailing nonprofit structures and management practices. A bona fide participatory society is emerging—and nonprofit leaders must be up to the challenge.

A bona fide participatory society is emerging—and nonprofit leaders must be up to the challenge.

The Driving Forces of Participation

The skyrocketing levels of education in the post–World War II era constitute the primary long-term driving force of greater participation. Since 1940, the percentage of Americans aged twenty-five years and over who have completed high school has jumped from 24.1 percent to 83.6 percent, while that for those who have completed at least four years of college has increased from 4.6 percent to 26.5 percent. More than one in every two adults has now completed at least some college. This reverberates throughout society. In the aggregate, education is the major institution that builds citizens and fosters the spirit and values of popular participation. A college education, in particular, is associated with numerous enduring attitudinal changes—including making people less fatalistic and more individualistic, informed, activist, and ambitious. Increasing education also engenders highly relevant behavioral changes. Studies have shown that educated citizens are more likely to vote, more likely to participate in the political process, more likely to demand involvement in critical healthcare-related decisions, and more likely to hold "participatory" attitudes—in favor of allowing employees, family members, and other

Figure 1: **Breadth of Stakeholder Participation in Governance and Decision Making**



normally excluded stakeholders to participate in relevant decision-making processes.

The second driving force is a long-term shift in value orientations. Simply put, younger generations are increasingly assuming the right to be included in the decision-making processes that most affect them. This diffusion of participatory attitudes is in line with what political scientist Ronald Inglehart has cogently argued: that each successive generation since World War II has placed a lower priority on "materialist" issues such as physical and economic security and a greater emphasis on "postmaterialist," or quality-of-life, issues. A fundamental component of this postmaterialist value shift is the desire to have a greater say.

Third is the incredible diffusion of computer-mediated communications technology. According to the National Telecommunications and Information Administration, between 1994 and 2004 Internet access jumped from 3.4 percent to 74.9 percent of U.S. households. The Internet has proven to be a tremendous engine of participation. Not only does it facilitate the input, communication, and information-sharing essential for open decision making to occur but also has given rise to several highly participative forums and practices—including "targeted media," specialized nonprofit knowledge communities, democratized information processes, and decentralized, open-source projects. The hallmark of these Internet-based activities is how participatory they are: individuals and individual groups can have autonomy over practically any strategic-level decision. Not surprisingly, consumers' propensity for the highly participative interactions afforded by advanced communications technology is spilling over into the "off-line" not-for-profit world—not only by increasing individuals' capacity to mobilize and acquire the information that makes for more effective participation in traditional decision-making processes, but also by increasing their demand to have a say in important service-related decisions.

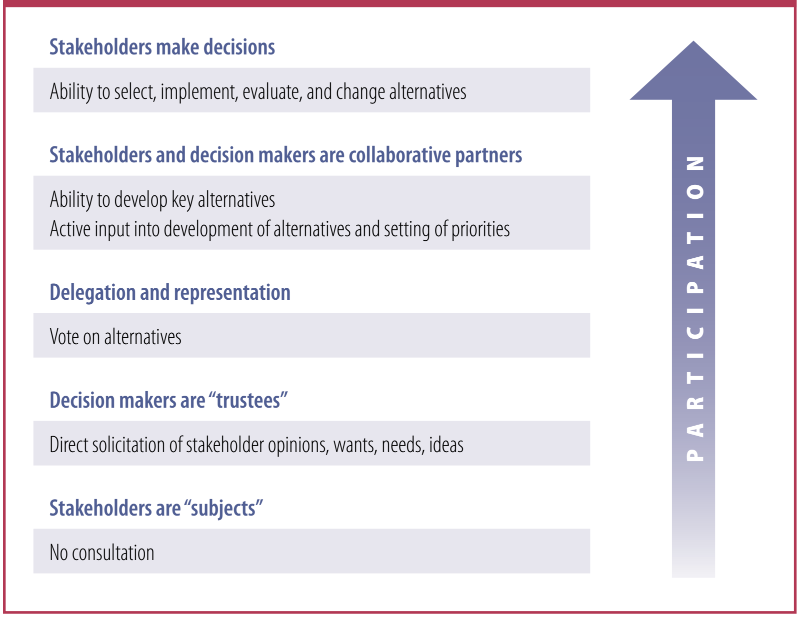
In short, through expanding education, we now have the societal capacity and desire to engage in and support participatory practices; through the diffusion of advanced computer-mediated communications, we have the appropriate technology to facilitate complex, open organizational decision-making processes; and through intergenerational value shifts and "spillover" from Internet-based participation, we have the underlying expectations and values that justify and demand stakeholder inclusion. The "future that has already happened," in effect, is an ongoing explosion in the desire, ability, and opportunity of stakeholders to play a powerful role in individual- and organizational-level decision making. The implications for nonprofit governance, organization, and leadership are considerable.

Simply put, younger generations are increasingly assuming the right to be included in the decision-making processes that most affect them.

Participation in Organizational Governance and Decision Making

The most fundamental change in the governance of nonprofit organizations will be the widening and deepening of the organizational "selectorate," or the set of people who have the right to participate in strategic decisions. As "widening and deepening" implies, there are two discrete dimensions to this expansion. First, as Figure 1 shows, organizations will feel growing pressure to increase the breadth, or "representativeness," of the constituents involved in decision making beyond the traditional power centers of the board and executive management.

Figure 2: **Depth of Stakeholder Participation in Decision Making**



It is the rare organization that achieves the deepest levels of participation where stakeholders have significant control over decision making.

Many nonprofit organizations have already learned the benefits of devolving tactical and operational decision making to employees, and sometimes customers. And that's normally where it ends: other stakeholder groups are excluded from direct involvement in organizational decisions.

Yet the participatory forces mentioned above are creating increased pressure on nonprofits to open up. A good example is the educational sector, which has experienced progressively more intense demand for involvement in funding, curriculum, hiring, personnel, discipline, and accreditation issues by consumers in public meetings, in the legislative process, through participation in programs and on committees, in the lodging of complaints and investigations, and via the use of surveys, polls, and the media. Key stakeholders now see it as normal to demand information, justifications for actions taken, and even policy changes from teachers and administrators. Students and parents alike are demanding a say, and administrative workloads and teaching approaches have adjusted accordingly.

Depth of Participation

A further challenge for the status quo is that, even in the most stakeholder-oriented organizations, participation is generally limited to providing input and being heard; as Figure 2 illustrates, there is little "depth" to the participation, in the sense of having the power to make the ultimate decisions. The majority of organizations are on the second rung of the ladder, where stakeholders are only indirectly included in the decision-making process via the "representative" role by which individual board members serve their constituencies. A significant minority of organizations (37 percent, according to BoardSource) make it a step higher by using some form of advisory board, council, or committee to facilitate constituents' participation in governance and oversight functions.[2]

It is the rare organization that achieves the deepest levels of participation where stakeholders have significant control over decision making. Sometimes, exceptional programs, such as the World Bank's "participatory poverty assessment" or those prevalent in community-based natural resource management, reach this cutting edge of participatory management by engaging the local community at the outset in setting priorities, developing alternatives, and selecting projects.

Still, given the challenges of devolving power within the typical nonprofit organization, the highest rung on the participatory ladder is most readily attainable through an "exit" strategy, whereby a stakeholder or group of stakeholders forms a new, independent venture. By definition, such autonomous groups are the epitome of "participatory" organizations—the founders alone are able to make the critical strategic decisions regarding when and where and how to act.

Democratization of Information

The democratization of information accompanying the spread of the Internet has brought about several other participatory phenomena that similarly take place outside the purview of the traditional nonprofit organization. It has led, first of all, to the decentralized generation and acquisition of sector-specific knowledge for individual managers and organizations. The low cost of rapid, ubiquitous information exchange facilitated by centralized online databases such as GuideStar, moreover, has been a boon to the organizational transparency and accountability movements. Democratized web-based knowledge has also facilitated the rapid diffusion of sector-specific best practices and benchmarking data. This in turn allows the public to take much more active decision-making and advocacy roles in local-level policy making. Citizens can now easily benchmark and compare service levels, tax rates, and societal outcomes (e.g., crime rates). It also drives the flourishing "community indicators" movement, which strives to improve community quality of life through the use of measurable community indicators and, in advanced cases, through online, spatially enabled community statistical systems.

An excellent example is the National Neighborhood Indicators Project, a collaboration between the Urban Institute and community organizations in twenty-one cities. By integrating the active involvement of local community organizations, advanced "neighborhood information systems," and the sharing of data by public administrative agencies, the partnership's approach effectively represents a new paradigm in the control and use of administrative information that significantly enhances local-level citizen participation in community development and policy making.

Not only does the Internet's information-sharing power enhance individual capacity to participate in making decisions, but the generally highly participative interactions afforded by web-based technologies further increase stakeholders' expectations that they will be included in important decision-making processes. And together, this increased capacity and expectation for participation is spilling over into traditional "off-line" not-for-profit activities.

This is clearly visible in the health sector, both in consumers' increasing use of the Internet to help diagnose and make treatment decisions and the broader self-managed care and "patient empowerment" movements. Consumers overall are no longer shy about taking a greater role in their own medical care. This is not due solely to their enhanced ability to obtain relevant knowledge via the Internet; it is also due to their heightened expectations of the right to a greater role in making medical-related decisions.

Pressure for Open Decision Making

This is mirrored in the increased pressure on nonprofits in general for open decision-making practices. Fortunately, opening up to stakeholder input can carry significant benefits for the innovative organization. One of the most interesting developments is the increasing interest in the "bottom-up economy," where consumers and businesses co-create value for the enterprise through a form of participatory product development. Nonprofit leaders should follow suit by moving beyond traditional needs assessment data-gathering techniques and looking for ways to incorporate bottom-up approaches to both developing and delivering their services.

The fact is, there is currently as little organizational democracy that takes place regarding the most important strategic-level organizational issues as there is regarding the incorporation of broader groups of external stakeholders. But things are beginning to change. Strategic decisions regarding business expansion, product development, entrepreneurial activities, program evaluation, and the like are increasingly being made by a broader organizational "selectorate"—which includes stakeholders both inside and outside the organization—and these groups are slowly demanding, and acquiring, a deeper level of input in making the ultimate decisions. Though the specific adaptive strategy will vary according to organizational size, age, and subsector, all nonprofits will feel increasing pressure to incorporate "inclusive governance" practices that effectively engage constituents in board-level decisions.

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Participatory Organizational Structures and Forms

The increasing potential of stakeholders to actively participate in decision making is also exerting pressure on the traditional top-down organizational structures prevalent in the nonprofit sector. Even the most democratic of commonly used organizational models, including Total Quality Management, are "participatory" primarily in their inclusion of employees and customers in operational decision making. The full range of stakeholders is not included, and decision making is primarily nonstrategic. Still, such models can be a good way for an organization to initiate participatory management practices.

A significant problem after that is the dearth of practical organizational models that are both compatible with existing organizational forms and fully conform to the requirements of a participatory age. One alternative is to incorporate even more decentralized forms of teamwork within the traditional organization. Generally speaking, "self-managed" and "self-directed" teams can be used to facilitate strong participation in making workplace decisions within the bounds of goals that are set and defined externally, in the first case, and by the team itself, in the second. Flexible "self-organizing" teams that have decision-making power negotiated ad hoc according to the task at hand are the most radical departure from the traditional workplace hierarchy. These self-governing "loose hierarchies" or "heterarchies" (good examples of which are "hot groups" in the private sector and "smart mobs" in social movements) are ideal for decentralized mobilization, collaborative problem solving, and most information-related projects. They are not a panacea, however, and are inappropriate for many tasks. Moreover, they are difficult to incorporate into traditional nonprofit organizations, which typically lack both the institutional capacity and suitable frameworks within which such highly decentralized stakeholder participation can be effective.

A significant problem [. . .] is the dearth of practical organizational models that are both compatible with existing organizational forms and fully conform to the requirements of a participatory age.

To get around these limitations, organizations are increasingly turning to non- and semi-permanent participatory decision-making processes such as Open Space technology, Future Search meetings, citizen summits, participatory budgeting, citizen juries, and consensus conferences. They are feasible in even the most hierarchical of organizations. The U.S. Navy, for one, has employed highly democratic Appreciative Inquiry techniques in special multiday sessions to make critical organizational decisions. What is notable about all these techniques is how they allow otherwise hierarchical, command and control organizations to temporarily employ participatory organizational models to decide major strategic issues.

Since few stakeholders are interested in attending meetings or committing large blocks of time to all of their group affiliations, organizations can also resort to computer-mediated technologies. Through the use of real-time consultation, centralized information gathering, e-relationships, online training, web-enabled databases, discussion lists and bulletin boards, and online surveying and polling, avant-garde organizations can build their participatory capacities while facilitating the participation of a broader range and new generation of constituents.

Increase in Interorganizational Partnerships

By reducing communication costs, the spread of computer-related technologies is similarly fostering an increase in interorganizational partnerships, which are inherently more participatory given the greater number of individuals conferred decision-making control. At the extreme end of the decentralized, collaborative continuum—and probably the most exciting information-related participative development facilitated by the Internet—is the "open-source" organizational model. This originally referred to the free and open access to software source code given by enterprising computer programmers, but the movement has recently spread from computer software to other areas—ranging from popular culture to education to journalism. Most well known is Wikipedia, an "open content" encyclopedia being written collaboratively by thousands of volunteer contributors from around the world.

The movement is beginning to have a broader impact on the nonprofit community. It has been instrumental in, for example, the rise of "participatory politics," which is heavy on bottom-up advocacy, as well as "participatory culture" in the realms of the arts, music, religion, popular culture, and journalism. And promising open-source knowledge enterprises, such as the California Open Source Textbook Project, an open-source textbook repository, or Appropedia, a wiki designed to build knowledge on sustainable development, are becoming increasingly salient. Beyond the generation of specialized sectoral knowledge, open-source models and other forms of "loose hierarchies" could ultimately play an important role in, among other places, intense data-gathering, problem-solving, and brainstorming efforts; in volunteer and fundraising drives; in interactive online communities and support groups; in advocacy and policy research; in community indicators projects; and in the development of software and management tools.

In the end, traditional top-down organizational structures—with their inflexibility and "thinking/doing" dichotomy—have always been inefficient. The increasingly participatory (internal *and* external) environment engendered by rising levels of education, changing value orientations, and the spread of computer technology is now spurring dynamic nonprofits to adapt by becoming more flexible, horizontal, collaborative, and transparent.

Sectoral Challenges and Opportunities

The transition to a participatory society will also bring about a series of significant changes visible chiefly at the macro level. For the not-for-profit sector as a whole, the growing consumer demand for participation will create a new set of "winners" and "losers" as consumers flock to those organizations that allow them to assume a greater role in making strategic decisions. Organizations and venues without satisfactory, genuine, participatory processes will see their market share, participation rates, and customer satisfaction levels decline. This is already evident in the much-lamented decline of "traditional" civil society organizations such as the PTA, 4-H, Elks, Moose, and Kiwanis. It is also discernible in the decline of several traditional religious organizations and the rise of the most decentralized forms of religious congregations.

This shift in consumer demand is also engendering a rise in interorganizational collaborations, intersectoral partnerships, and "self-start" organizations. Participatory segments of society will be more likely to form a new organization when an existing one does not adequately respond to their desire for input or whenever they want complete control over strategic decision making. For this very reason, we will continue to see a rise in the number of personal foundations, where founders are able to take a decidedly active role in charitable decisions. The recent focus on "social entrepreneurship," with its ability to allow nonprofit

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organizations to free themselves from granters' stipulations, is also more than tangentially related to this development.

As a result of the technological and value changes, participatory engagement in nonprofit activities can also be briefer, more intense, and less centralized. This is reflected in who does the work of the nonprofit sector. The rise of the "episodic volunteer" is one salient example. Nonprofits are increasingly entering into partnerships to tap this growing short-term volunteer labor pool. Habitat for Humanity in western New York, for example, has teamed up with local Starbucks stores to offer one-day volunteering opportunities involving both customers and employees. More broadly, the HandsOn Network is increasingly becoming the communication bridge of choice between those who are interested in volunteering and local nonprofit organizations that need assistance. By having HandsOn do much of the legwork—coordination, project identification, marketing, and volunteer and organizational certification—this "outsourced" volunteer management system makes it easier for both the nonprofit organization and the budding episodic volunteer.

