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CONVERSATIONS WITH LEADERS

# The 21st Century Nonprofit Board

Reality bites as  
new issues  
confront  
board chairs

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# The 21st Century Nonprofit Board

## Reality bites as new issues confront board chairs

Nonprofit boards across America are grappling with the countervailing forces of funding pressures and increasing demands for their services, with most saying they are unable to meet their community needs.<sup>1</sup> To deal with these and other issues, board chairs are looking for deeper business expertise, greater diversity, and new skills on their boards to deal with new realities.

Almost 80% of boards are actively recruiting for between one to six members, indicating not only a time of renewal, but a shortage of experienced people, and challenges in retaining directors.<sup>2</sup>

While their goal remains the same – to provide services for “charitable or mutual benefit purposes” as defined by the tax law – the way nonprofits deliver on their mission is changing in line with ongoing funding issues, and 21st century thinking about community engagement and advances in information technology.

Hybrid for-profit and nonprofit structures are proliferating, mergers are on the rise, and the public is demanding greater transparency. Many boards are also finding they need to re-examine their strategic direction and the talent mix needed to align with changing directions.

In our work globally with leaders in the nonprofit sector, and in a series of recent interviews, we identified three major issues facing nonprofits today:

### Funding

**Challenges with revenue models, cashflow management, and merger opportunities.**

### Change

**How to influence teams to innovate and collaborate, as well as harnessing information technology for analytics and marketing.**

### Succession

**Ensuring the best leadership and management to drive the organization forward, and also to ensure the board itself is refreshed in an orderly manner rather than reactively.**

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<sup>1</sup> Nonprofit Finance Fund, 2014 *State of the Nonprofit Sector Survey*

<sup>2</sup> BoardSource *Nonprofit Governance Index Survey*

# FUNDING

## Where capitalism meets mission

Nonprofit revenues were impacted by the recession, as governments cut back funding while relying even more on nonprofits to provide community services. The good news is that wealthy donors are continuing to give generously, and the more sophisticated nonprofits are developing new methods of funding.

A growing trend is for nonprofits to supplement donated income with earned revenues. Social impact bond financing is also coming to the fore.

Roy and Patricia Disney Foundation executive director Sylvia Obagi has noticed a big growth in “social enterprises” which she describes as “capitalism meets mission.”

Obagi, who was formerly operations director for the Annenberg Foundation in Los Angeles, says most nonprofit leaders do not think of income generation as their top priority. “They say their purpose is to serve, and raising money is secondary. But this kind of thinking is one of the biggest mistakes a nonprofit can make. Without a strong fundraising culture, nonprofits often lurch from one financial crisis to another.”

With more than 70% of all donations to nonprofits, or around US\$250bn worth, coming from individuals,<sup>3</sup> it is clear that attention to the big donors requires time and dedication – “and it begins with the board,” Obagi says.

Real estate entrepreneur Bennet Greenwald says that “with government budgets coming apart at the seams, many nonprofits are simply kicking the can down the road” when it comes to funding. He believes the United States is undergoing major political shifts that will further impact the way nonprofits are funded.

Greenwald, who chairs the Second Chance program providing services for men, women and youth in San Diego, says new funding realities are forcing boards to spend more time on budgets and less time on programs.

## Living on the edge with a slow cashflow

BoardSource CEO Anne Wallestad says tougher economic times have “pulled back the curtain” on the fragility of many nonprofits. “We are seeing organizations that are completely undercapitalized, living on the edge, living month to month, waiting for grant checks to arrive – that’s sort of the nature of how they operate.”

She says more sophisticated board talent and senior leaders are needed to ensure nonprofits are built to last. “Things need to change dramatically if we don’t want to continue seeing nonprofits limping along like this.”

Finding leaders who know how to grapple with the complexity of nonprofit finances is a big challenge, Wallestad says. “Nonprofit financial statements are really different from for-profit financial statements, because you have different types of revenue streams, different horizons or timelines, multi-year grants and complexity in accrual versus cash accounting as well as auditing practices.”

Veteran businessman and board member Ralph Walter says nonprofits need board members with business experience “not because they are businesses in the true sense, but because they need to be run like businesses and have a business-like approach to transparency and fiscal discipline, but in a way that is often very different from a business.”

