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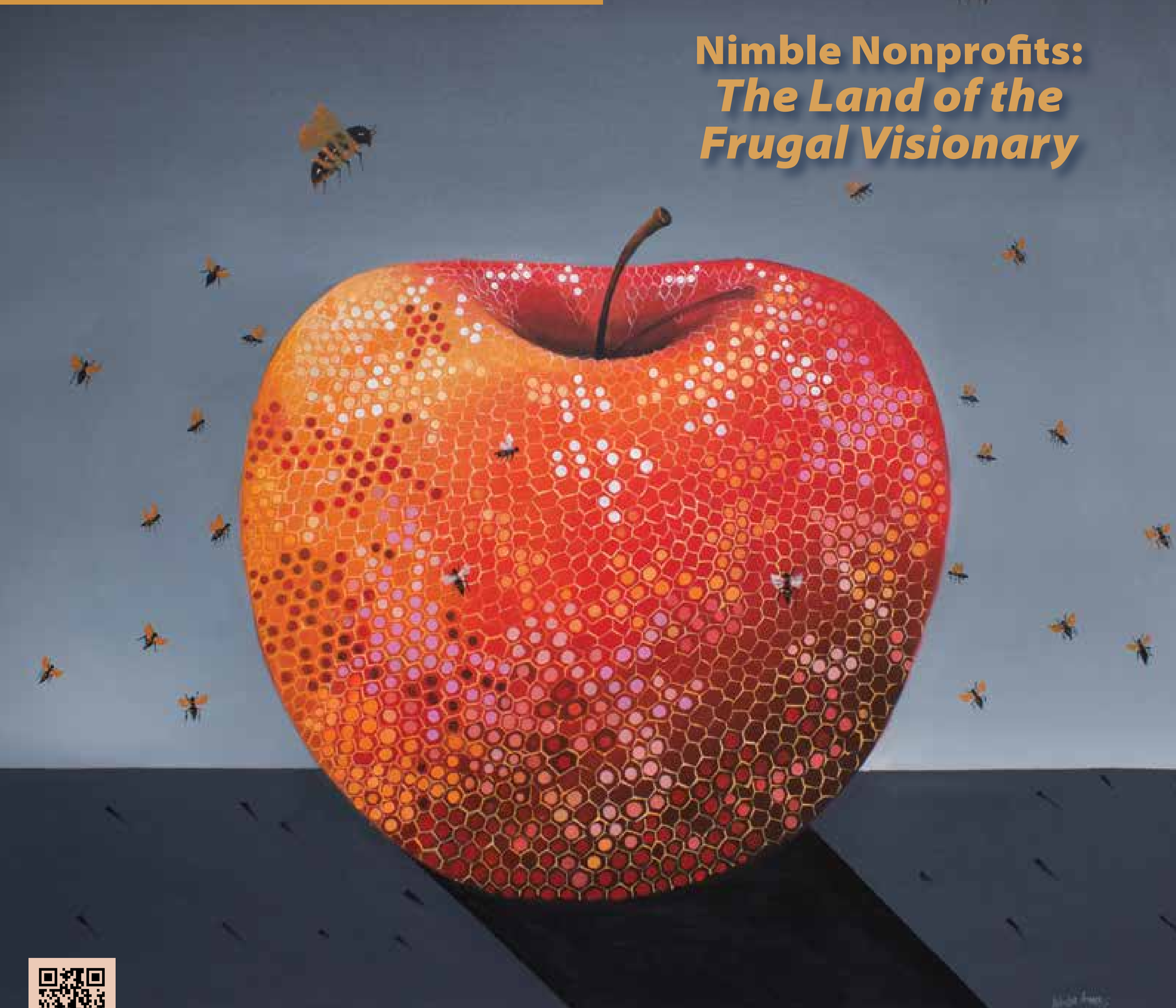

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The Nonprofit Quarterly

Summer 2015

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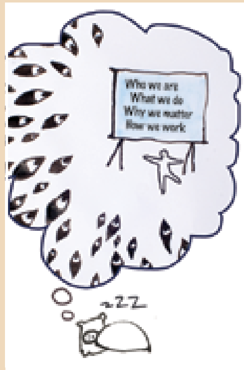

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Ruth McCambridge, Executive Director

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Editor in Chief
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Advertising Sales
617-227-4624, advertising@npqmag.org

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Welcome

Dear readers,

On its surface, this edition of the *Nonprofit Quarterly* is about saving money while expanding capacity—but it is also about addressing the problems that come with well-established ways of doing things that are not always best for us.

And if necessity really is the mother of invention, then the recession acted as parent to many interesting aspects of our various organizations, forcing us to overturn some of those ways of doing things and to invent new ones better suited to our current environment.

This edition looks at some of those inventions—or creative ways to thrive, as one article describes it—and also at examples of the shortsightedness we exhibit when we do not recognize our assets, or recognize them but fail to take action.

These assets, as you will read, are everywhere like coins on the ground—in your networks, your unexplored partnerships, a technological shift (or two or three), your supporters whose energies are not engaged . . . you name it. Even the most stable of organizations in moments of scarcity suddenly "see" such assets—and then it is not pennies you save but previously unexplored riches you can put to use for your mission.

Thus, a theme of this issue is the treasure to be found in the unseen (or, yet to be seen), and perhaps the most useful conceptual frame for this idea is contained in Donella Meadows's extraordinary essay "Places to Intervene in a System." Meadows writes, "There are places within a complex system (a corporation, an economy, a living body, a city, an ecosystem) where a small shift in one thing can cause big changes in everything"—and then lists in ascending order the most powerful leverage points for a system. Although this is in the back end of the magazine, read it first as a stage setter. Let it sink in, and then go back to the more practical articles in the front.

Another surprise in the back end is an odd but powerful article on the agency of "things" in human networks such as boards. This may sound far-fetched, but you will find that you know exactly what kinds of things the authors are talking about, because you will have had your own experiences of the power of an artifact taking on Godzilla-like proportions.

This issue also features articles on collective budgeting, what organizations need to think about when incurring debt, the valuable *free* real estate GuideStar offers organizations to optimize their visibility (are *you* taking advantage of this opportunity?), the ins and outs of directors and officers liability insurance, and one organization's experience contracting out its IT—as well as an exposé of bank trustee fees, and a special insert on how organizations can reasonably expect to cut costs on expenditures they make to advance their missions.

As happens every season, we began with an idea that became more refined as we received input from those who were involved, and we deeply appreciate all who contributed to this edition.

It's NEVER about the Donuts

by Allison Moen Wagstrom

Sometimes, taking our nonprofit budgets in hand requires a deeper dive than may feel completely comfortable. Think business model!

Editors' note: *"It's Never about the Donuts" and partner piece, "Budgeting Time for Collaborative Budgeting," were first published as blogs on April 7, 2015, and May 22, 2014, respectively, by the Nonprofits Assistance Fund.*

I felt sick to my stomach. After a month of avoiding a serious look at our budget and a reforecast for the next six months, I was seeing a deficit of $80,000. I knew that grant funding had not come in as expected and that donations were slower than in previous years. I knew that we had included more stretch goals than baseline fundraising goals. I rechecked my forecast as the dread and fear sunk in. Then I got to work cutting our expenses. First, I went to the things we didn't need for programs: the perks; like the donuts we occasionally brought in for staff meetings and the meal we provided for board meetings. I scoured my office. What else could I cut? The water cooler bubbled. I could cut that. We didn't need the delivered water—that was extravagant. I went to the supply orders over the past four months. I looked into reduction of our printing expenses; I banned colored printing. It's been over six years since this happened, and I can still feel the dread in my stomach.

I was doing everything to avoid the personnel budget line. Our people are what make nonprofits work. Without them our impact would shrink. These people were my friends. I would not recommend cutting staff or salaries without first looking under every single rock. I totaled up my work and felt even sicker than before. I had only saved $7,000. My deficit remained ($73,000). Then it hit me: it's not about the donuts.

Allison Moen Wagstrom is portfolio manager/financial specialist at Nonprofits Assistance Fund.

A Broken Budget Process

The forecast told me what I already instinctively knew: our business model wasn't working. Not only did we have issues with donations—funders had switched focus since the recession, and there was a competitive landscape for individual

"SEAGULL'S DREAM" BY LANI TANAKA/WWW.LANITANAKA.COM/

contributions—but our budgeting process in and of itself was broken. We didn't acknowledge the true funding environment. We did not challenge our assumptions. But, finally, we were forced to face our reality.

A collaborative budget process might be an uncomfortable adjustment for many financial leaders, but it could very well be revolutionary for an organization.

Collaborative Budgeting

At Nonprofits Assistance Fund, we talk about collaborative budgeting (see below). We recommend that your budget process be inclusive of other staff members and the full board. When you include more people in the process, you are able to hold each other accountable to realistic assumptions. Working together, you can be more creative in your solutions. You have more time during the budget process to address issues with your business model than you do—like I did—in the late hours four months into your year.

So, may your budget assumptions come true and may your donuts be plentiful!

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Budgeting Time for Collaborative Budgeting

At Nonprofits Assistance Fund, we teach that a budget is just another version of a mission statement or strategic plan, expressed in a different language: the language of numbers. In order for this to be true in practice, a budget must be the cumulative effort of all who implement the organization's mission, including key leaders from all areas of the organization—board members, program directors, executives, HR leaders, and finance staff. The idea of including this many people in the budgeting process might be daunting for some financial leaders. Those of us with decades of experience trust ourselves to produce comprehensive, accurate budgets very efficiently. Involving people who are not as financially savvy or who may have a bias toward a particular program seems like begging for headaches and complication.

Over the past year, our staff has put a lot of energy into teaching the principles of collaborative budgeting. But our advocacy for nonprofit collaborative budgeting doesn't stop there. We like to practice what we preach by being our own client, always striving to implement the good advice we give. In anticipation of our fiscal year, we engaged in a collaborative budgeting process ourselves. As the finance director coordinating the process, I had a chance to stretch beyond spreadsheets and formulas.

Last year we had the advantage of having just gone through a six-month strategy-planning process that involved not only our board and staff but also a number of clients, funders, and community leaders. Using our new strategic framework as the guide, we began our budget process by focusing on what plans we had for the immediate fiscal year to come. We teach that a budget should start with the mission, plans, and strategies of an organization. To help us stay focused on our program goals, I put a stipulation on the first budget conversations I had with our board treasurer, our executive director, our associate director, and our program director: no numbers could be discussed. In each of these meetings, we talked about what aspirations we had, what ideas had come out of our strategy planning, what activities we envisioned would be necessary to achieve our mission over the next year. The narrative would guide the number crunching and not the other way around.

By putting the emphasis on mission, once we began to talk about numbers we could identify what resources we needed in order to accomplish our goals. We could prioritize how to deploy our resources across our various programs because we saw how they each fit into the larger plan for the whole organization. As we determined our needs for staffing, for travel, for infrastructure, we were also crafting our fundraising plan for the next year. As it came together, we could be confident that our one-year budget was built to help us achieve the vision and goals laid out in our long-term strategy.

A collaborative budget process might be an uncomfortable adjustment for many financial leaders, but it could very well be revolutionary for an organization. Our budget should be more than a mechanical formula. Our budget should be more than a fearful attempt to control spending. Our budget should be more than wishful thinking that some new donor will magically appear to fund our latest initiative. To be truly useful and relevant, our budget should be a collaborative effort that expresses our mission in financial terms. Try it yourself. Make time to budget collaboratively for your next fiscal year.

—Curtis Klotz, finance director, Nonprofits Assistance Fund

The Price of Nonprofit Debt

by Woods Bowman

When borrowing money, nonprofits are in the position of risking not their own but the public's assets. This should compel nonprofits to make judicious decisions about how much risk they can incur when borrowing, either in the short or long term.

Nonprofits take on debt (i.e., borrow) in the short term to cover temporarily inadequate cash flow and in the long term to finance capital expenditures that they expect to recover in the course of doing business.[1] Capital expenditures naturally carry an element of risk. That chicken came home to roost for many arts organizations during the Great Recession, when even the most carefully made projections encountered a perfect storm of waning revenue sources. (Arts organizations, of course, gamble fairly regularly on the staging costs of a production or a new or improved performance space. Their financial analysis may beautifully justify the gamble—but, as they say, man plans and God laughs.)

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

Nonprofits have as many opportunities as anyone else to make fatal or at least seriously hobbling errors when it comes to the details of debt transactions and the projections on which they are based. The *New York Times* reported (for instance) that Cooper Union in New York City "borrowed $175 million for 30 years at a rate of 5.75 percent and then spent most of the proceeds on a lavish new building while continuing to run operating deficits. It also agreed to a prohibitively expensive prepayment penalty, making it financially impossible to extricate itself from the terms of the loan."[2]

Although nonprofits are urged on to greater heights of entrepreneurial behavior, when it comes to borrowing they are not risking their own assets but the public's, so they have a special obligation to gauge risk, limit it, and get the very best terms possible for any endeavor.

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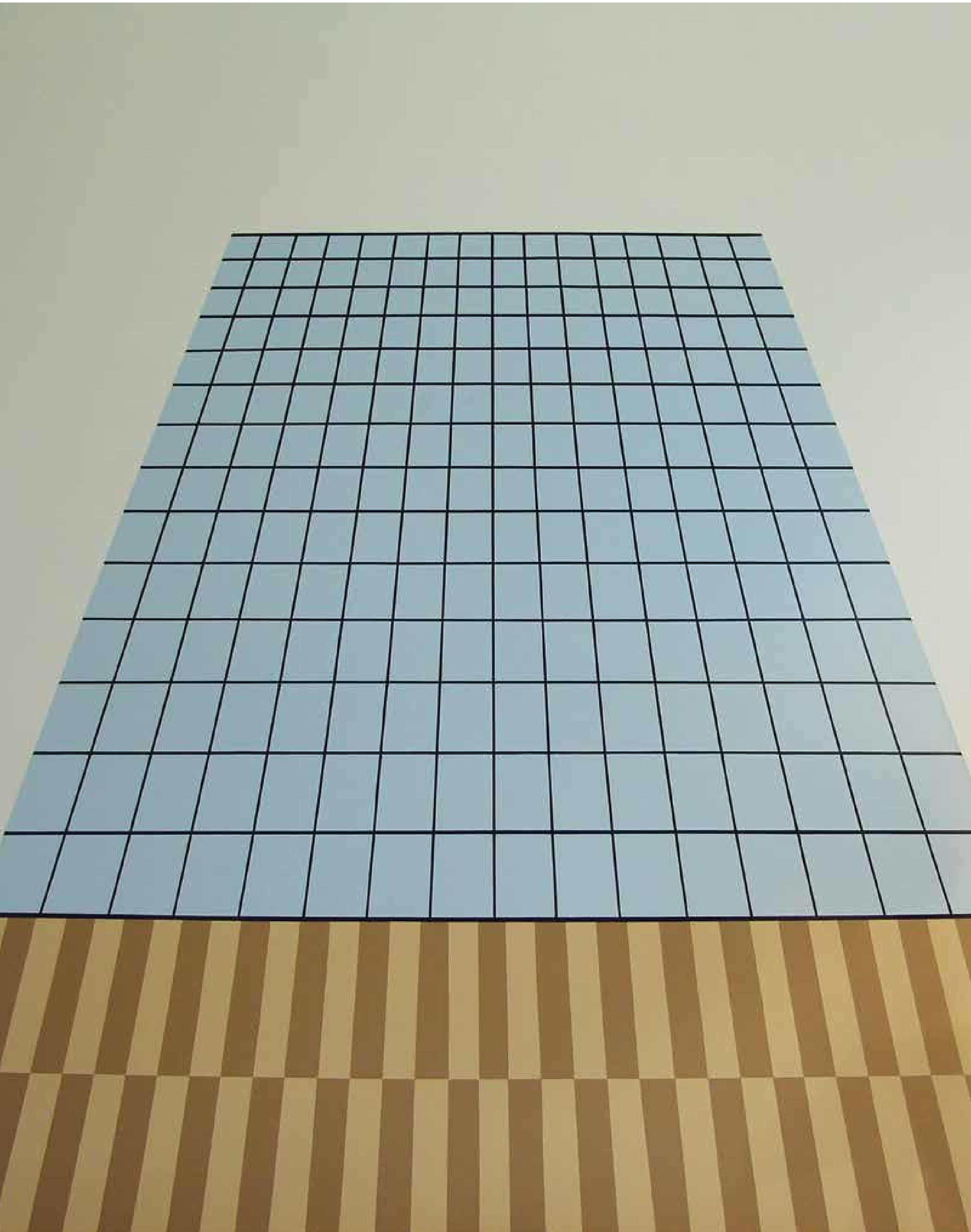

Short-Term Debt (and Its Long-Term Headaches)

Many nonprofits maintain a line of credit (LOC) with a local bank that enables them to pay their bills during months when cash flow is negative. The risks associated with this kind of borrowing are simple. In a tumultuous revenue environment, nonprofits may not be in a position to pay off a line of credit within the parameters of the contract, which may cause the loan to be converted to long-term debt. Repayment becomes a new and constant drain on net cash flow that is over and above operating costs. It shrinks an organization's future options for programming and financing.

An implicit method of borrowing that costs nonprofits dearly is past-due trade debt. It is customary for vendors to give buyers thirty days to pay. After this point, a debt becomes past due and the buyer must pay a late charge or lose a prompt-payment discount. In effect, a delinquent buyer is implicitly "borrowing" from a vendor, making the vendor an unwilling lender. Unwilling lenders charge punitive fees, similar to a standard credit card interest rate of 1.5 percent per month, or 18 percent per year. Although past-due fees are equivalent to interest, they may be buried in the payment for goods and services in their annual filings with the Internal Revenue Service.

Table 1 shows the subsectors that borrow most heavily from their vendors. The first column is the National Taxonomy of Exempt Entities (NTEE) code.[3] The aggregate amount of past-due trade debt is $16 billion (including lesser amounts not shown), or 1.3 percent of total nonprofit spending. Healthcare institutions alone owe $10 billion, but other subsectors have higher percentages of trade debt relative to their spending. Assuming that the average interest rate on past-due amounts is similar to a standard credit card rate, nonprofits pay vendors interest-like fees of $250 million per month, or $3 billion a year. My best guess is that at least half is profit to the vendor.

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Table 1: Implicit Borrowing from Vendors, FY2012[4]

		Past-Due Trade Debt (in millions of dollars)	Relative to Annual Spending
E	Healthcare	10,262	1.5%
L	Housing, Shelter	1,847	11.4%
B	Education	1,150	0.5%
P	Human Services	827	0.7%
A	Arts, Culture	521	2.3%
S	Community Improvement	393	3.9%
U	Science, Technology	254	1.4%
C	Environment	119	1.8%

Nonprofits as Lenders of Short-Term Debt

Anecdotes abound of buyers—governments in particular—being delinquent on their commitments. Nonprofits holding past-due receivables play the role of unwilling lender. Table 2 shows estimated receivables that are over thirty days past due to subsectors that account for over 90 percent of all implicit "lending" to customers and clients. The total for the nonprofit sector is $75 billion, or 5.8 percent of total program service revenue. Once again, healthcare institutions lead the list.

Table 2: Implicit Lending to Customers and Clients, FY2012

		Past-Due Receivables (in millions of dollars)	Relative to Program Service Revenue
E	Healthcare	42,825	5.1%
B	Education	12,708	6.4%
P	Human Services	6,831	6.0%
L	Housing, Shelter	2,240	17.9%
F	Mental Health	2,021	7.1%
U	Science, Technology	1,175	13.4%
J	Employment	989	6.7%
S	Community Improvement	911	17.3%

Long-Term Debt

There are two ways to pay for capital projects—gifts and borrowing. Many nonprofits will mix these, raising as much as they can in charitable gifts and borrowing the rest. Borrowing is seductive because it raises cash quickly and easily—unlike fundraising. But gifts have the benefit of not having to be repaid. Borrowing, on the other hand, increases long-term debt, which carries significant risk since it saddles an organization with an increased and constant drain on net cash flow for many years. Also, assets used as collateral become forfeit in case of default.

Financing capital projects is a complex balancing act of blending equity and debt. The economics of every project is different, and each must be evaluated on its own merits. Estimates of fundraising and borrowing capacities should be realistic; it should be unnecessary to stress this point, but the following cautionary tale suggests otherwise.

When the Field Museum of Natural History in Chicago raised less money than the project budget required, it borrowed. The result was a crisis in its operating budget that forced the museum to cut deeply into its research program.[5] In response to cost overruns, organizers of the new August Wilson Center for African American Culture in Pittsburgh borrowed $11.2 million. The center defaulted, and its creditors now have possession of the property.[6]

During a project's concept/preplanning phase, an organization should assess its capacity to fundraise and to borrow. Financing decisions determine the scale of a project, which is not easily changed after work commences. A project's budget should utilize as much equity as possible to minimize borrowing. As a general rule, 10 percent of donors contribute 90 percent of the resources (counting pledges) to a capital campaign. Before an organization decides on the scale of a project, it should canvass a large sample of the most generous 10 percent of likely donors to determine the depth of philanthropic support. The period of time when leadership gifts are lined up is called the "quiet phase" of a capital campaign.

Financing capital projects is a complex balancing act of blending equity and debt. The economics of every project is different, and each must be evaluated on its own merits.

How Big Is the Nonprofit Sector's Debt?

My calculations, based on data on individual tax-exempt nonprofits obtained from the Core Files of the National Center for Charitable Statistics

(NCCS)—for organizations' fiscal years ending in 2012—show nonprofits owing $195 billion on commercial mortgages and $362 billion on tax-exempt bonds, totaling $557 billion. Other sources, like the Federal Reserve, show nonprofits owing $199 billion on commercial mortgages and $241 billion on tax-exempt bonds, totaling $440 billion.[7] Differences between sources may be explained by sampling error, because far less than half of nonprofits have such long-term debts. It seems safe to assume that the total long-term debt of the nonprofit sector lies between $440 and $550 billion.

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Nonprofits spend over $20 billion a year on interest. The bulk of this is due to mortgages and tax-exempt bonds, but the number also includes interest paid on lines of credit (LOCs) used for short-term borrowing. I calculate that interest paid relative to the amount of mortgages and tax-exempt bonds outstanding is 3.7 percent. To put this number in perspective, the average rate on thirty-year AAA tax-exempt bonds is 3.0 percent, and mortgage rates are usually higher.[8]

As one might guess, universities and hospitals borrow more funds and pay more interest than other nonprofits. Table 3 shows how much interest various subsectors paid in the fiscal year ending in 2012, which, according to my calculations, accounts for 97 percent of all interest paid by nonprofits. Although $20 billion is a large number, it is modest compared to total spending of the nonprofit sector. (Spending is defined here as expenses minus depreciation.)