Organizations should also increasingly be prepared to work and collaborate with nonprofit entrepreneurs, smaller independent and ad hoc organizations, and self-employed "e-lancers" who bid for outsourced work online. And given the difficulty of navigating, directing, and implementing participatory organizational responses, there will also be more work for those educators, writers, trainers, and consultants with expertise in guiding nonprofits through the process.

The Challenge of Leading and Managing in a Participatory Era

In the end, much of the impact in the nonprofit community will be felt and shaped by the individual manager. Are you a leader who unwittingly engages in "false participation," believes in a top-down hierarchical approach, or routinely hides information from your subordinates? Do you shield yourself from your employees and customers with a layer of bureaucracy? Do you serve on a board that does not disclose salary information of top managers? Do you regularly develop policies without engaging key stakeholders? Do you survey clients or employees only to justify a decision you've already made, rather than to obtain quality input? Do you believe that your primary task is to develop the "best" policy option, and then try to convince people of that option's worth? If so, you'll be doing yourself and your organization a disservice.

Enlightening is U.S. Navy Captain Mike Abrashoff's story, wonderfully related in his 2002 *New York Times* best-selling book, *It's Your Ship: Management Techniques from the Best Damn Ship in the Navy*, of the epiphany he had at his induction ceremony as commander of the USS *Benfold*.[3] When he saw the crew cheering the departure of his traditional, "coercive" predecessor, he "knew then that command and control leadership was dead." If command and control leadership is dysfunctional in the military, it probably is in every organization.

But doesn't the emergence of a more democratic, participatory age mean that newer generations will be unwilling to be led? No. As Abrashoff found out, he was able to implement a leadership approach that focuses on active listening, communicating the organizational purpose, generating bottom-up ideas, and strengthening others in a climate of trust—to turn an underperforming vessel into the "best damn ship in the navy." In many instances, workers will only want input and to know the reasons for the actions that are to be taken. Of Daniel Goleman's well-known leadership styles typology, the mobilizing "Authoritative" approach will still be effective in the day-to-day management of the typical nonprofit organization.[4] What will change is the decline of the "Coercive" style of leadership and the concomitant increase in the extent to which the "Democratic" style becomes a critical component of managers' leadership repertoires. Managers must be prepared to assume more participative and open forms of leadership that are less manipulative with regard to the withholding of information.

Conclusion

As the late Senator Daniel Patrick Moynihan (D-NY) once counseled, "Stubborn opposition to proposals often has no other basis than the complaining question, 'Why wasn't I consulted?'" In the participatory society, all managers must take Moynihan's wisdom to heart, since their role will increasingly involve leading their organization to respond and adapt to a progressively more participatory strategic environment featuring transparent information, loose hierarchies, interorganizational collaborations, new types of organizations and workers, bottom-up and open-source models, "temporary" and technologically based participatory decision-making procedures, and broader and deeper input from organizational constituents. In the end, while we can't know the ultimate form this participatory future will assume, we do know that people will want to participate in areas where they are capable and passionate—and these areas are rapidly expanding. Though stakeholders will not care to participate everywhere, nonprofit managers must everywhere be prepared to accommodate participatory demands by opening up and facilitating the decision-making process. Much of this "future" is already happening.

Notes

1. Peter F. Drucker, with Joseph A. Maciariello. *The Daily Drucker: 366 Days of Insight and Motivation for Getting the Right Things Done* (New York: Harper Business, 2004).
2. See www.boardsource.org. The url to the original survey, cited in this article in 2005, is no longer available.
3. Michael D. Abrashoff. *It's Your Ship: Management Techniques from the Best Damn Ship in the Navy* (New York: Warner Books, Inc., 2002).
4. Daniel Goleman, with Richard Boyatzis and Annie McKee. *Primal Leadership* (Boston: Harvard Business Press Books, 2002).

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Nonprofit Management *Isn't* a Game

by Scott Helm, PhD

Is game theory useful to nonprofit managers? Will the matrices and mathematical calculations propel us to better decision making? One academic is skeptical and says it is better to embrace uncertainty.

Let's play a quick game! This game will teach you how to better formulate and execute strategies for your nonprofit organization. Ready? Good.

You are the executive director of a domestic violence shelter in Anytown, U.S.A. You are faced with the difficult decision of whether or not to apply for a grant from We Will Fund You Foundation. In order to make your decision, you consider the following:

- It will cost you $5,000 to apply for the grant;
- The grant is for $20,000;
- There is one other competitor for the grant, Another Shelter Charity; and
- The foundation will award the grant to you, the other organization, or both equally.

In preparation for your decision, you may develop a matrix (if you are so inclined) like the one on the following spread.

The strategy this matrix describes is a classic example of game theory known as "the prisoner's dilemma." This particular example assumes that the foundation prefers to fund both organizations if both organizations submit proposals, and the decision you must make is to apply—and thus jeopardize the $5,000 fee for the possible return of $20,000—or not apply—and thus save the $5,000 fee (of course, while saving on the fee, you lose out on the chance of receiving the $20,000 grant).

Using your strategy matrix, did you decide to apply for the grant? If your response is yes, you selected what game theorists call "the dominant strategy." The dominant strategy leaves you in a better situation no matter what the strategy is of Another Shelter Charity. If you apply, you stand to have a net benefit of $15,000 (if Another Shelter Charity does not apply) or a net benefit of $5,000 (if Another Shelter Charity does apply and the foundation decides to split the grant between the two organizations).

If you are struggling to understand how a simplified scenario like this relates to your more complicated reality, don't worry. This only means you are not susceptible to mainstream economic decision making—which may explain your success as a nonprofit leader!

Time to Take a Stand

The ongoing invasion of for-profit management theory is more than a potential threat to nonprofit

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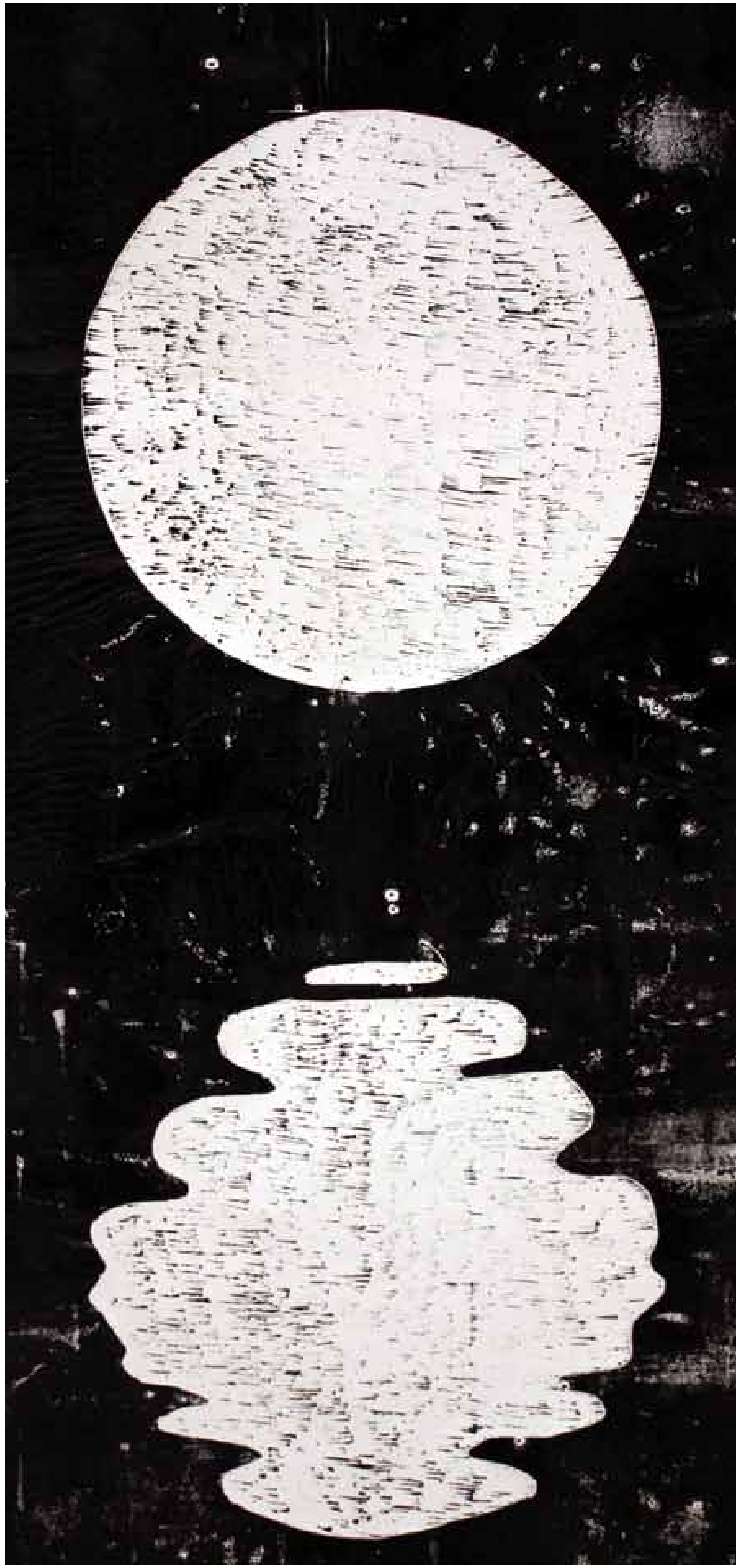
organization productivity. The far greater implication is a fundamental transformation of nonprofit culture through management frameworks emphasizing mainstream economics over social values. Game theory is one of the most recent invaders, and it exemplifies an alarming trend that nonprofit sector advocates have been reticent to push back against.

The more than one million United States charities confront our most vexing social problems. Managers awake each day with the arduous tasks of sustaining a business, providing services that never equal the level of need, and satisfying the competing demands of a diverse and fickle set of stakeholders. Whereas for-profit managers awake with the fear of not enough customers, nonprofit managers awake to the reality of too many.

It is for this reason that our quest for new nonprofit management frameworks is necessary. My question (and more often concern) is, Why are those of us engaged in the nonprofit sector so willing to jettison our management knowledge for models developed in the for-profit sector? In the ongoing search for a panacea promising to salvage nonprofit management from its "primitive state," we (meaning academics, authors, educators, consultants, and managers) willingly adopt models from our for-profit relatives with little to no hesitation. For example, in the last two decades the terms *crowding out*, *social enterprise*, and *venture philanthropy* have entered the lexicon of nonprofit management with limited resistance. Why? As a nonprofit community, have we considered the negative impacts of commercial behavior and/or venture capitalism? Have we offered alternative perspectives on concepts like value and efficiency?

I believe there is worth not only in protecting our nonprofit culture but also in cultivating our sector-specific body of knowledge. A sector comprising 9.6 percent of U.S. wages and salaries and more than 5 percent of GDP has made verifiable contributions to our collective understanding that should be understood and augmented.[1] Thus, the following offers a rebuke of game theory (and its insidious relatives that have made or will make their way into nonprofit management parlance) as a suitable nonprofit management model. More



"BLACK AND WHITE MOON SCREEN" BY CASSANDRA COURTNEY/WWW.CCOURTNEYDESIGNS.CO.UK

		ANOTHER SHELTER CHARITY	
		Don't Apply	Apply
YOU	Don't Apply	$5,000 (Money you save not applying)/ $5,000 (Money ASC saves not applying)	$5,000 (Money you save not applying)/$15,000 (ASC receives entire grant because you don't apply; benefit is $20,000 minus cost of applying)
	Apply	$15,000 (You receive entire grant because ASC doesn't apply; benefit is $20,000 minus cost of applying)/$5,000 (Money ASC saves not applying)	$5,000/$5,000 (You and ASC split the grant: $10,000 each minus cost of applying)

Beginning in the field of mathematics, game theory (initially operationalized by the "Nash equilibrium") was quickly adopted by economists as a decision-making model.

important, I offer preliminary criteria that we can use to judge the utility of new models. Such criteria will not restrict the flow of ideas between sectors, countries, or disciplines; instead, it will ensure we do not discard the abundance of nonprofit management knowledge in our humble quest for improvement.

Game Theory: A Primer

Game theory owes much of its mainstream acceptance to John Nash and his "beautiful mind." Beginning in the field of mathematics, game theory (initially operationalized by the "Nash equilibrium") was quickly adopted by economists as a decision-making model. Before I dismiss its relevance for nonprofit management, I would be remiss if I did not acknowledge the utility of game theory as a model in public policy and military strategy. It is partially because of this success that management scholars and consultants have been so eager to find applications for game theory in management fields.

Most people are introduced to game theory through "the prisoner's dilemma." Like our example, this game positions the player against one other player. The goal of the player is to determine the action that will maximize his or her benefit. At this point, you may interject: How am I supposed to know what the other player in the game will do? A good question, but one revealing your lack of initiation into economic axioms.

Like all mainstream economic decision models, game theory establishes a set of rules (axioms, or assumptions) that govern the actions of players. The rules can be summarized as follows:[2]

1. *The preferences of all players are revealed.* In our example, this would mean that we know the foundation plans to split the grant if both our organization and Another Shelter Charity apply. It also means we know what Another Shelter Charity prefers.
2. *All players have perfect information.* This is a classic economic axiom. For this to be true, as a nonprofit manager you would have to be aware of every possible action available to you. For example, let us assume you are planning a fundraising strategy. With perfect information, you would know every foundation that might possibly fund you, every donor interested in your mission, all government grants available to your programs, and the potential customers possibly willing to pay for your services. Additionally, you would need to know all possible competitors for foundation grants, donations, government grants, and fees for service. To further complicate matters, you must also repeat this same process of knowing for each and every fundraising scenario.
3. *You make decisions that maximize your organization's benefit.* This is the base of rationality underlying most economic decision models. However, what happens if maximizing utility is defined as stakeholder approval, and one stakeholder's values diametrically conflict with another stakeholder's values? This point has been well documented in the arts community, where organizational leaders find that the interests of artists (new productions) conflict with the interests of

funders (traditional productions).[3] By the nature of the two stakeholders' interests, no strategy will maximize approval.

4. *All players are rational and intelligent; therefore, it is possible to predict the actions of all other players.* In other words, if you know a funder is rational, you simply need to figure out what maximizes their utility and then establish a strategy enabling their funding of you to maximize their utility.
5. *The goal of the game is equilibrium among all players.* Ahh, equilibrium—the state of perfect balance, where all consumption and production is maximized. Of course, not all actors seek a balanced solution. Nonprofit A may want more than its share of equilibrium distribution. In this context, equilibrium is a predetermined goal at the outset of the game. In reality, actors in a system cannot know how their decisions impact equilibrium, and thus seek less balanced outcomes.

Using matrices and mathematical calculations, game theory propels the manager through a series of moves or scenarios. Each move is built on assumptions about the behavior of other players in the game. The result is either a dominant solution or a mathematical probability of success for a strategy. But what if a situation cannot be reduced to probabilities because of uncertainty? I will deal with that problem and other limitations of economic decision models like game theory in the remainder of this article.

Game Theory's Insidious Relatives

Hidden in the support for game theory is the belief that all human behavior can be reduced to probabilities and homogeneous behavioral motivations. The truth is, game theory is not alone in this approach. The good news is, the assumptions provide us with a rubric we can use to evaluate the validity of the theory.

Game theory demands adherence to its underlying assumptions. The assumptions create an environment in which decisions are made without uncertainty. If any one of the assumptions does not hold, uncertainty enters and the model loses predictive power. Deductive models suffer from this shortcoming.