Walter, who is the former Chief Operating Officer for brokerage Kayne Anderson Rudnick and Chicago Corp / ABN-AMRO, as well as vice-chair for finance with Knox College, says the big challenge is for nonprofits to measure outcomes – “and nobody likes to measure outcomes.”

While not all boards set the strategy for their organizations, Walter believes they must be engaged in strategy by asking tough questions and pushing staff to think through their plans. “No battle plan survives the first bullet, and to be honest I’ve seen some plans with nice tactical ideas but containing nothing strategic at all – not even a SWOT analysis.”

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<sup>3</sup> Giving USA Annual Report 2013

Wallestad adds that impact is often difficult to measure. “There is a bottom line that tells you how you are doing financially but since that is not what you are trying to accomplish, it is just one measure of the health of the organization. You can have great financials and be doing absolutely nothing – probably not for long since funding and donations would dry up. But the point is that – without impact measures – you’re really missing the big picture.”

## Making sense of the urge to merge

Going into the recession, there were reports of nonprofits considering mergers as a way of consolidating revenues and making efficiencies by eliminating overlapping roles. But this expectation has not played out in reality.

Says Wallestad: “The mergers that work are those where there is a clear opportunity for two or more organizations to do more – or better – together. Sometimes people think that you can put two weak organizations together and make one strong one, but the reality is that it actually takes two relatively strong organizations for a merger to go off well. Walter agrees. “I’m not sure about how much you can consolidate nonprofits, but I do know that if you do not measure outcomes, you won’t know if something has value or not, or precisely where that value lies.”

At Heidrick & Struggles, we have noticed that nonprofit leaders who pursue mergers when finances are shaky often come unstuck. But leaders with the experience and political acumen needed to navigate the complexities of M&A will act proactively in order to pursue a growth strategy.

For example, when two established Boston nonprofits merged into the Crittenton Women’s Union, CEO Elisabeth Babcock commented: “We took two platforms and bone structure and put them together in a way that allowed us to drive ahead new work and a new agenda. We would have never had the organizational or financial capacity to do this without merging.”<sup>4</sup>

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<sup>4</sup> *Stanford Innovation Review*, Spring 2014

*“I’m not sure about how much you can consolidate nonprofits, but I do know that if you do not measure outcomes, you won’t know if something has value or not, or precisely where that value lies.”*

**Ralph Walter**

# CHANGE

## Innovation demands experience and diversity

Nonprofits at their core are tackling tough social problems and therefore need innovative thinking and solutions. Their leaders, faced with greater income uncertainty than for-profits, are tasked with being creative with resources and projects, managing disparate groups of volunteers, hiring and retaining staff with eclectic backgrounds, and selecting board members with multiple skills.

But as they evolve in the 21st century, many boards in our observation are also in the throes of cultural change. They endeavor to work with CEOs and management to change mindsets and influence behaviors in a way that will make them more cohesive and effective.

This businesslike approach draws on “mission-first” thinking which is moving away from silos and focusing more on an enterprise-wide view, and espousing more collaborative management practices.

For boards, this means bringing new skills and perspectives to the boardroom table to keep abreast of trends. Technology is playing a big part, as boards ask whether their “cause” is capturing the minds and hearts of the next generation, and if they have right systems in place to communicate their mission.

Many are asking about the role of social media, crowd-funding, and data analytics which is able to make sense of their stored information. Many organizations are developing their own platforms or have already joined others in collaborative ventures.

At the very least, software tools are available to help nonprofits:

- Analyze their funding patterns (where it comes from, where it goes).
- Map their existing and potential supporters.
- Measure the perceived impact of their work.
- Develop mobile apps for “instant giving”.

One thing is certain, in the nationally and globally connected world of the Internet, the work of nonprofits is transparent. Everything they do now takes place under the real-time spotlight of social and online media, with board accountability magnified commensurately.

According to NPR board member Paul Haaga Jr, “The role of boards generally is becoming much more serious, and nonprofits are no exception. They have a real duty and obligation to be working hard and holding the management feet to the fire and being willing to make tough decisions like budget balancing, and stopping things that may be fun to do but which may not fit the strategic purpose.”

Haaga has been on NPR’s board since 2011 and most recently served as its vice chairman and the chairman of its finance committee. He has also served as chairman of the board at the Natural History Museum of Los Angeles County and as a trustee of the Huntington Library, Art Collections, and Botanical Gardens in San Marino.