The last column of Table 3 shows the amount of interest paid within a subsector divided by the amount of spending in the same subsector, expressed as a percent. Although healthcare and education institutions spend much more on interest than other subsectors, it is a smaller fraction of their spending in general. Nonprofit housing corporations are a contrasting case. They spend far less than education and healthcare institutions, but borrowing is a very important means of financing real estate, so interest is a significant fraction of spending on nonprofit housing.

It is difficult to say how much profit the for-profit sector earns from lending to the nonprofit sector, because there are substantial costs associated with lending. The largest portion is what economists call "opportunity cost," which is the amount a lender could have earned on the most attractive alternative—namely, the value of the best lost opportunity. If lenders did not buy nonprofits' bonds, they could buy other tax-exempt bonds issued by state and local governments instead. Thus, the interest rate on these other investments is the lost opportunity of lending to nonprofits. My best guess of the profit margin on loans to nonprofits is 20 to 40 percent, which translates into $4 to $8 billion. To put these numbers in perspective, I estimate contemporaneous spending to have been $1,250 billion.

Is the nonprofit sector overextended with debt? Table 4 compares long-term borrowing of nonprofits and nonfinancial, noncorporate businesses. The latter group is used for comparison because it is closer in size to the nonprofit sector than the much larger corporate sector is.

Table 3: Interest on Nonprofit Borrowing, FY2012

		Interest Paid (in millions of dollars)	Relative to Spending
E	Healthcare	9,882.8	1.4%
B	Education	5,895.7	2.5%
P	Human Services	1,968.0	1.8%
L	Housing, Shelter	1,334.0	8.3%
A	Arts, Culture	330.0	1.5%
W	Public Benefit	211.4	3.0%
S	Community Improvement	203.3	2.0%
F	Mental Health	187.4	0.7%

Table 4: Borrowing by Nonprofits Relative to Benchmarks, FY2014[9]

	Nonprofits (NP)	Nonfinancial Noncorporate Business (NNB)	NP as % of NNB
Real estate	$ 2,906.0 Bn	$ 4,571 Bn	64%
Long-term debt (mortgages and bonds)	$ 435.0 Bn	$ 1,146.5 Bn	38%
Long-term debt as % of real estate	15%	25%	

Given that long-term debt is a very important means of real-estate financing, the table shows the amount of real estate owned by both sectors. Although nonprofits own 64 percent as much real estate as nonfinancial, noncorporate businesses, they have only 38 percent as much long-term debt. Moreover, nonprofit long-term debt is only 15 percent of the value of its real estate, but the amount of debt owed by nonfinancial noncorporate businesses is 25 percent of the value of their real estate. Either nonprofits as a group are not as eager to borrow as for-profit businesses or they are financially weaker and less able to borrow.

All of this information points to a fairly conservative and judicious use of debt by the nonprofit sector, which makes sense since this sector does have the unique ability to use gifts to constitute capital instead of debt. However, there is substantial variation in indebtedness among nonprofits. As the anecdotes related in this article suggest, some nonprofits are dangerously overextended. At the top of a list of "10 Ways to Kill Your Nonprofit," recently published in the *Nonprofit Quarterly*, is "overwhelm it with liabilities [debt]."[10] In many cases, fixed costs related to debt will stick around longer than the board members who voted for the deal in the first place.

Some nonprofits also borrow from insiders (directors and officers) and lend to insiders. Both internal borrowing and lending are fraught with potential conflicts of interest. Although very few nonprofits do it, the total of all insider debt is substantial. Insiders owe nonprofits $480 million and nonprofits owe insiders $1.5 billion. These numbers were calculated by the author from National Center on Charitable Statistics data; however, so few nonprofits engage in such activities that the sampling error may be as much as 50 percent.

Notes

1. "Nonprofits" as used throughout this article refer to operating public charities—that is, 501(c)(3) tax-exempt entities other than private foundations.
2. James B. Stewart, "Cooper Union Inquiry Puts Nonprofits on Notice," *New York Times*, April 9, 2015, www.nytimes.com/2015/04/10/business/cooper-union-inquiry-puts-nonprofits-on-notice.html.
3. Content in tables 1 through 3 was derived by the author from National Center for Charitable Statistics (NCCS) 2011 Core Files on individual tax-exempt nonprofits (proprietary data). The NCCS gathers the data from Form 990 informational returns that tax-exempt nonprofits file annually with the U.S. Internal Revenue Service. These estimates were calculated by the author from data on individual nonprofits contained in the NCCS Core File for 2011 (fiscal year 2012), but only those nonprofits that follow generally accepted accounting principles (GAAP). Given that mortgage lenders and bond underwriters almost always demand to see a borrower's audited financial statements, based on GAAP these figures capture nearly all long-term debts of the nonprofit sector.
4. "National Taxonomy of Exempt Entities," National Center for Charitable Statistics (NCCS), accessed April 16, 2015, nccs.urban.org/classification/NTEE.cfm.
5. Heather Gillers and Jason Grotto, "Dinosaur-size debt," *Chicago Tribune*, March 8, 2013, www.chicagotribune.com/news/ct-met-field-museum-debt-20130308-story.html.
6. Elizabeth Bloom, "The rise and fall of the August Wilson Center," *Pittsburgh Post-Gazette*, February 8, 2014, www.post-gazette.com/ae/theater-dance/2014/02/09/Rise-and-fall-of-August-Wilson-Center/stories/201402090045.
7. Data are from *Z.1 Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, Fourth Quarter 2014*, Federal Reserve Statistical Release (Washington, DC: Board of Governors of the Federal Reserve System, 2014), 133, table B.101, www.federalreserve.gov/releases/z1/current/z1.pdf.
8. The rate is from "US Municipal Bonds," *Bloomberg Business*, accessed April 16, 2015, www.bloomberg.com/markets/rates-bonds/government-bonds/us/. Rates on AAA tax-exempt bonds issued before the beginning the Federal Reserve's interest rate reduction program (Quantitative Easing) were at least 1.0 percent higher and are likely to return to that level when the Federal Reserve allows interest rates to reach normal market levels.
9. Data are from *Z.1 Financial Accounts of the United States*, 79, 133, and 135, tables L.103, B.101, and B.104.
10. Mark A. Hager and Elizabeth A. M. Searing, "10 Ways to Kill Your Nonprofit," *Nonprofit Quarterly* (Winter 2014): 66–72, nonprofitquarterly.org/management/25400-10-ways-to-kill-your-nonprofit.html.

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Creative Frugality (and Its Limits)

Editors' note: *Before you read this section, we want to issue a disclaimer. We do not in the least believe that nonprofits should be cash starved or that they function at their best that way. We have written often about the profound faultiness of the idea that nonprofits must be poor to be pure—but given that many of us are not blessed with unlimited, unrestricted funds, most of us are on a constant lookout for cash savings. What we want to push you on a bit is to add to that mindset the notion that there are sometimes ways to improve our work even as we reduce fixed costs—ways to streamline without harming the work or abridging the faith and expectations of our stakeholders. Some of these ways are relatively exclusive to nonprofits and some may have to do with smart uses of technology—and some need capital to seed the shift.*

So please do not read this section as an admonition to cut into your powerful nonprofit muscle but rather as encouragement to review your operating assumptions in order to make yourself yet more powerful in the delivery of your mission.

"PASSING BY" BY YSABEL LEMAY/WWW.YSABELLEMAY.COM/

A Penny Saved: Creative Ways to Thrive

by Beth Bird

Resourcefulness and ingenuity often require looking inward to find those hidden gems of cost savings or revenue within an organization.

When the recession hit in 2008, individual donors started to pull back contributions. Nonprofits were forced to initiate cost-saving measures. Then came the slashing of government grants. Again, nonprofits were forced to find more ways to save costs.

Drastic revenue loss has devastated many nonprofits over the last seven years. While this has forced some to downsize, others have pushed back in such imaginative ways that they not only managed to save money but also furthered their mission and their programs at the same time. For them, it has not just been the simple fulfillment of the adage, "A penny saved is a penny earned." Rather, it has been, "A penny saved is a penny, goodwill, program expansion, and mission fulfillment earned."

How are they doing it?

Beth Bird is director of Eide Bailly's Nonprofit Industry Practice. She is a passionate supporter of the nonprofit community and currently serves on the boards of Give Us Wings, IFP Minnesota, and Sisters of St. Joseph Ministries Foundation.

Generating New Energy

When in 2011 the Frank Lloyd Wright Foundation conducted an energy audit, the organization learned it was using more energy than necessary on its Taliesin West property, a national historic landmark sitting outside Scottsdale, Arizona. This set off an important initiative to become a net-zero site, meaning it will produce as much energy as it consumes. Over the next thirty years, cost savings are estimated to reach more than $2 million.

The road to saving millions, however, has required careful planning and generous donations of solar panels and installation. Because Taliesin West is a historic site, solar fields had to be placed carefully to ensure that the integrity of design was not compromised.

With the solar panels and installation donated by private businesses and the remaining costs covered by an investment from the foundation, the solar fields were completed soon thereafter, and the cost savings have begun and will be invested directly into the preservation, education, and public-engagement activities of the foundation. (And Wright's integrated approach to design and life and the mission of the foundation are extended further as Energizing Taliesin West™ emerges as a platform for advancing Wright's lessons of sustainability into education programs for both graduate students in architecture and the public at large.)

Also turning energy savings into cost savings is Cancer Support Community Arizona (CSCAZ). CSCAZ maintains a historic bungalow and provides services that lend emotional and social support to people with cancer and their loved ones. Like the Frank Lloyd Wright Foundation, CSCAZ was able to secure the donation of an energy audit, which provided a detailed list of improvements and conservation measures that would be cost effective. Because the list contains stand-alone improvements (replacing windows, upgrading electrical outlets, etc.), the organization has been able to space out the projects in such a way that a big cash outlay was not (and will never be) required. Thanks to rebate dollars from Arizona Public Service, the investment thus far has been minimal—about $2,000—and the savings have already started to add up. Most important, the cost savings mean additional program funds. CSCAZ estimates that the annual savings in energy costs will allow them to serve approximately sixty-five more members each year.

Growing to Save—Really?

Expanding scope to save on costs doesn't make sense at first glance, but the concept of economies of scale came into play when St. Paul, Minnesota–based Mano a Mano International Partners, an organization that works to improve health and increase economic well-being in impoverished Bolivian communities, determined that it could actually save money by broadening current activities to include servicing partner organizations.

Mano a Mano regularly ships supplies to Bolivia, a costly endeavor that requires not only thousands of dollars to pay for shipping containers but also skill in navigating the complex process of getting those containers through all the necessary channels. Organization leaders realized that they could partner with other U.S. organizations needing to ship to Bolivia, to maximize container space and share costs. As of summer 2013, Mano a Mano has collected and shipped more than 3.5 million pounds of surplus supplies that were destined for U.S. landfills. The cost savings they have achieved as a result of coshipping have meant the completion of more projects.

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Finding a Partner in a Big Cost Center

Another impressive example of using existing resources to capitalize on partnerships comes from The Road Home, a nonprofit in Salt Lake City that assists homeless individuals and families. In 2013, the organization provided 119,660 nights of shelter to 680 families. The cost of providing new linens as old ones became overused began to mount. Fortunately, The Road Home has a dedicated board services committee that used creativity and community connections to solve this growing concern, coming up with the idea of reaching out to local hotels to ask for lightly used linens that the hotels would otherwise discard. Many hotels readily agreed, and the board members themselves picked the linens up and delivered them to the shelter.

These relationships have been lasting, and the hotels now reach out to The Road Home whenever they have inventories of items they plan on discarding. Hotel employees have become engaged as volunteers, too, and the hotels have offered other in-kind donations. The Road Home has achieved incredible cost savings—estimated at about $60,000 annually—as a result of the donated linens, as well as found one more avenue to further support the in-need population benefiting from The Road Home's services.

Using a combination of online tools, JA created a virtual volunteer management system that allows it to recruit and place volunteers as well as provide online training.

Putting Technology to Use to Expand Capacity while Saving

Managing a large volunteer pool can be burdensome. Scheduling, training, and communicating with volunteers can take up a lot of staff time. Denver-based Junior Achievement–Rocky Mountain, Inc. (JA) knows this firsthand, and set out to find a tool that would allow it to achieve efficiencies for the benefit of both the organization and its volunteers. Using a combination of online tools, JA created a virtual volunteer management system that allows it to recruit and place volunteers as well as provide online training.

The result has been tremendous: time spent on scheduling and communication has been cut by 60 percent. This use of technology has allowed JA to use staff in a different capacity, and even though JA has experienced growth in its abilities to expand program reach, the organization has been able to save on hiring additional staff. The new system has resulted in the ability to raise 10 percent more revenue, reach 10 percent more students, and recruit 13 percent more volunteers.

JDRF MinnDakotas, an organization focused on curing, treating, and preventing type 1 diabetes, also knows the value of putting technology to use in order to expand program reach and save on costs. JDRF serves three states—Minnesota, South Dakota, and North Dakota—which means that geography can present challenges when it comes to providing education and demonstrating value to its supporters. The organization found, however, that it could use this geographic weakness as a strength through the use of technology.

Through the power of videoconferencing, JDRF arranged for its educational event, Research Spotlight, to be available in five locations across three states. To minimize costs, the organization turned to local hospitals as host locations, drastically cutting down on potential venue, food, and technological-support costs. The result has been remarkable, because technology has meant increased exposure to—and connection with—donors, showcasing the value of what the organization is doing to fund type 1 diabetes research; in addition, the videoconferencing platform has enabled greater outreach to people affected by the condition.

Optimizing Underutilized Assets

In 2013, the idea of streamlining resources also occurred to Metro Meals on Wheels (MMOW), located in Minneapolis. At the time, the organization was supporting the billing needs of seven member programs. The organization conducted a study with the University of Minnesota Carlson School of Management that revealed two important findings: (1) programs using MMOW's billing service had a collection rate of 98 percent, compared to a 91.5 percent collection rate for those doing it themselves; and (2) those that used MMOW's billing services rather than a third party's services were able to get the same benefit for half the price.

The first finding meant that more revenue could be captured and the second finding meant that programs could save money, resulting in reallocation of funds to provide more meals to those in need. An additional seven programs signed up to use MMOW's centralized billing services, and another eight are scheduled to get on board this fall. Patrick Rowan, MMOW's executive director, notes that the effort is part of a larger, long-term strategy to relieve small nonprofits of their administrative burdens—helping them to redirect resources (both dollars and staff time) to their important mission work.

Similarly, YWCA Utah was able to look to its own resources as a means of achieving cost savings and expanding its ability to serve. The organization took an unused asset—basement real estate—and turned it into a means of generating operating revenue in such a way that it does not divert staff or attention from its core mission-supporting programs.

The idea came when the organization was left with a finished, spacious basement as a result of a capital campaign that allowed them to build its Center for Families. The staff at YWCA knew that they would not need the space for their own services and programs for several more years, and determined that they could rent it out as office space. Since 2013, they have collected almost $50,000 in annual rent from a private business. This has allowed the organization to not only offset some of its costs but also, more importantly, to support the expansion of its services. With the help of that revenue, the YWCA increased the number of domestic violence survivors and their children served by 10 percent, as well as increased the number of shelter residents it was able to assist in finding safe, affordable, and permanent housing. The revenue also helped make it possible for the YWCA to add a new initiative: a research publication that offers data and insights to Utah leaders who have had input in shaping the support available to women and their families.

What It Means to Be Resourceful

We at Eide Bailly have been fortunate enough to be exposed to the initiatives described here (and a slew of others) through the Eide Bailly Resource*full*ness Award—an annual program our CPA and business advisory firm started in 2013 that provides recognition to nonprofits that have undertaken sustainable and creative revenue-generation initiatives. We work with more than 1,900 nonprofits across the country and will never be able to honor every sponsorship, volunteer, and in-kind donation request that comes in from our clients and the larger community; yet we see that the greatest stress plaguing our nonprofit community is that of finding and maintaining revenue streams. The Resource*full*ness Award was our solution to creating something that could benefit every nonprofit organization, because the ideas submitted for the award that stream in can be shared and discussed with the broader community. Our hope is that sharing these ideas will inspire others to think differently about how they deploy resources, and plan strategically for future needs.

While we bestow prize money on winners, the award goes beyond cash; it pushes to elevate the level of discussion of sustainable revenue streams (which can be reflected as the inverse—i.e., cost savings) to extend beyond the development function and instead live at the level of business strategy with the CEO, the CFO, and the board.

Our Lessons

The Resource*full*ness Award was generated to help inspire ideas in leaders in the nonprofit community, but we accountants and board members have come away with our own valuable lessons:

- **First and foremost, look inward.** Often, there are gems hidden within your own organization that have the potential to provide cost savings or revenue. If you cannot find them, look to other nonprofits for inspiration, or ask somebody outside your organization to give your operations a look with fresh eyes.
- **Know that sometimes you have to spend money to make money.** Cost savings often follow an investment. Of course, do your due diligence to predict the savings that will follow, but do not be afraid of investing in something with promise.
- **Consider partnerships.** Over and over we have seen the benefit of collaborating with other nonprofits. Sometimes the partnership is a result of mission alignment and sometimes there's simply an opportunity to lower costs by sharing resources.

Ultimately, passion for mission and purpose drives ingenuity in operations. Opportunities to save money lead to opportunities to *do* more. And for that thriftiness, we are all richer.

Over and over we have seen the benefit of collaborating with other nonprofits. Sometimes the partnership is a result of mission alignment and sometimes there's simply an opportunity to lower costs by sharing resources.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 220203.

Valuable **Free** Real Estate Available at **GuideStar:**

Ignore at Your Own Risk

by Lindsay J. K. Nichols, Gabe Cohen, and Ruth McCambridge

When you take the time to update and elaborate on your profile on GuideStar, you're showing your organization's commitment to transparency while communicating directly with your stakeholders.

LET'S IMAGINE THAT A DEEP-POCKET DONOR HEARS something truly fabulous (and well deserved) about your after-school program. Not only did that donor grow up in the area and have an attachment to it, she is also deeply concerned about the new generation of children growing up in the neighborhood and facing twenty-first century challenges. She decides on a whim to look you up on GuideStar. What does she find?

If you are lucky, she finds up-to-date financials—and by up to date, we mean less than three years old. The financials, however, contain some unexplained quirks. Perhaps one year the operation looks flush and the next it looks like it is losing money hand over fist. Nowhere are these quirks explained, because your Form 990 is up there all by its lonesome. She could do some further research, but if you can't be bothered to place your information on the most widely used resource for information about U.S. nonprofits, then why should she go looking for it?

This problem has a quick fix, and that is to use the space GuideStar offers to nonprofits to explain their programs, clarify information in their 990s, and otherwise inform potential donors (and others who may be interested in you).

LINDSAY J. K. NICHOLS is America's Charities' vice president of marketing and communications. **GABE COHEN** is GuideStar's media and outreach manager. **RUTH MCCAMBRIDGE** is the *Nonprofit Quarterly*'s editor in chief.

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Each of the over two million nonprofit organizations in GuideStar's database has a profile—a page on its site devoted entirely to the organization so that people can access in-depth information about it. Most of these profiles present data that the organizations have submitted to the IRS. IRS information, however, doesn't always give a complete or timely picture of your nonprofit to GuideStar's thirty-five thousand daily visitors—and we're not even counting the thousands more who access the information via a growing series of application programming interfaces (APIs) that GuideStar has created over the last two years.

When you take the time to update your profile on GuideStar, you're demonstrating your organization's commitment to transparency and communicating directly with its stakeholders through GuideStar and GuideStar's vast data distribution network—*for free*.

The Limitations of Depending on Your 990 to Tell Your Story

We all know that it takes too long for a nonprofit's Form 990 information to become available to the public—through www.guidestar.org or elsewhere—after it has been filed with the IRS. As a result, our nation's social change makers are looking at information that is often more than a year old. We also know that making decisions about philanthropy by relying solely on a Form 990 is problematic, because the information provided on that form is limited. The IRS didn't develop those data fields for the purpose of evaluating nonprofit effectiveness; in truth, they were designed simply to help the IRS determine whether nonprofits are in compliance with the laws governing exempt organizations. In addition, just under half of nonprofits file the 990-N, which has only eight questions, and public academic institutions (because they are government entities) and faith-based organizations aren't required to file at all. So when individuals and others look to the 990 to decide where to give their money and time, they're not even working with the right kind of information.

What Makes Up the GuideStar Nonprofit Profile?

In the same way that updating your personal Facebook and LinkedIn profiles gives you a way to communicate directly with all the people in your life at the same time, updating your GuideStar Nonprofit Profile ensures that millions of prospective donors and funders will find accurate, timely information about your organization. In fact, your information is seen by more than seven million people who access GuideStar data

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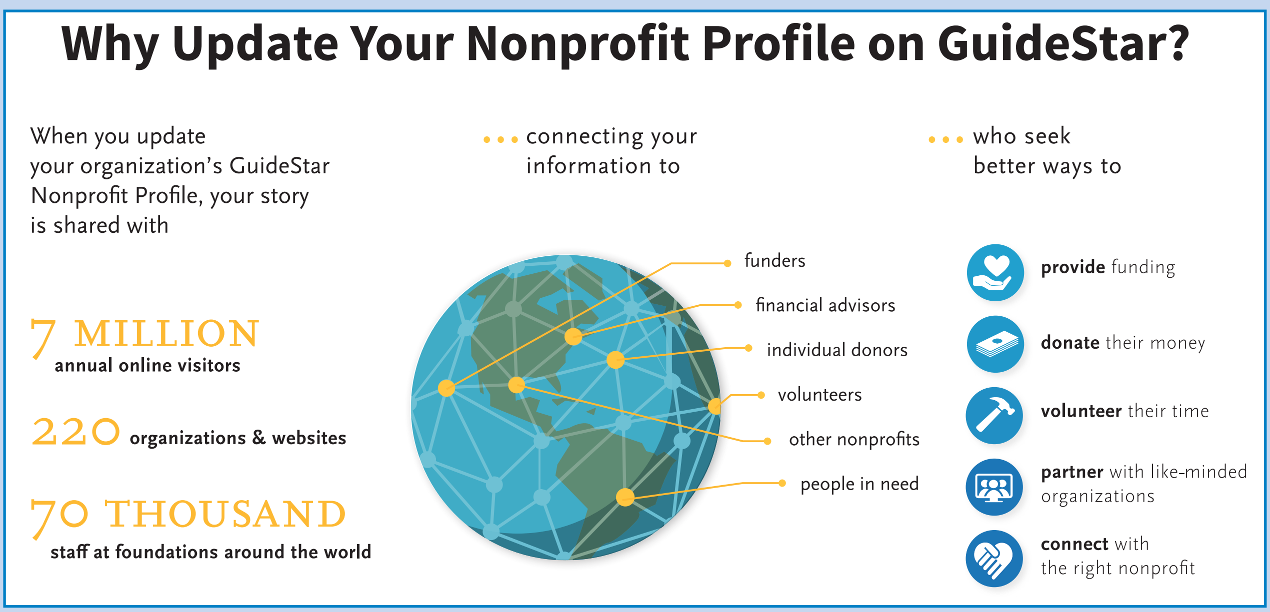


Four Great Reasons to Update Your GuideStar Nonprofit Profile

1. **Take charge of your organization's online identity.**

   You have the power to choose what millions of people see about your organization each year. Providing the public with your most up-to-date and complete information means that you are sharing your organization's true story. You get your most up-to-date information in front of GuideStar's millions of users as well as visitors to more than 220 other websites, applications, and platforms, including AmazonSmile, JustGive, Network for Good, VolunteerMatch, dozens of online giving portals, all major U.S.-based donor-advised funds, thousands of foundations such as the California Endowment, more than sixteen leading community foundations, and more.