For example, let's revisit our opening game and see what happens when assumptions do not hold. Remember, we are operating under the following assumptions:

1. The preferences of all players are revealed.
2. All players have perfect information.
3. You make decisions that maximize your organization's benefit.
4. All players are rational and intelligent; therefore, it is possible to predict the actions of all other players.
5. The goal of the game is equilibrium between all players.

In our opening game, we assumed the foundation preferred to fund both organizations (if both organizations submitted proposals). This type of assumption obviously leaves out two potential options we did not account for in our matrix: a) the foundation only wishes to fund one organization, or b) the foundation does not wish to fund either organization. Nonprofit managers know that funders often choose between these very options, and, because your organization is not identical to the other organization, there is some likelihood the foundation could be more enamored with the other's proposal. Another possible scenario occurs if the two key players and/or the foundation are operating on imperfect information. For instance, after submitting proposals, both you and Another Shelter Charity might discover that three other organizations are also competing for the same grant.

Often, in real world management, we operate from incomplete information. In this game, incomplete information changes the potential outcome of our decision. The dominant strategy we perceived with two players is no longer valid. Further, an inundation of proposals may alter the decision-making process of the foundation. Research has shown that when foundations have imperfect information on grantees, they rely on network information to make a decision.[4] Stated plainly, they rely on their "friends" in the foundation world to provide them with information they use to serve as reasoning for their decision. Under this scenario, lack of

Hidden in the support for game theory is the belief that all human behavior can be reduced to probabilities and homogeneous behavioral motivations.

perfect information has led to foundation decision making that is not rational. Thus, we can no longer predict the actions of the foundation.

The disruptions in the game have created a situation lacking an equilibrium solution. Game theorists would argue that a manager could set up a new game, with new entrants and a new range of foundation decisions, and run the calculation again. This is true. However, the new game is subject to additional disruptions. And even if we could possibly conceive of all the potential disruptions (which we cannot, because of imperfect information), when would a manager have the time to run all these games?

Because research shows that donors are not rational in their decision making, a model assuming their rationality is bound to exclude strategies that may prove effective.

Total condemnation of a management theory for shortcomings in the assumptions of said theory may seem extreme. "Don't throw the baby out with the bathwater" is a common response from those in favor of models relying on rationality. For instance, Hagen Lindstät and Jürgen Müller argue that game theory provides managers with useful strategy options when faced with complex real-world scenarios.[5] Despite theoretical limitations, they believe that game theory offers managers the best model for assessing trade-offs between risks and opportunities. Unfortunately, game theory's rational underpinnings push decision makers down a path blocking important strategic options. This happens because we are forced to conceive of rivals who are intelligent, all knowing, and rational. In reality, decisions are made by human beings, and human beings make decisions based on experience and socialization. All human decisions are inherently not rational and are thus suboptimal from a game theory point of view.

We see this in the behavior of donors. "Crowding out," a complementary theory to game theory, says government donations "crowd out" private donations because rational individuals will not contribute to an organization if someone else (in this case, the government) does so for them. Instead, they will save their donations for a public good that is not subsidized. However, empirical research shows that crowding out does not impact the behavior of donors.[6] Why? Because donor behavior is more influenced by environmental factors, like the donor's parents having modeled the behavior, than utility-maximization behavior. Because research shows that donors are not rational in their decision making, a model assuming their rationality is bound to exclude strategies that may prove effective.

Finally, in order for rational models to work, we have to have a homogeneous definition of value. In the for-profit sector, value is operationalized as price. If you buy a new iPad for $499, you and the retailer agree that the value of the iPad is $499. Nonprofit value is far more difficult to define. Using the example of domestic violence, we may find a multitude of factors influencing a shelter's definition of value. The level of domestic violence in the community—whether or not someone has been impacted personally by domestic violence—and the perception of need for domestic violence services are just a couple of the criteria. If someone previously not impacted by domestic violence comes in contact with the damage incurred by an attack, personal valuation of services is likely to rise. This change, coupled with the imperfect information leading to a lower valuation before the change, explains the level of irrationality in nonprofit markets.

How to Decide

So the question naturally emerging from the above discussion is, How should we evaluate the usefulness of management models? Quite simply, we should utilize what we know. When confronted with a new decision-making model, we should first ask, How well does this model reflect the realities of the nonprofit sector? In order to avoid poor model fit, I suggest following these advisories:

You know what they say about assuming. When I was growing up, my mother would always tell me, "When you *assume*, it makes an *ass* out of *u* and *me*." Sound familiar? The advice my mother offered so many years ago happens to be a sound suggestion for evaluating new management models. If a consultant or educator offers you a new framework for management, ask what the underlying assumptions of the model are. If the list of assumptions is longer than your arm, you can probably be certain the model is not based on reality. The real world is unpredictable. In an effort to control the unpredictability, models make assumptions. These assumptions are useful in theoretical testing but lose practicality for managers. Assumptions narrow the application range of a model.

So, if a model is suggested, and said model has assumptions, validate those assumptions before adopting the model. Otherwise, you may end up dealing with unintended consequences of your decision.

Induce your decision making. Game theory and other rational model theories are developed through deductive reasoning. A more practical approach to decision making is through a process of induction. Inductive decision making is incremental. For example, imagine that you are a nonprofit executive trying to decide between starting one of two programs. An inductive process demands that you conduct a needs assessment on the populations you serve, assess internal capacity, assess receptivity of funders/donors, and utilize information from previous program launches. Inductive processes begin with the collection of facts from the operating environment (deductive processes assume donors will act in a specific way). These facts can then be analyzed to calculate the best way forward. Inductive processes can be more cumbersome and time-consuming, but you arrive at a decision with evidence and support.

Embrace the abyss of uncertainty. As humans, we have an innate desire to reduce the uncertainty in our lives. At times we are able to reduce uncertainty to risk, or a calculable probability of success or failure (think chances of having a heart attack based on family history, diet, and behavior). Unfortunately, much nonprofit management work requires us to make decisions when there is uncertainty. We are not sure how staff changes will impact productivity or how a new program will impact our reputation among similar service providers. Regardless, using models that assume away uncertainty does not prepare us for the reaction our strategy will cause (good or bad). Instead, utilize decision-making frameworks that account for uncertainty. Develop contingency strategies in the event of negative feedback. Frameworks that embrace the abyss of uncertainty will better prepare you and your organization for unintended consequences, enabling organization survival.

* * *

I started this article with the purpose of debunking yet another rational management model invading nonprofit management. Despite what I believe to be a cogent argument against game theory, the trend of bringing for-profit models into the nonprofit sector continues. Nonprofit management has a great deal to offer our collective understanding of decision making and governance. Surviving on limited resources and operating in multiple stakeholder environments are just two areas in which nonprofit managers have established the standard for effectiveness. But until nonprofit stakeholders view their sector (and its management) as a for-profit peer rather than a pupil, we will be continually forced to respond to this invasion of ideas.

[I]f a model is suggested, and said model has assumptions, validate those assumptions before adopting the model. Otherwise, you may end up dealing with unintended consequences of your decision.

Notes

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Managing *in the* New Economic Reality

by Jina Paik

Short-term "cash needs" measures like dipping into cash reserves or using lines of credit are not the answer to weathering the recession. Instead, such long-term internal tactics as cutting costs, generating new revenue, and managing financials strategically, and external strategies like engaging board members and funders and cultivating partnerships and collaborations, are key to improving your economic situation.

Most nonprofit organizations are nothing if not resourceful, and in an environment where your fortunes are largely determined by others, it takes a good deal of care and creativity to stay afloat. But the recession has stretched many nonprofits to their limits and forced them to learn new coping strategies. What follows is what we at Nonprofit Finance Fund (NFF) have heard about the problems nonprofits have been confronted with over the past few years, and the management strategies used to address them.

Economic Stresses Force Nonprofits to Take Action

Four years of difficult economic times have left many organizations in a weaker financial position, with less cash, neglected facilities, rising debt, and ever-more delayed payables. In the words of one Montana arts and culture organization leader, who responded to our 2012 national State of the Nonprofit Sector survey: "We just finished our most recent audit. . . . It shows a substantial deficit for the third year in a row. While our organization is holding on . . . funding organizations look at the tax return, our lack of reserves, and our P&L, and it looks as if we are sinking. . . . Our staff is stretched to the limit, our board has no experience in running campaigns, and no major funder wants to give to an [NPO] without a solid financial future. It's a horrible cycle and there is no way out."

We saw many nonprofits experience a sudden drop in foundation giving in 2008 through 2009, forcing organizations to scramble to meet expenses. Many were unable to do so and had to dip into cash reserves, borrow from other internal funds (more on this later), or use lines of credit. Organizations that had to employ drastic short-term strategies at the beginning of the downturn are now left to repair balance sheets that were stripped of assets, overly leveraged, or neglected.

For many organizations, government funding has been declining overall since the beginning of the economic downturn. Some organizations have experienced cuts to core programs but were offered money for other initiatives less central to their mission. And many organizations have experienced delays in terms of contract payments and even contract signing. These issues are financially destabilizing, to say the least,

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"MONEY" BY JANET TOWBIN/WWW.JANETTOWBIN.COM

With changes in private and public funding, many nonprofits have opened themselves up to considering any and all tactics at their disposal.

especially for safety-net organizations that are heavily reliant on government support—recent funding cuts and payment delays mean they can't cover costs, have to turn away people in need, or dip into reserves. As one Delaware nonprofit leader explained in the survey: "We currently shelter thirty-six homeless men and operate two transitional houses while turning away over one hundred individuals monthly." It also means that core administrative and fixed facilities costs may be threatened when contracts that covered some portion of them are lost.

This does not mean that no nonprofits are experiencing growth. There are some fields that have experienced a significant increase in demand for services, requiring nonprofits to be resourceful in assembling the funds necessary to support the needs of the communities they serve. One of these fields is community health. With the downturn of the economy, communities have increasingly become unable to afford health insurance coverage or are not eligible for Medicaid coverage in their states. In response, many centers have developed plans to expand the infrastructure needed to support both existing demand and anticipated increases with the implementation of the Affordable Care Act. For example, one community health center in an underserved neighborhood embarked on a project to double its services. Despite the challenging economic conditions and highly competitive environment for capital, this nonprofit was able to put together a creative financing structure using New Markets Tax Credits and a combination of public and private investments to fund its expansion.

Nonprofits Often Start with Internal Actions

With changes in private and public funding, many nonprofits have opened themselves up to considering any and all tactics at their disposal.

If an organization is experiencing cuts, often the strategies employed first are internal to the organization, as these are the ones fully within the control of management. Internal actions often focus on *cutting costs*, *developing new revenue strategies*, *employing cash management tactics*, and *improving financial and cash management processes*.

1. Cost-cutting measures

When cutting costs, be careful not to cut essential programs or functions. Cost cutting is a tried-and-true tactic that almost every nonprofit has had to use in the last few years; the trick is to figure out which cost-cutting measures result in the biggest savings with the least disruption. For some organizations, cutting back surfaces efficiencies; for others, reductions are a financial necessity but less sustainable in the long term.

Staffing creativity may be necessary. The rightsizing of an organization may have to occur multiple times as an organization contracts and grows with the environment. As one arts and culture nonprofit from Georgia reported: "At the end of our last fiscal year, we had a deficit and [took] strong action to reduce the debt. For this season, we have reduced programming and staff in an effort to eliminate the debt. The debt will be eliminated at the end of the year, and we will begin to produce a more consistent season next year. Our biggest challenge will be strategically adding staff . . . back to accommodate the increased workload without causing the same strain on the budget as occurred in the past." Some organizations may end up using more contracted workers, whose hours can be adjusted, to avoid having to lay off and then rehire permanent staff. Others may investigate the more widespread use of volunteers, but this generally takes volunteer management capacity.

2. Revenue-generating strategies

When you invest in more fundraising, make sure you are not engaging in unrealistic thinking—give this strategy time to develop. "More money" is the response I usually hear when I ask nonprofit leaders what's most needed in their organizations. Indeed, in NFF's 2011 survey, 61 percent of respondents identified "fundraising assistance" as the single most desired type of technical assistance. The economic challenges have prompted many nonprofits to focus more resources on investments in fundraising—either in staff, consultants, and/or time spent fundraising by non-fundraising staff. The difficult lesson many are learning, however, is that it takes time for new fundraising activities to bear fruit—if it pays off at all. Many organizations that have weathered the recession had their fundraising capacity and relationships firmly in place and ready to be deployed when people became ready to give.

New revenue strategies work best when they are closely associated with who you are. In addition to fundraising, nonprofits are looking to maximize income-generating revenue streams. One healthcare nonprofit facing shrinking government funding for HIV screening—a needed service within its poor and isolated community—sought out new funding opportunities to subsidize existing services. It added more well-funded screenings for hepatitis to its service offerings as a means of supporting healthcare workers' salaries. Likewise, other nonprofits able to generate income through service fees, sales, or other activity began looking at pricing—balancing what a client can/will pay versus an amount more meaningful to the nonprofit's financial sustainability.

3. Cash management

Using restricted money to cover other items is a dangerous practice. With funding cuts and delays, nonprofits have been using their own cash to close the gaps. In fact, NFF's 2012 survey showed the use of cash reserves as the number one way organizations are managing government funding delays. For organizations without reserves, cash has most often come from delaying payables or taking on debt. In some cases, managers used cash from up-front (sometimes restricted) payments, leaving them obligated to deliver on future programs, possibly without the funds to do it—not considered a best practice! One *NPQ* reader recently commented that everyone calls the financial staff at her organization the "reallocation team." It is dangerous to reallocate funds, as many organizations discovered during this period: you risk being unexpectedly audited by a funding source.

When cash is tight, make active use of cash-flow projections. In an environment where many organizations have been experiencing payment delays for their services—particularly from government—having a good handle on cash flow has been critical to meeting payroll and keeping the doors open. Managers using cash-flow projection tools have been able to predict cash shortfalls and address them by managing their own payables, or, in some cases, through a line of credit. While managers most often run monthly cash-flow projections, organizations in crisis may create weekly—or even daily—projections.

Do use your line of credit when timing is the issue. Since the economic downturn, we've seen increased interest in opening lines of credit. This may seem like an attractive option when faced with funding delays, but organizations may confuse *cash-flow* needs with *cash* needs—a problem we see often. *Cash-flow* problems are a timing issue—money is coming in but perhaps not in time to pay off vendors. In these instances, lines of credit can be an appropriate way for an otherwise financially healthy organization to manage cash-flow timing issues. *Cash* problems are very different—they are an issue of not having secured enough total revenue to cover expenses. Organizations facing overall cash shortages are often turned down by lenders because there is no concrete source of repayment, raising concerns that the line of credit would be used to plug operating deficits, thus destabilizing the organization in the long term. (Thinking you might get a grant is different from having an award letter.)

Use a line of credit thoughtfully. In an example of appropriate line-of-credit use, one California child care nonprofit took on a line of credit to manage extended delays in state funding while in the midst of shifting its business model. It used the credit to invest in the move away from its underutilized child care centers to preschool programs, which were in high demand and more lucrative. The organization was able to manage expenses while waiting for income from the preschool programs, and eventually repaid the loan.

4. Financial management processes

If you are not clear on why you are failing, get an expert analysis of your organization's financial dynamics. As the economy brought financial challenges into stark relief for many nonprofits, leaders began to expend more resources on increasing their own financial capacity. They wanted to understand the financial dynamics that drove their organizations, plan around

In some cases, managers used cash from up-front (sometimes restricted) payments, leaving them obligated to deliver on future programs, possibly without the funds to do it—not considered a best practice!

uncertainties, and communicate financial needs more clearly to stakeholders. Recently, a New York nonprofit sought help because it was on a financial cliff. It had been incurring deficits for several years and was at a point where another year of deficits would have meant closing its doors. It operated many programs but didn't know which ran deficits and which produced surpluses. With a program profitability analysis, management was able to understand which activities drove revenue versus where the cost centers were, and could consider how best to balance programs that both achieved their mission and improved their financial position. In another example, an arts organization faced with an unsustainable business model had to undergo programmatic and financial soul-searching. It needed to rebuild support among funders, board members, and clients, but to do so it first had to understand its value in the marketplace and the internal financial dynamics that had driven past decisions regarding programmatic investment. Only then could the organization communicate a new plan for programs and finances more in line with core values.