He believes the skills mix required for nonprofit boards has had to move beyond broad business experience to more focused financial disciplines, with a need for strong audit committees, finance and budget committees, as well as people with “serious investment experience.”

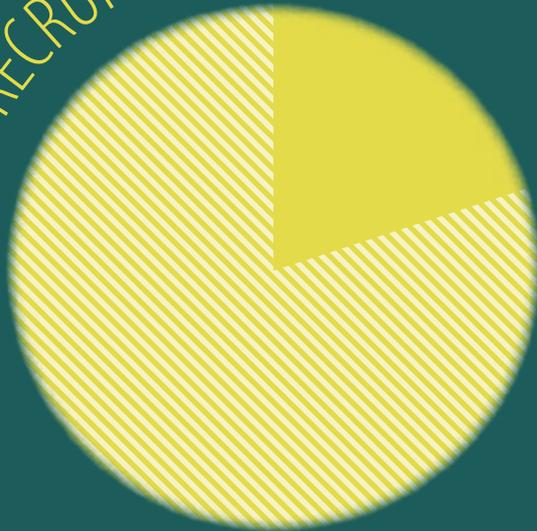
Another leading chair confides: “We used to have one generation of mainly volunteers on the board, and now we have the chairman of a law firm, and the chief operating officer of a US\$6bn asset management firm. In fact, I am no longer the smartest man in the room.”

Ralph Walter believes generational change is an accelerating issue. “The people who have the time and the money to devote to nonprofit work tend to be older, often retired, like myself. But we obviously only have a finite amount of time left and so we have to be looking out for people in their 30s, 40s and 50s to take our place.”

# The 21st Century Nonprofit Board

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RECRUITMENT



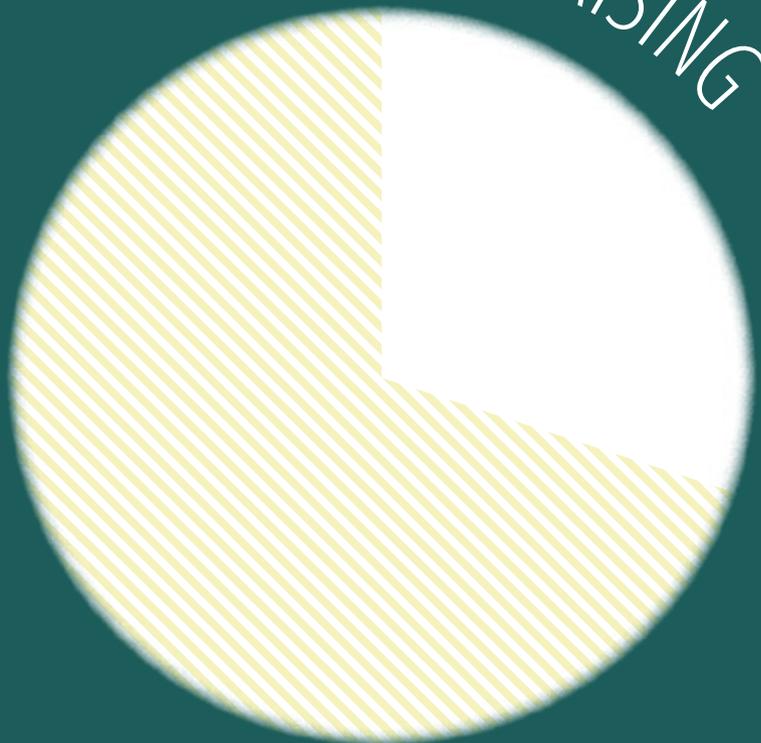
80%

of boards are actively recruiting between **1–6** members

70%

of all donations (worth US\$250bn) come from individuals

FUNDRAISING



## SOURCES

Nonprofit Finance Fund,  
2014 *State of the Nonprofit Sector Survey*  
Giving USA *Annual Report 2013*  
BoardSource