2. **Increase funding.**

   Updating your organization's profile on GuideStar gives you the opportunity to increase funding and visibility for your organization:

   - Some profiles are viewed tens of thousands of times a year.
   - You can activate a donation button right on your GuideStar Nonprofit Profile.
   - More than seventy-five thousand foundation staff use GuideStar data to make philanthropic decisions.
   - You can sign up to receive real-time alerts when there is a change to your organization's IRS status that might affect donations.

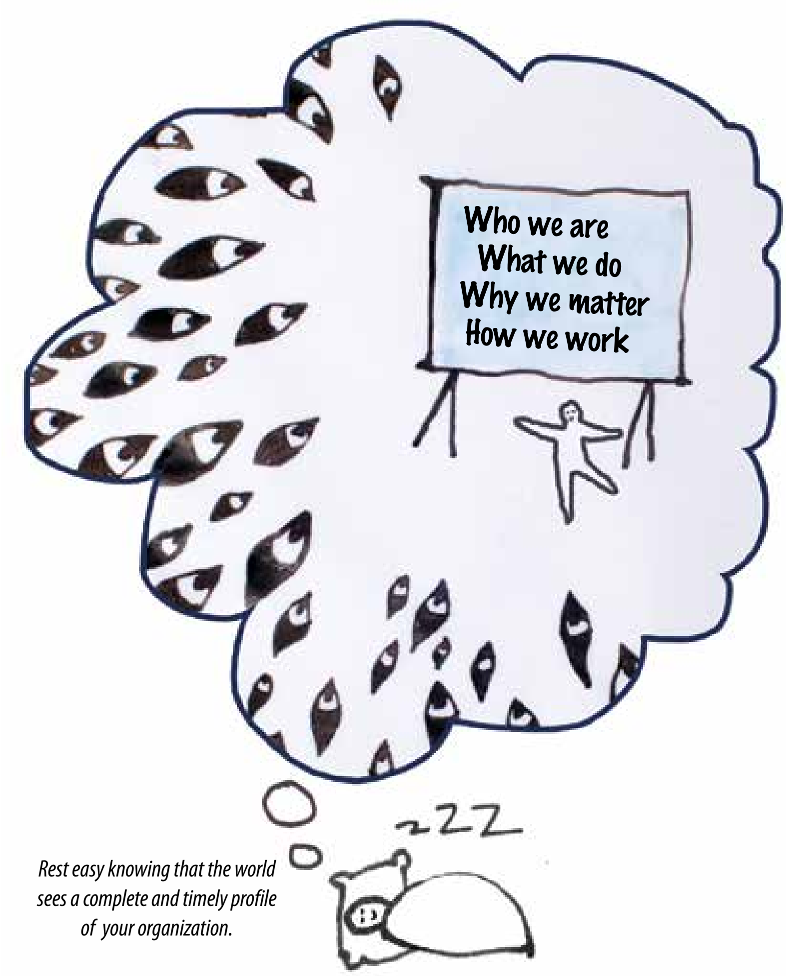
3. **Save time with your grant applications.**

   Grant applications can be prepopulated with information that nonprofits have already updated in their GuideStar Nonprofit Profile. In support of the Simplify initiative, this process uses the existing central database of nonprofit information to eliminate the repetitive elements of grant applications and enable more efficient grantmaking.[1] GuideStar is working with nine of the largest grants-management software vendors to add this functionality; it will be fully functional with at least two of the vendors by the end of this year.

4. **Don't spend a dime.**

   Updating your GuideStar Nonprofit Profile is *free*.

Your nonprofit's supporters are watching. Take advantage of the valuable free real estate on GuideStar to tell your story.



Rest easy knowing that the world sees a complete and timely profile of your organization.

each year, and then by millions more as your information travels through GuideStar's data-distribution network.

How to Update Your GuideStar Nonprofit Profile

1. Go to www.guidestar.org/update.
2. Click on the blue "Get started now" button at the top of the page.
3. Sign into your account (use your registered e-mail address and password)—or, if you don't have an account, create one.
4. When you are signed in, you should see your organization listed on the page. Click on your organization's name. If you do not see your organization's name, you must request permission to manage your organization's profile.
5. To request permission, enter your organization's Employer Identification Number (EIN), click on the "Request permission" button, enter the required fields, and submit your request. Your request will be approved in one to two business days.

GuideStar's Role

> *GuideStar exists to help people make more intelligent decisions within the social sector. That all starts with better data about nonprofits. Nonprofits are better positioned than anyone else to tell their own story. Our job is to take that data and amplify it. In the end, it's the people, communities, and ecosystems served by the nonprofits that will benefit.*
>
> —Jacob Harold, GuideStar's president and CEO

GuideStar is the only organization that encourages nonprofit transparency on a national scale and allows nonprofits to supplement the public information that is available from the IRS. From the launch of its first website, in October 1996, GuideStar has provided nonprofits with a way to update their information in its database. Then, as now, the goal was to give nonprofits a platform through which they could tell their full stories, enabling them to go beyond basic IRS and Form 990 data and share information about their missions, programs, leadership, needs, and accomplishments. Organizations could update as often as they wished, allowing them to provide more current information than what is available in IRS records.

In late 2007, GuideStar launched the second generation of its program and named it the GuideStar Exchange;[2] after extensive conversations with nonprofits, foundations, and other key users of their data, GuideStar revised the information collected from the organizations. GuideStar also introduced functionality that allowed nonprofits to increase their transparency by posting their applications for exemption, IRS letters of determination, audited financial statements, and most recent Form 990s to their profiles. Although GuideStar has continued to refine the GuideStar Exchange over the last eight years, the goal has remained the same: to allow nonprofits to provide meaningful information in an ongoing way so that the millions of people

What Are Data?

Simply put, data are information in its most basic form. Data include all of the pieces—the statistics, facts, figures, goals, descriptions, etc.—that make up your organization and the sector at large. Data can be quantitative *and* qualitative. They can be about breadth as well as depth. They can be programmatic and financial. They can be issues and interventions, resources and organizations. They can be retrospective and prospective. So when GuideStar urges you to share your nonprofit's data, they are asking for more than just financials—they are asking for information about your programs and progress, your photos and videos, your stories and achievements.

Qualitative (stories and descriptions)	*and*	**Quantitative** (numbers)
Contribution (you helped)	*and*	**Attribution** (you were responsible for)
Subjective (peoples' perceptions)	*and*	**Objective** (facts)
Independent (just about you)	*and*	**Comparative** (you in the context of others)
Prospective (goals for the future)	*and*	**Retrospective** (what happened in the past)

[W]hen GuideStar urges you to share your nonprofit's data, they are asking for more than just financials—they are asking for information about your programs and progress, your photos and videos, your stories and achievements.

Are You Bronze, Silver, or Gold?

Today, there are three participation levels for nonprofits that update their GuideStar profiles. Organizations sharing basic information (mission statement, address, information about leaders and board members, etc.) are Bronze participants. Organizations sharing additional financial information (such as an audited financial statement or basic financial information similar to that reported on the 990) reach the Silver participation level. Organizations that share additional *qualitative* information about their impact become Gold-level participants; soon, GuideStar will collect *quantitative* information about an organization's impact, which will be a new Platinum level.

	Bronze	Silver	Gold
Description	**Basic information**	**Financial information**	**Impact and effectiveness information**
Requirements	Organization address, contact name, and e-mail	Audited financial report or basic financial information	Five Charting Impact questions (goals, strategies, capabilities, indicators, progress)
	Mission statement	Bronze-level requirements	Silver-level requirements
	Geographic area served		Bronze-level requirements
	Name of organization leader and board chair		
	Program names		

GuideStar Collects Diversity Data

Without sector-wide standards for how data on diversity is collected, nonprofits and foundations have had difficulty identifying trends, gaps, overlaps, and opportunities. More comprehensive diversity information across the sector is needed to help foundations better understand their constituencies. Higher-quality diversity information is also needed for nonprofits to better evaluate the impact of their work and hold them accountable to their goals. Ultimately, diversity standards enable the social sector at large to better measure progress and make informed decisions about philanthropy.

To help bridge this gap, in October 2014 GuideStar launched a first-of-its-kind program to collect diversity data from nonprofits on a national scale. The voluntary program is helping to set standards for how data about diversity within the social sector is collected. GuideStar worked in collaboration with the D5 Coalition, which developed the standards with a wide range of partners to advance transparent and uniform data collection about staff, board, and volunteer demographics in the nonprofit and philanthropic sectors, enabling more informed decisions about philanthropy. The launch also coincided with a pilot partnership between Green 2.0, which collaborated with GuideStar, and D5 to seek participation from environmental organizations in this groundbreaking diversity-tracking effort. This is in response to the problematic "green ceiling"—the mainstream environmental movement's failure to keep up with the changing face of America, which was documented in *The State of Diversity in Environmental Organizations: Mainstream NGOs, Foundations & Government Agencies*, a report commissioned by Green 2.0 from Professor Dorceta Taylor.[3] Green 2.0's working group advocates for improved diversity in the mainstream environmental movement.

Since the launch of the initiative, close to three thousand nonprofits nationwide (including more than seventy-five top environmental advocacy nonprofits) have submitted diversity data to GuideStar.

who use GuideStar data every year—and the millions more who visit the sites of GuideStar's data-distribution network—have a more complete and accurate picture of those organizations.

Who Participates?

To date, more than 110,000 nonprofits have provided GuideStar with some level of information by updating their profiles, including more than forty-two thousand nonprofits that have reached the Bronze, Silver, or Gold participation level. Since June 2013 alone, nonprofits have shared millions of data points through this process. This nonprofit-provided information is combined with Form 990 and other IRS data to create a much more complete picture of a nonprofit's operations, programs, and results. Organizations can also update their information on GuideStar at any time and know that millions of people will see their most up-to-date information long before the IRS releases it. Keeping information current means that people inside and outside the nonprofit sector know they are accessing the most reliable and complete picture of an organization.

The Evolution of a Common Profile

Of course, GuideStar recognizes that the sector changes. There are shifts in the kinds of information people are looking for. New best practices emerge. Thus, the information GuideStar collects from nonprofits in their reports has adapted and will continue to evolve with the sector as well. One aspect of GuideStar's efforts has never changed and never will: *Allowing nonprofits to provide their most complete and up-to-date information is about empowering nonprofits to* *tell their full stories to the nonprofit universe. Self-reported information and transparency are the cornerstones of this program.*

However, two major developments are coming to GuideStar Nonprofit Profiles over the next few months. First, the online interface where nonprofits update their profile information is getting a facelift to provide a more streamlined user experience. The goal of the redesign is to make it easier and more intuitive for nonprofits to update their profiles, track their progress, and reach each participation level; another potential feature of the redesign will be to make the interface mobile responsive, in order to make it easier for nonprofits to update their profiles in our increasingly mobile 2015 world.

Second, one of the bigger behind-the-scenes projects at GuideStar right now is an overhaul of the way information appears on an organization's GuideStar Nonprofit Profile. The redesign will leverage GuideStar's wealth of historical nonprofit information and will group information into sections that will tell each nonprofit's story more clearly. The new profile pages will include a range of interactive data visualizations that can help users make sense of the complex nonprofit information that drives decision making in the social sector.

For the good of the sector, GuideStar is continually evolving its Nonprofit Profiles to promote widespread adoption. GuideStar works with a variety of partners—including BoardSource, Independent Sector, BBB Wise Giving Alliance, D5 Coalition, Green 2.0, the Cultural Data Project, and others—to ensure that the profile is multidimensional, nonduplicative of other reporting efforts, and useful for a wide variety of stakeholders. For example:

- In March 2014, GuideStar and BoardSource announced a new initiative that enabled nonprofits to share information about how their organizations are governed, shedding light on a critical indicator of organizational strength and stability that is often hidden from public view. To date, more than two thousand nonprofits have provided this level of detail.
- In May 2011, GuideStar partnered with BBB Wise Giving Alliance and Independent

GuideStar works with a variety of partners . . . to ensure that the profile is multidimensional, nonduplicative of other reporting efforts, and useful for a wide variety of stakeholders.

Sector to launch an initiative called Charting Impact, a standard framework for creating reports that enable stakeholders to easily and clearly understand the objectives, benchmarks for progress, and impact of nonprofits and foundations. This sector-wide initiative was developed by nearly two hundred leaders to help organizations of all types, sizes, and missions convey their efforts to advance the common good, thus establishing an industry standard for reporting in-depth mission objectives and results. The cornerstone of Charting Impact is a series of five questions that encourage strategic thinking and the open sharing of ideas, strategies, and results within the nonprofit community. To reduce the information-sharing burden on nonprofits, in August 2013 Charting Impact was integrated into the GuideStar Exchange program. Organizations that answer the five Charting Impact questions reach the Gold participation level, which to date has been accomplished by more than six thousand organizations.

• • •

Let's imagine once again that the deep-pocket donor hears something truly fabulous and well deserved about your after-school program. This time, when the donor visits GuideStar she finds information that explains the various pieces of your more up-to-date 990, and she also reads all about the impact you've made in the past year. Do you think she gives you money? We're willing to bet she does—or at the minimum, that she reaches out to start a conversation about something on your GuideStar Nonprofit Profile. GuideStar gives you a great way to maximize your organization's reach and impact with just a few clicks of a button, and it's *free*. So what are you waiting for? Go maximize your real estate!

One Foundation's Experience Using GuideStar Nonprofit Profile Information

Dolores Estrada is manager of grants administration at The California Endowment. When in 2010 The California Endowment decided to transition to a ten-year, $1 billion comprehensive community initiative, they decided as part of the initiative to reduce the burden of grantmaking on their grantees to maximize the benefit of their investments. "In doing so," Dolores explained, "we needed a solution that would allow us to have access to essential information for our decision making as well as an external (cloud) repository of information. Integrating the GuideStar Nonprofit Profile into the organization's application process helped us to create a cost-efficient workflow that allowed us to process proposals in less time while having an outside repository of the data needed for decision making. Using GuideStar has helped our grantmaking workflow. It has significantly helped to reduce the turnaround time from intake to award process—from 120 days to under fifty-five days.

"In addition, GuideStar has been a great partner by paying attention to the field's needs and developing tools that make the 'how' of grantmaking more focused. Most important, it has provided excellent customer service to both The California Endowment as a client and The California Endowment's grantees as users of its Nonprofit Profile information."

Notes

1. To learn more about the Simplify initiative, visit www.simplifynow.org/.
2. To learn more about GuideStar Nonprofit Profiles, visit www.guidestar.org/update.
3. Dorceta E. Taylor, *The State of Diversity in Environmental Organizations: Mainstream NGOs, Foundations & Government Agencies*, diversegreen.org/report/.

To comment on this article, write to us at feedback@npqmag.org. Order reprints from http://store.nonprofitquarterly.org, using code 220204.

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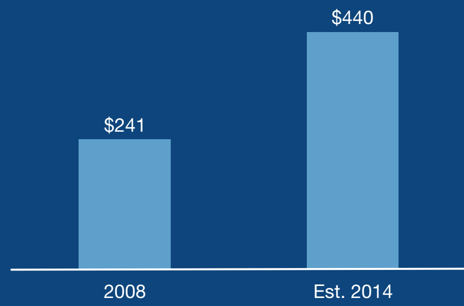

The national average state unemployment tax act (SUTA) cost per employee has increased by 182% since 2009, as state unemployment trust funds rebuild post recession

SUTA Cost per Employee $241 (2008), $440 (Estimated 2014)

Source: U.S. Department of Labor

Overpaying on your State Unemployment Insurance cost?

As a 501(c)3 nonprofit organization or governmental entity, you have options when it comes to financing your unemployment insurance obligation to your former employees. Learn more at one of these free webinars presented by First Nonprofit Group:

Thursday, July 16, 2015
at 11:00 am EST

Thursday, July 30, 2015
at 1:00 pm EST

Wednesday, August 12, 2015
at 11:00 am EST

Wednesday, August 26, 2015
at 1:00 pm EST

Who should attend?

Nonprofit executives from 501(c)3 nonprofit organizations or governmental entities, with more than 10 employees, who are looking for a solution to their unemployment tax obligation or those already taking advantage of the reimbursement method.

About First Nonprofit Group

First Nonprofit Group provides 501(c)3 nonprofits and governmental entities with safe, cost-saving alternatives to SUTA. More than 1,700 organizations, representing all sectors of the nonprofit community, rely on First Nonprofit to maintain and manage their unemployment insurance costs.

To register, visit: http://www.firstnonprofitcompanies.com/npq/

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An AmTrust Financial Company

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Chicago, IL 60606
Phone: 800-526-4352,
www.fristnonprofitcompanies.com

Directors *and* Officers Liability Insurance:

Why It's Worth the Cost

by Pamela E. Davis

Do we really need D&O insurance? What risks might we face by deferring this cost?

***Editors' note:** The data used in this article were taken from over 1,500 claims against nonprofit directors and officers (D&O) insurance policies issued by the Nonprofits Insurance Alliance Group—based in Santa Cruz, California, but serving more than 14,500 nonprofits in 32 states and Washington, D.C.*[1] *The Nonprofits Insurance Alliance Group serves small to midsize nonprofits, and experiences may well differ for very large organizations with complex business relationships: references to employment practices liability (EPL) claims being both the most expensive and most frequent of nonprofit D&O insurance claims must be understood in light of this fact. There are data suggesting that this may be a different case with other insurance carriers, whose insureds include very large nonprofits, such as the Mayo Clinic and Johns Hopkins University, rather than our community-based charitable nonprofits with budgets typically under $10 million—in which case non-EPL D&O claims are showing as less frequent but generally more costly.*

Insurance carriers tend to withhold information as a business practice, so the information in this article is something of "breaking news"—offering, as it does, new and more detailed information on nonprofit D&O insurance than is generally known. Our hope is that this article is just the beginning of the Nonprofit Quarterly*'s ability to present increasingly open information about how insurance for nonprofits actually works.*

Does a nonprofit organization really need to purchase directors and officers (D&O) liability insurance? The short answer is "yes." What follows is the longer answer.

D&O insurance covers the organization and its directors, officers, and trustees against actual or alleged wrongful acts in three major areas:

1. Governance liability: claims resulting from general governance decisions;
2. Fiduciary liability: claims resulting from alleged fraud and improper financial oversight, including oversight of employee benefit plans (Employment Retirement Income Security Act [ERISA]) and use of grant funds and donor contributions; and
3. Employment practices liability: claims resulting from employment-related activities.

Of these types of claims, employment practices liability claims are by far the most frequent and, generally, the most costly. Employment-related claims spiked during the recession of 2009, and those of us handling these claims expected them

Pamela E. Davis is president and CEO of the Nonprofits Insurance Alliance Group.

"BUBBLES AND BELINDA ON THE TRAPEZE" BY BRIAN NASH/WWW.BRIANNASH.NET/


NASh

Employees and their attorneys seem more willing than ever to sue nonprofits (unlike ten years ago, the focus of these lawsuits is no longer on for-profit companies).

to continue for a few years—when nonprofits were cutting back on their workforces because of dips in funding—and then return to a more normal level once funding improved. However, that appears not to be the case. Employees and their attorneys seem more willing than ever to sue nonprofits (unlike ten years ago, the focus of such lawsuits is no longer on for-profit companies); furthermore, employment law has become more complex, and it is much easier for all employers, including nonprofits, to fail to follow both the spirit and the letter of the law.

The other two areas of coverage relate to governance and fiduciary liability alleging improper governance decisions, or alleged fraud and improper financial oversight or improper use of funds. While these claims may also be large, they are far less frequent than employment-related claims.

D&O and Nonprofits

While the risk of sizable employment claims is present in every state, California seems to produce the most expensive ones—both in cost of defense and in indemnity payments. The average employment practices claim against a nonprofit in California is about 45 percent more expensive than claims against nonprofits in the rest of the United States. This is likely because California has more complex and stringent employment laws that are more protective of employees, and also because in California compensation and cost of living are relatively higher than in many other states, and so the attorney fees tend to be proportionately higher.

The chart below illustrates the relative risk and cost of these various types of claims gathered over a ten-year period by Nonprofits Insurance Alliance Group. The chart indicates averages for all claims; however, nearly 65 percent of employment practices claims close with only expense payments—and no indemnity payment at all. These are typically claims that do not go any further than a complaint to the U.S. Equal Employment Opportunity Commission or a state-based organization such as California's Department of Fair Employment and Housing. If these claims, whose average expense to handle is $6,500, are removed from the data, an average employment practices claim that actually has merit will typically cost between $150,000 and $200,000 to ultimately resolve—whether by way of settlement or trial. Unless a nonprofit has these types of discretionary funds available to undertake defending and settling such claims, it behooves every nonprofit to provide D&O insurance protection for their organization and their board of directors.

The Three Major Areas of D&O Insurance Coverage for Nonprofits

Employment Practices Liability

With 94 percent of the claims dollars under a D&O policy emanating from employment practices allegations, that is the area that demands attention. This is also an area where targeted risk management can have the most immediate impact. Specifically, it is critical for organizations to have clear and up-to-date employment handbooks with policies that are strictly followed in both letter and

Alleged Wrongful Acts

	Governance	Fiduciary	Employment Practices
Percent of all claims costs	5%	1%	94%
Number of claims	117	51	1,346
Largest claim	$775,000	$82,000	$938,000
Average claim	$23,000	$6,000	$33,000
Defense costs as % of total	75%	86%	45%

spirit. The most common types of employment practices claims are the following:

- Sexual harassment;
- Racial and gender discrimination;
- Retaliation, including against whistleblowers;
- Defamation;
- Failure to accommodate (as per Americans with Disabilities Act [ADA]); and
- Improper employee classification (exempt/nonexempt and independent contractor/employee).