Engaging funders may seem obvious, but less obvious has been knowing how much to reveal to funders about financial challenges.

External Responses Help Strengthen Relationships

As we saw in the last example, many nonprofits quickly need to look beyond their own walls when considering strategies for improving financial strength. Externally focused strategies, such as *engaging board members*, *engaging funders*, and/or *creating partnerships and collaborations*, are often helpful in strengthening the key relationships that directly or indirectly result in revenue or cost savings.

1. Engage board members

Get the board to step up as partners in developing financial strategy. In the past few years, nonprofit managers have increasingly reached out to their boards to enlist their know-how and networks. Board members, particularly for smaller organizations, have started to play a more active role in helping organizations manage through tough times. More than giving money, they have given time and expertise. For one organization facing a period of financial instability, the board was critical in reaching out to funders to explain the situation and address any concerns they might have had about the organization's long-term game plan and stability. They also dug into the financials, making sure they understood the details in a deeper way and helping leadership think about how they could get on a path to better long-term health. This engagement of boards around the financial health of the organization often prompted requests for more useful, clear reports that could generate meaningful board discussion. Boards wanted more strategically presented material that allowed for well-informed decision making and governance. Conversely, we saw nonprofit managers eager to educate their boards on the organization's financial dynamics, trends, and needs as a way to begin a dialogue around the importance of more-concerted board efforts. Our 2012 survey showed that around two-thirds of nonprofit leaders wanted to see their boards more actively engaged—either directly or indirectly—in fundraising for the organization.

2. Engage funders and friends of the organization

Figure out how to talk with funders about what you really need. Engaging funders may seem obvious, but less obvious has been knowing how much to reveal to funders about financial challenges. Since the recession, we saw more nonprofits wanting to engage long-time funders regarding their continued commitment to their missions as well as how economic circumstances have affected their financial picture. Those able to have these conversations not only created trust through transparency but in many cases also strengthened their funder relationships. Yet NFF's 2012 survey reflected that many nonprofits didn't feel comfortable talking to their funders about deeper financial issues. Only one in five respondents felt they could raise the topics of cash flow, operating reserves, or working-capital needs with their funders; even fewer felt they could discuss debt or building reserves. While these conversations may be difficult to start, due to actual or perceived reluctance on both the funder and nonprofit sides, they are increasingly important in a world of diminished resources. As one California human services organization said, "We will respond to the decrease in funding by continually transforming our programs so that they are as efficient and effective as possible. We will also be diligent and intentional in our messaging to our funders so that they see the benefit in contributing to us."

3. Create collaborations and partnerships

Look for supply chains you can be a link in. More and more, nonprofits are looking to partner with other organizations to find efficiencies and increase programmatic impact. In NFF's survey, around half of nonprofits said they had collaborated to provide programs and would continue to do so. These partnerships range in depth from a coordinated but separate effort to a joint program to a full legal merger of two organizations. Collaboration can be a smart way to access necessary but non-core services that are ably provided by another organization. One of my favorite examples is Pine Street Inn, a homeless services nonprofit in Boston that decided to get out of the clothing business ("as nice as it was, it wasn't essential for housing") and instead partner with a neighboring Goodwill Industries to provide clothing to their homeless clientele. As the executive director tells it, "When I went to meet the head of Goodwill she showed me a huge barrel of socks. . . . She told me they threw them out because no one bought them. . . . I laughed, because one of my first jobs at Pine Street was . . . collect[ing] socks. We went through so many socks. Here was Goodwill five blocks away, and they could have supplied us with all the socks we needed for free. I think of this story often because I don't think we collaborate or share information enough in this sector, even in simple ways."

Cautionary Tales

While we've seen many strategies that have helped nonprofits maintain or even improve financial health in the last few years, we've also seen a few that should carry cautionary messages. These strategies were often examples of "silver bullet thinking"—our term for tactics that appear as a singular solution to transform a business model and are often taken without comprehensive planning and research. We've seen silver bullets not only fail to produce the kind of financial stability nonprofit leaders hoped for but also actually leave organizations in worse shape. Silver bullets take many forms, but let's look at a few common ones—*new earned income ventures*, *new fundraising strategies*, and *endowment building*—and their associated financial risks.

While we've seen many strategies that have helped nonprofits maintain or even improve financial health in the last few years, we've also seen a few that should carry cautionary messages.

1. New earned income ventures

Be realistic about new business ventures—they all need time and capital, and most fail to generate expected net revenues. Many organizations have strong business models that include earned income activities from ticket sales, specialized services, and/or program fees. Appropriate earned income efforts become a silver bullet when organizations start new ventures to generate income *without proper planning or investment*. Just think of how many new small businesses fail, even without a nonprofit organization to support. New earned income ventures often require up-front capital in amounts difficult to attain for most organizations, and an appetite for risk—and stomach for failure—that many nonprofits can't afford. A new venture may also mean adding a whole new line of business to the organization—one that requires its own staff, has its own priorities, and incurs its own set of fixed expenses. For example, one religious organization decided to take advantage of its prime location and ample space by renting rooms on its upper floors. The strategy could potentially have added thousands in revenue, but it required investment to bring the rooms to code and ongoing costs for facility maintenance, a building manager, and marketing efforts. Plus, the facility- and room-rental business often monopolized the attention of the board members, who were responsible for most of the organization's regular operations. And, while the activity did generate some revenue, it proved difficult to analyze if it was generating sufficient *net* revenue to validate the tremendous effort.

2. New fundraising strategies: individual donors

Raising money from individuals takes an understanding of and investment in the process. With government and foundation funds in increasingly

As expected funding sources fell through and long-time revenue streams declined, it highlighted restricted endowments' inability to help an organization through a difficult time.

short supply, many nonprofits are pinning high expectations on a new source of funding: individual donations—either in large campaigns with many small donations or a few targeted high-net-worth donors. This strategy may prove to be a good solution for some organizations, particularly since comparable flexible operating money is often difficult to raise. But tactics for generating individual funds differ from strategies for raising foundation or government dollars. If this is a new effort for an organization, it may require hiring new staff with a whole new set of skills, relationships, and experience. It's a decision that may require immediate up-front investment in staff and systems, and the return will likely take time.

3. Endowments

If you need operating cash, do not place money in an endowment. The current economic climate has resulted in many struggling organizations, including ones with large endowments. As expected funding sources fell through and long-time revenue streams declined, it highlighted restricted endowments' inability to help an organization through a difficult time. The total assets may look wonderful on paper but are of little help if inaccessible during times of crisis. For example, one New York human services organization with a sizable endowment has been struggling as much as its non-endowed peers with the steady decline in government funding for core safety-net services. During the past few years, the endowment has not always been able to generate significant income as investments underperformed. Also, because this inaccessible/restricted endowment often created an appearance of financial health, the organization often needed to educate funders about its continued need for ongoing support.

Endowment-building activities can undermine fundraising for annual operations. Organizations looking to create an endowment should consider that while traditional endowments may provide steady resources to an already strong organization, starting or dramatically increasing one is not the answer for most nonprofits. And if you raise the dollars, the corpus is often tied up in restrictions disallowing usage during periods of crisis, even in the face of bankruptcy. Also, most organizations must raise a relatively large endowment to ensure investment revenue that creates real impact on an annual basis. Board-designated reserves, which can be used at the discretion of the board, have much greater flexibility and are a better vehicle for most organizations.

Strategies for Financial Strength

So what are some actions that nonprofits can take to improve their financial situation? Three tactics that will improve your ability to make strategic and informed decisions are *understanding your income statement and balance sheet*, *your cash situation*, *and your data*.

1. Understand what your income statement and balance sheet are really telling you

You can't solve a problem without knowing it exists and from where it originates. Organizations that take the time to analyze both their true operating performance in a given year and their overall resilience as reflected in the balance sheet have the clearest understanding of their financial condition and are therefore best positioned to make smart decisions accordingly. I worked with one human services organization that seemed to be fairly financially stable, judging by their annual profitability—in most years, revenue kept up with expenses. But the balance sheet told a very different story. They had outstanding loans accrued from the last ten years that they had no ability to repay with existing or prospective money. Additionally, the balance sheet reflected ownership of an extensive amount of property, all of which was fully depreciated and in need of immediate maintenance. This understanding of the balance sheet was critical for the organization's fundraising and decision making—an examination of the income statement alone would have masked the nature and immediacy of its true needs and the fact that it had no cash or receivables to absorb deficits.

When looking at their income statements, smart leaders are making sure that they separate restricted from unrestricted funding—something that is not always made clear externally in audits or other nonprofit accounting treatments. These organizations then know whether they are running an operating surplus or deficit. "Counting" restricted funding (such as foundation grants for future years) in the year it was awarded rather than in the year it can be spent can skew the view of an organization's current financial situation. In addition to looking only at the amount that's spendable in a given year, it's also important to separate operating from non-operating money, such as from a capital campaign or endowment gift. Looking at finances like this year after year will help an organization understand its true ability to meet operating expenses.

While surplus and deficit are an important measure of one year's performance, the balance sheet reflects an organization's overall financial resilience. It shows all of an organization's resources (assets), how much is owed to others in payables and debt (liabilities), and how much cash is accessible to cover expenses. By examining the ratio of assets to liabilities and the funder restrictions placed on them, nonprofit leaders can begin to understand how much financial breathing room an organization has for operations.

2. Understand your cash situation

Every nonprofit, whether in a cash crisis or not, should understand its cash-flow situation. Reviewing cash-flow projections regularly will help you predict your organization's need for cash throughout the course of the year and allow you to plan for potential shortfall. By seeing a visual landscape of cash coming into and leaving the organization, managers can begin to distinguish between seasonal lags in cash versus what might be a lack of cash (liquidity) in general, each of which requires very different interventions. Cash-timing strategies might include extending payables (provided that you are staying within your vendor's credit terms), accelerating the collection of receivables, or accessing an outside line of credit. On the other hand, overall cash shortages will require broader management tactics that result in increased revenue or reduced expenses. Finally, keep in mind that if the cash received is restricted for future periods, it should be tracked separately to ensure appropriate usage; otherwise, your organization may end up using dedicated funds in a way not intended by the donor.

3. Be willing to make data-driven decisions

Beyond having access to the right data (be it financial, programmatic, or management), management needs to understand the implications of the data and be willing to make difficult choices based on the information. The organizations we've seen most often on the right track were the ones with access to accurate, timely, and actionable management data, an understanding of what the data were saying, and a willingness to take decisive action based on the data. Management and planning tools most often used by organizations that were able to be nimble in their decision making included profit/loss statements, balance sheet reports, cash-flow projections, profitability analyses, and dashboards. But more important than the volume of data, effective leaders knew how to zero in on the key programmatic and financial metrics that should be used to drive their decisions. To be truly helpful, the data must be presented well, in clear and regular reports. Often, the ability to make "real-time" decisions from these management reports and analyses was the key to turning a deficit situation into a break-even or surplus year.

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A Blend of the Old and the New

There are many exciting new ideas within the nonprofit sector right now—public/private partnerships, mergers and collaborations, pay-for-success/social impact bonds, and social investment instruments, to name a few. While organizations will certainly need to include new options in their tool kit of responses, the tried and true will continue to be important. Sustainability for most organizations will continue to include grant writing, cultivating donor relationships, and applying for government contracts—all while keeping costs as low as possible. Nonprofits need to understand this, and so do funders. As demand for nonprofit services continues to grow and resources become more limited, nonprofits that can proactively take stock, plan, and respond to the changing world will have the competitive advantage and, more important, best be able to deliver on mission.

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Technology's Effect *on* Nonprofit Management

by Holly Ross

With the proliferation of accessible data, decentralized, flatter organizations, and pressure to leverage technology, we must turn the challenges into opportunities and keep up with the pace of change.

"STUDY N. 5" BY FEDERICO CORTESE/WWW.FEDERICOCORTESE.COM

When I am engaged in some form of public speaking, I usually find a few audience members I can connect with. You know, those people in the crowd who really seem to get what you're saying and nod when you make eye contact. About a year ago, I was at an event in New York City, talking about the role of social media in nonprofit fundraising. I found one of those audience members. He was younger and had a typical Brooklyn, New York, look, with skinny-cut pants, facial hair, and thick-rimmed glasses.

He could barely sit still through most of the talk, so I was unsurprised when he leaped to his feet in the question-and-answer period. He began his question with a two-minute preamble, in which he repeatedly referred to "old-fashioned" fundraising—the "traditional" kind. Finally, he landed on his question and asked the panelists, "So what do you think is going to happen to all the organizations that are still stuck on these old-fashioned fundraising techniques, like, you know, *e-mail*?"

I was floored and have no idea how I answered his question, but I do recall flying off the dais to catch him as he went out the door at the end of the

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program. His question had summed up a thought I've been grappling with as a nonprofit leader myself—technology isn't that "other thing" that you do anymore. It's not merely ubiquitous but pervasive, embedded into the very fabric of the way we find a restaurant on a Friday night or track our workouts at the gym. This young man made it clear that, for his generation, technology is not second nature—it's just plain natural.

[T]echnology isn't that "other thing" that you do anymore. It's not merely ubiquitous but pervasive, embedded into the very fabric of the way we find a restaurant on a Friday night or track our workouts at the gym.

Of course, this young leader is the "new normal," but there are plenty of us still around who remember a time before text messaging existed, and when all you could do on a phone was make a call—and even then it had to be attached to a wire. That said, we all recognize that technology has changed the landscape of fundraising and afforded us remarkable leaps forward in our work, such as:

- Cloud computing, which has made it possible for us to do more of our work, from anywhere, at any time;
- An abundance of data coupled with advances in data-analysis tools, which have helped nonprofits better understand the impact and effectiveness of our work;
- Mobile phones and tablets, which are beginning to rival laptops in functionality and flexibility; and
- Social media, which has brought us one tweet closer to our supporters.

What once was the purview of specialists has become part of all we do, both personally and professionally. Despite all the possibilities, however, for many nonprofit leaders this transition has been somewhat uncomfortable. While we strive to wear technology well, it is often, at best, an itchy second skin. It is not natural for us, nor even second nature. Yet it's a gap we must bridge, because technology has not only changed what is possible for us to do in our organizations—it has changed how we lead and manage them.

In situations like this, I think it's appropriate to quote Dr. Phil: "You have to name it before you can claim it."[1] Our job as leaders is to, well, lead. We must articulate the discomforts technology has injected into leadership and manage these in ourselves before we can bring our organizations past the initial discomfort and into the future.

Technology and Leadership: Challenges and Opportunities

Technology has created a flatter information environment, and we can either attempt to tamp down the results or we can leverage them. In essence, technology has jump-started the concept of a learning organization, so that the term itself has nearly filtered out of our language; now "learning organization" is or should be the default mode for any organization looking to maximize its impact.

But it takes a certain confidence of leadership—and modeling from that leadership—to embrace the idea that all staff need and can add to the organization's wisdom and strategic positioning. And sometimes the push for transformation of this kind comes from the outside in (or the bottom up), so the two sides have to meet.

Ultimately, technology hasn't changed what, fundamentally, makes a good leader. Even after a solid decade of disruptive technologies, 2009 research from the Center for Creative Leadership identified seven key leadership qualities that probably still look very familiar:[2]

1. Leading: directing and motivating people;
2. Strategic planning: translating vision into realistic business strategies, including long-term objectives;
3. Managing change: using effective strategies to facilitate organizational transformation;
4. Inspiring commitment: recognizing and rewarding employees' achievements;
5. Resourcefulness: working effectively with top management;
6. Doing whatever it takes: persevering under adverse conditions; and
7. Being a quick learner: quickly learning new technical or business knowledge.

However, technology has dramatically altered how those qualities manifest in leaders and how staff, board, and stakeholders perceive their leadership. In other words, good leaders still have to direct and motivate people well, but technology has changed *how* leaders do it, and the leader's use of technology in directing and motivating people can influence how stakeholders feel they are being led. Also, there are simply more people than ever inside of our organizations who lead from the positions they hold.