# 43%

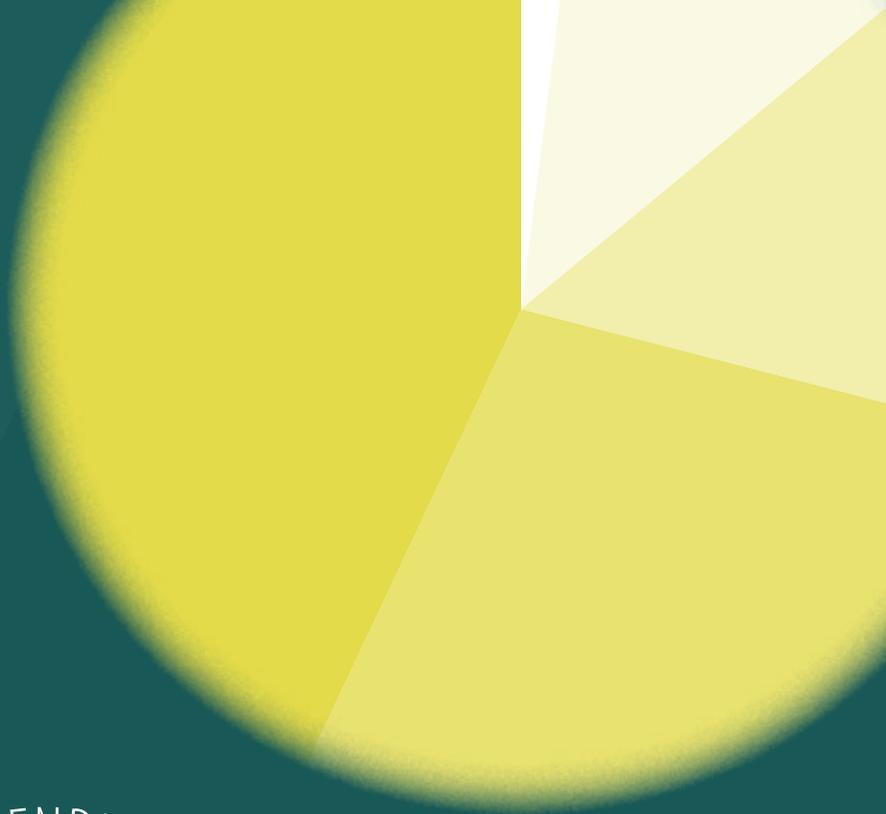
## AGE

of board members  
are between 50-64

**15%** are 64+

**28%** 40-49

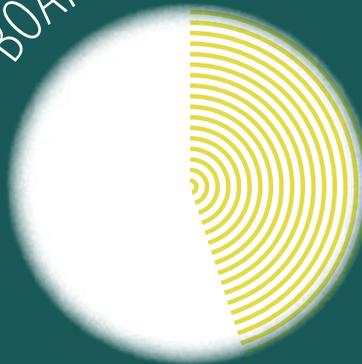
**12%** 30-39



## CEO GENDER



## BOARD GENDER



### CEOs

**62%** FEMALE

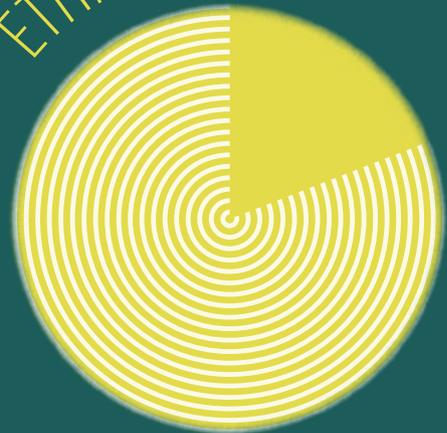
**38%** MALE

### BOARD MEMBERS

**45%** FEMALE

**55%** MALE

## ETHNICITY



# 82%

of board members  
are caucasians

BoardSource statistics show that nonprofit boards are mostly made up of over-50s, with 43% between 50 and 64 and another 15% aged 65 and over. But younger generations also coming through the ranks, with 12% aged between 30 and 39 and 28% between 40 and 49.

MasterCard Foundation board chair Lois Juliber says the perspective of youth is a vital part of regeneration and innovative thinking. But that viewpoint needs to be leavened with experience.

“In addition to the older generation and the monied generation, everybody wants ‘young people’ on their boards. You need their perspective and their networks, but you also need to realize they don’t have maturity or life experiences.”

According to BoardSource, while women chief executives are in the majority on nonprofit organizations (62% of CEOs, against 38% male CEOs), and boards are about even, with 45% female and 55% male, diversity of ethnicity is a different story. Caucasians make up 82% of boards.