One of the most frequent claims, particularly over the past several years, has been improper classification of employees. Some D&O insurance policies offer defense of these actions, but none of these policies are going to cover back wages and penalties owed to the employee. Those are the full responsibility of the nonprofit, and they can be substantial. Many nonprofits believe they can be thrifty by classifying employees as exempt so that they don't have to pay overtime, or by hiring people as contractors or consultants so that they don't have to pay benefits. There are extensive rules about such distinctions, and if they are not followed carefully, these claims can create serious problems for the nonprofit and its board if an employee or group of employees files a lawsuit. Employees cannot give "permission" to be misclassified; the responsibility for getting this right rests squarely on the shoulders of the management of the nonprofit.

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Termination of employment is the action that triggers the majority of employment-related claims against nonprofits. In fact, 80 percent of the total dollars spent on claims in the employment practices area involve either involuntary termination or constructive discharge claims. And most claims have multiple allegations attached to them, such as failure to accommodate, defamation, and retaliation, as well as wrongful termination.

In addition to being expensive in terms of legal costs and indemnity payments, the litigation of employment practices claims can take a significant toll on an organization, even with the very best in legal representation. There are typically voluminous documents that need to be collected and time spent by the human resources department (if the nonprofit is even large enough to have such a department) and other executives preparing for and undergoing depositions. These are time-consuming distractions from the mission of the nonprofit. In most of these cases, plaintiff attorneys have no incentive to encourage plaintiffs to participate in early mediation, because plaintiff attorneys can often recover the majority of their fees as part of the settlement of the claim. At first, nonprofits that believe they have done nothing—or very little—wrong want no part in a negotiated settlement; often, they want their day in court to prove their innocence. However, once nonprofits see how prolonged and difficult these claims can get, most are more than ready to have the insurance company find a way to resolve the claim at the earliest possible opportunity. Fully 31 percent of employment practices claims take more than one year to be resolved, and 7 percent take more than two years.

Governance Liability and Fiduciary Liability

Although governance and fiduciary claims are less frequent, it is worth noting the types of allegations made against nonprofits for which a D&O policy may or may not afford important coverage. Governance claims include the following:

- Breach of contract (those unrelated to employment, such as leases);
- Discrimination in housing access; and
- Improper board elections.

Fiduciary claims include the following:

- Attorney general investigations;
- Improper fundraising allegations;
- Improper reporting of revenue;
- Mishandling of donations;
- Failure to report payroll taxes; and
- Mismanagement of employee benefit plans.

The Importance of a Good Broker

With any financial service—including insurance—it is critically important to have expert advice. Your insurance agent or broker should be familiar with the various D&O policies that are on the market and be able to help you to understand the coverage details of each policy form. All D&O

Risk management for employment practices claims is equivalent to overall good organizational leadership.

policies are worded slightly differently and offer different amounts of coverage for various types of allegations. For example, some D&O policies will offer defense for breach of contract and allegations of misclassifying employees, but no D&O policy will actually pay damages related to a non-employment-related breach of contract, or misclassification of employees, or failure to pay payroll taxes. Most D&O policies do not offer coverage for these actions at all. These are nuances that a good broker will be able to explain to a nonprofit client.

Also, just because there is a list of coverages summarized on the declarations page of an insurance policy does not mean one should assume that all of these coverages are included in the D&O policy that is attached. It is not uncommon for insurance companies to list many types of coverage on the front page of the policy but actually only provide the coverage if a specific box is checked and the premium has been paid. An insurance broker or agent with experience can help you to avoid these pitfalls. And, coverages offered in the policy are one thing, but it is also valuable to ask your insurance broker or agent about the insurer's reputation for defending and appropriately handling these sorts of claims. Are they known for interpreting the coverage on behalf of the insured organization, or do they try to find ways to avoid covering the claim? Are they good communicators? Do they keep you informed on how the claim is going and what their strategy is to get the best result? What is the quality of the defense counsel the insurer will be assigning if you have a claim?

Insurance brokers are typically compensated by commission from the insurance company. A typical commission rate is 15 percent of the premium, although some brokers get additional, or contingent, commission from insurance companies at the end of the year as a reward for placing a certain amount of business with that carrier. It is important to ask an insurance broker how he or she is compensated and what the commission is on each quote given to you for consideration. Very large nonprofits may choose to work with a broker on a fee-for-service basis, but this practice is fairly uncommon.

When a Case Goes to Trial

Sometimes the contract language in the D&O policy gives the insurance company both the right and the obligation to select the defense attorney and make the final determination about when or even whether to settle a claim. While this may at first be off-putting to a nonprofit executive or to board members who may think they will get a better result if they have more control of the handling of the claim, our experience tells us that this is unlikely. Many policies that allow nonprofits more control also require that the nonprofit fund the cost of the claim up to a prescribed self-insured retention. We find that the best results come when experienced attorneys who specialize in labor law handle the cases impartially. An attorney who has been working with the nonprofit providing advice on a difficult situation and who is then hired to defend that claim can end up in the position of defending his or her own advice. Our experience has shown us that an attorney who was not involved in the advising process is in a better position to objectively handle the defense of the claim.

Risk management for employment practices claims is equivalent to overall good organizational leadership. Many claims result from leadership either not knowing about the law or not caring about following it in a manner that results in an outcome that is respectful to both the employee and the organization. In most cases, the situation causing the claim is not clear-cut. Usually, neither the situation alleged by the employee is as egregious as described nor are the steps taken by the nonprofit as impartial or thoughtful as they might have been. Often, by the time a situation has escalated to termination, emotions are high on both sides and judgment can be clouded. And even when the nonprofit has taken all of the proper steps and is in complete compliance with the law, the outcome at a jury trial is far from certain. A "jury of our peers" typically means a jury comprised of employees, and just about every juror has felt frustrated or wronged at some point by a supervisor. It is far easier for most jurors to sympathize with the employee than to side with the organization. Depending on the judge, the defense may even be prohibited from telling the jury that the defendant organization is a nonprofit one.

While some jurors may be slightly more inclined *not* to see their local nonprofit as a rapacious corporation and go easier on them in the courtroom, the notion that the law offers protections to nonprofits that it does not offer for-profit corporations is an oft-cited myth. Many states have "volunteer protection" statutes on the books, but these simply do not extend protections to the organization itself. In fact, many of these state statutes try to deflect some of the individual volunteer liability by placing it strictly on the nonprofit itself. And, even if the volunteer seems to have protection under these statutes, no state statute can override federal discrimination or harassment laws. Nonprofits are subject to the exact same employment laws and requirements as for-profit employers. Innocent or not, if a nonprofit or volunteer is sued, there is no alternative but to answer the lawsuit and successfully defend or settle the case. Either path can be quite expensive and time-consuming. As indicated on the earlier "Alleged Wrongful Acts" chart, between 45 percent and 86 percent of any D&O claim is the cost to pay a defense attorney. And even when the nonprofit is found through trial to have done nothing wrong, the financial costs and disruption to the organization often render it a hollow victory.

If You Do Not Do Anything Else, Do This

We insure nearly 15,000 nonprofits, and we know from twenty-six years of experience that nonprofits do great work, but most are stretched thin. The demands on nonprofits seem to grow no matter how hard or long they work. But there are a couple of things that we believe are essential on the governance side that will more than repay the time, energy, and money expended. These are: (1) get good professional advice before taking a significant employment action; and (2) remember that a 501(c)(3) nonprofit is held in trust for the public, and management is accountable to them.

We feel so strongly about the first piece of advice that we have three employed attorneys providing unlimited, free employment risk management advice to our member insureds who have D&O insurance with us. Yes, it is a significant expense, but we know that in the long term it is going to save all of us time and money, and will cut frustration. It is our number one risk-management tool, and we think that every nonprofit ought not to have to think twice about picking up the phone or sending an e-mail and getting free expert advice to avoid the many employment practices pitfalls.

Finally, some of the most expensive and contentious governance and employment claims we see arise from nonprofits who either do not have or do not follow prudent nepotism policies, or seem not to understand that nonprofits are public organizations and, simply, are entrusted to their care. Those in management who treat a nonprofit like a small, personally owned business and hire many relatives as staff and board members usually lack the external controls that result in the best risk management. It is absolutely imperative that we, as nonprofits, operate transparently and always in the best interests of the public we serve.

We cannot promise that you will never be subjected to a lawsuit even if you do practice good risk management; nor can we promise that the time period for the lawsuit will be short, or that the cost to defend and/or indemnify will be small. However, if you have complied with the law and acted with integrity and transparency, your chances before a judge or jury just got a whole lot better.

While some jurors may be slightly more inclined *not* to see their local nonprofit as a rapacious corporation and go easier on them in the courtroom, the notion that the law offers protections to nonprofits that it does not offer for-profit corporations is an oft-cited myth.

Note

1. All data used in this article are from over 1,500 claims against D&O policies from 2005 through 2014, issued by Nonprofits Insurance Alliance Group. All claims were against 501(c)(3) nonprofits. Insurers in the Nonprofits Insurance Alliance Group are Alliance of Nonprofits for Insurance, Risk Retention Group (ANI), and Nonprofits Insurance Alliance of California (NIAC). Both ANI and NIAC are 501(c)(3) nonprofits themselves, and together they insure 14,500 nonprofits for all types of liability insurance. These data are for only one line of coverage offered by the Nonprofits Insurance Alliance Group: D&O insurance.

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ADDITIONAL INSURANCE AND RISK MANAGEMENT RESOURCES

The following links to additional resources for nonprofits wanting to know more about insurance were provided by the Nonprofit Risk Management Center, a national nonprofit resource organization that provides risk advice, tools, and consulting help to nonprofits who do not want to leave their missions to chance. The Center's resources include their weekly *RISK eNews*, a periodic newsletter (*Risk Management Essentials*), informative books, and innovative cloud applications. Affiliate members of the center enjoy free risk help and access to a large "vault" of practical webinars. The center's website includes hundreds of articles on risk and insurance topics, and the forthcoming issue of the center's newsletter will focus on insurance. In addition, a new book on insurance will be published in fall 2015. To learn more about these resources, visit www.nonprofitrisk.org or call 703-777-3504.

American Institute for Chartered Property Casualty Underwriters (CPCU) and Insurance Institute of America (The Institutes)
www.aicpcu.org

Chartered Property Casualty Underwriters (CPCU) Society
www.cpcusociety.org

Insurance Services Office, Inc. (ISO)
www.verisk.com/iso.html

International Risk Management Institute, Inc. (IRMI)
www.irmi.com/online/default.aspx

National Association of Insurance Commissioners (NAIC)
www.naic.org

Public Risk Management Association (PRIMA)
www.primacentral.org

Risk and Insurance Management Society (RIMS)
www.rims.org/Pages/Default.aspx

Society of Insurance Research (SIR)
www.sirnet.org

University Risk Management and Insurance Association (URMIA)
my.urmia.org/home

On Using What You Have *to* **Resist Buying** What You *Do Not* Need:

An IT Fable from the Front Lines

by the editors

Your IT system cannot be considered a stand-alone project but rather needs to flow from and integrate into your larger organization—its plan, budget, culture, and capacity.

The *Nonprofit Quarterly* has heard any number of stories about nonprofits trying to piece together the right IT infrastructure only to be met with a confusing array of options. Each of the options carries attendant costs beyond the purchase or lease—sometimes up to and including the need to purchase another solution when the one opted for does not fit properly. We liked this story from Trish Tchume of the Young Nonprofit Professionals Network (YNPN), who engaged people within her own network to help get the right fit. In the end, she wound up not only with a system suited to the network's needs but also a group of people within that network who are ongoing and engaged resources for YNPN as it moves into a more sophisticated digital future.

When Trish took on the leadership of YNPN it hit a rapid growth stage, and over her three-year tenure YNPN has grown from twenty-seven to forty-two chapters, with an estimated fifty thousand members. That rate of growth called the infrastructure into question, particularly as it related to the organization's ability to gather, sort, and use information. YNPN wanted to be able to communicate effectively across its dispersed network to help the organization move forward, and staff needed to get a better handle on the demographics and attitudes of that network. YNPN knew it needed a constituent relationship management system but had no idea how to choose the right one both to meet the variety of needs for chapters in the network and best suit the capacity of the national organization.

And this, as Trish explains, is where the challenges began. "When you mention that you are looking for a CRM system, people come out of the woodwork offering advice. Vendors, of course—many of them fast talkers who come with hard-sell tactics and a drive to sell you way more than you need or can handle—are sure that what they can offer is exactly the solution you need, never mind that they do not know the size of your budget, the capacity of your staff, or the particularities of your constituent needs. But peers, too, are surprisingly opinionated." In particular, YNPN ran up against what Trish calls "the Salesforce problem," when upward of ten peers urged her to go with Salesforce because it was free. Yet, as Trish discovered, it was free in name only: the attendant "costs" and challenges of tailoring the system to YNPN's network and training countless volunteers on the intricacies of Salesforce were steep. And then there were the colleagues and advisors who felt a deep commitment to open-source tools like CiviCRM because the values behind open-source tools aligned with YNPN's values—but even those required custom builds and created the need for expert staff.

So Trish did her own research, using resources like Tech Soup and Nonprofit Technology Network (NTEN), and she emerged from that preliminary research with a better sense of how to approach the project—and two key lessons:

1. Your IT system cannot be considered a stand-alone project but rather needs to flow from and integrate into your larger organization—its plan, budget, culture, and capacity.
2. Get help. It is not possible, wise, or cost effective to work on a project of this magnitude "on the side" of any staffer's—especially an executive director's—core responsibilities.

It was clear that YNPN needed someone with expertise but also someone who understood the unique organization fairly intimately, so that the understanding of culture and purpose and translation of terms would be less of a problem—and for that YNPN simply had to turn to its own network of young professionals, some of whom had been involved in similar projects.

YNPN ended up selecting and contracting with two chapter leaders known for their data systems expertise, who laid out the pros and cons of each option and whose contracts together totaled less than $7500. The contracts were scheduled to include the following:

- Preinterviews with current federated database users;
- Preinterviews with potential database partners;
- Creation of a feasibility report based on data gathered in preinterviews;
- Collaboration with YNPN to create a communications plan regarding the project and chapter participation in the project;
- Presentation at YNPN's annual conference on the data system selection process and chapter needs;
- Generation of an online survey to determine the systems being used by current YNPN chapters as well as the hopes and fears regarding a national solution to YNPN's database needs;
- Writing of a request for proposal (RFP) based on data from chapters and preinterviews;
- Distribution of the RFP to potential partners;
- Assisting in the assessment or contract review process;
- Creation of a recommended list of top solutions; and
- Establishment of a group of chapter leaders for ongoing advice on the system.

In the end, the process delivered just what the network needed: a well-supported and tailored system that was neither too small nor too large but well matched to the needs, capacity, budget, and resources of the people in YNPN's network.

In the end, the process delivered exactly what the network needed: a well-supported and tailored system that was neither too small nor too large but well matched to the needs, capacity, budget, and resources of the people in YNPN's network.

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The Real Cost *of* Bank Trustees

by Rick Cohen

Unbeknownst to much of the nonprofit sector, four of the largest corporate banks in the country have trustees on several prominent charitable foundations. A number of court cases have taken banks to task for improperly using their roles as trustees to further their own self-interests toward maximizing their power and profits instead of the philanthropic priorities of the organizations they are paid to serve. In so doing, money that could have been going to the charities is instead lining the pockets of these banks.

Editors' note: *The research for this article was supported by a grant from the Fund for Investigative Journalism.*

Imagine you've been invited to be a trustee of a longstanding family foundation. You join the board meeting and nod and exchange pleasantries with the other trustees—and then you are introduced to one whose affiliation might be Bank of America or JPMorgan Chase & Co.

Individuals and banks may be trustees (or cotrustees) of a foundation—that is, a trust established to charitably benefit a class of beneficiaries consistent with the instructions and priorities of the grantor of the trust, who can name as trustees individuals, banks, or both to carry out the beneficial purposes of the trust. As a trustee, you might not be able to shake hands with John Pierpont Morgan but you'll know from the trust documents some of the powers of the bank trustee—typically, to be paid, often handsomely, for the foundation's investment, management, and administrative functions. (Indeed, while more than likely your individual role as a foundation trustee is gratis, when a bank is serving as a trustee its interest may fundamentally be one of getting paid—and, in light of competitive pressures on banks' bottom lines, getting paid profitably.)

Sometimes, however, bank trustees' powers are more extensive—more like those of the trustee *you* might be—such as having a say in

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

 "ICE CREAM SANDWICH" BY RANKIN WILLARD/WWW.RANKINWILLARD.COM

The bank trustee role is a business function built right into the operations of some foundations, but it gets scant attention among nonprofits.

determinations about potential grant recipients' qualifications for foundation dispositions, or suggesting modifications in the trust's priorities if those priorities have become impractical or unnecessary.[1] The bank trustee role is a business function built right into the operations of some foundations, but it gets scant attention among nonprofits. As a foundation trustee, however, you'll be familiar with the latent power of the bank trustee—a power that Mary L. Smith, the widow of oilman William Wikoff Smith, discovered when the bank trustee of the W. W. Smith Charitable Trust attempted to get a large, retroactive fee increase for its role in administering the trust Smith left in support of medical research, college scholarships, food and clothing for children and the elderly, and maritime education.

In this article, we look at the costs charged by a handful of large banks as trustees (not individual bankers as trustees) to private foundations that they serve—specifically, banks serving private foundations with assets of over $50 million. The costs are drawn from the 2014 financial information of three of the four largest banks in the United States: JPMorgan Chase, Bank of America, and Wells Fargo (the fourth, Citigroup, does not appear to hold bank trustee roles with private foundations with over $50 million in assets). Given the mammoth size of these banks, the trustee fees earned from their services to foundations can hardly constitute a large slice of their profits. But banks are back to earning huge profits in our society, taking in just short of 30 percent of total U.S. profits, and higher profits than they were generating before the financial crisis of 2008.[2] Increasingly, bank profits are dependent less on lending and more on other business activities. And while this analysis doesn't establish exactly how profitable bank trustee roles with private foundations might be nor purports to calculate the bank trustee earnings of all banks, what it does establish is that three of the largest banks in the nation are functioning as bank trustees for dozens of foundations and earning substantial revenues for their services. For these banks—and likely for others—bank trustee roles constitute a revenue source that is largely unknown to the American public and even to most nonprofits.

Large Banks Earning Bank Trustee Fees

In the competition among American industries for the title of most distrusted, banks rank near the top. Sitting at the head of *Time* magazine's list of the twenty-five people most "blameworthy" for the global financial crisis at the end of the last decade is Angelo Mozilo—once the CEO of Countrywide Financial Corporation, the nation's largest mortgage lender, whose collapse led to a "rescue-sale" by Bank of America and a $8.7 billion settlement of predatory lending charges filed by eleven state attorneys general.[3] In the view of the *Economist*, "Start with the folly of the financiers"—abetted by the ratings agencies such as Moody's and Standard & Poor's, entities that the public might have believed were trustworthy guides of investor risk but actually "were paid by, and so beholden to, the banks"—and end with a national and global collapse in the housing markets and overall financial systems of Europe and America.[4] Although it is rising in public attitudes from the bedrock basement to which the industry sank, beginning in 2007 and 2008, the banking sector is still viewed by the American public, according to Gallup, as "below average"—a category that includes the airline industry, the pharmaceutical companies, advertising and PR firms, and electric and gas utilities.[5]

Not long before the national and global fiscal collapse, banks had earned themselves a troubled reputation in philanthropic circles, due to an unusual case in Philadelphia. Wachovia (now Wells Fargo) had been the bank trustee for the W. W. Smith Charitable Trust. Wachovia had inherited this fiduciary role when it acquired First Union Bank, which had been the bank trustee after it acquired CoreStates Bank, which itself had become the Smith trust's bank trustee when it absorbed Philadelphia National Bank (PNB)—and so on during the wave of serial bank mergers and acquisitions that occurred in the 1980s, 1990s, and early 2000s.[6] And that trustee wanted an increase in its annual fee—a shift in the calculation to a percentage of the trust's total assets rather than a percentage of its annual income; in 1998, when First Union made the request, this would have more than tripled its annual fee, from $261,799 to $914,370. First Union and then Wachovia as its successor also asked that the fee be increased retroactively for the previous fifteen years, on the theory that the bank trustee had been inappropriately undercompensated all that time. The trust's only other trustee, Smith's widow, didn't agree, and the bank trustee went to court and challenged the institution it purportedly served as a fiduciary.

"Why Mr. Smith put that provision in his trust is he wanted this money to go to charity, not to PNB, and he wanted a reasonable limitation on it," Lawrence Barth, a senior deputy attorney general, said about the controversy. "And experience has shown, in this case, that the bank can live within it, and should live within it, and should not gain windfalls."[7] The notion of 5 percent of assets, as First Union and then Wachovia requested as a fee, was essentially equivalent to what nonprofits would expect as the mandatory minimum qualified distributions, or "payout," from a private foundation (or, if increased, a potential "windfall")—not a service fee to a bank. Charity might have had more at stake in the outcome of the litigation than just the Smith trust assets if Wachovia could sue to get higher fees going back years. For most of the nonprofit world, the idea that a big bank might earn a million dollars a year for serving as a trustee to a foundation with a somewhat limited range of activities was unknown. "If Wachovia wins this case, they're coming after other private foundations and other high-net-worth individuals with trusts who give away lots of charitable donations," Bruce W. Brown, a former administrator of the Smith trust and senior official at two other Philadelphia foundations, told the *Chronicle of Philanthropy*. "Charities need to pay attention to this, because they're the ones who could lose."[8]

A 2003 Georgetown Public Policy Institute study examining 238 foundations found in their 1998 Form 990 filings that twenty-five of them had paid their bank trustees in the aggregate of $13,837,726, and observed, "The 990-PF's provided no details about the bank trustees. It was impossible, therefore, to assess the services that banks provided to the foundations and the banks' relationships to the principals at the foundations."[9]

The analysis collected information about any bank that might have served as a bank trustee for the foundations in the sample of that study. Although the number of federally insured financial institutions has fallen to its lowest level since the federal government began counting banks in 1934, there were nonetheless 6,891 commercial banks in existence as of September 2013—an untold proportion of which may be serving charities and foundations as trustees.[10]

The following table shows the twelve largest banks in the nation according to SNL Financial:[11]

Bank	Headquarters	Total assets ($B)	Total deposits ($B)
JPMorgan Chase & Co.	New York, NY	2,415.69	1,287.77
Bank of America Corp.	Charlotte, NC	2,102.27	1,119.27
Citigroup Inc.	New York, NY	1,880.62	968.27
Wells Fargo & Co.	San Francisco, CA	1,527.02	1,079.18
Bank of New York Mellon Corp.	New York, NY	374.31	261.13
U.S. Bancorp	Minneapolis, MN	364.02	262.12
PNC Financial Services Group Inc.	Pittsburgh, PA	320.30	220.93
Capital One Financial Corp.	McLean, VA	297.05	204.52
HSBC North America Holdings Inc.	New York, NY	290.01	110.30
State Street Corp.	Boston, MA	243.29	182.27
TD Bank US Holding Co.	Cherry Hill, NJ	234.62	195.51
BB&T Corp.	Winston-Salem, NC	182.34	127.48

The table reveals at a glance the extreme concentration of assets and deposits in the top four banks. For example, the total assets of the fiftieth-largest bank in the United States, FirstMerit Corp., based in Akron, Ohio, are less than one 1 percent as large as JPMorgan Chase's.