As with most change, the coin of technology change comes with two sides. Nonprofit leaders from around the country have long reported their greatest technology challenges in Nonprofit Technology Network's (NTEN) annual Community Survey. The following are some of the most cited issues—issues that come with both challenges and opportunities:

Responsiveness. Inherent in responsiveness are two ideas: timeliness and thoughtfulness. A responsive person must offer a reply that arrives when it is needed and contains the information that is requested. Somewhere between typing up responses to memos on carbon paper and direct messages on Twitter, we forgot about the thoughtfulness in service of the timeliness.

By now, we've all had the experience of the person who e-mails you just hours after sending a message, to ask, "Did you get my earlier e-mail? What's your answer?" It's clear that the expectation has shifted. Leaders must now be prepared to respond to any situation as quickly as possible, day or night. You may know (or be) the executive who answers e-mail before going to sleep at night and again upon waking because of this shift.

Social media has further hastened this need to respond. We saw this famously play out for the Susan G. Komen Foundation. On January 31, 2012, news broke that the foundation would no longer fund breast-cancer screening at Planned Parenthood. Just hours later, Planned Parenthood sent an e-mail to its supporters with the news. Moments after that, the angry tweets and Facebook posts directed at Susan G. Komen began flooding the social web. Komen's supporters also posted in these social spaces, but the organization itself said nothing—for nearly a full day.

In an age when anyone can contribute to the conversation about your organization and your issue, lack of responsiveness can translate into lack of leadership, and you won't always like what fills the vacuum.

Visibility. Technology has made it possible for us to share anything and everything about our lives. Did you go for a run? Post your route and times on Facebook! Go out for a great dinner? Better get an Instagram pic of that! Along the way, we've come to expect some of the same from our leaders. While you don't (usually) have to tweet what you had for lunch, stakeholders and staff are more frequently asking for leaders to share the *why* along with the *how*. As Charlene Li puts it in *Open Leadership: How Social Technology Can Transform the Way You Lead*: "Rather than using the word 'transparency,' which implies complete openness and candor, I prefer to describe this skill as making information and processes 'visible.' You make visible your goals, and also the challenges, threats, and opportunities you face."[3]

Being a visible leader means sharing what you're working toward, how you plan to get there, and where you fail and succeed along the way. Before visibility was the norm, it was possible for leaders to remain enigmatic—sitting in the corner office, dictating to the lower echelons. Now, leaders must be highly visible, demonstrating what matters in their organization through shared actions and words. This is how you build and sustain culture in a Twitter-informed era.

You must have a clear, concise, and consistent message that is shared in your community. As Jamie Notter and Maddie Grant put it in their book, *Humanize: How People-Centric Organizations Succeed in a Social World*: "If you don't say anything, or if the messages are mixed or unclear, then your people will simply invent what they think the culture is supposed to be."[4]

Thinking Different(ly). "Doing whatever it takes" is one of those leadership qualities we all look for. Social media and other technologies have certainly expanded our possible definitions of it. For example, there used to be a couple of ways to get your message out to the public; now there are dozens.

While the possibilities have been expanding exponentially, our sector has responded by doubling down on the notion of "best practice." Search Amazon.com for "nonprofit best practice" and you will find over 13,000 results, from marketing to accounting. The notion of documenting the "best" way to build a website is simply anachronistic. Relying on best practices, what *has* worked, keeps us from focusing on what *will* work: the possibilities technology opens up for us.

Letting go of best practices will release us from the tyranny of incrementalism (if we focus

In an age when anyone can contribute to the conversation about your organization and your issue, lack of responsiveness can translate into lack of leadership, and you won't always like what fills the vacuum.

[T]echnology has not necessarily made management easier—indeed, there are new challenges that reflect the changes that technology has wrought in jobs, social action, financial transactions, and a host of other realms.

on our best practices, we can serve 3 percent more people next year!) and opens us up to finding truly innovative solutions to the age-old problems we want to solve. In fact, technology may help us to find those creative solutions.

Crowdsourcing, the act of soliciting solutions from the public via social media and the web, can deliver hundreds of ideas quickly—ideas that leaders can use to seed new programs or answer new challenges. At GalaxyZoo.org, for example, individuals can help catalog and tag hundreds of thousands of images from the Hubble telescope, building a massive database that scientists from around the world can use in their research.

Technology and Management: Empowering the Edges of Your Organization

Starting in the mid-1990s, the productivity rate of American workers began to expand dramatically, frequently increasing more than 2.5 percent per year, after decades of stagnant productivity gains. Most impressively, these gains were found largely in service industries, not manufacturing. The reason? Increased computing power.[5]

As in the profitmaking sector, when computers, networks, and the Internet reached an efficient level in the nonprofit sector, managers could help staff do more in less time, building efficiencies that meant productivity gains and the ability to serve more people. But it took decades of experimentation to realize technology's power as it is now, and developments still progress apace. Our work lives are no less busy, because advances have brought with them increased expectations. We are expected to respond quickly to queries, inform and consult with stakeholders differently when a decision affects them, curate data, and share information more openly. We have had to learn how to manage employees and contractors working at a distance, to figure out how to integrate data-reporting duties into jobs that have not been focused on this in the past, and to choose the right software among the many options for financial management, fundraising, constituent records management, and our website presence. We have started thinking about social networking communications policies. To this end, we have had to redesign jobs and the way we communicate.

So, technology has not necessarily made management easier—indeed, there are new challenges that reflect the changes that technology has wrought in jobs, social action, financial transactions, and a host of other realms. There may be two areas in which the challenges are most felt, and those are in the management of data and in the decentralization that is occurring as a result of a flatter information platform.

1. Data

Nonprofit managers have long used data to make informed decisions about what's working and what's not, and technological advances in the gathering, storing, and accessing of data are bringing a sense of certainty that might feel luxurious to some. Many levels of staff can now enter, search for, and access information more quickly; create and document systems that can be used by entire organizations; and produce materials for their programs in a fraction of the time, at a fraction of the cost. While technology can certainly make us more efficient, its proliferation has also drastically changed some of our management assumptions.

At this point, there is very little in our nonprofit work that does not leave a trail of data behind it. Sent out an e-mail? If you have the right e-mail tool, you can see exactly who opened it, what links they clicked on, and where they went on your site. Even phone calls can be tracked and analyzed with the advent of Voice over IP services.

While some might feel that more data means more opportunities for better decision making, the proliferation of data in the last decade has made data-informed decision making harder, not easier. Managers have more data points to wade through, those data are often contradictory, and managers rarely have the statistical background to perform the kind of sophisticated analysis that might be needed to make sense of so much information. In the coming years, good managers will have to learn which data are important to look at and build the skill set that will allow them to understand those data fully.

2. Decentralization

With so much information and production power in the hands of nonprofit staff at all levels of an organization, it's no surprise that today's managers are feeling the squeeze from the bottom. As computer scientist Vint Cerf noted about the Internet: "The Internet is based on a layered, end-to-end model that allows people at each level of the network to innovate free of any central control. By placing intelligence at the edges rather than control in the middle of the network, the Internet has created a platform for innovation."[6]

Simply put, we have become accustomed to finding the information we need and acting on it incredibly quickly, and that access and desire for action is not limited to the top of the org chart. In a traditional, top-down organization, only the top of the pyramid really engages with questions of vision, mission, and strategy. The top makes the decisions, wordsmiths the language, and then bestows it on the bottom of the pyramid.

Today, we need decentralized structures to succeed. Those who used to be at the bottom of the pyramid must be empowered to represent the vision, mission, and strategy in their work and then bring their experiences back to the leadership. The pace of change is too quick to wait for the next regularly scheduled strategic planning retreat to get feedback from your staff.

The challenge here, besides the new model, is that a decentralized, flatter organization ends up requiring more from leadership than the traditional hierarchy. If you're going to empower the edges of your organization to represent you in social spaces, at meet-ups, and through e-mails in ways they never did before, they can't simply memorize your mission statement: they must truly understand your strategies.

This decentralization does not stop at the walls of your organization. Technology has given people the sense that they should be able to communicate with you, so your constituents and stakeholders may be feeling more and more empowered to demand accountability (think Komen). In the end, this forces nonprofits to think much more deeply about their methods of creating dialogue with stakeholders and to communicate in a way that may be less tightly controlled than in the past.

* * *

Technology is the application of science for practical purposes. Surely, technology is our creation, but we are also its work. As much as we have shaped technology, it has shaped us—a symbiotic relationship that brings both great possibilities and great limitations. Recognizing those tensions and navigating wisely will be the biggest challenge for nonprofit leaders and managers in the coming decades.

So, we are faced with a choice. We can embrace the discomfort and try to work through it, or we can decide it's not for us and leave the possibilities on the table. That young leader I spoke with last year? He's not leaving *anything* on the table. Currently, he's using social media to recruit new advocates for his cause: a mobile app to help his supporters track their actions and rank their activity levels. And he's even set up one of those old-fashioned websites!

The challenge here, besides the new model, is that a decentralized, flatter organization ends up requiring more from leadership than the traditional hierarchy.

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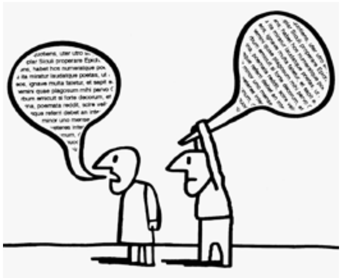

Dr. Conflict

by Mark Light, MBA, PhD

Remember the saying "You're either part of the problem or part of the solution"? If you want to bring a concern to your seniors' attention, come prepared with a fix! But "[t]here is no magic number," says Dr. Conflict, when it comes to determining optimal span of control. Instead, "the choice must achieve harmony with the situation you have, not the one you dream about."

Dear Dr. Conflict,

About a year and a half ago, we moved from two separate fundraising teams (with two supervisors) to one under a single manager. This has been a struggle, because eight of the eleven gift officers are regionally based and they rely heavily on management for guidance. Therefore, although the gift sizes are standardized, management still needs to be heavily involved with cultivation due to our unique volunteer structure.

I'm worried for my team and my management. I'm one of those rare people who love their job, their bosses, their team. I'm concerned that it will be hard to maintain a stabilized state. Throughout the growth and change, upper management has not participated in implementing procedures, and so we do not have any automated processes to make managing eleven direct reports feasible.

I think that my manager should only have a maximum of six to eight direct reports, because the workload is too large a burden for one person. In fact, it's the largest number of direct reports in our whole division and, I believe, the entire organization.

Am I right about the number of direct reports, and, if I speak up, how do I avoid a massive pushback from the top? Please point me in the right direction!

Control Spanner

Dear Control Spanner,

Starting with your question about six to eight direct reports, Dr. Conflict is sorry to burst your bubble, but there is no magic number. Most executives will say it's seven, but taking this approach is the top mistake that executives make around this topic.[1] Why? Because situation is everything, and what works for you doesn't work for someone else.

Though there isn't a "one best way" for exact size, the trend is for flatter and wider. Using data from Fortune 500 companies, a recent study found that the number of direct reports has doubled during the last two decades, from about five between 1986 and 1990 to about ten between 2004 and 2008.[2] Granted, your organization is not one of America's largest companies with the commensurate depth of support staff, but it does suggest that your agency's shift might have been overdue.

Determining the right span of control begins with deciding how to manage your staff. You work hard to recruit and hire, orient and develop, and reward and retain your wonderful people, right? Assuming that you believe in "hire hard, manage easy," how exactly do you want to do this?

Marcus Buckingham uses checkers and chess to frame the answer: "In checkers, all the pieces are uniform and move in the same way; they are interchangeable. . . . In chess, each type of piece moves in a different way, and you can't play if you don't know how each piece moves. . . . Great managers know and value the unique abilities and even the eccentricities of their employees."[3] The point is, if you want to be a great chess-playing talent manager, you'll need more time with each employee, and that translates to a shorter span of control.

Let's nuance this a bit more with the work of Henry Mintzberg.[4] The first question he asks about organizational design is, How do people coordinate work? If folks do a lot of talking to each other up close and personal, this takes time, and you'll need shorter spans of control. This is usually the case with simple structures, in which the boss uses direct supervision, or “adhocracies,” where people come together to mutually solve problems. Think smaller nonprofits or task forces and consultancies.

If you coordinate work through standardization—be it processes (testing for HIV, social service client intake), skills gained before coming to the job (MD, JD, MBA), or where you delegate the ends, not the means (A–Z projects)—you can have much larger spans of control. Think professional bureaucracies like hospitals and higher education, machine bureaucracies like factories and blood banks, or divisional organizations like chapters, franchises, or program- or client-focused groups.

Mintzberg’s second question is about structural elements. If you have detailed policies, formalized job descriptions, and job specialization (you do A, she does B), you are taking a bureaucratic approach that allows for wider spans of control with less supervision.[5] But if you’re informal about these matters—the opposite of bureaucratic—you are taking an organic approach that requires shorter spans of control and more supervision.

Which is better: up-close or standardized coordination, organic or bureaucratic structure, shorter spans of control or wider ones? There is no right or wrong answer, because the choice must achieve harmony with the situation you have, not the one you dream about.

When it comes to the “situation is everything” of the organization, you must first decide whether it’s dynamic or stable. A dynamic world where things are constantly changing requires quick responses that often generate innovative solutions. A stable world offers the chance to build a finely tuned, high-performing operation—a smooth-running machine, as it were.

Not surprisingly, age and size correlate to the situation, structure, and coordination elements. Younger and smaller agencies flourish in dynamic environments, use up-close coordination, have organic structure, and use shorter spans of control. These can be very exciting places to work for those who like the challenge (and stress) that comes with constant adaptation.

Older and larger organizations thrive in stable climates, rely on standardization for coordination, have a bureaucratic structure, and use wider spans of control. Unfortunately, bureaucratic structures have a reputation for “dull and repetitive work, alienated employees, obsession with control . . . massive size, and inadaptability.”[6] But these are the most popular structures, are “indispensable,”[7] and can improve when management uses job enrichment to give employees the chance to use different skills, increase their autonomy, and help develop their careers.

Dr. Conflict is now ready to answer your question about whether in your situation a “maximum of six to eight direct reports” is correct. From a situation standpoint, fundraising is always dynamic and demands constant adaptation. This requires up-close coordination that takes time to deliver, which is why your regional officers rely heavily on management for guidance. This, in turn, necessitates your organic structure that is low on standardized procedures; every day is different, and you cannot script it in advance. Add it all up, and you should indeed be using shorter spans of control. For once, smaller is better.

Why did your management widen the span of control? Maybe it was to follow the trend. Maybe the board chair runs a big factory and compelled it. Most likely it was to save money. No matter: the wider span of control is penny wise and pound foolish.

What about the “massive pushback from the top”? The *wrong way* to go is to offer up the problem and let them find the solution, which might be to reduce the span of control by one—you. Better to outline the problem and then provide the solution, which is to make you an assistant manager with a span of control of three people. You did say you were “one of those rare people who love their job, their bosses, their team,” didn’t you? Now prove it and become that great, chess-playing talent manager that you are obviously destined to be.

Notes

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Dr. Conflict is the pen name of Mark Light, MBA, PhD. In addition to his work with First Light Group (www.firstlightgroup.com), Light is executive in residence at DePaul University School of Public Service, where he teaches strategic management, human resource management, and ethical leadership. John Wiley & Sons published his most recent book—*Results Now*—in 2011.

A Tale of Two "Turnarounds": Heading Back in the Right Direction

by John H. Vogel Jr., Kelly L. Winquist, and Christine J. Spadafor

When faced with a crisis, it is difficult to know where to begin to repair the damages. The key is not to get overwhelmed. Instead, pinpoint essential areas needing attention, come up with strategic goals, and focus on achieving them, measuring progress along the way.