“At a time of great change, in a creative age where collaboration and inclusion is becoming more important for growth, the issue of diversity needs to be addressed,” says BoardSource’s Wallestad.

Diversity of background and experience is also essential, in the view of Paul Haaga, who artist wife Heather chairs two nonprofit boards and has a background in marketing – “as well as being an artist and a mom.”

He says “meaningful experiences that allow people to contribute meaningfully” can come from a variety of different areas.

Ralph Walter says it is incumbent on all boards when they do a CEO search to make sure that diverse options emerge. “This is something that wasn’t even considered 10 years ago, but a lot of boards are now focusing on diversity. There has been much lip service given to diversity, but we need to realize that diversity of skills and people always follows development, or the advancement of any enterprise.”

*“At a time of great change, in a creative age where collaboration and inclusion is becoming more important for growth, the issue of diversity needs to be addressed”*

**Anne Wallestad**

# SUCCESSION

## It's about strategic direction, and the mix

Succession planning is a routine feature of the modern corporate landscape, but nonprofits are still playing catch up. Twenty percent of those surveyed by BoardSource admit they do not conduct formal, written evaluations of the chief executive officer, and only 55% of boards say they have assessed their own performance in the past three years. Around one-third of nonprofit boards have never evaluated their own performance.

Before nonprofits can recruit a board member or a senior executive, they need to look at their strategic direction, asking three questions relating to the space between desired outcome and reality:

- 1 What have we got now?**
- 2 What do we need in the future?**
- 3 How do we fill the gap?**

These questions cannot be answered without assessing the chief executive and leadership team, and conducting regular board effectiveness reviews. All board members we interviewed believe the most important duty of a board is to have oversight of the chief executive's performance.

Bennett Greenwald says: "One has to speak with candor and with frankness about things that are sensitive. For example, one cannot and should not sit on a board of an under-performing nonprofit for any length of time without saying, 'My goodness I think the emperor may have no clothes.'"

He also believes continuity of service is crucial to a successful nonprofit performance, which means a focus on executive retention, and an understanding of appropriate rewards.

"You have to have some knowledge of what this organization really does and I think that takes a couple of years, so I'm a big anti-term limits guy. I am also a big outcomes guy. And if boards want to achieve a good

outcome they really need to look at the chief executive compensation."

Juliber says success depends on the mix. "At MasterCard we have a small board of 10 with a great mix of business experience, academe, philanthropy, and a world leader – usually the former president of a country. That mix, combined with the work we do, and because we're a young foundation, leads to some extraordinary dialogue and sound decision-making," Juliber says.

## Is your leadership compensation really competitive?

The cost of unexpected turnover at the top of nonprofits can be high, not only in productivity but in lost fundraising and, most importantly, in lost impact. While there are compensation benchmarks, the sector needs to become more competitive if it is to retain the best.

Greenwald is concerned about the disparity between for-profit and nonprofit compensation when it comes to bringing the best talent into the organization.

"Chairmen are often faced with employing a CEO who has an advanced college degree, who has been running an organization the size of a big business, trying to save lives for the past 15 years, and they have to pay them US\$200,000, while some investment banker is getting millions of dollars – and we tell them, 'You should get less because you run a nonprofit,'" he says.

Greenwald, and others interviewed, feel that higher-paid jobs in the for-profit sector are luring away leadership talent that would otherwise be retained. Surveys regularly show high percentages of nonprofit leaders expressing dissatisfaction about their salaries.

But just as important as salary scales is the ability to measure performance. According to Alnoor Ebrahim, associate professor and faculty chair of the Social

Enterprise Initiative at Harvard Business School, one of the biggest challenges facing nonprofits today is their ability or willingness to measure their progress.<sup>5</sup>

“They need to create a culture that values both performance assessment and learning from failure,” he says. “Few board members are willing to challenge their CEO and senior management on whether the organization is achieving its mission, or how it might better do so. But if we’re ever going to solve the most difficult problems facing our society, we need nonprofit boards to be relentless in pushing their organizations to measure their progress, to be honest about failures, and to learn from them.”

## The part played by passion

Experience counts on boards, according to Haaga, who says board service is “so different from other things that smart people do” that experience on other boards, preferably in leadership roles such as chair or committee chair, is a prerequisite.