After reviewing multiple potential sources of information, the *Nonprofit Quarterly* chose to rely on GuideStar to identify private foundations for which JPMorgan Chase, Bank of America, and Wells Fargo served as paid bank trustees to 501(c)(3) nonoperating foundations with assets over $50 million (excluding the banks' own corporate foundations).[12] Based on the GuideStar advanced search mechanism, the total number of foundations worth above $50 million with these banks in official trustee roles breaks out as follows:

For most of the nonprofit world, the idea that a big bank might earn a million dollars a year for serving as a trustee to a foundation with a somewhat limited range of activities was unknown.

JPMorgan Chase as Bank Trustee—Fees Paid by Year				
Foundation	2013	2012	2011	2010
Hagedorn Fund	325,561	301,623	242,563	224,915
Edward E Ford Foundation	211,160	208,779	240,112	221,774
Booth Ferris	1,226,923	1,361,310	1,131,889	1,048,186
Wm R Kenan Charitable Trust	2,075,534	2,016,254	1,610,166	N/A
Dora Roberts Foundation	480,717	471,735	252,511	253,550
Beatrice P. Delaney Char. Trust	361,057	384,206	419,187	372,646
Thomas J. Watson F	191,928	82,508	163,467	136,927
Hendrick Home for Children Char TR	546,034	523,425	191,146	273,711

Wells Fargo as Bank Trustee—Fees Paid by Year				
Foundation	2013	2012	2011	2010
Charles K Blandin Residuary Trust 30/15962	1,010,659	826,227	816,863	1,119,463
Donnell B & Elizabeth D. Stewart Fdn	110,719	92,940	96,986	0
Kate B. Reynolds Charitable Trust	2,229,274	2,151,967	2,095,705	1,925,014
Nora Eccles Treadwell Charitable Trust	223,412	205,539	154,287	165,718
Emma Eccles Jones Foundation	181,452	150,306	149,741	132,916
Charles Cannon Charitable Trusts	949,251	900,956	1,119,945	877,416
Lawrence & Janet Dee Foundation	161,648	174,909	199,923	123,029
Emil Buehler Perpetual Trust	214,621	121,716	137,248	132,980
Carlos & Marguerite Mason F	558,381	663,469	1,280,749	1,176,924
Chanticleer Charitable Trust	113,222	102,725	103,260	95,215
William & Marie Selby Foundation	272,328	271,920	294,204	269,837
Egtvedt Charitable Trust	271,816	255,280	258,895	244,440
Tw Ld McEachearn	507,477	528,813	1,039,279	984,035
Grundy Foundation	N/A	19,144	96,768	95,658
William A. Badger Foundation	187,306	196,220	200,687	205,531
W.W. Smith Charitable Trust	177,310	173,398	162,802	161,803
Elisabeth K. Harris Foundation	0	0	0	0

Bank of America as Bank Trustee—Fees Paid by Year				
Foundation	2013	2012	2011	2010
Frank & Seba Payne Fdn	415,698	481,507	438,950	406,178
Herbert Zahl Foundation	10,275	7,766	7,329	6,559
UD M DAVIS FOR W DAVIS MEM DN	54,858	57,144	54,191	40,774
Dr Ralph and Marian Falk Med Res Tr	651,771	588,612	646,511	N/A
L G Balfour Foundation	276,226	283,086	304,403	237,790
U W Eugene Higgins Foundation	977,245	895,298	463,050	444,557
Carl C Anderson Sr And Marie Jo Anderson Charitable Foundation	244,642	378,228	134,306	121,300
Edward & Della Thome Memorial Fdn	485,100	486,140	576,683	1,024,703
Seth Sprague Educ & Char Foundation	121,929	118,604	102,839	97,125
Boeing Company Charitable Trust	281,003	270,266	231,339	61,930
Hillcrest Foundation	211,389	511,769	593,678	566,813
Elizabeth Morse Genius Char Trust	421,112	424,012	377,138	339,023
Sidney W Sylvia N Souers F	104,284	44,775	42,128	22,678
The Patrick and Catherine Donaghue Medical Research Foundation	174,945	136,998	115,082	129,713
Charles Edward Stuart Charitable	342,119	260,295	237,503	239,012
Kronkosky Charitable Foundation	1,475,967	1,390,885	1,118,316	1,085,480
Doree Taylor Charitable Fdn	282,780	128,398	126,241	257,904
John & Polly Sparks Foundation	299,497	179,744	N/A	N/A
Lewis Humphreys Charitable Trust	199,935	494,914	228,759	N/A
Milton E Daniel Trust	212,619	337,119	298,317	272,565
Melville Charitable Trust	N/A	11,372	229,985	176,872

Adding in foundations with between $10 million and $50 million in assets, Citigroup shows up as a bank trustee serving a small number of private nonoperating foundations. Overall, the distribution of private nonoperating foundations with bank trustees from these four megabanks is as follows:

Bank	Foundations larger than $50M in assets	Foundations with assets between $10M and $50M
JPMorgan Chase	8	56
Bank of America	21	150
Citigroup	0	4
Wells Fargo	17	32

A total of 288 private nonoperating foundations have bank trustees from these four banks. It may seem like a small number, except that only 6,623 private foundations in the entire nation have more than $10 million in assets:

Private foundations filing Form 990s	91,872	
Private foundations with assets greater than $10M	6,623	7.2% of all foundations
Private foundations with assets greater than $10M with JPMorgan, Bank of America, Citigroup, and Wells Fargo trustees	288	4.3% of foundations w/greater than $10M in assets

Although a relatively small number of foundations have assets above $10 million, those few control a large part of private foundation assets:[13]

Size of foundation assets	Number of foundations filing 990s	Total assets ($)	Percent of total
Less than $100,000	20,491	646,002,699	0.085
$100,000–249,999	11,426	1,919,948,863	0.252
$250,000–499,999	11,017	4,027,504,367	0.530
$500,000–999,999	12,129	8,793,104,862	1.158
$1–5M	21,242	48,437,840,037	6.377
$5–10M	4,831	34,227,916,036	4.506
$10–100M	6,252	172,291,707,444	22.684
More than $100M	873	489,175,748,837	64.406
TOTAL	**88,261**	**759,519,773,145**	**99.998**

As the table demonstrates, more than 87 percent of foundation assets reside in foundations with $10 million or more in assets. Beyond the four largest banks, others among the larger banks also serve as bank trustees, sometimes for well-known foundations:

- Bank of New York Mellon is a bank trustee for the Arthur Vining Davis Foundation, known to many for its support of public television and longstanding partnership with filmmaker Ken Burns;
- PNC Financial Services is the bank trustee for more than seventy private foundations with assets of greater than $10 million, including the Pittsburgh-based McCune Foundation and the Ruth Lilly Foundation. Another PNC foundation is the GAR Foundation, which contributes significantly to the Fund for Our Economic Future, in Cleveland, Ohio;
- Capital One is a bank trustee for the C. Homer and Edith Fuller Chambers Foundation, in New Orleans, and several other foundations in Louisiana; and
- Regions Bank is the bank trustee for the Robert R. Meyer Foundation of Birmingham, Alabama, whose grant application strongly encourages applicants to join the Alabama Association of Nonprofits.

The foundations that have as bank trustees JPMorgan Chase, Bank of America, or Wells Fargo are no less well known. JPMorgan Chase's Booth Ferris Foundation is particularly well known in the New York City area for its support of human service agencies such as the Henry Street Settlement and the now-bankrupt Federation Employment & Guidance Service (FEGS).[14] In 2014, the William G. and Marie Selby Foundation, with Wells Fargo as its bank trustee, gave $200,000 to the Conservation Foundation of the Gulf Coast for the purchase and dedication of a conservation easement on the Myakka River in Florida.[15]

As noted earlier, the role of a bank trustee is much broader than simply functioning as a vendor to a foundation for a series of discrete managerial and investment tasks. The role includes investing foundation assets, balancing

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spending and investment priorities, and pursuing and protecting donors' interests and priorities. While meant to protect the charitable and philanthropic interests of donors, bank trustees can also exercise significant control over the assets of foundations. For example, a bank trustee might resist supporting movements to increase the social or mission investment of assets and instead emphasize investments for return. While a bank trustee might be able to resist conflicts of interest that individual foundation trustees could in theory succumb to—that is, individual enrichment and personal inurement—bank trustees have been challenged for selling the banks' own products to the foundations they serve or investing foundation assets in bank equities. And, when the relationship of the founders and donors to their foundations becomes more attenuated (as at times it does), the potential latitude of the banks to exercise power grows.

Most of the foundations' 990s examined here indicate that the banks spend approximately thirty-eight to forty hours a week in their bank trustee roles. One of the least reliable data points in a 990, however, is the estimate of hours worked by trustees—individual or corporate. Whether or not the bank trustees are devoting that much time to their roles at the foundations in question, we suspect that the bank trustee function is not a charitable contribution on the part of the banks. Back in 2000, a presentation by Standish Smith of HEIRS® outlined an issue that warranted monitoring—the profitability of the bank trustee role. Smith suggested that some corporate trustees might occasionally be "tempted to blur the line between the right to control (the legal interest) and the right to enjoy (the so-called beneficial interest)" of the foundations and trusts they are charged with overseeing.[16] Specifically, he identified several factors that could make the banks' roles as trustees a little less than trustworthy at times—notably, the profitability of the function (particularly the profitability of the banks' trust and investment departments), citing operating margins of between 30 and 45 percent. Given returns that high, bank trust departments could in many cases cut the fees they charge for their trustee functions and thereby increase the amount of money available for the trusts' or foundations' charitable distributions; however, with increasing competitive pressures in a consolidating market, banks might start looking at their trustee function as an arena for upping the revenue they make from private foundations as well as for building power via their control over these foundations.

Charitably Trusting the Banks

For the sake of argument, we can assume that in most cases bank trustees try to treat the foundations they serve fairly and then some. As small parts of the business economics of large banks, bank trustee functions shouldn't be all that attractive an arena for profit-motivated banks to maximize their returns. However, as suggested above, this changes after a merger or acquisition, and is exacerbated by the competitive pressures the banks face following the Great Recession.

A major motivation in bank mergers is to achieve efficiency through stripping the two or more united entities of redundancies, reducing unnecessary costs, and maximizing potential returns wherever they exist in the combined megabank. That includes raising what the new megabank owners might see as inadequate compensation to make the role of bank trustee more productive vis-à-vis financial return to the bank. That First Union and then Wachovia would want to triple their fee as a trustee and hike fifteen years of back fees as well is, in the business models of bank mergers, understandable. Of course, a push from banks for higher trustee fees is likely to be met in some cases—when the foundations' founders or other trustees are paying attention—with pushback by nonprofits trying to maximize philanthropic resources and minimize nonphilanthropic administrative fees.

JPMorgan Chase is the product of mergers and acquisitions, including Manufacturers Hanover Corporation, Chemical Banking Corporation, First Chicago Corporation, The National Bank of Detroit (NBD), Bank One Corporation, The Chase Manhattan Corporation, and Washington Mutual Bank. Bank of America, as it stands today, is the product of a merger with NationsBank, several additional acquisitions such as FleetBoston, and, in the wake of the financial crisis, Countrywide. Wells Fargo today reflects other banking giants that were acquired by Wells or by the banks Wells acquired, such as First Fidelity Bancorp, First Union, CoreStates, Wachovia, and the troubled World Savings Bank. As the relationship between the original bank trustee and the philanthropic donor becomes attenuated by the passage of time—and, in U.S. banking, often serial bank mergers and acquisitions (which more often than not result in formerly local bank trustees moving out of state)—it should not be surprising that what was once a bank service to longstanding wealthy depositors develops into more of a business relationship between the bank trustees and the foundations they help govern. That makes the W. W. Smith case an example of a struggle over fees and services that could become more rather than less likely, as banks feel the pressures to make every possible cost center one that comes out well in the black.

At roughly the same time as the W. W. Smith Charitable Trust case came before the courts in Philadelphia, a flurry of attention was focused on other cases—these questioning the fees charged and/or the services that banks delivered for those fees in their roles as bank trustees. In a 2005 article published in the *Chronicle of Philanthropy*, Brad Wolverton indicated that some banks were reducing the trustee services they provided under their current fees or, like Wachovia, were suing for fee increases. As summarized in the *Chronicle*, "Many charities and foundations believe they are losing millions of dollars a year to the very institutions they pay to safeguard their assets."[17] Richard D. Greenfield, a lawyer from Easton, Maryland, representing, according to the *Chronicle*, various trusts and foundations challenging the banks, put it like this: "Bank officials don't think anyone is going to raise a big fuss if excessive fees are taken, and they have learned from experience that members of foundation and charity boards tend not to rock the boat."[18]

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Wolverton writes about the McCune Foundation of Pittsburgh suing its then-trustee National City Bank in Cleveland, not only for improperly overseeing the investment of foundation assets but also for refusing to allow family members a voice in the investment decisions, and for investing much of the foundation assets in the bank's own stock.

Why would a donor choose a bank as opposed to an individual to serve as the trustee of a charitable entity? Wealthy individuals or families thinking about establishing a charitable trust—that is, a philanthropic grantmaking entity—sometimes choose corporate trustees, such as the trust department of a bank, to manage their assets and ensure that the charitable purpose of the trust is maintained. Often, the choice of trustee is a bank with which the donor has a long-established relationship. Among the multiple reasons a donor would choose a bank might be: the bank's experience in the management of trusts and estates; the bank's experience in investment of assets for maximum returns; the reliability of an "institutional" trustee as opposed to an individual trustee (who might have personal concerns and agendas); the bank's presumed fidelity to the donor's charitable priorities and intent; the bank's hoped-for neutrality and objectivity in the face of the competing interests of a donor's various family members; and, in theory, the bank trustee's institutional continuity as compared to individual trustees who might leave the foundation board for one reason or another. As more individuals and families generate significant asset holdings that they want to insulate from estate taxes, wealth advisors increasingly suggest that potential donors establish irrevocable charitable trusts and select corporate trustees—that is, the trust departments of banks as well as other trust administrators—to ensure their assets get used for the charitable purposes the donors want and expect while alive and after they are gone.

As noted earlier, making a bank a trustee for a foundation, particularly with few other trustees to counter it, gives the bank broader powers than some observers might assume. Wolverton writes about the McCune Foundation of Pittsburgh suing its then-trustee National City Bank in Cleveland, not only for improperly overseeing the investment of foundation assets but also for refusing to allow family members a voice in the investment decisions, and for investing much of the foundation assets in the bank's own stock. McCune lost in court (although, according to Wolverton, the foundation continued to criticize the bank publicly). As James Edwards, a member of the McCune board, told the *Chronicle*, bank trustees "want to act like they don't have a conflict of interest, but any fool can see they do." A similar challenge to Bank of America (having acquired Pacific National Bank and others) succeeded, finally, in making the case that it had overbilled trusts and foundations for some years, with a U.S. Court of Appeals judge ordering Bank of America to pay $111.5 million in punitive damages and restitution to thousands of claimants.

In 2005, the Pennsylvania Supreme Court ruled unanimously in favor of Mary Smith and against Wachovia's request to receive a retroactive hike in its fees.[19] The decision overturned a lower court decision that had gone in Wachovia's favor, with the implication that Wachovia might have to return to the Smith trust the higher fees it had begun awarding itself at that time.[20]

According to the Smith trust's former administrator Bruce Brown, William Smith had a personal relationship with G. Morris Dorrance, the former chairman of PNB, who served as the institutional cotrustee of Smith's foundation. But with First Union and then Wachovia, the Smith trust had a bank trustee that was no longer local but based in Charlotte, North Carolina; and, as Brown noted, "Dorrance knew Bill Smith—his interests, his passions, his intentions for his charitable funds. Not one of the 'revolving door' representatives from North Carolina-based Wachovia knew Bill Smith." It was a relationship of trust—the root of the concept of trustee; “no such relationship of trust exist[ed] . . . between Mrs. Smith and Wachovia, a banking institution foreign to the Philadelphia market.” Wachovia, in Brown’s opinion, could “take advantage of” the law and “fatten its bottom line, but any increased fees will come out of the pockets of charitable grant recipients.” The Smith case and other cases of charities struggling with their bank trustees reflect a different/past economy—one in which the local banker in the trust department knew well the wealthy clients it served as institutional trustee for their charitable foundations.

Brown suggests that the Smith case showed that the concept of a bank’s “trust department . . . [now is] an oxymoron.” For as charities have discovered in dealing with bank foundations, increasingly the program officers aren’t within their communities but rather hundreds or even thousands of miles away. In 2007, a report by the National Committee for Responsive Philanthropy described the postmerger situation succinctly:

> Community advocates . . . may fear a shift in decision-making power out of the acquired company’s community, resulting in a loss of affinity or loyalty—a fear that there will be no one at high levels of leadership in the new mega-corporation who cares about the concerns of their community; neither face-to-face conversations nor creative thinking will take place to address local needs. Another concern includes whether a larger mega-corporation will shift focus away from a unique set of local needs to a national set of priorities. Lastly, there is the fear that funding will be stripped from local organizations to give to larger, regional, or national organizations that can provide wider publicity for the post-merger bank, thus better enhancing the bank’s public image while providing a significant administrative ease of fewer grantees within a larger budget.[21]

With the bank trustees serving charitable foundations, the dynamic is much the same. The relationship is likely to be impersonal, institutional, and distant. The banks’ view of the bank trustee role may in some circumstances be less about service and more about business. In much of the litigation that has emerged around bank trustee roles, donors and foundations have complained that the banks are putting their own priorities, including sometimes the banks’ own philanthropic objectives, over the philanthropic priorities of the founders, donors, and family members involved in the charitable institutions.

When the bank trust department fulfills its bank trustee role with a charitable trust or private foundation, the calculus may well emphasize the bank’s economic return as much as the foundation’s charitable distributions. In the Form 990, aspects of what the bank trustee might be engaged in doing—the management of assets, investments, and capital flows—may be the least understandable, least consistent, and most opaque information presented in the IRS filings. Although speaking about the trustee reports in general—but applicable to the information in Form 990s—Standish Smith noted the problem of understanding and interpreting the banks’ reports, not only by external watchdogs but also by foundation insiders themselves: “The trust accounting statements to which I have been exposed do not always appear to be models of clarity or disclosure. That’s unfortunate, since the trustee–beneficiary relationship is, in theory, a fiducial relationship of great sensitivity, it seems beneficiaries should be entitled to statements that are timely, comprehensive, detailed and understandable.”[22] Presumably, most bank trustees balance the banks’ own financial imperatives with the interests of their foundation or charitable trust clients. For those that don’t, the importance of watchdogs that monitor—and understand—Form 990 filings to track how much banks earn from their bank trustee roles and how they are investing the foundations’ moneys cannot be overstated: as Smith observed, every dollar that is paid to Bank of America, JPMorgan Chase, Citigroup, or Wells Fargo in excess of what the banks need and deserve is a dollar that could have gone to a charity instead.

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W. W. Smith Postscript

After years of litigation, what happened to the fees that the W. W. Smith Charitable Trust was ordered to pay its Wachovia (subsequently Wells Fargo) bank trustee? While the fees skyrocketed in fiscal year 2003 as Wachovia took advantage of the lower court ruling that increased its compensation, the fees subsequently fell in later years in response to the Pennsylvania Supreme Court ruling, as the graphic below makes clear.

The ratio of the bank trustee fee to the foundation's assets in 2013 is roughly back to where it was in 1999, except for the years that the Smith trust shelled out substantial legal fees, including $472,665 in 2002 and $77,379 in 2005. Basically, the bank trustee and the foundation have come full circle, minus the costs incurred in the litigation—and the mental toll it took on Mary Smith—when the friendly trust from the local Philadelphia bank that had handled the Smith family's philanthropic interests for so many years transformed into a distant trustee, located in North Carolina and then beyond, that viewed the foundation as a revenue source rather than an entity to safeguard and protect.

Notes

1. See, for instance, *Quarrie et al. v. Commissioner of Internal Revenue*, 603 F.2d 1274 (1979) (http://openjurist.org/603/f2d/1274/ca-v-commissioner), addressing the powers of the Northern Trust Company, the bank trustee of the William F., Mabel E., and Margaret K. Quarrie Charitable Fund: "In the event that at some future date, any of the aforesaid charitable uses in the judgment of the Northern Trust Company shall have become unnecessary, undesirable, impracticable, impossible or no longer adapted to the needs of the public, the income otherwise to be devoted to such use shall be distributed to such charitable, scientific, educational or religious corporations, trusts, funds or foundations as the Northern Trust Company may select to be used for their general purposes."

Fiscal year	Bank trustee	Compensation ($)	FMV assets ($M)	Grants paid ($M)
1999	First Union	237,734	$173.7	$8.885
2000	First Union	271,306	$179.6	$6.434
2001	First Union	275,237	$159.6	$7.606
2002	Wachovia	296,449	$137.5	$7.729
2003	Wachovia	910,015	$132.6	$7.222
2004	Wachovia	338,841	$139.3	$7.491
2005	Wachovia	318,616	$136.4	$7.080
2006	Wachovia	191,334	$134.4	$7.469
2007	Wachovia	193,484	$150.0	$4.930
2008	Wachovia	187,628	$130.5	$6.836
2009	Wachovia	173,997	$104.9	$4.310
2010	Wells Fargo	161,823	$110.3	$4.010
2011	Wells Fargo	162,802	$129.7	$4.001
2012	Wells Fargo	173,398	$124.3	$5.739
2013	Wells Fargo	177,310	$137.4	$6.601

2. Ben Walsh, "No, Regulation Is Not Keeping Banks From Making Money," *Huffington Post*, November 12, 2014, www.huffingtonpost.com/2014/11/11/bank-regulation-profits_n_6140510.html.

