



# DIRECTOR'S *Monthly*



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CORPORATE CRISIS

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## NONPROFITS

# Nonprofits Experience Crisis Too

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*An experienced director flags causes and cures of nonprofit crisis.*

This is a not a news flash. We read and hear about it all too often. A beloved and respected charity in crisis. Whether it is the local food pantry running short, or as I learned from my Sunday paper, the internationally acclaimed philharmonic symphony facing a serious deficit and lay offs—nonprofits experience crisis too!

Of the nonprofits I have been privileged to serve as a trustee, all have encountered “crisis” to one degree or another—from financial surprises to organizational distress. Even a short list of the well-known charities that have faced serious difficulties and crisis would be extensive: United Way of America, Hawaii’s Bishop Estate, New Era, the International Olympic Committee, the Allegheny Health System, and the list goes on...

Much has been published on nonprofits and good governance. Some articles emphasize differences vis-à-vis the for-profit sector, and some emphasize similarities. My own experience after serving both is that although there are many common themes, when it comes to crisis between the two groups, nonprofits have their own crisis dynamics—both general and specific.

### General Reasons For Nonprofit Crisis

In nonprofits, three primary over-arching reasons for crisis surface time and time again: becoming a tradition-bound organization, having flawed strategies, and failing to perform.

*Becoming a tradition-bound organization.* Often, nonprofits and charities

#### DIRECTOR SUMMARY

Nonprofits can be vulnerable to crisis for a variety of reasons—ranging from general causes such as having flawed strategies to specific causes such as the “mysteries” of fund accounting. Directors can overcome these forces with the right mix of attitude and action. ▀

The role of the National Association of Corporate Directors is to enhance the governance and performance of business entities. Since its founding in 1977, the NACD has pursued this goal by offering a broad spectrum of educational and membership benefits, including publications, seminars, and consultative services. The NACD lists all interested members on The Director’s Registry, which is used by member companies and others that seek qualified directors. To educate the corporate community and to provide networking links among NACD chapter members, the NACD holds an annual Corporate Governance Conference, where it presents a Director of the Year Award.

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have long histories and rich traditions that have served them well. We do things “this way” because it is efficient and always worked. Conversely, the world changes and markets change dramatically, precipitously, over night—and the polarities of tradition and change can lead directly to dramatic collisions.

**Having flawed strategies.** A great strategy is a work in process. Today, successful “key” strategies must be developed or renewed every few years. Many nonprofits and charities think of strategy in terms of decades if they seriously address strategy at all. If an organization’s strategy does not address today’s competitive landscape or its performance is below par, it is time to form new plans.

**Failing to perform.** Whether nonprofit or for-profit, financial and operating performance counts. Historically, for many understandable reasons, high financial and operating performance standards have not been essential or required in many nonprofits. Likewise, bad bargains are often encountered. For example, “We don’t pay much, so we don’t expect much” is an unacknowledged (but very real) bargain in some nonprofits.

## Specific Reasons for Nonprofit Crisis

Beyond these three general causes of failure, there are over a dozen specific reasons and causes that regularly surface with nonprofits experiencing crisis and failure.

**Mysteries of fund accounting.** Most nonprofits have used fund accounting that is complex and difficult to understand. A cartoon that you often find floating around the executive suite in nonprofits reads “Fund accounting was designed by nonprofit executives to keep trustees in the dark.” If you serve on a nonprofit board and you don’t really understand items such as due from and “due to,” “temporarily restricted,” “negative fund balance,” “hidden reserves,” “nonrecurring items,” and all that jazz, then be ready for surprises. Better yet, make sure somebody does understand these issues.

**Recognizing changes in unrealized gains (or losses).** Losses is the operative word here. Related to the mysteries of fund accounting are important recent accounting changes that require nonprofits to recognize unrealized gains and losses in their financial reporting and annual income statements. For several years, this has played in favor of many nonprofits with large stock market portfolio gains that hid many a substantial operating loss or negative cash flow result from easy detection. Given the current testy stock market and the newfound awareness of unrealized losses, a number of nonprofits are paying the piper and facing the imminent reality of having lived beyond their means.

**Excessive debt.** Nonprofits often make use of excessive debt. This has been especially true during the recent bull market where they could issue tax-exempt bonds (debt!) cheaply and then

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effectively invest the monies in stock market funds to earn a spread. This has financed many organizations’ habits for lots of years. If your favorite nonprofit has used this approach, I trust they had the good foresight to issue those tax-exempt bonds at a fixed rate with a sound debt-repayment plan.