“For example, you may have a brilliant surgeon or a fabulous executive at engineering, or someone with a great IQ, but they just don’t know how to deliberate and collaborate and make decisions with good but not perfect levels of information,” he says. “And board members have to be able to evaluate people, and then to perhaps jump back into a situation they haven’t thought about for a few months and be able to jump back in and be a meaningful participant.”

Ralph Walter agrees. “Anyone who thinks his or her resume looks better because they have a nonprofit board on it is probably somebody you don’t want on your board.”

Obagi also warns that business expertise alone is not enough. “I’ve seen a lot of really super, smart, successful corporate executives sitting on nonprofit boards but they really don’t understand how programs and services are delivered or how the organization fits within its broader ecosystem. You also need a deep sense of passion for the nonprofit world – a real sense of mission,” she says.

Lois Juliber, who has served on the boards of DuPont, Goldman Sachs and Kraft, the Board of Trustees of Wellesley College, and Women’s World Banking, after retiring as Chief Operating Officer of Colgate-Palmolive, says board members coming in from the business world need at least 12 months to “learn philanthropy from inside out, not the outside in” by immersing themselves in the kind of work the organization actually performs.

“They need to realize they can’t give orders, that they need to be thoughtful about their comments, since the staff will take them very seriously. And they need to realize their behavior or style will end up influencing the culture of the board and the organization.”

Greenwald echoes the advice when he speaks of the humility needed by newcomers: “If you come in with the attitude that ‘I know the one perfect way to run organizations, you are really dead at the door. You really need to spend a year or even two, just listening and learning. How does this organization work, what is it like? What are the dos and don’ts?’”

## The critical role of culture

The goal of a chairperson is to guide to consensus a relatively large group of people (between 15 and 16 on average, according to BoardSource) to work together in harmony on behalf of the organization.

Culture is critical to this objective, and if high performance is not happening, the “true heart” of the nonprofit will need to be examined.

As Sylvia Obagi points out, “Sometimes people recruited on to a board will either fit into an existing culture and embrace it and continue to grow it and expand on it, but at other times you need to bring a leader who can harness the ambition, turn around the organization and create a new culture, one that is much more effective.”

She believes culture impacts and embraces governance. “The way a chairperson achieves successful governance on a board is to drive the process which ensures the board is developed properly, that the right individuals are recruited, expectations are set from the get-go, and the level of accountability is understood by all.”

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<sup>5</sup> ‘What Every Nonprofit Board Needs to Know’, *Forbes*, 7 September 2012

Obagi cites the principle of adaptive change as a driving force for cultural renewal. “As organizations grow in their lifecycle, all elements, including leadership at CEO and board chair level, undergoes change. At various stages you will find you do not have the right team in place, so you go through a restructuring process, then mature, then perhaps go back to infancy. You always need to be changing and adapting – not just for the sake of change, but to stay relevant. This involves reviewing performance of talent from boardroom to executive team.”

*“The best chairs are able to motivate board members to continue to give and participate...”*

## Conclusion

The opportunity exists for boards to shape a high-performance nonprofit organization capable of dealing with today’s issues, including an increasing workload and revenue challenges.

Those who do this, in our experience, have solid expertise from the business world.

We have also seen some great successes in the nonprofit sector, as well as some spectacular failures of businesspeople to address governance concerns.

Many senior business leaders join nonprofits out of concern for the values espoused by the organization. Unfortunately, others do so for reasons of personal prestige, and some also overlook their oversight role, or are persuaded that the mission is so worthy they cannot interrogate the strategy.

We look for two main competencies in the character of any new board member – motivation, and depth of experience. Boards want people who are “politically aware and yet politically objective” – those who know how to navigate the personality-driven landscape of vested interests and alliances, in order to deliver on the mission.

We believe the most important decision a nonprofit organization can make is who they choose as their board chair. You want a leader who:

- **Sets the culture and expectations of all board members.**
- **Is not afraid to propose changes when necessary.**

When we work with boards, we take a holistic look at the strategy and future outlook, then map the market, perform a board effectiveness review if necessary, and also examine senior leadership if required. We want to deliver the right people for the existing and future dynamic of the board – how it operates and what makes it successful.

The best chairs are able to motivate board members to continue to give and participate, and invest in the board in terms of development, in the same way they would invest in any other asset group. And as always, leadership talent is the key.

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# HEIDRICK & STRUGGLES

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