3. "25 People to Blame for the Financial Crisis: Angelo Mozilo," *Time*, accessed May 4, 2015, content.time.com/time/specials/packages/article/0,28804,1877351_1877350_1877339,00.html.

4. "The origins of the financial crisis: Crash course," *Economist*, September 7, 2013, www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article.

5. Frank Newport, "Business and Industry Sector Images Continue to Improve: Images of 24 business sectors are most positive since 2003," *Gallup*, September 3, 2014, www.gallup.com/poll/175616/business-industry-sector-images-continue-improve.aspx.

6. Patricia Horn, "Legal fight could hurt trust's giving: Wachovia wants a bigger fee, plus $5 million for work from the past," *Philadelphia Inquirer*, January 25, 2004, articles.philly.com/2004-01-25/news/25367313_1_wachovia-legal-fight-smith-trust.

7. Ibid.

8. Brad Wolverton, "Bank Sues Philadelphia Trust in Quest for Additional Compensation," *Chronicle of Philanthropy*, April 14, 2005, philanthropy.com/article/Bank-Sues-Philadelphia-Trust/177273.

9. Christine Ahn, Pablo Eisenberg, and Channapha Khamvongsa, *Foundation Trustee Fees: Use and Abuse* (Washington, D.C.: The Center for Public and Nonprofit Leadership, Georgetown Public Policy Institute, September 2003), www.foreffectivegov.org/files/npa/final_trustee_pdf.pdf.

10. Constantine Von Hoffman, "Number of U.S. banks drops to record low," *Moneywatch*, CBS News, December 4, 2013, www.cbsnews.com/news/number-of-us-banks-drops-to-record-low/.

11. Zuhaib Gull, "Top 50 US banks in Q4'13," SNL Data Dispatch, February 27, 2014, www.snl.com/InteractiveX/Article.aspx?cdid=A-27025657-13098.

12. This review also excludes entities identified as 4947(a)(1) Non-Exempt Charitable Trusts. As defined by the IRS, "In general, a private operating foundation is a private foundation that devotes most of its resources to the active conduct of its exempt activities. [It] may qualify for treatment as a private operating foundation. These foundations generally are still subject to the tax on net investment income and to the other requirements and restrictions that generally apply to private foundation activity. However, operating foundations are not subject to the excise tax on failure to distribute income." In other words, unlike nonoperating foundations—which are foundations that do not "operate" programs—operating foundations don't have a payout requirement.

13. National Center for Charitable Statistics, Urban Institute, nccs.urban.org/.

14. "2014 Contributions—Strengthening NYC," Booth Ferris Foundation, fdnweb.org/boothferris/grants/category/strengthening-nyc/.

15. "Summary of Foundation Grants," William G. and Marie Selby Foundation, www.selbyfdn.org/page/summary-of-foundation-grants.aspx.

16. Standish H. Smith, "Reinventing The Corporate Administration of Personal Trusts—A Marketing Opportunity For Banks" (presentation to the Financial Analysts of Philadelphia, The Racquet Club of Philadelphia; April 20, 2000), heirs.net/downloads/reinventing.pdf.

17. Brad Wolverton, "Loss of Trust," *Chronicle of Philanthropy*, April 14, 2005, philanthropy.com/article/Loss-of-Trust/177275.

18. Ibid.

19. Patricia Horn, "Court blocks unilateral hike in trustee's fees: Wachovia Corp. barred from raising trust fees," *Philadelphia Inquirer*, April 29, 2005, articles.philly.com/2005-04-29/business/25426994_1_wachovia-retroactive-fees-smith-charitable-trust.

20. *W. W. Smith Charitable Trust v. Wachovia Corporation*, J. E04001/04 (Pa.Super. 2005), charitygovernance.blogs.com/charity_governance/files/W.W._Smith_e04001_04.pdf.

21. Becky Sherblom, *Banking on Philanthropy. Impact of Bank Mergers on Charitable Giving*, (Washington, D.C.: National Committee for Responsive Philanthropy, June 2007), ncrp.org/files/NCRP_BankMergers_final.pdf.

22. Smith, "Reinventing The Corporate Administration of Personal Trusts."

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Nonprofit Governance and the Power of Things

by Fredrik O. Andersson and Avery Edenfield

Nonprofit boards are famously prone to acting in ways that suggest unseen forces. This soon-to-be-classic article takes on two types of such forces: the dominant coalition and the inanimate actor.

First, people build walls. But they need doors to get through them. But doors need closing. They could hire a person [. . .] to do this job. But they delegate this job to a machine. Now that the machine is broken, a text must be substituted to enroll the passing door user in closing the door.

—Greg Myers

Who really governs a nonprofit organization? Over the past decade, several scholars have asked this question and highlighted the need for new perspectives and research on nonprofit boards and governance. The common assumption, of course, is that the board is always at the center or in control of the governance process. But this assumption has created a very limited—and opaque—vantage point from which to examine nonprofit board governance. It is also entirely human-centric—which, as we will show, does not allow for a full-spectrum analysis of all that is brought to bear on the creation of a system.

In order to dismantle and examine power relations inside and outside the boardroom—in other words, to open the black box of governance politicking, power struggles, and actual board behavior and decision making—we may need to go beyond the established frameworks and images and begin to pull in alternative views and ideas to better comprehend questions such as who really governs. One such alternate perspective is the concept of the dominant coalition, which we reintroduce here as an entry point into the question.

The basis of the dominant coalition approach to nonprofit governance is that one must distinguish between boards and governance, because the board is a structure whereas governance is a function; and even though the governance process may officially be the work of the board and include all or most of its members, it is entirely possible that in actuality it does not. The dominant coalition concept explicitly recognizes that nonprofit governance is a political and organizational process that inherently involves multiple layers and stakeholders inside as well as outside the boardroom. As a consequence, governance research needs to give explicit consideration to the existence of a "dominant coalition"—that is, a discrete collection of people outside of the board who act as a group to exercise power and engage in some or all dimensions of governance.

We are using the dominant coalition lens as an entry point because, in a very real sense, regardless of who is involved, the dominant coalition by definition represents the veritable "home" for nonprofit governance activity. But while the dominant coalition lens provides an alternative entry point, we must also examine the issue from multiple perspectives; and a key question is which additional theoretical perspectives are likely to be useful in understanding the dominant coalition and, further, the larger phenomenon of dominant coalitions in nonprofit board governance. One such perspective that brings useful insights to the study of dominant coalitions (as well as nonprofit governance) is actor-network theory (ANT).

ANT is a useful complement to the dominant coalition perspective because, analytically, ANT focuses on elements such as the ways in which actant networks overcome resistance and strengthen internally; how they gain coherence and consistency; how they enlist others to invest in or follow the program; how they bestow qualities and motivations to actors; and how they become functionally indispensable. All of these features are of great interest when considering dominant coalitions and nonprofit governance; but of particular interest to us is the symmetry ANT draws among actors—human and nonhuman alike. This symmetry is useful because it allows examination of a broad ecosystem of communication and can include a multitude of what ANT researchers term "actors," or agents: "any actors—cell phones, blogs, people, and so forth—that have the ability to act and do act within the network."[1]

This article focuses on ANT as a door into this concept of human-nonhuman symmetry, and presents two central ANT concepts: *enrollment* and *inscription*. We then assess a critical governance incident—the firing of a cooperative's founder—from a "conventional" nonprofit governance perspective, a dominant coalition perspective, and, circling back, an ANT perspective, to show how these lenses help illuminate different aspects of nonprofit governance.

Actor-Network Theory (ANT)

Broadly defined, actor-network theory is an analytical framework that enables us to examine networks consisting of an array of actors. ANT is a so-called antiessentialist perspective, meaning it does not simply assume or accept that there is a clear separation between, for example, society and nature, or context and content. Instead, ANT is interested in the overlap of such pairings, and looks at the pairings as properties of collective activity. Put differently, a "thing" (say, board structure) attains significance and meaning in relation to another "thing" (say, board member behavior), which is why it is relevant to study actors and practices from a network perspective.

Clay Spinuzzi describes ANT as "a materialist, non-Cartesian approach, and as such it does not draw lines between humans and nonhumans."[2] In this regard, ANT is radically symmetrical. One of the most startling features—and its most defining—is this symmetry among human and nonhuman actors. That is, rather than human-centered theory, which places a premium on human agency and activity, ANT supports a broader examination of actors (both big and small) and is useful for analyzing and understanding the networks that support an organization—itself a network and an actant.[3] Because it enrolls many actors (including governments, funders or investors, employees, etc.), a large corporation or a university can be a stronger, more robust network than a small business or cooperative. As Spinuzzi describes it:

> Each actant enrolls the others; that is, it finds ways to convince the others to support its own aims. The longer the networks are and the more entities that are enrolled in them, the stronger and more durable they become.[4]

This symmetrical approach ascribes politics and agency to material artifacts—even seemingly mundane texts like memos, e-mails, signs, etc. For humanists, this may seem to detract from human agency and responsibility. ANT doesn't anthropomorphize objects, however; rather, it provides a tool to consider the various ways humans and nonhumans work together to accomplish tasks and, importantly, build networks.

We will now consider the two important concepts mentioned earlier that provide language to describe the linkages between factors that create these networks: *enrollment*—the ways humans and nonhumans work together to accomplish tasks and, importantly, build networks—and *inscription*, a term used to describe "all types of transformations through which an entity becomes materialized into a sign" (for example, when a group agreement is inscribed into a handbook as a policy, or an expectation of behavior becomes a conduct code).[5]

How Little Actors Become Big Actors: Enrollment and Inscription

At the human-nonhuman level, enrollment and inscription occur to create and strengthen networks, creating enduring links between network nodes. Enrollment and inscription are important concepts to many actor-network approaches, as they provide language to talk about these linkages between "actor" (what it means to be "enrolled in a network") and how these "little actors become big actors" (by "translating the interests of other actors and enrolling them," often through exchanges of power, money, commodities, obedience, etc.).[6]

Greg Myers explains actor-network theory's concern with the role of inscription as a part of network enrollment, and that inscriptions play an important role in constructing the links and deploying a network:

> In an analysis based on actor-network theory, attention shifts from the writer as subject to a range of other potential actors constructed in the text, and to text itself as a

> circulating artifact. The text makes complex links between various kinds of actors, links we understand and draw on without thinking about them.[7]

This idea that the writer is not the only subject/actor in the creation of a text and that the text itself contains actors, too—and, furthermore, that the text itself is an actor—opens up a whole new world of exchanges and links of power. That is, texts play a vital role in creating and maintaining a network, and are themselves enrolled. To demonstrate the importance of inscription in exchanges in power, Myers uses actor-network theory to examine the function of texts in the United Kingdom's Heysham nuclear power plant:

> The plant is kept safe, if it is safe, by written plans, testing procedures, monitoring systems, record keeping, and training manuals. It is marked as dangerous, if it is dangerous, by reports on health statistics, techniques for interpreting those statistics, estimates of seepage and diffusion and currents, models of decontamination, routes of trucks and trains. Plans for energy needs and costs argue for it, financial accounts that include decommissioning argue against it.[8]

The Heysham plant is inscribed/translated into manageable, transportable artifacts (texts, procedures, systems, techniques, etc.). As such, these artifacts are deployed in networks that enable interpretations, relationships, and political network dynamics among the plant's employees, researchers, and activists. These nonhuman artifacts are linked with human beings to create a broader network called Heysham nuclear power plant. Each actor needs to be continually reenrolled through exchanges of money, power, information, etc., in order for the network to remain stable. In this way, the artifacts are vital to maintaining the network and are coactors alongside the network's human members—for example, providing policy makers with environmental impact statements and employees with information on risk. Or, to look at it another way, Bruno Latour, examining the function of scientific instruments as inscription devices, writes, "Yes, scientists master the world, but only if the world comes to them in the form of two-dimensional, superimposable, combinable inscriptions."[9] Latour and Myers reveal the tools humans use in aid of inscription—and the sign itself—to be not neutral objects but rather cosubjects/coactors in a network.

Texts are integral to enrolling objects in a network. Latour's famous door closer example and Myers's Heysham nuclear power plant example describe two actor-networked approaches to enrollment on very different scales. Myers first uses Latour's example to show that both small and large systems operate through the same complex of enrollment. Myers sums up Latour's door closer example like this:

> First, people build walls. But they need doors to get through them. But doors need closing. They could hire a person [. . .] to do this job. But they delegate this job to a machine. Now that the machine is broken, a text must be substituted to enroll the passing door user in closing the door.[10]

The substitution of an inscription in the place of the broken machine is an example of enrollment within a network. On a much bigger scale, Myers then demonstrates that the Heysham nuclear power plant, though vastly larger and more complex, relies on the same processes of enrollment as the unassuming door closer:

> The same processes of delegation are going on in the safety system of the Heysham nuclear power plant. Machines are substituted for humans watching, texts substituted for humans directing, organizations speak for individuals; the whole system can be seen as a complex of the human and nonhuman.[11]

The Heysham plant should be understood as part of an ongoing process of enrollment and disenrollment. Myers's description of the plant accounts for its imbrication in the social and cultural network around the object and for a range of human and nonhuman actors. Actor-network theory—attending to a broader range of actors to account for the social, political, material, and economic implications of networks in this way—can help reflect on governance in nonprofits by providing a framework that accounts for the totality of the material world rather than focusing solely on the human agent acting in that world. This broad ecological analysis is especially useful when accounting for political change in an organization, as we can begin to analyze the roles that not just people but also texts, places, narratives, and objects—indeed, the whole web of enrolled actors that make up an organization—play in the act of governance.

Examining a Critical Governance Incident: The Firing of a Founder

In order to begin to comprehend how ANT can contribute to the field of nonprofit governance, we decided to use the event of the firing of an organization's founder. Firings are entangled in governance in multiple ways, involving issues such as accountability, authority, and strategic leadership—and analyzing such critical incidents as a firing enables researchers to look for patterns and to seek insight into how and why people engage in the activity.

Milwaukee Cooperative

The site of our research was a cooperative in Milwaukee, Wisconsin, which has a two-tiered pyramid structure. The top tier consists of member-owners: individuals who have bought into the cooperative by paying a fee. Membership privileges include participating in members-only events, voting in elections, and other privileges, some of which are dictated by state law.[12] The bottom tier consists of the Workers' Collective and the board of directors.

The Workers' Collective, a group of autonomous workers that includes bouncers, bartenders, an events coordinator, and a finance team, manages the cooperative. The Workers' Collective is responsible for the daily operations, scheduling, bookings, and stock of the bar. In addition to working closely with member-owners, it responds directly to the board of directors. A pseudo-manager has recently been instated to supervise the bar.

The board of directors is a group of nine members democratically elected by co-op members in open elections, and is dictated by Wisconsin state law as legally responsible "for the co-op's continued viability" and accountable to the member-owners. While the board is legally accountable for the actions of the cooperative at the state and federal level and oversees the Workers' Collective, the workers manage the day-to-day operations of the bar—from hiring and training to inventory and events. Though the board of directors shares the burden of legal responsibility, the bar operates by collective management. Additionally, the bar supports a full bartending, cleaning, and auxiliary staff.

The Firing

A founder, "Sophia," was recently fired.[13] Sophia was integral to the founding of the Milwaukee cooperative, having worked on the idea from its conception; however, Sophia was a self-admitted alcoholic, and at times, while intoxicated, would act inappropriately. Following a series of write-ups by the manager, Sophia was suspended by the board, which then provided the Workers' Collective with a mediator to decide whether to eventually reinstate or fire Sophia. After a brief meeting with the mediator, the Workers' Collective unanimously decided that Sophia's employment would be terminated.

Looking at the Firing from Different Perspectives

In this section we examine the firing incident from the three perspectives mentioned earlier, and discuss how bringing in additional perspectives helps illuminate and open up the ways we approach and understand nonprofit governance.

The "Conventional" Perspective

The term "firing," or "termination," primarily occurs in the conventional governance literature as part of a particular board role—as in, nonprofit boards must fulfill their fiduciary as well as legal responsibilities and perform such tasks as hiring and firing the executive director, ensuring that the organization's mission is protected, and so on. Yet after searching the existing literature, we found little nonprofit governance research focusing on the dynamics or process of firings. One exception is Linda Hartenian, who analyzed circumstances and behaviors associated with the termination of nonprofit volunteers (but not managers or other paid staff).[14] There is, however, plenty of research focusing on various factors that can aid in comprehending and analyzing such situations as firings, founder's syndrome, nonprofit "scandals," executive transitions, and accountability and oversight issues (including systems and practices vis-à-vis nonprofit risk management, fraud detection, and internal control).

Overall, the existing "conventional" literature is very useful for bringing context and formal boundaries to nonprofit governance, but it can be excessively normative, a bit static, and/or overly focused on structure, inputs, and outputs rather than on the dynamics that help explain and bind these elements together. Janet Greenlee et al., for example, studied fraud in the nonprofit sector and found that 72 percent of the fraud cases they examined resulted in termination; they go on to offer practical advice on how to boost accountability by improving board quality, buying insurance, and having an audit committee.[15] The authors also note that 7 percent of the fraud cases resulted in no punishment, and when they asked why, received such answers as "fear of bad publicity" or "internal discipline sufficient." Despite the interesting governance implications of these statements, the authors did not examine them in any further detail.

The Dominant Coalition Perspective

Board research is sometimes accused of being involved in ideal models with assumptions far from practice; thus, what is needed is research and insight into what is "actually going on" when we talk about governance. David Renz and Fredrik O. Andersson's emphasis on dominant coalitions offers one step in this direction.[16] A key question from a dominant coalition perspective is, who really governs a nonprofit? And in order to answer it, one must start to examine the political dynamics surrounding the formation of alliances and partnerships—as well as how power differentials among board members and other stakeholders influence nonprofit governance processes and outcomes. Hence, one way to understand disparities between what boards are *expected* to do and what they *actually* do can be explained by power relations. Renz and Andersson argue that process studies integrating decision making inside and outside the boardroom are very much needed, as we still know little about how power and influence inside and outside the boardroom contribute to nonprofit governance.

To comprehend a firing from a dominant coalition perspective, it is essential to conduct our observing and theorizing based on what has been and/or is going on in practice—rather than only making assumptions based on simple models—by exploring the politicking and strategizing in and around the boardroom and how the stakes of various actors are balanced in reality. We must ask which are the power sources and techniques applied by various actors, including the dominant coalition. Hence, a central premise of the dominant coalition perspective is that we must consider both interior *and* exterior aspects of dominant coalitions. We must continue to develop our capacity to explore and analyze the power, behavior, processes, and consequences of the dominant coalition as an entity/agent as it relates to governance, noncoalition members, and organizational outcomes, and we must also continue to work on understanding and examining the role of power and influence, etc., within the dominant coalition itself—i.e., the governance of the dominant coalition.

Given "Sophia's" role as a founder, Renz and Andersson also view her firing as a particularly interesting governance incident—founder-driven dominant coalitions are an especially important and common form of dominant coalition in the nonprofit world, due to the fact that every organization begins with a founder or set of founders who bring together some (often small) group of people to help them establish and develop the organization.[17] Thus, unlike other types of coalitions that may—but do not necessarily have to—emerge at particular points later on in the ongoing life of an organization, founder-based coalitions are a natural part of the start-up phase in the life of an organization.

At this very early stage, little empirical nonprofit governance research based on the dominant coalition perspective exists; it is clear, however, that with its emphasis on human agency, power, and alliances, the dominant coalition perspective allows us to get a more nuanced view of who really governs nonprofit organizations and how—or, in other words, helps us to open the black box of actual behavior associated with nonprofit governance rather than the behavior we are used to associating with board governance and so take for granted.

The ANT Perspective

Actor-network theory is especially useful here because, as we will see, the shifting networks of humans and nonhumans that characterize the intensely social aspect of such businesses as the cooperative in quesion—businesses that don't have a preconceptualized structure, which a more conventional business may have at the ready—help to demonstrate how a business takes shape and changes over time. An analysis of a termination event as it unfolds can provide insight into how these kinds of big, political decisions are made at the board level. Using actor-network theory's approach to understanding networks of political alliances allows us to trace power.

The founding actor network of the Milwaukee cooperative is a mixture of individuals with different experiences, motives, values, and levels of expertise. Together with documents like bylaws, the liquor license, codes of conduct, and mission statements, they formed a network that was stable and powerful. Other actors, like "contractor," "Common Council," or "lender" could be temporarily enrolled through translation of goods and services, but this continually remade network of founders formed a dominant coalition that largely controlled the organization. Renz and Andersson identify several key issues with founder-driven dominant coalitions, including high levels of influence and long-lasting impact on the structure. Even when founders may not be seeking this level of influence, for a democratically elected board of directors and an organization that strives to represent its membership this influence may be problematic. Actors are enrolled for a variety of reasons and purposes, and as long as they are continually enrolled into the network, their position is stable. Over time, as the business evolves, founders leave and new enrollments are added to the networks.

Change

In the instance of the Milwaukee cooperative, as original founders left and enrollments changed, staff and directors began to relate to the organizational texts differently. They did not share the relationship to the texts that the original founders had. For example, the employee handbook was a relatively new document that came about because of tension over expectations of employees. Practices and agreements were inscribed in this handbook, which was then enrolled into the new network through multiple connections and with a variety of rhetorical consequences. This was also the case with the newly formed incident report—a document meant to function both horizontally and vertically by empowering employees to take autonomous action in a situation and to inform the board of any issues. Through inscribing a particular "take" on a situation, employees were able to frame a scenario—to give it an authenticity to be acted upon by the board—and these portable artifacts were invoked in a variety of ways. Just as with the door closer and Heysham nuclear power plant, inscriptions enabled particular interpretations and relationships: whoever wrote and submitted the incident report could, however unintentionally, reconstruct the scene with a bias; and just as new texts were enrolled in a growing and changing network, so, too, the finance committee and other founders enrolled into the new, stronger networks and shifted their allegiance to the texts.

However, other actors had fewer enrollments—fewer connections—and were thus enrolled in a weaker network. The same is true of an older document the organization called their manifesto, which traces back to the very beginning of the cooperative and its founders. Sophia found herself with fewer enrollments and a weak network, while new personnel, like "experienced bartender" and "pseudo-manager," had multiple enrollments and thus a strong, stable position across networks (of course, so long as "experienced bartender" and "pseudo-manager" were continually reenrolled).