Editors' note: *This article is based on the experiences of two organizations that were in desperate straits. It tells the story, from the perspective of the executives, of what it took to turn the ships so that they were headed back in the right direction. They may not be all the way back in safe port, but who is these days? The circumstances that led to the organizations' turning point had many elements that were unique to each one. The fact that they took such similar actions provides useful insights.*

The year was 2006. Two large and important nonprofit organizations faced desperate situations. St. Jude's Ranch for Children had run through all of its unrestricted reserves and was losing $826,000 a year. The chairman of the board of directors believed they had three months before they would have to declare bankruptcy and close their doors. At the American Red Cross, about two-thirds of the revenues came from the Blood Services Division. In 2005, the Blood Services Division lost approximately $300 million, which caused the Red Cross to run a deficit of more than $100 million. Given its unique charter, the Red Cross was not in danger of going bankrupt, but it *was* in serious jeopardy of losing its independence as a nonprofit organization and coming under much stricter government oversight.

The financial losses were only one example of the troubles plaguing these two organizations. For example, Christine Spadafor, who would become the new CEO of St. Jude's Ranch, recalls an employee telling her that he had accumulated several hundred hours of comp time. "Everyone kept track of his or her own hours," Christine recalled, "and if they worked an extra hour or two one day, they believed they had earned comp time, which they could (and did) use whenever they wanted without notifying their supervisor."

Today, both of these organizations are financially healthy and providing higher-quality services to their clients. St. Jude's Ranch has been voted one of the top five charities in Nevada and the ninth best place to work in that state, and the Red Cross Blood Services Division has dramatically improved its operations, as demonstrated by the following metrics:

- 70 percent reduction in laboratory testing issues;
- 52 percent reduction in recalls; and
- 63 percent reduction in storage, shipping, and return issues.

In describing the changes that occurred within the two organizations, we do not want to imply that all their problems were solved; but what happened certainly changed their trajectories and positioned them for sustainability. Jack McGuire, the former CEO of the Blood Services Division, draws an analogy of driving down the road and discovering that you have made a wrong turn. Turning the car around does not mean you will reach your destination, but at least you will now be headed in the right direction. Because both organizations took actions that were surprisingly similar, we believe there are important insights and lessons to share. Both U-turns were difficult and painful. The boards and the senior management teams took dramatic actions in order to change the way the organizations did business. We will focus on the five key areas where both followed a similar script: *new leadership*; *board actions*; *hiring and firing*; *financial issues*; and *cultural change*.

Methodology

The primary source of information for this article was interviews. Our research began when we wrote a Harvard Business School–style case study about St. Jude's Ranch for Children, now taught in the MBA program at the Tuck School of Business. In the course of writing the case, visiting the site, reading through hundreds of pages of documents, and interviewing the key participants, we felt there were important milestones and insights. For the American Red Cross portion of this article, we relied on Jack McGuire, who served as head of the Blood Services Division and also served, for a couple of years, as acting director of the American Red Cross. Jack participated in several in-depth interviews and numerous follow-up discussions. We did not have access to internal Red Cross documents but were able to gain additional supporting information from articles, annual reports, and other public information.

A Snapshot of Each Nonprofit

	American Red Cross Blood Services Division	St. Jude's Ranch for Children
Industry	Blood	Foster Care
Revenue in 2005	$2 billion	$5.4 million
Number of Employees	Over 10,000	105
Headquarters Location	Washington, D.C.	Boulder City, Nevada
Location of Offices/Campuses	National	Southwest USA (Texas and Nevada)

The Problems at the Blood Services Division of the American Red Cross

In 2006, the Blood Services Division was the nation's largest supplier of blood and blood products, providing about half of the blood used in medical procedures in the United States. In addition to its financial problems, the Blood Services Division was operating under a consent decree with the Food and Drug Administration (FDA), requiring that it fix its problems or its leadership would be jailed.

The Blood Services Division was decentralized and inefficient. It was organized geographically, with each region allowed to set its own prices and sell blood anywhere in the United States. So, if pricing were higher in a different part of the country, one division would sell blood to another division rather than serve the hospitals in its region. Being organized regionally also meant that the Blood Services Division could not take full advantage of economies of scale.

A careful analysis of the Blood Services Division revealed that each region actually operated eight different businesses. For instance, although all the businesses involved blood, collecting blood is a very different business from selling hemoglobin. Each business served different customers, competed with different companies, and was governed by different regulatory agencies. When the Blood Services Division ran into financial problems, rather than focusing on the losses in any particular product line it tried to increase blood prices by 20 to 25 percent. The result was angry customers, reduced market share, and increasing losses.

The Problems at St. Jude's Ranch for Children

St. Jude's Ranch for Children is a nonprofit that provides therapeutic residential foster care and related community services. It transforms the lives of abused, at-risk children and homeless young adults and families. St. Jude's Ranch provides a safe, homelike environment on its three campuses—where children are nurtured, learn life skills, and heal from traumas they have encountered—as well as community homeless and sibling preservation programs. In 2006, in addition to its financial problems, St. Jude's Ranch faced numerous organizational and operational issues. For example, the State of Texas revoked the contract of one of St. Jude's facilities and stopped referring new children.

New Leadership

As is typical in many turnaround situations, the first step both boards took was to install new leadership. In hiring a new CEO, both the Blood Services Division and St. Jude's Ranch selected people who had the same characteristics in three important respects:

1. Technical knowledge of the industry;
2. Significant experience working with nonprofit organizations; and
3. Personal resources.

The American Red Cross hired Jack McGuire as its new CEO for the Blood Services Division. Jack had extensive knowledge of the healthcare sector and the blood industry from his work at Johnson & Johnson and several start-ups. The Blood Services Division had even been his customer at one point, when it purchased his company's medical devices to help manage its blood supply.

Jack's background also included serving on the board of a number of nonprofit organizations. His work with nonprofits gave him credibility with the staff at the Red Cross and also made him sensitive to the cultural difference between nonprofit and for-profit organizations—he did not try to turn the Blood Services Division into a clone of a Johnson & Johnson business unit but instead focused on leveraging experience gained from the for-profit world that could benefit the nonprofit world.

Christine Spadafor had extensive experience working with the Boston courts as a pro bono attorney, representing neglected/abused children. Although she had limited experience with foster care, she had direct experience working with the government on public health issues when she was at the U.S. Department of Labor and the U.S. Environmental Protection Agency. In addition to possessing a Harvard law degree, Christine was a registered nurse, had a master's degree from the Harvard School of Public Health, and had been the general counsel of a children's hospital as well as CEO of a mental health facility.

Like Jack, Christine had served on several nonprofit boards, including a biomedical research organization and a nonprofit serving critically ill children and their families. Both Jack and Christine had also previously been involved with organizations that had undergone a turnaround, and so knew what to expect.

Interestingly, neither one was dependent on their new organization to build their career or make money. Jack was nearing retirement and had sufficient financial resources to do so. During the turnaround at the Blood Services Division, he risked getting fired on several occasions because he refused to waver from his team's vision and plan. "It was much easier to hold firm and 'walk the talk,'" Jack admitted, "knowing that my family and I were financially secure and not dependent on this job."

Similarly, Christine had been a partner at the Boston Consulting Group and two other international consulting companies, and had established her own successful consulting company. Because she cared about St. Jude's Ranch and the children it served, she was determined to do what it took to turn it around. But she was confident that if the board did not like what she was doing and fired her, she could go back to running her company.

As CEOs during a turnaround, Christine and Jack aggregated unusual power and responsibility. Most nonprofits make important (and often unimportant) decisions in a collaborative way with lengthy discussions, but during the turnaround, when it came to issues like hiring and firing, Jack and Christine often made unilateral decisions. Similarly, they did their own analysis of what was wrong and what had to change. While both were careful to stay within the vision they had worked out with their boards, they will admit to having been the primary, if not the sole, strategist in setting a new direction.

Some differences between Jack's and Christine's approaches are noteworthy. Jack stressed the importance of being consistent in the message sent to employees, board members, and stakeholders. He knew he was making progress when an FDA commissioner reported that people from every region of the Blood Services Division recited the same six corporate objectives when asked about changes being made in the organization. As Jack saw it, "the CEO's job is to clearly envision what the new organization needs to look like and then consistently sell it to everyone around him time after time."

Christine, on the other hand, placed a premium on establishing credibility and stability. As soon as she started, she focused on recertifying the lagging Texas campus with the state foster care system. By achieving this early victory, she gained not only credibility but also momentum, and she gave an early signal of how the new organization would be different.

Board Actions

The boards played a critical role in both situations. The first step was recognizing the full nature and extent of the problem, something most nonprofit (and for-profit) boards tend to underestimate until it is too late. Generally, boards are unwilling or unable to take the drastic steps required. For St. Jude's Ranch, the wake-up call came when they realized they would be bankrupt in three months. Before she became the CEO, Christine was hired as a consultant to do an organizational assessment. She knew the national board was ready for bold action when they unanimously accepted and fully supported implementation of all the recommendations in her report.

Increasing financial losses, the loss of some major customers, and the worsening relationship with the FDA were the impetus for the Blood Services Division. In desperate times, boards often make the mistake of hiring a "savior" who promises to solve all their problems. These two boards wisely chose experienced leaders who understood that executing a successful turnaround would be demanding, painful, and time consuming. Most importantly, they gave their new CEOs their full support and the freedom to run the organization in a new way.

Finally, both boards had to be fully engaged during the turnarounds. Board attendance and involvement were spotty, especially at St. Jude's Ranch. To get board members more involved, both Jack and Christine organized board retreats, where they reaffirmed the mission, began a discussion of the new vision, and developed concrete three-year strategic plans. They then updated and reinvigorated the board's committee structures to foster greater engagement.

Hiring and Firing

Firing people is never a pleasant job, but it is critical in any turnaround. Christine told the national board of St. Jude's Ranch, "Expect 100 percent turnover the first year, because we are raising the bar." The actual rate was not that high, but it was substantial, especially with senior managers. Thankfully, some firings actually helped build morale and sent a clear message. When she discovered that one of the people who picked up donations from the Las Vegas casinos was keeping some of the items, Christine immediately fired the employee and transparently announced the reason at the next town hall meeting: "Stealing from the children is never tolerated at St. Jude's Ranch."

At the Blood Services Division, Jack also found two people acting unethically, and fired them. By the time firings and layoffs were completed, only two of the thirty-six top people were still with the division, and both had new roles. "When you need to lay off people at a nonprofit," Jack reflected, "how you do it is very important. I tried to make decisions about who to let go in a completely objective, cold way but implemented it very warmly." For both organizations, choosing the right people to lay off, and doing it in a transparent, logical way, was critical.

Turnover, firings, and layoffs gave both organizations the opportunity to hire new people with the right skill set and attitude. These hiring decisions were crucial. In some cases, both Jack and Christine found people inside the organization they could promote to fill the new positions. At times, both made mistakes. "The key," said Christine, "is to recognize your mistake immediately and correct it"—as she did when she terminated a new CFO within months of his having been hired.

Financial Issues

Faced with dire financial circumstances, the boards and senior management at both organizations developed short-term and long-term financial plans. Both organizations resisted the temptation to look for a "silver bullet" or make dramatic cuts in their expenses in order to balance the budget. Instead, they developed business plans designed to put the organization on solid long-term footing while at the same time figuring out ways to get through the immediate crisis.

At St. Jude's Ranch, most of the operating expenses are related to personnel. Regulatory requirements about child-to-staff ratios, plus the needs of the children, make it very difficult to cut staff. Therefore, operating expenses, even during the first year of the turnaround, went up by about $300,000. The only major line item that was cut was fundraising, which had become bloated and ineffective. On the other hand, new leadership uncovered some great opportunities to increase revenues. By increasing occupancy, St. Jude's Ranch added $400,000 of revenue in program service fees from state agencies. By doing better-focused fundraising, St. Jude's Ranch increased contributions by $300,000, grants by $78,000, and special events receipts by $50,000.

But the biggest improvement on the revenue side came from in-kind donations. "As our reputation in the community improved, St. Jude's Ranch was able to apply for more grants, especially in-kind grants," explained Christine. "We applied for and won a $1 million extreme makeover from HomeAid of Southern Nevada. As part of this in-kind donation, the contractor, Pardee Homes, transformed the dilapidated buildings and dirt yards at the Boulder City campus into attractive buildings with grass yards." Christine recalls a wide-eyed child asking, "Are we allowed to walk on the grass?"

Although St. Jude's Ranch has run a surplus every year since fiscal year 2007, it is still highly dependent on grants and contributions. Each year it sets targets for each area of fundraising, closely monitors the grants, and works hard at communicating with donors. Senior staff and the board are also determined to build a more sustainable business model that is less dependent on grants and donations. Early on, Christine realized that reimbursement from the State of Nevada and the State of Texas only covered about half the cost of residential foster care, even when St. Jude's Ranch had relatively full occupancy. With the current budget problems in these states, it is unlikely that they will increase the reimbursement rate, even if St. Jude's Ranch provides compelling evidence of being underfunded. So, the staff and board are looking to build or acquire additional, complementary services related to their mission that might be profitable and will reduce their dependence on donations.

The key to the financial turnaround at the Blood Services Division of the American Red Cross was the realization that it was involved in eight distinct businesses. For example, its main business was collecting, processing, and then selling blood to hospitals for transfusions. This business represented about 80 percent of the Blood Services Division's revenue. The Red Cross was the dominant player in this business, and its competition was mostly other nonprofit organizations. But the Blood Services Division also collected blood and separated out hemoglobin (and other proteins), which it sold to the pharmaceutical branches of hospitals. In this second business, the Blood Services Division competed with companies like Bristol-Myers Squibb, which used its economies of scale, its distribution network, and the latest equipment to gain market share.

A careful cost analysis convinced senior management that six of the eight businesses would never be profitable, and that hospitals were being well served by the existing competition. The deficit of $300 million faced by the Blood Services Division provided the impetus to make changes. Over the next year and a half, the Blood Services Division sold off the six unprofitable businesses. It kept the blood transfusion business and one other specialized business related to reagents. The second business will probably continue to run a small deficit, but since no one else provides this service, the Red Cross believes *it* should.

By selling off six businesses, the Blood Services Division not only reduced its losses but also was better able to concentrate on its core business of supplying hospitals with blood for transfusions. As a result, within eighteen months the Blood Services Division was generating a positive cash flow.

Implementing Cultural Change

Improving the financial performance of both organizations played an important role in transforming the organizations' culture, which both Christine and Jack considered their greatest challenge. As Jack observed, "By focusing attention on the financial problems, we created a real sense of urgency and a clear message that things had to change."

Saint Jude's Ranch needed to develop a culture with a much higher degree of transparency, professionalism, and accountability. Financial accountability provided a good starting point. Senior management made sure that everyone fully understood the organization's dire financial condition. Staff members also received updates about operational and financial metrics linked to the three-year strategic plan at monthly town hall meetings conducted by Christine.

To change the culture of St. Jude's Ranch, senior management created and tracked metrics that clearly demonstrated how the organization was doing. St. Jude's Ranch tracked overall measures like "For every $1 donated, 88 cents go directly to our children." And it tracked smaller metrics like "Was a receipt and thank you sent within forty-eight hours of receiving a gift?" One of the first new hires in 2006 was a human resources director, who created job descriptions, personnel policies, and an annual evaluation process, providing structure, fairness, and accountability. Most importantly, senior management continually reinforced the ways in which this heightened accountability benefited the children.

The existing culture at the Blood Services Division was one of serving and helping. Employees were attracted to the Red Cross because of a desire to work for an organization that saved lives. As a disaster relief organization, people were used to acting first and hoping that donations would be sufficient to cover the costs. It was also a decentralized organization in which each local chapter had a great deal of autonomy in the way it did business.

To transform the culture, senior management needed to get everyone focused on the same set of goals. "My job was to take the plan and sell it," Jack explained. "I needed to be more than a manager. I needed to be a cheerleader, a coach, and a good listener." In transforming the culture, senior management made sure everyone understood and "shared" the problem. The most important question that helped transform the organization was not "What should we do?" but "What happens if we cease to exist?" The idea that the Blood Services Division might fold and that people would no longer have access to an adequate blood supply was a powerful motivator. It got employees to think about revenues and expenses and do business differently.