**Lack of accountability.** Governance and management is hard work and it requires strong accountability at both the board and executive level. Because many nonprofit directors are unpaid volunteers, they may not feel that they owe the organization any more than their wisdom, expressed in boardroom discussions. In fact, nonprofit directors have significant fiduciary duties related to fulfillment of their nonprofit’s mission, and preservation of its tax-exempt status.

**Conflicts of interest.** Interestingly, conflicts of interest are unusually common in the nonprofit world. I personally believe this is because so many of the trustee relationships of nonprofits are based upon friendships and personal relationships. When you combine these with the typical trustees’ genuine interest in being helpful and polite, you often end up with lots of serious conflicts of interest and the related surprises, bad results, or outcomes.

**Limits of fund raising.** Not surprisingly, there are many wonderful and talented nonprofit executives who truly believe there is no problem more fundraising can’t solve. In reality, there are limits to fundraising, and one of them is this: Donors want to give to vision and vitality. They do not want to give to debt, dysfunction, and operating losses. The healthiest nonprofits have a productive balance between fundraising revenues and earned operating revenues. Yes, there are important charities like disaster relief that will always be 100 percent donor-driven. And, yes, that symphony I mentioned will never be world-class without a world-class endowment no matter how efficiently it is run. Nonetheless, earned revenues matter.

**Lack of talent.** Talent counts in the boardroom, in the executive suite, and throughout the organization. This is equally true in nonprofits and for profits. Many nonprofits lack the resources they need to hire or retain the best talent.

**CEO missing in action.** Related to lack of accountability and lack of talent, it is quite common for nonprofits to have a CEO missing in action. This takes many forms and can include a CEO retired on the job, not capable of doing the job, or failing to perform because of some personal impairment. Especially watch for the beloved CEO-founder who can’t let go and the loyal board that won’t say farewell.

**Fraud.** On occasion, the dark side of the human condition prevails even in the best nonprofits and charities just as in the for-profit world.

**Mission issues.** A loss of focus on the mission is quite common. Missions can change over time.

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**Unreasonable or inappropriate compensation and benefits.** Surprisingly, nonprofits that are financially well off can have problems with excessive compensation. Many a nonprofit board has faced problems or scandal related to pay or questionable benefits. Sometimes it makes you wonder if the individual executive is serving the organization or the other way around. Inevitably, unreasonable pay or benefits leads to other unhealthy behaviors in the organization rather than doing the important work of the nonprofit. Nonprofit executive pay demands close scrutiny and full disclosure to avoid problems.

**Process vs. action.** Many large nonprofits become geared toward process. This can lead to inaction rather than the all-critical action and activity an organization needs to thrive.

**Unwilling to “dismount.”** The book of *Ecclesiastes* reminds us that there is a time for everything. Conversely, many charities, ministries, and nonprofits believe they are born to continue forever. What’s the old saying? When you discover you are riding a dead horse, the best strategy is to dismount. Paul D. Nelson, president of Evangelical Council for Financial Accountability has great insights on this topic and has published articles based on this theme.

## Special Concerns for Trustees Serving Nonprofits in Crisis

Nonprofit executives and trustees often ignore financial or other problems at nonprofits. A wise nun I worked with over the years put it this way “When it comes to nonprofit boards, top executives often check their judgment at the door when they serve as trustees!” She was also fond of saying “no margin, no mission!”

To be sure, most nonprofit trustees are committed, talented, and hard working. But many nonprofit trustees are there for

### *Directors can be vital catalysts for action.*

the honor and to serve in polite society. They don’t have any “chips” in the game. When in polite society and not having “chips” in the game, there is a profound reluctance to act when the going gets tough. Because of a profound reluctance to act, action most always comes late. Generally, late action means the organization has literally exhausted all of its financial resources and run out of cash before serious steps are taken to deal with very real problems.

## Real Change

I am pleased to report as you have likely experienced, nonprofits generally do survive in a time of crisis. Indeed, often times a crisis becomes the catalyst for critical change, positive transformation, renewal, or rebirth.

Every nonprofit that I have encountered involving a crisis required the following attitudes and actions for a successful return to health.

- ▶ confrontation (rather than denial)
- ▶ a team that buys into the need for change to make things happen
- ▶ tough decisions
- ▶ disciplined action, and
- ▶ hard work.

Directors can be an important part of that team—and vital catalysts for action. ▶

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