This change of enrollments led to the dissolution of a network. While actors could be reenrolled or enrolled in another network, this did not happen for a multitude of reasons, and the reconfiguring of the founding network and dissolution of connections left Sophia in a weak position.

First, incident reports complaining of Sophia's behavior, including violation of the business's new "Safer Space Policy," were submitted by the workers. These reports went to the (new) manager, who issued write-ups and submitted them to the board. Then, members of the board acted upon those artifacts by suspending Sophia and "empowering" the Workers' Collective to act. Finally, the Workers' Collective unanimously voted to fire Sophia. As all links were broken, the dissolution of the old founding network was complete.

The incident report, the "Safer Space Policy," and the experienced bartender and pseudo-manager were all newly enrolled actors with multiple connections, and their interests translated across numerous nodes, including the Workers' Collective, the board, and member-owners. In these newly configured networks, the new actors ("incident report," "Safer Space Policy," "pseudo-manager") held more power than Sophia; left without enrollments, Sophia was removed completely.

• • •

In this article we have sought to expand the opportunities of the dominant coalition perspective for studying nonprofit governance by illuminating views and ideas from actor-network theory, broadly defined. Scholars will need to explore and examine the dominant coalition idea from multiple perspectives in order to determine which theoretical perspectives are likely to be more or less useful in understanding the dominant coalition and, therefore, the larger phenomenon of dominant coalition in nonprofit board governance.[18] One of the theoretical perspectives we propose is social network theory, which could help answer such questions as how are dominant coalition members linked to each other, and what is the nature of these relationships. Social network theory is a strong perspective for understanding the power of human relatedness and the advantages and opportunities made possible by a person's position.

ANT also encourages and enables scholars to take into account the agency of nonhumans (machines and texts, among others) by showing how an ANT network can be conceived as a heterogeneous amalgamation of textual, conceptual, social, and technical actors. Rather than focusing on just human actors, ANT uses the concept of the actant to represent any agent, collective, or individual that/who can associate or disassociate with other agents. Thus, ANT is interested in how actants themselves develop as networks and become nested in other networks.

Our ANT analysis of the firing of an organizational founder revealed as it unfolded that network changes at the board level make it possible to fire a founding member who at one time held power. This analysis reveals the evolution of a network: it is ultimately Sophia's lack of enrollments in the new, robust network that enabled the Workers' Collective and the board of directors to displace her.

Overall, paying close attention to the political and power-focused lens offered by the dominant coalition perspective and combining it with an ANT lens looks to be a promising approach for nonprofit governance research. Because ANT can be considered as much a method as a theory, it informs both the conceptual frame used for interpretation and guides the processes through which networks are examined.

A key purpose of this article has been to show how alternative perspectives, in addition to what we labeled the "conventional" perspective, can help illuminate and open up the way we approach and understand nonprofit governance. The "conventional" lens offers obligatory insights into the legal requirements, roles, and requirements of boards and board members, and so is useful in comprehending the overall framing of nonprofit governance. The dominant coalition perspective adds to this structural frame of governance an explicit focus on actual stakeholder behavior, by asking such questions as "who really governs?" and taking into account elements such as power, politics, and alliances, both inside and outside the boardroom. Finally, the ANT lens directs attention to the intimate and inseparable coexistence between various human and nonhuman actants by showing how they connect and thus bring meaning and significance to various elements of the nonprofit governance process.

But why bring these additional perspectives to the table? What do they contribute to the study of boards and governance? We believe it is important to look at the subject through different lenses because nonprofit governance can be inherently complex—even, at times, ambiguous and deceptive—and often surprising. In order to comprehend and take account of the peculiarities of such a dynamic construct, we must move beyond single narrow perspectives—which end up promoting narrow responses and solutions—and take steps to increase versatility and thus increase options for scholars and practitioners.

To be clear, we are not saying that employing a particular governance perspective (e.g., the conventional one) is wrong; but each perspective is a window that enables us to see some things but not others. For example, we would argue that ANT is not very useful as a standalone perspective from which to study governance. What we *are* saying is that it is important to expand our understanding of nonprofit governance by developing options. And, taken together, these options can help us to see the tapestry that is nonprofit governance in a new—and hopefully useful—light.

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Fredrik O. Andersson is assistant professor in the Department of Public and Nonprofit Administration, Helen Bader Institute for Nonprofit Management, University of Wisconsin-Milwaukee. **Avery Edenfield** is a PhD candidate at the College of Letters & Science, University of Wisconsin-Milwaukee.

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The Surprising Alchemy of Passion and Science

by Lissette Rodriguez

Through the smart use of data, organizations can better assess the reach and success of their missions without sacrificing the passion undergirding their work. Learning organizations exemplify the fundamental characteristics required to determine whether an organization is fulfilling its goals—and if not, how those shortcomings can be addressed.

***Editors' note:** "The Surprising Alchemy of Passion and Science" is the transcript of a speech given by Lissette Rodriguez of the Edna McConnell Clark Foundation at the Alliance for Nonprofit Excellence's tenth annual conference, "Setting the Standard: Operational Excellence for the New Nonprofit Sector," which took place on April 30, 2015. Please visit www.emcf.org and join EMCF's mailing list if you are interested in staying connected with Propel*Next *and learning about new resources.*

We all come to this work with a passion for improving lives. It drives us to get up early, stay late, and work through lunch. We do it even when the challenges are great and the rewards are tough to reach. (And let's face it—we did not get into this business for the money!) We also work at a relentless pace that does not leave much time for rest or reflection—because the need usually outpaces the resources we have at our disposal. So passion is our fuel, and it's what has made the third sector a robust part of our communities.

A few weeks ago I was visiting an organization working just outside of a major U.S. city. Working with poor, mostly migrant families to provide social, counseling, and educational services, this organization was living proof of what passion can accomplish in an underserved and underresourced community. Through sheer grit and determination, the board and executive director have built a $2 million agency in a place with little funding, infrastructure, or services—but, of course, great need. Passion helped that organization start and get to where it is today. But will it be enough to get to the next level?

Over the last few years I have focused on this very question: How do organizations and leaders harness their passion for justice, love of people and communities, and commitment to better our world while increasing their understanding of whether and how they are having an impact? I believe science and measurement can help us and can do so in the context of the passion that drives us. It can be done without turning our organizations into soulless assembly-line enterprises. It can happen without sacrificing the deep feeling of mission that often feeds personal and organizational purpose and meaning. It takes a delicate balance of trust in what we know and the recognition of what we don't yet understand, and it takes a deep appreciation for the seen and the unseen and the measured and the intuitive, giving each its proper place and due.

I am an unlikely convert to this work. For twelve years at YouthBuild I saw young people who had dropped out of high school arriving at the doors of local programs with many disappointments, lack of support, and failures weighing them down. They were facing tough odds; but they were also young, full of promise, and, with the right supports, ready to take advantage of opportunities. These youth had no time to waste, and neither did the adults seeking to support them. The goal was to make every minute count if participants were to emerge with better prospects for the future.

By the time I arrived at the organization, YouthBuild leaders had spent years on program design and implementation. They'd also listened deeply to participants to calibrate the approach. But we still had many questions about how best to carry out certain elements of the program to make the greatest difference in preparing young adults for a healthy and self-sustaining life. We had some clues, but we needed more information to get better. It was at YouthBuild where I developed a sense of urgency for understanding how we might better use data to make the nine program months really count.

Prior to this, I had often seen myself squarely in the passion camp. I thought my side was incompatible with the data nerds. Either you run an organization driven by passion or you're a bean counter. Either your workplace is a place where individuals are unique or you run a nonprofit as a heartless business that crunches numbers, drives toward maximum efficiency, and takes human connection out of the equation.

I was caught up in a false dichotomy: do you care about odds or do you care about people?

But that isn't the way I see it today. I've learned that you can improve the odds *and* make a real difference in people's lives.

I believe we can all harness data to empower ourselves and our organizations to make the most of our passion. Your passion is what brought you to this kind of work; it's what gets you out of bed each morning, and it may have gotten you through more than one sleepless night when you wondered if your organization was going to make payroll. You need it, and the world needs it as well. But passion is not enough if you want to truly understand whether and how you are making a difference.

All of us who have worked with families in crisis or struggling communities have countless anecdotes to illustrate the ways in which we've helped people, neighborhoods, and organizations. These stories are important because they bring to life how our work is making a difference in the lives of individuals. But beyond these stories, do we truly know how we are doing with the groups of people that we reach through our organizations? How can we know we are doing the best we can with our resources if we don't collect and use data about our services? How do we know what we might improve—or stop doing—if we don't take the time to analyze and act upon the information we are collecting?

Smart use of data is what helps you do the job today even better than you did it the day before. It enables you to keep learning from your experiences. It is an important and vital addition to the intuition you already possess and use every day. Science plus passion gives us more fuel for the work than either one alone. It creates a powerful alchemy that enables us to do more, achieve more, and create more for the people and communities we serve.

The Propel*Next* Story

To show how this can work, I'm going to tell you about Propel*Next*, an initiative housed at the Edna McConnell Clark Foundation. We help youth-serving nonprofits boost their impact on young people's lives. To do so, we support our grantees to collect and use their data to understand who their clients are, what they need, and how they can serve them better. We are one of many organizations working on this, and our approach is hardly the only one; but core to our hypothesis is the belief that there is a way to do this work that enhances and does not detract from purpose and mission. Central to our approach is the idea that the bridge between science and passion is the creation of cultures of learning.

We've all heard the term "learning organizations." I remember when I first heard that phrase: it was in 1990, after the release of Peter Senge's book *The Fifth Discipline*. So, what is a learning organization? In our context, it is an organization that appreciates its past performance but does not rest on it, and is always open and looking for new ways to do deeper, better, more impactful work. It is an organization that does not use data just once, making one set of changes and then moving on. It creates an ongoing process of review, learning, and reflection. Leaders in these organizations regularly ask themselves, "Are we doing the best we can for every client?," and look for the answer to that question in data, not just anecdotes. And for every improvement they make, they reassess, tinker, and continue to improve.

From time to time, they'll go back and ask themselves deeper questions, such as, "What were we trying to achieve when we created or revised this program? Why are we implementing it this way, and does this still respond to the needs we want to address?" They routinely inquire, "What do our beneficiaries or participants think of the services they are receiving? Have funding pressures diluted or changed our approach in ways that undermine our goals?" This is one way our grantees have connected passion and science: by revisiting the original vision that brought the organization to life and examining that vision in today's light to see what is still relevant, what needs to shift, and what's the best way to use data to inform the next set of choices.

This may all sound good, but anyone who has run an organization or a program knows that pulling this off is not an easy feat. I get it. Just yesterday, I was sitting in a meeting with the evaluators of Propel*Next*, and believe me, it is hard to maintain a learning orientation while listening to what has not gone well from people who share that information in excruciating detail. But I hang onto the fact that we want to get better, and that helps to deal with the disappointment of what didn't go as expected. I remind myself that I would rather know sooner than later that something is not working as we thought it would. Why keep repeating what does not appear to be successful? That's what keeps me going.

To illustrate how becoming a learning organization can make you both more passionate about your work and better at it, I want to share the story of one of our grantees, Taller San Jose. Taller San Jose was founded twenty years ago by Sister Eileen McNerny, who, over the years, built a highly regarded program that trains hard-to-reach, disadvantaged young people for careers in healthcare, construction, and business. Everyone at Taller is driven by a deep commitment to giving youth opportunities for productive and meaningful lives.

By being deliberate and thoughtful in their learning, Taller's staff have used data to reactivate their passion. Executive director Shawna Smith recently told me that using data has created a fresh opportunity for her organization to deliver on the promise it originally made to the young people of their community.

How? First, Taller was able to better understand and reconnect with those it wanted to serve.

Taller San Jose was founded to serve the most disconnected, hardest-to-reach young people—those youth who did poorly in school, dropped out early, landed low-paying jobs that they could not hold. Maybe they didn't even have a place to sleep at night. These young people are challenging. They are hard to engage and hard to support. But these were the very youth that Taller saw as full of promise and was committed to serving.

Over the years, Taller began to drift from these young people without realizing it. They still served high-risk youth, but maybe not *quite* so high-risk. Maybe their students were reading at a ninth- or tenth-grade level instead of a fifth-grade level.

Supported by a team of consultants, Shawna and her team looked at their data and recognized this shift. They recommitted themselves to serving the highest-risk young people, and created a more purposeful approach to reaching them. They defined the requirements for participating in their program in a way that was clear, specific, and measureable. Today, a significant percentage of the youth at Taller represent the highest-risk young people from low-income families with reading and math levels at the fifth- to eighth-grade level—youth with the fewest options and the greatest needs. Data enabled Taller to do a better job of reaching the youth it had intended to reach all along.

It also enabled them to serve those clients better. And that leads into the second example I want to share.

The staff at Taller learned something important from looking deeply at their data. The young people who graduated from Taller's training programs were successful at landing jobs. They knew that. But until they analyzed their longer-term results, they did not know these youth were far less successful at keeping those jobs. With this knowledge, Taller went digging deeper to understand why. Staff learned that when the youth lost jobs, it almost never had anything to do with the technical skills Taller had taught them. Instead, the problem was life circumstances and life-skills challenges. These youth lost their transportation. Or their housing. Or their child care. In hindsight, this is not surprising, of course: these were the very challenges the youth brought with them in the first place, and they were not going to magically disappear after training. But Taller's staff had overestimated the power of their training to get participants through *future* tough circumstances. Looking at their data, Shawna and her team realized that technical skills were an insufficient investment without additional supports and life skills.

This insight led to a major redesign of the program. To make a lasting change, Taller knew it had to beef up its supportive services to be on par with the technical training. Until then, Taller's supportive services were informal, ad hoc, and not well tracked. The organization's emphasis was on its highly regarded technical training programs. Today, Taller invests as much in supportive services as it does in its technical training. Taller developed a set of indicators that measure how a young person builds self-sufficiency. These indicators aren't just to monitor progress—Taller uses them to pinpoint specific areas where a young person might need additional support.

If Shawna were here, she'd be the first to tell you that this change was hard. Her staff had to rethink their roles and work in new ways. Budgets had to adjust. But the results are impressive. Today, 77 percent of Taller's participants represent the highest-risk youth they were created to serve, up from 36 percent just two years ago. Remarkably, in spite of serving an even more challenging group of youth, program retention is slightly up, at 76 percent, indicating that the program is addressing the needs of a substantial number of participants. But the results were transformational. Young people are doing better. They are sticking with the program, and their job retention rates are much higher. The youth are getting jobs and keeping them!

The staff at Taller became empowered and invigorated by a richer understanding of their impact, and funders are impressed by the results and are now funding a significant expansion of Taller's programming.

By now I hope you're thinking, "I'm intrigued." You may even be thinking, "Can *I* do some of this (or more of this) at *my* organization?" I think the answer is yes, you can. Propel*Next* may only be able to directly help a small number of organizations, but we are committed to sharing what we learn and offering insights and resources for those of you looking to incorporate data more fully into your work.

So I'd like to share what, based on our experience, I believe are the prerequisites for becoming a learning organization:

1. *Committed leadership.* Leaders—not just the executive director but also board members and top program people—need to be committed to the idea that using data will eventually make the work and results better. In my experience, leadership support is foundational, and nothing moves without it. It takes courage to be this kind of leader, and to be open to hearing exactly what you may not want to hear and take action to turn it around.
2. *Healthy curiosity and spirit of purposeful inquiry.* This is not data to hammer people over the head with nor inquiry to see what your staff is doing wrong; this is information to feed learning about what can be done better. Yes, your data may lead to some tough decisions, but the first steps are to make it safe for people in the organization to ask questions, and to help identify options for moving forward.
3. *Resources.* It is critical to line up resources to do this work. Nonprofits often need some outside expertise to help guide the process and internal skills to advance the work. Also, in my experience, time for analysis and reflection is also an important resource. You need to be intentional about setting aside time for reflection—after all, collecting data and never looking at it would truly be a waste. Of course, this means funders must invest in you in order that you can take this on. In the end, you want quality data that provide you with a platform for strategic decision making and from which to act upon what you're learning, even when that leads to hard choices and unpopular decisions. You owe it to the people and communities you serve.
4. *Stamina.* This kind of work takes time—often years—and requires patience. It is important to pace yourself and limit the data that is collected to what can actually be used, rather than trying to gather everything you think you will want to know on day one. Becoming a learning organization does not happen overnight. It is an iterative process and will hopefully lead you to make each version of the work better than the one before.

If you take on the journey toward become a learning organization, know that the path is not straightforward. You will hit obstacles. Your passion will be tested. Your assumptions and beliefs *will* be challenged. But it is a journey that has the potential to change what you do and how you do it, with people and communities being the ultimate beneficiaries.

Lissette Rodriguez is managing director of Propel*Next* at the Edna McConnell Clark Foundation.

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Places to Intervene in a System

by Donella H. Meadows

Leverage points are places within a system where a small change can produce major effects. Recognizing where these points occur and understanding how best to use them will help you to better manage your organization.

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Folks who do systems analysis have a great belief in "leverage points." These are places within a complex system (a corporation, an economy, a living body, a city, an ecosystem) where a small shift in one thing can produce big changes in everything.

The systems community has a lot of lore about leverage points. Those of us who were trained by the great Jay Forrester at MIT have absorbed one of his favorite stories. "People know intuitively where leverage points are. Time after time I've done an analysis of a company, and I've figured out a leverage point. Then I've gone to the company and discovered that everyone is pushing it **in the wrong direction!**"

The classic example of that backward intuition was Forrester's first world model. Asked by the Club of Rome to show how major global problems—poverty and hunger, environmental destruction, resource depletion, urban deterioration, unemployment—are related and how they might be solved, Forrester came out with a clear leverage point: Growth. Both population and economic growth. Growth has costs—among which are poverty and hunger, environmental destruction—the whole list of problems we are trying to solve with growth!

The world's leaders are correctly fixated on economic growth as the answer to virtually all problems, but they're pushing with all their might in the wrong direction.

Counterintuitive. That's Forrester's word to describe complex systems. The systems analysts I know have come up with no quick or easy formulas for finding leverage points. Our counterintuitions aren't that well developed. Give us a few months or years and we'll model the system and figure it out. We know from bitter experience that when we do discover the system's leverage points, hardly anybody will believe us.

Very frustrating. So one day I was sitting in a meeting about the new global trade regime, NAFTA and GATT and the World Trade Organization. The more I listened, the more I began to simmer inside. "This is a HUGE NEW SYSTEM people are inventing!" I said to myself. "They haven't the slightest idea how it will behave," myself said back to me. "It's cranking the system in the wrong direction—growth, growth at any price!! And the control measures these nice folks are talking about—small parameter adjustments, weak negative feedback loops—are PUNY!"

Suddenly, without quite knowing what was happening, I got up, marched to the flip chart, tossed over a clean page, and wrote: "**Places to Intervene in a System**," followed by nine items:

9. Numbers (subsidies, taxes, standards).
8. Material stocks and flows.
7. Regulating negative feedback loops.

6. Driving positive feedback loops.
5. Information flows.
4. The rules of the system (incentives, punishments, constraints).
3. The power of self-organization.
2. The goals of the system.
1. The mindset or paradigm out of which the goals, rules, feedback structure arise.

Everyone in the meeting blinked in surprise, including me. "That's brilliant!" someone breathed. "Huh?" said someone else.

I realized that I had a lot of explaining to do.

In a minute I'll go through the list, translate the jargon, give examples and exceptions. First I want to place the list in a context of humility. What bubbled up in me that day was distilled from decades of rigorous analysis of many different kinds of systems done by many smart people. But complex systems are, well, complex. It's dangerous to generalize about them. What you are about to read is not a recipe for finding leverage points. Rather it's an invitation to think more broadly about system change.

That's why leverage points are not intuitive.

9. Numbers (subsidies, taxes, standards).

Numbers ("parameters" in systems jargon) determine how much of a discrepancy turns which faucet how fast. Maybe the faucet turns hard, so it takes a while to get the water flowing. Maybe the drain is blocked and can allow only a small flow, no matter how open it is. Maybe the faucet can deliver with the force of a fire hose. These considerations are a matter of numbers, some of which are physically locked in, but most of which are popular intervention points.

Consider the national debt. It's a negative bathtub, a money hole. The rate at which it sinks is the annual deficit. Tax income makes it rise, government expenditures make it fall. Congress and the president argue endlessly about the many parameters that open and close tax faucets and spending drains. Since those faucets and drains are connected to the voters, these are politically charged parameters. But, despite all the fireworks, and no matter which party is in charge, the money hole goes on sinking, just at different rates.

The amount of land we set aside for conservation. The minimum wage. How much we spend on AIDS research or Stealth bombers. The service charge the bank extracts from your account. All these are numbers, adjustments to faucets. So, by the way, is firing people and getting new ones. Putting different hands on the faucets may change the rate at which they turn, but if they're the same old faucets, plumbed into the same system, turned according to the same information and rules and goals, the system isn't going to change much. Bill Clinton is different from George Bush, but not all that different.

Numbers are last on my list of leverage points. Diddling with details, arranging the deck chairs on the Titanic. Probably ninety-five percent of our attention goes to numbers, but there's not a lot of power in them.

Not that parameters aren't important—they can be, especially in the short term and to the individual who's standing directly in the flow. But they RARELY CHANGE BEHAVIOR. If the system is chronically stagnant, parameter changes rarely kick-start it. If it's wildly variable, they don't usually stabilize it. If it's growing out of control, they don't brake it.

Whatever cap we put on campaign contributions, it doesn't clean up politics. The Feds fiddling with the interest rate haven't made business cycles go away. (We always forget that during upturns, and are shocked, shocked by the downturns.) Spending more on police doesn't make crime go away.

However, there are critical exceptions. Numbers become leverage points when they go into ranges that kick off one of the items higher on this list. Interest rates or birth rates control the gains around positive feedback loops. System goals are parameters that can make big differences. Sometimes a system gets onto a chaotic edge, where the tiniest change in a number can drive it from order to what appears to be wild disorder.

Probably the most common kind of critical number is the length of delay in a feedback loop. Remember that bathtub on the fourth floor I mentioned, with the water heater in the basement? I actually experienced one of those once, in an old hotel in London. It wasn't even a bathtub with buffering capacity; it was a shower. The water temperature took at least a minute to respond to my faucet twists. Guess what my shower was like. Right, oscillations from hot to cold and back to hot, punctuated with expletives. Delays in negative feedback loops cause oscillations. If you're trying to adjust a system state to your goal, but you only receive delayed information about what the system state is, you will overshoot and undershoot.