Conclusion to the Two Tales

The story of these two organizations carries important lessons. Faced with a desperate turnaround situation, many organizations become overwhelmed and do not know where to begin. These two organizations narrowed their focus to five essential areas: new leadership, board actions, hiring and firing, financial issues, and cultural change. In so doing, St. Jude's Ranch and the Blood Services Division of the American Red Cross climbed out of a deep hole and survived.

Both organizations continue to face major challenges. For St. Jude's Ranch, the challenge is to create a sustainable business plan that is less dependent on donations and limited state reimbursement. The Blood Services Division continues to operate under a consent decree with the FDA. In a press release issued on June 17, 2010, the FDA wrote: "Since

2003, the American Red Cross has made progress addressing some of its quality issues, including standardizing procedures, upgrading its National Testing Laboratories, and increasing oversight of the organization. However, to fully comply with federal regulations and consent decree provisions, the American Red Cross must make swift, additional progress on all of the issues the FDA has identified." Developing a customized and highly sophisticated software system is one of a number of these complicated challenges.

In advising an organization trying to dig its way out of trouble, Jack's advice is "be consistent." When an organization is reeling, it is especially difficult and terribly important for the leader to be consistent in his or her message and actions. Christine is a strong believer in engaging the entire organization to collectively achieve and measure outcomes. She strongly advises all organizations, but particularly those going through a turnaround, that "the system that analyzes areas for improvement must equally measure success." To measure outcomes requires gathering objective data, which, in a time of crisis, can seem like a poor use of resources. However, without targets and the data to measure progress, it is impossible to change the culture or know if you are achieving your strategic goals and successfully transforming the organization.

Putting These Stories in Context

Nonprofit turnarounds have become a hot topic. Most of the literature we read about turnarounds was based on specific case studies. It generally emphasized the importance of improving, reinvigorating, or even re-creating the board of directors. In many instances, especially with those organizations that declared bankruptcy, the board played an even more significant and hands-on role than was the case with the Blood Services Division or St. Jude's Ranch. The literature is clear: the board must recognize when a turnaround is needed, and then fully support the tough decisions that have to be made by the executive leadership.

Another common feature of the literature is the importance of having the organization's leadership deal directly with customers and midlevel managers. (Jack traveled the country to deliver his message about how the Red Cross Blood Services Division was changing.) Finally, all the literature stressed the importance of reevaluating the strategy of the organization in light of the mission and core values. Many organizations did something similar to what Christine did at St. Jude's Ranch, and held an offsite retreat for the board where they reaffirmed their mission and developed strategies.

In two respects, our article provides a different perspective from what we found in the literature. First, in selecting turnaround leaders, both organizations selected people who did not need the job financially nor were looking to build a career. Second, our article clearly articulates the fact that even a successful turnaround in which the organization's culture improves and its financial condition becomes stable does not fully insulate the organization from its past. Turning around a nonprofit is always a work in progress.

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Vanishing Act: When a Fiscal Sponsor Disappears

by Rick Cohen

This case study in the broad ramifications of fiscal sponsor failure suggests that, when looking for a fiscal sponsor, it is not enough for nonprofits to review such fundamentals as their policies, board makeup, Form 990s, and audited financials.

Editors' note: *This article was originally a two-part feature published on* NPQ*'s website, on February 3 and February 14, 2012, as "Vanishing Act: Activist Groups Say Donations Disappeared with Fiscal Sponsor" and "A Global Nonprofit Ponzi Scheme? Lessons Learned from a Fiscal Sponsor's Collapse," and updated based on information available in May 2012.*

Dr. Julie Ray runs la mica Biological Station, a research and education facility that focuses on conserving the local environment, history, and culture of central Panama. Working on location, she is unable, as she put it, "to run the NGO" herself. So she chose the International Humanities Center (IHC) to be the project's fiscal sponsor, because of IHC's "experience working with projects located abroad who wanted to fundraise in the U.S."

From 2008 until May of 2011, IHC was quick in paying La MICA's expenses; Ray would request advances deposited into the project's account, and present expense receipts whenever she returned stateside. Then, communications and payments from IHC became a bit more sporadic and, at times, nonexistent. Advances and payments that were normally same-day transactions began to take two to three weeks or more. Ray was told that there was only one IHC staffer who could process money transfers, and that when he went on vacation, the process stopped.

Ray finally contacted IHC in December to inquire how she might be able to help expedite the process. Should she submit her requests for funding more than a month in advance if it was taking IHC a month to process requests? Was IHC so short-staffed that managers of projects like La MICA Biological Station should be thinking about how to adjust their financial planning? Two e-mails from Ray to IHC leadership got no response. Then Ray learned of a letter that had been sent to some projects from IHC's executive director, Steve Sugarman, on December 15, announcing that IHC was insolvent—all but broke, in fact—and therefore unable to meet its obligations to a number of the projects on whose behalf it had collected donations.

Unfortunately, La MICA was not alone in looking for money that it thought IHC was holding on its behalf. IHC was a fiscal sponsor for over two hundred groups (its list of projects numbered as many as three hundred, by some reports), largely politically or culturally progressive activist organizations, all of which were blindsided by the news that it had gone out of business. Most disturbing of all was news that the funding that IHC held and managed for these groups had largely evaporated.

The groups included the Afghan Women's Mission, the Alliance for Bases Clean Up, the Amazon Fund International, Champions Against Bullying, Courage to Resist, the Election Defense Alliance, the Fair Trade Festival, Global Voices for Justice, the National Network Opposing the Militarization of Youth, the Prisoners Revolutionary Literature Fund, and Public Lands Without Livestock. They all counted on IHC's nonprofit legal and accounting structure to receive and deposit charitable donations in restricted accounts on their behalf and to respond to requests for disbursements to pay their bills. In return, IHC received a 10 percent fee. It was a fairly straightforward arrangement, and, until December, most of the projects were satisfied with IHC's service and considered Sugarman a supporter, an ally, and even a friend. But then approximately $1 million disappeared.

What Was the International Humanities Center?

An understanding of how fiscal sponsors work is essential to comprehending what happened with IHC and the groups whose money it held. Fiscal sponsors are established nonprofits that provide their own tax-exempt status—and often a significant back-office accounting and fund management service—to smaller groups on a fee-based contractual basis. The fiscal sponsor receives grants and donations for the "projects" or "programs" that it sponsors, and then typically makes payments to the staff, vendors, and contractors on the projects.

Founded in 2003, IHC was a low-profile fiscal sponsor, with California mailing addresses over the years in Woodland Hills, Malibu, and, most recently, the Pacific Palisades. While not as well-known as the Tides Center, in San Francisco, or Third Sector New England, in Boston, IHC wasn't small; over its lifetime it processed as much as $5 million a year for its affiliated projects, as well as grants and expenses for hundreds of other projects. It grew from revenues of $599,788 in 2003 to as high as $5,253,670 in 2007, although revenues then declined to $3,451,798 in calendar year 2009. That year, the largest disbursements were more than $400,000, for Voter Action (a group focusing on election vote count accuracy), $329,700, for the Palast Investigative Fund (which supports independent journalism examining electoral and economic issues), and $150,000, for Soldier's Heart (which supports programs for integrating veterans back into their communities).

In the closing months of 2011, communications between IHC and some of the projects became sporadic. By early January 2012, some of the projects were informed that their sponsor was out of business. The website was down, and phones either weren't being answered or had been disconnected. Payments on behalf of the projects had stopped, and money was missing. Explanations of what had happened to the groups' funds were confusing and inconsistent.

What Happened?

The story behind the IHC collapse is murky. The relatively tiny groups that lost funds are now trying to piece together what happened and just how much of their money has been lost, and they have put public authorities or agencies (such as the California attorney general, the Internal Revenue Service, and even the Federal Bureau of Investigation) to the task of chasing down IHC's executives, managers, accountants, and lawyers. An e-mail list formed to tabulate losses did so for only a portion of IHC projects—reportedly amounting to around $1 million, according to interviews of project directors—but many of those groups still don't know how much they lost, because they had no reliable way of knowing how much IHC had received on their behalf. The approximate $1 million sum is spread across fewer than one hundred of the IHC groups, but for the small, community-based activist organizations that relied on IHC, losing hundreds—or even just tens—of thousands has the potential to devastate parts of their operations.

The news of IHC's collapse struck most, if not all, of the IHC-affiliated projects as a complete shock. Staff or board members at the IHC projects we contacted were unanimously stunned, "blindsided," and bewildered. What went wrong?

Peaceful Uprising, which focuses on nonviolent direct action on environmental issues, was among those contracted to IHC. In November, Peaceful Uprising started to notice that IHC was developing a pattern of delaying payments on bills and failing to respond to communications. According to the organization, it didn't take long to figure out that IHC was "unable to give us access to the [moneys donated to Peaceful Uprising] or to return them—which has left us unable to pay our small staff, rent for our space, or any other expenses." But groups didn't report widespread awareness of major problems suggesting a potential IHC collapse until December, when communications between IHC and the projects became strained, payments to vendors became slow or nonexistent, and Sugarman sent out the December 15 letter that stunned even those projects that hadn't suffered any lagging financial transactions.

Sugarman's letter, which for unexplained reasons did not go out to all the projects, acknowledged that IHC had "fallen behind on fulfilling payment requests in a timely manner . . . [a] situation [that] has grown increasingly critical in the last few months." The letter explained that the center was "running a considerable deficit that has severely impacted all operations" and that "[the] letter perhaps should have been written long before this, but deep concern for the distress it would cause everyone prevented me from doing so." Sugarman called on projects to help him "stop [the bleeding] so the patient can heal," implying that timely payments would not be restored immediately because of a need to reduce the organization's deficit. He "beg[ged the] patience and cooperation" of the projects, and asked them not to contact him "or other staff members with [. . .] anger." Other than saying that he was forgoing his salary, Sugarman offered no specifics as to how the fiscal sponsor of the more than two hundred organizations would rectify its financial distress, closing his letter with a remarkable statement: "Beyond the anger and betrayal you will undoubtedly feel, thank you for working with us, and allowing us the space to rebuild this organization."

One month later, the story changed: there was no rebuilding of IHC going on. On January 16, Sugarman sent another letter, again only to some of the projects, announcing that IHC would "soon be closing its doors." The "work will continue," Sugarman added, but IHC "can no longer be the vehicle that it has been in that endeavor due to multiple circumstances and issues that were largely unanticipated and/or beyond our control." As in the December letter, Sugarman offered an explanation of sorts for the surprise announcement of the center's closing, which presumably had been in the works sometime earlier: "This letter would have gone out weeks ago were it not for the difficulty of seeking counsel through the holidays, and in reaching a consensus amongst the various attorneys consulted," Sugarman wrote. "No radio silence was ever intended," he continued, and "[r]ecently received donations will be returned or redirected to the appropriate destination."

In response to, as Sugarman described it, the "misunderstandings, misstatements and conjecture about IHCenter floating around," Sugarman affirmed that "all funds were used solely to benefit the projects and their support, and to maintain IHCenter and its tax-exempt status"—implicitly contradicting the idea that IHC had diverted any moneys that had come in for the projects to pay for other costs. If IHC had not diverted the money, however, it would have been able to return the funds collected for its projects—or transfer them to some other fiscal sponsor that would take on its assorted projects—and call everything even. But some of the projects say they are aware of funds that were held by IHC and were not paid out, according to an ever-increasing spreadsheet of project losses made available to the *Nonprofit Quarterly*. The groups' spreadsheet counts over $890,000 owed to forty-five of the projects, including a high of $404,967 owed to the Afghan Women's Mission, $80,000 to Peaceful Uprising, $40,000 to the Palast Investigative Fund, and $31,151 to the Election Transparency Coalition. The groups are trying to contact others on the IHC project list.

"Donations continue to be solicited outside the organization on behalf of all projects," Sugarman's letter added. "As funds become available they will be directed toward project balances, so that your work can continue under a new fiscal sponsor. There is no definite time frame as to when this will occur." Sugarman promised to keep the projects "apprised."

Deena Metzger of Mandlovu, one of the IHC-affiliated projects, wrote to her group's supporters and constituents about the impact of the IHC situation on her organization—which lost everything—and on other projects. "Tatenda—which is the organization supporting the African *nganga*, Mandaza Kanenwa [. . .] has lost almost all the funds it raised this year to support Mandaza, his family and community [note: a spreadsheet of IHC groups' losses put the Tatenda loss at $60,000]. Topanga Peace Alliance lost all their assets, and the rent that was to be paid each month to the Topanga Community House was not paid since spring. Headwaters Productions lost its scholarship fund. Another organization lost all the funds designated for a solar village experiment station. These are the ones I know about." As for Mandlovu, Metzger reported a loss of $20,000.

None of the several IHC-affiliated project leaders contacted by *NPQ* had heard from Sugarman about his progress in making up the funds that they lost. IHC's website appears to be down, as do links to descriptions of projects sponsored by IHC. Per GuideStar, the last posted 990 form for IHC is from 2009, which may or may not mean that the organization is having some difficulty presenting its financial picture in a timely and complete way. *NPQ* called two telephone numbers listed for Sugarman and IHC. One was disconnected, and the other was a "textPlus" number—to which we sent a message that got no response. *NPQ* sent an inquiry to Sugarman's IHC e-mail address as well, to no avail.

Causes of IHC's Demise

Clues as to what might have caused the organizational "bleeding" that Sugarman referred to in his December 15 letter are scattered throughout various documents and e-mails. According to IHC's 990 form for 2009, the center had started off the year with $598,387 in cash but ended the year with only $103. At the beginning of the year, it held $691,934 in savings and temporary cash investments, but by the end that number was down to $456,119, a decline of more than one-third. Over $830,000 in cash evaporated that year. In comparison, both numbers had barely budged in 2008, despite the nation's fiscal collapse in the fourth quarter of that year. So was IHC's demise caused by the economy, or was it something more?

Between 2008 and 2009, contributions and grants reported by IHC dropped from $4,958,494 to $3,451,798 (down 30.2 percent), its program service revenue fell from $1,054,625 to $537,446 (down 49.0 percent), and total overall revenues dropped from $6,235,623 to $3,960,031 (down 36.5 percent). It was the beginning of the recession, to be sure, but those are eye-popping financial declines, and we don't know what the organization's 990s might have shown for 2010. None of the projects contacted by *NPQ* indicated that their donors had disappeared in parallel magnitude. The 2008 and 2009 declines in IHC revenues suggest something more than the downward spiral of the recession. The organization cut its overall expenses between 2008 and 2009 by 36.2 percent, but were unfulfilled financial commitments to the organizations IHC sponsored beginning to pile up?

As of 2007, the organization had a positive total in its unrestricted net assets. At the beginning of 2008, that number had shifted hugely to negative $300,000, suggesting that IHC probably owed its sponsored projects moneys that it had spent on itself. By the end of 2008, that number had grown to negative $614,000, though it dropped to a negative $201,000 in 2009. In addition to discovering a batch of unknown liabilities, the auditors documented a growth in IHC's temporarily restricted assets, from $973,000 to $1.557 million in calendar year 2008, a number that stayed at $1.553 million in 2009. IHC might have been able to draw unrestricted funds from its program service revenues, but the number plunged from $1.055 million in 2008 to $537,000 in 2009.

If IHC had professional auditors looking over its finances in earlier years, the nonprofit's 990 forms would have revealed operating deficits, because IHC would not have been able to dip into project accounts that would have been classified as restricted assets. It is incredible that an organization selling its function as a financial back-office operation wouldn't have been aware of these problems. Or, if they *were* aware, the organization would seemingly have had to be engaged in an all-but-intentional Ponzi scheme, knowingly using donations for projects' future expenses to pay their (and IHC's) past expenses. Of course, eventually all Ponzi schemes collapse of their own accord, as money coming in cannot cover past-due calls forever.