Same if your information is timely, but your response isn't. For example, it takes several years to build an electric power plant, and then that plant lasts, say, thirty years. Those delays make it impossible to build exactly the right number of plants to supply a rapidly changing demand. Even with immense effort at forecasting, almost every electricity industry in the world experiences long oscillations between overcapacity and undercapacity. A system just can't respond to short-term changes when it has long-term delays. That's why a massive central-planning system, such as the Soviet Union or General Motors, necessarily functions poorly.

A delay in a feedback process is critical RELATIVE TO RATES OF CHANGE (growth, fluctuation, decay) IN THE SYSTEM STATE THAT THE FEEDBACK LOOP IS TRYING TO CONTROL. Delays that are too short cause overreaction, oscillations amplified by the jumpiness of the response. Delays that are too long cause dampened, sustained, or exploding oscillations, depending on how much too long. At the extreme they cause chaos. Delays in a system with a threshold, a danger point, a range past which irreversible damage can occur, cause overshoot and collapse.

Delay length would be a high leverage point, except for the fact that delays are not often easily changeable. Things take as long as they take. You can't do a lot about the construction time of a major piece of capital, or the maturation time of a child, or the growth rate of a forest. It's usually easier to slow down the change rate (positive feedback loops, higher on this list), so feedback delays won't cause so much trouble. Critical numbers are not nearly as common as people seem to think they are. Most systems have evolved or are designed to stay out of sensitive parameter ranges. Mostly, the numbers are not worth the sweat put into them.

8. Material stocks and flows.

The plumbing structure, the stocks and flows and their physical arrangement, can have an enormous effect on how a system operates.

When the Hungarian road system was laid out so all traffic from one side of the nation to the other had to pass through central Budapest, that determined a lot about air pollution and commuting delays that are not easily fixed by pollution control devices, traffic lights, or speed limits. The only way to fix a system that is laid out wrong is to rebuild it, if you can.

Often you can't, because physical building is a slow and expensive kind of change. Some stock-and-flow structures are just plain unchangeable.

The baby-boom swell in the U.S. population first caused pressure on the elementary school system, then high schools and colleges, then jobs and housing, and now we're looking forward to supporting its retirement. Not much to do about it, because five-year-olds become six-year-olds, and sixty-four-year-olds become sixty-five-year-olds predictably and unstoppably. The same can be said for the lifetime of destructive CFC molecules in the ozone layer, for the rate at which contaminants get washed out of aquifers, for the fact that an inefficient car fleet takes ten to twenty years to turn over.

The possible exceptional leverage point here is in the size of stocks, or buffers. Consider a huge bathtub with slow in and outflows. Now think about a small one with fast flows. That's the difference between a lake and a river. You hear about catastrophic river floods much more often than catastrophic lake floods, because stocks that are big, relative to their flows, are more stable than small ones. A big, stabilizing stock is a buffer.

The stabilizing power of buffers is why you keep money in the bank rather than living from the flow of change through your pocket. It's why stores hold inventory instead of calling for new stock just as customers carry the old stock out the door. It's why we need to maintain more than the minimum breeding population of an endangered species. Soils in the eastern U.S. are more sensitive to acid rain than soils in the west, because they haven't got big buffers of calcium to neutralize acid. You can often stabilize a system by increasing the capacity of a buffer. But if a buffer is too big, the system gets inflexible. It reacts too slowly. Businesses invented just-in-time inventories, because occasional vulnerability to fluctuations or screw-ups is cheaper than certain, constant inventory costs—and because small-to-vanishing inventories allow more flexible response to shifting demand.

There's leverage, sometimes magical, in changing the size of buffers. But buffers are usually physical entities, not easy to change.

The acid absorption capacity of eastern soils is not a leverage point for alleviating acid rain damage. The storage capacity of a dam is literally cast in concrete. Physical structure is crucial in a system, but the leverage point is in proper design in the first place. After the structure is built, the leverage is in understanding its limitations and bottlenecks and refraining from fluctuations or expansions that strain its capacity.

7. Regulating negative feedback loops.

Now we're beginning to move from the physical part of the system to the information and control parts, where more leverage can be found. Nature evolves negative feedback loops and humans invent them to keep system states within safe bounds.

A thermostat loop is the classic example. Its purpose is to keep the system state called "room temperature" fairly constant at a desired level. Any negative feedback loop needs a goal (the thermostat setting), a monitoring and signaling device to detect excursions from the goal (the thermostat), and a response mechanism (the furnace and/or air conditioner, fans, heat pipes, fuel, etc.).

A complex system usually has numerous negative feedback loops it can bring into play, so it can self-correct under different conditions and impacts. Some of those loops may be inactive much of the time—like the emergency cooling system in a nuclear power plant, or your ability to sweat or shiver to maintain your body temperature. One of the big mistakes we make is to strip away these emergency response mechanisms because they aren't often used and they appear to be costly. In the short term we see no effect from doing this. In the long term, we narrow the range of conditions over which the system can survive.

One of the most heartbreaking ways we do this is in encroaching on the habitats of endangered species. Another is in encroaching on our own time for rest, recreation, socialization, and meditation.

The "strength" of a negative loop—its ability to keep its appointed stock at or near its goal—depends on the combination of all its parameters and links—the accuracy and rapidity of monitoring, the quickness and power of response, the directness and size of corrective flows.

There can be leverage points here. Take markets, for example, the negative feedback systems that are all but worshiped by economists—and they can indeed be marvels of self-correction, as prices vary to keep supply and demand in balance. The more the price—the central signal to both producers and consumers—is kept clear, unambiguous, timely, and truthful, the more smoothly markets will operate. Prices that reflect full costs will tell consumers how much they can actually afford and will reward efficient producers. Companies and governments are fatally attracted to the price leverage point, of course, all of them pushing in the wrong direction with subsidies, fixes, externalities, taxes, and other forms of confusion. The REAL leverage here is to keep them from doing it. Hence antitrust laws, truth-in-advertising laws, attempts to internalize costs (such as pollution taxes), the removal of perverse subsidies, and other ways of leveling market playing fields.

The strength of a negative feedback loop is important RELATIVE TO THE IMPACT IT IS DESIGNED TO CORRECT. If the impact increases in strength, the feedbacks have to be strengthened too.

A thermostat system may work fine on a cold winter day—but open all the windows and its corrective power will fail. Democracy worked better before the advent of the brainwashing power of centralized mass communications. Traditional controls on fishing were sufficient until radar spotting and drift nets and other technologies made it possible for a few actors to wipe out the fish. The power of big industry calls for the power of big government to hold it in check; a global economy makes necessary a global government.

Here are some other examples of strengthening negative feedback controls to improve a system's self-correcting abilities: preventive medicine, exercise, and good nutrition to bolster the body's ability to fight disease, integrated pest management to encourage natural predators of crop pests, the Freedom of Information Act to reduce government secrecy, protection for whistleblowers, impact fees, pollution taxes, and performance bonds to recapture the externalized public costs of private benefits.

6. Driving positive feedback loops.

A positive feedback loop is self-reinforcing. The more it works, the more it gains power to work some more.

The more people catch the flu, the more they infect other people. The more babies are born, the more people grow up to have babies. The more money you have in the bank, the more interest you earn, the more money you have in the bank. The more the soil erodes, the less vegetation it can support, the fewer roots and leaves to soften rain and runoff, the more soil erodes. The more high-energy neutrons in the critical mass, the more they knock into nuclei and generate more.

Positive feedback loops drive growth, explosion, erosion, and collapse in systems. A system with an unchecked positive loop ultimately will destroy itself. That's why there are so few of them.

Usually a negative loop kicks in sooner or later. The epidemic runs out of infectable people—or people take increasingly strong steps to avoid being infected. The death rate rises to equal the birth rate—or people see the consequences of unchecked population growth and have fewer babies. The soil erodes away to bedrock, and after a million years the bedrock crumbles into new soil—or people put up check dams and plant trees.

In those examples, the first outcome is what happens if the positive loop runs its course, the second is what happens if there's an intervention to reduce its power.

Reducing the gain around a positive loop—slowing the growth—is usually a more powerful leverage point in systems than strengthening negative loops, and much preferable to letting the positive loop run.

Population and economic growth rates in the world model are leverage points, because slowing them gives the many negative loops, through technology and markets and other forms of adaptation, time to function. It's the same as slowing the car when you're driving too fast, rather than calling for more responsive brakes or technical advances in steering.

The most interesting behavior that rapidly turning positive loops can trigger is chaos. This wild, unpredictable, unreplicable, and yet bounded behavior happens when a system starts changing much, much faster than its negative loops can react to it.

For example, if you keep raising the capital growth rate in the world model, eventually you get to a point where one tiny increase more will shift the economy from exponential growth to oscillation. Another nudge upward gives the oscillation a double beat. And just the tiniest further nudge sends it into chaos.

I don't expect the world economy to turn chaotic any time soon (not for that reason, anyway). That behavior occurs only in unrealistic parameter ranges, equivalent to doubling the size of the economy within a year. Real-world systems do turn chaotic, however, if something in them can grow or decline very fast. Fast-replicating bacteria or insect populations, very infectious epidemics, wild speculative bubbles in money systems, neutron fluxes in the guts of nuclear power plants. These systems are hard to control, and control must involve slowing down the positive feedbacks.

In more ordinary systems, look for leverage points around birth rates, interest rates, erosion rates, "success to the successful" loops, any place where the more you have of something, the more you have the possibility of having more.

5. Information flows.

There was this subdivision of identical houses, the story goes, except that the electric meter in some of the houses was installed in the basement and in others it was installed in the front hall, where the residents could see it constantly, going round faster or slower as they used more or less electricity. Electricity consumption was 30 percent lower in the houses where the meter was in the front hall.

Systems-heads love that story because it's an example of a high leverage point in the information structure of the system. It's not a parameter adjustment, not a strengthening or weakening of an existing loop. It's a NEW LOOP, delivering feedback to a place where it wasn't going before.

In 1986 the U.S. government required that every factory releasing hazardous air pollutants report those emissions publicly. Suddenly everyone could find out precisely what was coming out of the smokestacks in town. There was no law against those emissions, no fines, no determination of "safe" levels, just information. But by 1990 emissions dropped 40 percent. One chemical company that found itself on the Top Ten Polluters list reduced its emissions by 90 percent, just to "get off that list."

Missing feedback is a common cause of system malfunction. Adding or rerouting information can be a powerful intervention, usually easier and cheaper than rebuilding physical structure.

The tragedy of the commons that is exhausting the world's commercial fisheries occurs because there is no feedback from the state of the fish population to the decision to invest in fishing vessels. (Contrary to economic opinion, the price of fish doesn't provide that feedback. As the fish get more scarce and hence more expensive, it becomes all the more profitable to go out and catch them. That's a perverse feedback, a positive loop that leads to collapse.)

It's important that the missing feedback be restored to the right place and in compelling form. It's not enough to inform all the users of an aquifer that the groundwater level is dropping. That could trigger a race to the bottom. It would be more effective to set a water price that rises steeply as the pumping rate exceeds the recharge rate.

Suppose taxpayers got to specify on their return forms what government services their tax payments must be spent on. (Radical democracy!) Suppose any town or company that puts a water intake pipe in a river had to put it immediately DOWNSTREAM from its own outflow pipe. Suppose any public or private official who made the decision to invest in a nuclear power plant got the waste from that plant stored on his/her lawn.

There is a systematic tendency on the part of human beings to avoid accountability for their own decisions. That's why there are so many missing feedback loops—and why this kind of leverage point is so often popular with the masses, unpopular with the powers that be, and effective, if you can get the powers that be to permit it to happen or go around them and make it happen anyway.

4. The rules of the system (incentives, punishments, constraints).

The rules of the system define its scope, boundaries, degrees of freedom. Thou shalt not kill. Everyone has the right of free speech. Contracts are to be honored. The president serves four-year terms and cannot serve more than two of them. Nine people on a team, you have to touch every base, three strikes and you're out. If you get caught robbing a bank, you go to jail.

Mikhail Gorbachev came to power in the USSR and opened information flows (glasnost) and changed the economic rules (perestroika), and look what happened.

Constitutions are strong social rules. Physical laws such as the second law of thermodynamics are absolute rules, if we understand them correctly. Laws, punishments, incentives, and informal social agreements are progressively weaker rules.

To demonstrate the power of rules, I ask my students to imagine different ones for a college. Suppose the students graded the teachers. Suppose you come to college when you want to learn something, and you leave when you've learned it. Suppose professors were hired according to their ability to solve real-world problems, rather than to publish academic papers. Suppose a class got graded as a group, instead of as individuals.

Rules change behavior. Power over rules is real power.

That's why lobbyists congregate when Congress writes laws, and why the Supreme Court, which interprets and delineates the Constitution—the rules for writing the rules—has even more power than Congress.

If you want to understand the deepest malfunctions of systems, pay attention to the rules, and to who has power over them.

That's why my systems intuition was sending off alarm bells as the new world trade system was explained to me. It is a system with rules designed by corporations, run by corporations, for the benefit of corporations. Its rules exclude almost any feedback from other sectors of society. Most of its meetings are closed to the press (no information, no feedback). It forces nations into positive loops, competing with each other to weaken environmental and social safeguards in order to attract corporate investment. It's a recipe for unleashing "success to the successful" loops.

3. The power of self-organization.

The most stunning thing living systems can do is to change themselves utterly by creating whole new structures and behaviors. In biological systems that power is called evolution. In human economies it's called technical advance or social revolution. In systems lingo it's called self-organization.

Self-organization means changing any aspect of a system lower on this list—adding or deleting new physical structure, adding or deleting negative or positive loops or information flows or rules. The ability to self-organize is the strongest form of system resilience, the ability to survive change by changing.

The human immune system can develop responses to (some kinds of) insults it has never before encountered. The human brain can take in new information and pop out completely new thoughts.

Self-organization seems so wondrous that we tend to regard it as mysterious, miraculous. Economists often model technology as literal manna from heaven—coming from nowhere, costing nothing, increasing the productivity of an economy by some steady percent each year. For centuries people have regarded the spectacular variety of nature with the same awe. Only a divine creator could bring forth such a creation.

In fact the divine creator does not have to produce miracles. He, she, or it just has to write clever RULES FOR SELF-ORGANIZATION. These rules govern how, where, and what the system can add onto or subtract from itself under what conditions.

Self-organizing computer models demonstrate that delightful, mind-boggling patterns can evolve from simple evolutionary algorithms. (That need not mean that real-world algorithms are simple, only that they can be.) The genetic code that is the basis of all biological evolution contains just four letters, combined into words of three letters each. That code, and the rules for replicating and rearranging it, has spewed out an unimaginable variety of creatures.

Self-organization is basically a matter of evolutionary raw material—a stock of information from which to select possible patterns—and a means for testing them. For biological evolution the raw material is DNA, one source of variety is spontaneous mutation, and the testing mechanism is something like punctuated Darwinian selection. For technology the raw material is the body of understanding science has accumulated. The source of variety is human creativity (whatever THAT is) and the selection mechanism is whatever the market will reward or whatever governments and foundations will fund or whatever tickles the fancy of crazy inventors.

When you understand the power of self-organization, you begin to understand why biologists worship biodiversity even more than economists worship technology. The wildly varied stock of DNA, evolved and accumulated over billions of years, is the source of evolutionary potential, just as science libraries and labs and scientists are the source of technological potential. Allowing species to go extinct is a systems crime, just as randomly eliminating all copies of particular science journals, or particular kinds of scientists, would be.

The same could be said of human cultures, which are the store of behavioral repertoires accumulated over not billions, but hundreds of thousands of years. They are a stock out of which social evolution can arise. Unfortunately, people appreciate the evolutionary potential of cultures even less than they understand the potential of every genetic variation in ground squirrels. I guess that's because one aspect of almost every culture is a belief in the utter superiority of that culture.

Any system, biological, economic, or social, that scorns experimentation and wipes out the raw material of innovation is doomed over the long term on this highly variable planet.

The intervention point here is obvious but unpopular. Encouraging diversity means losing control. Let a thousand flowers bloom and ANYTHING could happen!

Who wants that?

2. The goals of the system.

Right there, the push for control, is an example of why the goal of a system is even more of a leverage point than the self-organizing ability of a system.

If the goal is to bring more and more of the world under the control of one central planning system (the empire of Genghis Khan, the world of Islam, the People's Republic of China, Wal-Mart, Disney), then everything further down the list, even self-organizing behavior, will be pressured or weakened to conform to that goal.

That's why I can't get into arguments about whether genetic engineering is a good or a bad thing. Like all technologies, it depends upon who is wielding it, with what goal. The only thing one can say is that if corporations wield it for the purpose of generating marketable products, that is a very different goal, a different direction for evolution than anything the planet has seen so far.

There is a hierarchy of goals in systems. Most negative feedback loops have their own goals—to keep the bath water at the right level, to keep the room temperature comfortable, to keep inventories stocked at sufficient levels. They are small leverage points. The big leverage points are the goals of entire systems.

People within systems don't often recognize what whole-system goal they are serving. To make profits, most corporations would say, but that's just a rule, a necessary condition to stay in the game. What is the point of the game? To grow, to increase market share, to bring the world (customers, suppliers, regulators) more under the control of the corporation, so that its operations become ever more shielded from uncertainty. That's the goal of a cancer cell too and of every living population. It's only a bad one when it isn't countered by higher-level negative feedback loops with goals of keeping the system in balance. The goal of keeping the market competitive has to trump the goal of each corporation to eliminate its competitors. The goal of keeping populations in balance and evolving has to trump the goal of each population to commandeer all resources into its own metabolism.

I said a while back that changing the players in a system is a low-level intervention, as long as the players fit into the same old system. The exception to that rule is at the top, if a single player can change the system's goal.

I have watched in wonder as—only very occasionally—a new leader in an organization, from Dartmouth College to Nazi Germany, comes in, enunciates a new goal, and single-handedly changes the behavior of hundreds or thousands or millions of perfectly rational people.

That's what Ronald Reagan did. Not long before he came to office, a president could say, "Ask not what government can do for you, ask what you can do for the government," and no one even laughed. Reagan said the goal is not to get the people to help the government and not to get government to help the people, but to get the government off our backs. One can argue, and I would, that larger system changes let him get away with that. But the thoroughness with which behavior in the U.S. and even the world has been changed since Reagan is testimony to the high leverage of articulating, repeating, standing for, insisting upon new system goals.

1. The mindset or paradigm out of which the goals, rules, feedback structure arise.

Another of Jay Forrester's systems sayings goes: It doesn't matter how the tax law of a country is written. There is a shared idea in the minds of the society about what a "fair" distribution of the tax load is. Whatever the rules say, by fair means or foul, by complications, cheating, exemptions or deductions, by constant sniping at the rules, the actual distribution of taxes will push right up against the accepted idea of "fairness."

The shared idea in the minds of society, the great unstated assumptions—unstated because unnecessary to state; everyone knows them—constitute that society's deepest set of beliefs about how the world works. There is a difference between nouns and verbs. People who are paid less are worth less. Growth is good. Nature is a stock of resources to be converted to human purposes. Evolution stopped with the emergence of *Homo sapiens*. One can "own" land. Those are just a few of the paradigmatic assumptions of our culture, all of which utterly dumbfound people of other cultures.

Paradigms are the sources of systems. From them come goals, information flows, feedbacks, stocks, flows.

The ancient Egyptians built pyramids because they believed in an afterlife. We build skyscrapers, because we believe that space in downtown cities is enormously valuable. (Except for blighted spaces, often near the skyscrapers, which we believe are worthless.) Whether it was Copernicus and Kepler showing that the earth is not the center of the universe, or Einstein hypothesizing that matter and energy are interchangeable, or Adam Smith postulating that the selfish actions of individual players in markets wonderfully accumulate to the common good.

People who manage to intervene in systems at the level of paradigm hit a leverage point that totally transforms systems.

You could say paradigms are harder to change than anything else about a system, and therefore this item should be lowest on the list, not the highest. But there's nothing physical or expensive or even slow about paradigm change. In a single individual it can happen in a millisecond. All it takes is a click in the mind, a new way of seeing. Of course individuals and societies do resist challenges to their paradigm harder than they resist any other kind of change.

So how do you change paradigms? Thomas Kuhn, who wrote the seminal book about the great paradigm shifts of science, has a lot to say about that. In a nutshell, you keep pointing at the anomalies and failures in the old paradigm, you come yourself, loudly, with assurance, from the new one, you insert people with the new paradigm in places of public visibility and power. You don't waste time with reactionaries; rather you work with active change agents and with the vast middle ground of people who are open-minded.

Systems folks would say one way to change a paradigm is to model a system, which takes you outside the system and forces you to see it whole. We say that because our own paradigms have been changed that way.

0. The power to transcend paradigms.

Sorry, but to be truthful and complete, I have to add this kicker.

The highest leverage of all is to keep oneself unattached in the arena of paradigms, to realize that NO paradigm is "true," that even the one that sweetly shapes one's comfortable worldview is a tremendously limited understanding of an immense and amazing universe.

It is to "get" at a gut level the paradigm that there are paradigms, and to see that that itself is a paradigm, and to regard that whole realization as devastatingly funny. It is to let go into Not Knowing.

People who cling to paradigms (just about all of us) take one look at the spacious possibility that everything we think is guaranteed to be nonsense and pedal rapidly in the opposite direction. Surely there is no power, no control, not even a reason for being, much less acting, in the experience that there is no certainty in any worldview. But everyone who has managed to entertain that idea, for a moment or for a lifetime, has found it a basis for radical empowerment. If no paradigm is right, you can choose one that will help achieve your purpose. If you have no idea where to get a purpose, you can listen to the universe (or put in the name of your favorite deity here) and do his, her, its will, which is a lot better informed than your will.

It is in the space of mastery over paradigms that people throw off addictions, live in constant joy, bring down empires, get locked up or burned at the stake or crucified or shot, and have impacts that last for millennia.

Back from the sublime to the ridiculous, from enlightenment to caveats. There is so much that has to be said to qualify this list. It is tentative and its order is slithery. There are exceptions to every item on it. Having the list percolating in my subconscious for years has not transformed me into a Superwoman. I seem to spend my time running up and down the list, trying out leverage points wherever I can find them. The higher the leverage point, the more the system resists changing it—that's why societies rub out truly enlightened beings.

I don't think there are cheap tickets to system change. You have to work at it, whether that means rigorously analyzing a system or rigorously casting off paradigms. In the end, it seems that leverage has less to do with pushing levers than it does with disciplined thinking combined with strategically, profoundly, madly letting go.

Donella H. Meadows, scientist and environmental and social change activist, died suddenly of meningitis on February 20, 2001. Meadows wrote extensively about economic systems and sustainability, and wrote and worked tirelessly on behalf of the Earth.

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