In a 2009 interview given to *OpEdNews* (ironically, an IHC-affiliated project that may have lost $10,000 in this situation), Sugarman said, "Tough times call for tough decisions. The folks remaining full-time at IHCenter are highly qualified and dedicated. Those of us on sabbatical (myself, as Executive Director, and the Project Liaison) continue to work as much as possible unpaid. Yet the reality is that working without pay only lasts so long. So there is a juggling act between IHCenter responsibilities and finding other sources of income. I'm at that stage now. The irony is that last summer (2008), IHCenter was invited to submit a grant proposal that will provide three years of capacity building and infrastructure development. We were approved for this funding, right at the exact moment the economy backslid. The grant has been delayed ever since. We still hold out hope and vision that it will arrive."

Did Sugarman and his colleagues begin to draw on the funding they had received for the sponsored projects while they waited for the economy to turn around and this unnamed grant to emerge? Were accounts that should have been kept separate for each of the sponsored groups commingled and used for IHC operating expenses, leaving the projects without access to funds that were legitimately theirs? What really happened to IHC and its capital? As suggested above, there seem to have been underlying problems existing independently of the economic downturn of 2008 and 2009. Sugarman's January letter referred to a three-year IRS audit of the center that, he contended, "had nothing to do with cash flow issues, but certainly exacerbated them in terms of resources spent for staff time and related accounting and legal expenses." The letter also referred to "some internal management issues that necessitated a change in key personnel in the midst of these multiple challenges that has resulted in this crisis." Sugarman described the management issues as interrelated with the other problems, including the IRS audit. Years of IRS auditors laying siege to an organization usually indicates something less than salutary about the organization's finances. Had the IRS caught on to something in IHC's fiscal operations?

On March 16, 2009, IHC's director of operations, Dave Sanders, sent an e-mail to IHC projects announcing Sugarman's sabbatical, which had started two weeks earlier. Sanders announced that he would assume executive director functions, and assured IHC projects that the staff was trained and prepared to handle all incoming requests, but added that under his direction, the center would be "restructuring its administrative systems to increase efficiency and improve responsiveness to all Projects." A year later, Sugarman wrote to the projects with this instruction: "Dave Sanders is no longer employed by nor affiliated with IHCenter. Please do not contact him. If he makes contact with you please do not engage or respond, and please let me know immediately." The story behind that seems to be partly related to unconfirmed but widely circulated allegations that Sanders was either a party to—or victim of—a scam that caused the loss of hundreds of thousands of IHC-held dollars. A written statement from the director of Headwaters Productions (another project that used IHC as its fiscal sponsor) that was supplied to *NPQ* by multiple sources quotes Sugarman acknowledging a fraud that cost the organization a large sum—a fraud that Sugarman characterized as a "Nigerian investment scheme."

During this time, IHC was looking to expand. It moved into new offices in the Pacific Palisades, reportedly signing a long-term lease to overcome one aspect of what Sugarman described as IHC's "explosive growth from 2005–2008, without an adequate infrastructure." Rob Kall of *OpEdNews*, and others, have suggested that IHC's leadership thought the organization was heading toward major growth and needed a larger office and other accoutrements to attract investment capital from an angel investor to propel IHC to new heights.

Sugarman told *OpEdNews* that in 2008 a foundation "invited" IHC to apply for a three-year $15 million grant that would have supported "capacity building and infrastructure development," but the grant was delayed—apparently permanently—with the advent of the recession. At that moment, at the height of the recession, Sugarman was envisioning "sponsoring in excess of 1,000 projects by 2012" as a result of the foundation grant, the angel investor, or both. That magic bullet of a major organization-saving grant never happened.

Despite Sugarman's official written contention that no funds were diverted or misused, the projects tell a different story—one that makes IHC look like the operational equivalent of a Ponzi scheme.

The particularly damaging part of the IHC story is that these projects, like many typical nonprofits, received the largest part of their donations at the end of the calendar year. As IHC slid into insolvency at the end of the year, it seems likely that it may have had access to the largest inflow of the charitable donations that the projects were supposed to have been receiving.

How Did This All Happen?

The center-sponsored projects chose fiscal sponsorships because they didn't want to deal with the mechanics and accounting of setting up and running 501(c)(3) organizations. Remarkably, despite what appears to be a cascading litany of financial mismanagement at IHC, the project directors do not seem to harbor any personal animus toward Sugarman—despite Sugarman's frequent references in his communications to concerns that the projects would be angry at the center's having disbanded without giving back funds that were clearly theirs. Until the center's rapid descent into insolvency, most project directors said that they had experienced little or no problems with IHC's reporting, transparency, and bill paying.

The reality is that most of these projects trusted the center. They hired IHC and off-loaded their financial and managerial work to it, not only because they did not have the capacity for pursuing the technical functions of operating 501(c)(3) charities but also because they did not have the capacity to do the due diligence and monitoring that would have been required in order to discover that IHC's problems didn't just occur in December 2010 but were probably evident in financial decisions and dysfunctions dating back to 2008, if not earlier.

There are questions about IHC and its leadership, but the larger story may be the lessons the IHC imbroglio can teach about the system of nonprofit fiscal sponsorship. How are activists who have little or no capacity or interest in financial management to vet and monitor fiscal sponsors in order to ensure that they are functioning responsibly? What standards do fiscal sponsors hold themselves to that potential projects can look at when seeking to assess reliability? Given the vulnerability of the small projects that rely on fiscal sponsors like IHC, who is monitoring the fiscal sponsorship industry to ensure that this vital service for activist organizations doesn't morph into mismanagement or financial scams?

Sugarman and his operation may have thought they were on the path to a major business launch—a trajectory establishing IHC as a progressive fiscal sponsor competitor to the likes of the Tides Center. But, in actuality, the venture had been teetering for years, operating at less than optimal levels of staff and financial efficiency, and leaving the sponsored projects relying on a thin reed for the basic information they would need to determine their own financial health.

Losses beyond Dollars

Ironically, some of the IHC projects that first encountered Sugarman during his stint with the fiscal management operation Social and Environmental Entrepreneurs (SEE) are now hoping to re-affiliate with SEE as their fiscal sponsor, if they haven't already. Will the projects use their IHC experience to hold their new fiscal sponsor more accountable?

Several years ago, some of the better-known fiscal sponsors—Community Partners, Earth Island Institute, Third Sector New England, the Tides Center, and others—joined together to form the National Network of Fiscal Sponsors (NNFS). Its guidelines for fiscal sponsors laid out a framework of what to look for in a potential sponsor, and some tips on the best practices good fiscal sponsors use. Potential IHC projects might have raised their guard in the face of IHC's failure to follow one key NNFS best practice: the retention of "an independent certified public accountancy firm to conduct and present to the board of directors an annual financial audit consistent with Generally Accepted Accounting Principles (GAAP) and available to the public." Doing so is also a requirement of the California Nonprofit Integrity Act of 2004 for nonprofits with gross revenues of more than $2 million, a threshold that IHC passed in 2006.

Even so, the tiny groups would not have had much ability to gauge IHC on the recommended best practices concerning systems for handling funds, project fund accounting, sufficiency of staffing, and sufficiency of systems. If they had had such abilities, some might not have needed or wanted a fiscal sponsor in the first place.

Greg Wragg of STREATS, an organization for the homeless, and one of the groups that used IHC, says he looks at fiscal sponsors as something like a "supermarket" of financial services for small projects like his. But he does wonder who sets the standards and what benchmarks, if any, exist for gauging performance against the best practices outlined by the NNFS.

Much of the fiscal sponsorship literature is written mostly for an audience of potential and actual fiscal sponsors, but the literature lacks a consumer-oriented guidebook—a tool that projects might use to evaluate and compare potential fiscal sponsors, not just on cost issues but also on quality of service and integrity of operations.

For nonprofit executives with healthy salaries and their own accounting departments, all of these questions may seem moot, but to people like Dr. Julie Ray, the consequences are real. The money that La MICA Biological Station lost (the money that she knows of, anyway) would have funded two months of her work in Panama. Likewise, the Afghan Women's Mission's loss of $400,000 in the IHC collapse will undoubtedly impact the organization's programs in healthcare and education; it means less money for the eight schools it funds in cities and refugee camps in Pakistan, and fewer healthcare resources at the Malalai Clinic in Khewa, along the Afghanistan-Pakistan border, for the approximately 30,000 Afghani refugees in that region.

The fiscal sponsors likely know—and the IHC travesty clearly underscores—just how vulnerable these sponsored projects really are. The stories of the IHC projects serve to remind us that much of the nonprofit sector is small, grassroots, underfunded, and in need of support and protection in order to fulfill important functions in communities around the world that often go unnoticed. The role of fiscal sponsors in helping these fledgling groups function is pivotal. If, like IHC, they blunder, the impact on communities around the world, where every charitable dollar really means something, can be devastating.

Recovery

How do La MICA and other IHC projects recover from this kind of devastating situation? Film 4 Change lost its entire budget for the Albuquerque Film Festival that it runs. Without cash, the founder of the festival, Rich Henrich, said that the event would still continue but that it would be more of a "curated show": "We will push forward in showcasing what we can," Henrich told the *New Mexico Business Journal*, adding, "I anticipate the audience will be reduced and we won't be able to pull in big name celebrities" (who in the past have included Giancarlo Esposito, Dean Stockwell, and Dennis Hopper).

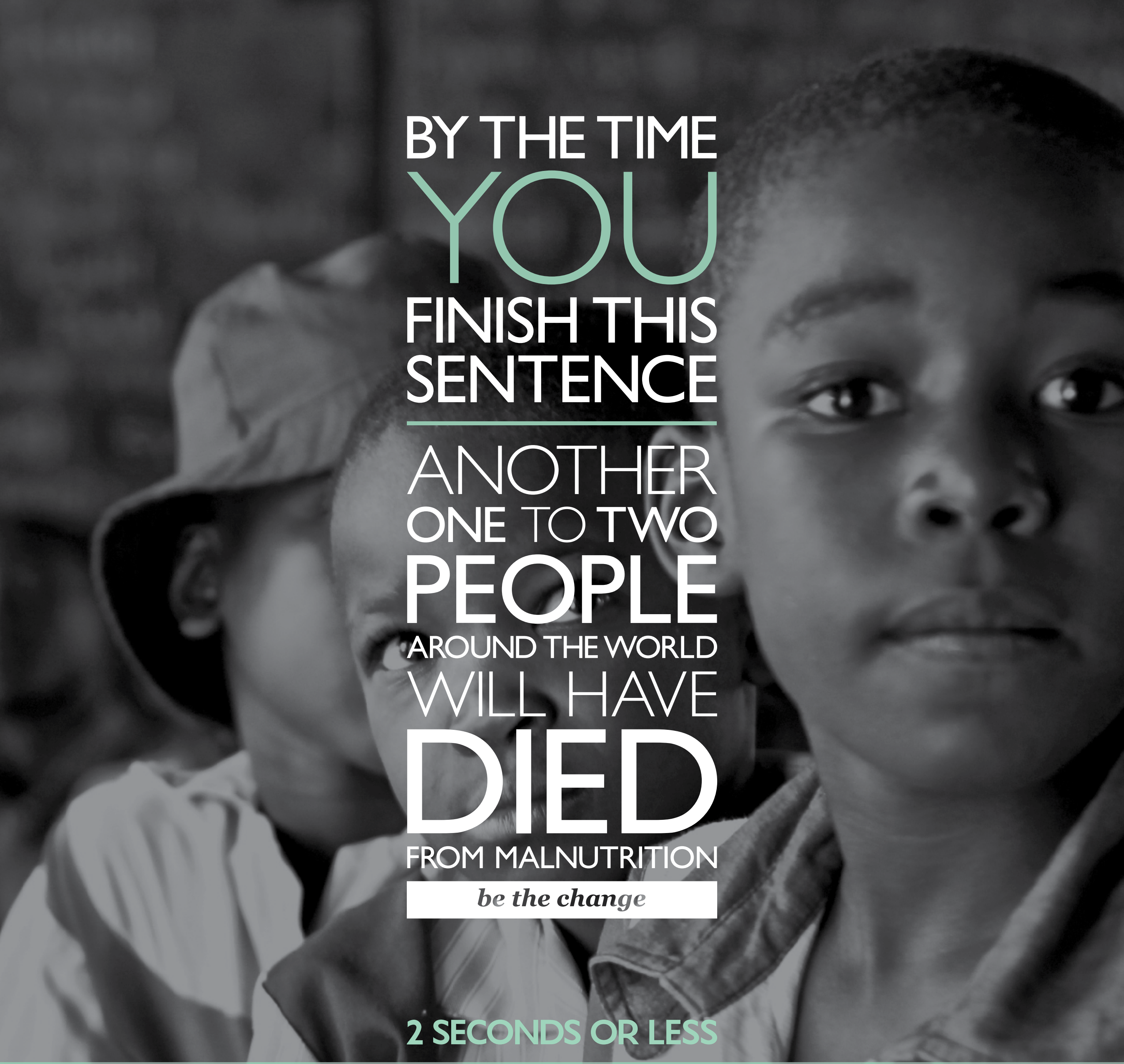
The impact on Peaceful Uprising has been a shift from four paid staff members to an all-volunteer operation from its Salt Lake City office. IHC groups like Peaceful Uprising have to try to explain to donors and vendors what happened to their funds. Henrich told the *Los Angeles Times* in May, "Word hit the street that we're not paying our bills. . . . It does a lot of damage to your reputation." Peaceful Uprising's Dylan Rose Schneider felt that the media coverage of the IHC collapse helped mitigate the bad press, however: "There are always going to be donors who think that you had bad judgment, but seeing that we were not alone in this, that this was an insidious thing—that can help the situation," he told the *Nonprofit Quarterly*. Peaceful Uprising's Henia Belalia added, "We've always responded to challenge with resolve. . . . We've reached out to our friends and allies locally and nationally for support, and the response has been overwhelmingly positive."

As small, personal, mission-oriented groups, the IHC projects have in many cases shown a resilience and determination not only to continue their operations but also to get to the bottom of the scandal and work with public authorities to bring potential wrongdoers to justice. The Jane Ayers Media spring fundraising letter, sent to past contributors in April, was less a request for new or replacement donations than a call for donors to help track down lost moneys that could be reported to authorities: "If any of you have given to Jane Ayers Media over the past few years, and it is fairly easy to locate that donation given through IHC, please let me know, and I will send it to the California Attorney General and District Attorneys who are now investigating IHC."

The IHC projects have reached out to the California attorney general's office and, more recently, the Federal Bureau of Investigation. The *Los Angeles Times* has reported that the FBI has launched an investigation that the *Nonprofit Quarterly* confirmed independently. Will these groups get back the funds that IHC pilfered and lost? It is hard to imagine that there is much money left or that Sugarman and others will miraculously come up with replacement funds. The IHC projects talking to California's attorney general and the FBI may get some justice but not much money.

The ultimate problem, however, is what small groups like these do to find fiscal sponsors they can trust. When the IHC groups begin to search for a replacement sponsor, they will look at the sponsor's publicly available Form 990s, the composition of the sponsor's board of directors, its audited financials, its fiscal sponsorship policies, and references and recommendations. Would any of that or more have warned them off Sugarman and IHC? Or do small, sometimes not particularly sophisticated nonprofits looking for potential fiscal sponsors need more muscular self-policing within the nation's nonprofit fiscal sponsors, and more aggressive support from state attorneys general offices that are supposed to protect nonprofits and charitable donors from predators like IHC?

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



the seed we sow

Our mission to end malnutrition focuses on sustainability. Our approach involves working with and educating young people about the benefits, methods and uses of sustainable agriculture. This way, generations to come can live happy and healthy lives even after our time with them is done.

who we are

Every two seconds, someone in the world dies from malnutrition. This statistic inspired a group of college-aged individuals to create 2 Seconds or Less change the face of poverty in third-world countries. Zimbabwe, our primary target area, is one of the poorest countries in the world. Due to economic and political turmoil, unemployment rates are extremely high. The people are harshly affected by the AIDS epidemic, leaving one in four children orphaned. Education, food, and other resources are rarities within the communities. We are working to combat these issues by creating sustainability, rather than dependency and building relationships within the country.

get involved

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