


SPRING
2010

Nonprofit Observer



**Save money and
improve efficiency
with a strategic alliance**

How to keep bad apples
from spoiling your board

Measuring effectiveness

*Are overhead ratios
becoming a thing of the past?*

**Red Flags Rule
applies to nonprofits, too**

Save money and improve efficiency with a strategic alliance

In December, nonprofit data source GuideStar released a summary of its annual survey of charities. The results were sobering: 51% of respondents reported decreased contributions between January and September 2009 over the same period in 2008. While trying to make do with fewer funds, 62% experienced greater demand for their services.

Having to do more — a lot more — with less is almost every nonprofit's biggest challenge these days. One of the best ways to meet this challenge is by doubling up, or forming a strategic alliance with another nonprofit, government entity or for-profit company.

TIES THAT BIND LOOSELY

“Strategic alliance” is a blanket term used to describe various types of partnerships between organizations. An alliance can be as simple as a contractual arrangement to share office space or an informal agreement to co-sponsor a one-time

event. Or it can be as complicated as combining programs and sharing grant money and human resources.

A nonprofit partnership enables charities to share ideas, research and best practices, and to reduce duplicative efforts.

Unlike mergers, however, strategic alliances aren't permanent, and they allow the participants to retain their operational and financial independence. Depending on the alliance, the partners may share some of their board members and staff. Indeed, combining overlapping programs and administrative, marketing, and public relations functions is one of the best ways for nonprofits to slash expenses.

These arrangements also help nonprofits focus on the most important aspects of their mission. Some charities get tunnel vision from working alone and fail to see when and why initiatives are having little effect. A nonprofit partnership enables charities to share ideas, research and best practices, and to reduce duplicative efforts. And teaming up with a *for-profit* company can introduce entirely different perspectives — particularly when it comes to using funds efficiently.



PICK A PARTNER CAREFULLY

The scope of your strategic partnership will likely determine the amount of time you spend researching and getting to know the other organization. But both groups should form small committees made up of board members and staff to meet and discuss certain issues, such as:

- ◆ The objectives of an alliance,
- ◆ Who will lead the project and make major decisions,
- ◆ How tasks will be divided based on each organization's strengths,
- ◆ How the project will be funded,
- ◆ Whether it's necessary to create a new legal entity,
- ◆ Sharing of staff, volunteers and outside consultants,
- ◆ Community and political leader support, and
- ◆ A timeline, including a completion date for the project.

Recognize that a strategic partnership can be fraught with risk — to your nonprofit's finances, other resources and reputation. Many nonprofits also fear losing their unique identity and culture. But several studies conducted by the Mandel Center for Nonprofit Organizations at Case Western Reserve University concluded that it's possible to mitigate such risk with strong mutual trust — and trust is rarely possible unless both organizations share a similar vision.

DIFFERENCES THAT WORK

Collaborations that make good financial sense still face an uphill battle in the face of philosophical differences. For example, a faith-based charity may wish to include a ministry aspect to its plans for a new homeless shelter, whereas its nondenominational partner may oppose any overtly religious content. Neither party is likely to budge on the fundamental issues, and even if they're able to negotiate a compromise, lack of trust could undermine their mission.

Tool of last resort

Charity watchdog Network for Good's CEO Bill Strathmann has called mergers among nonprofits "the tool of last resort." Many organizations that have gone through the process in which one entity legally absorbs the other would probably agree that mergers can be extremely difficult. Culture clashes are common, and staff and executive layoffs, not to mention the dismissal of board members, are almost always necessary. This can make for a difficult integration process and jeopardize the merger's long-term success.

But if your nonprofit is struggling and likely to go under without major financial assistance, you may want to consider a merger. You'll need to work closely with your financial advisors to determine the viability of this strategy and determine whether any larger, healthier nonprofits may be interested in a combination.

An unrelated charitable foundation also may be able to help you find appropriate merger partners and foster a good working relationship with them. Some foundations even provide bridge funding during the interim period.

Other differences may be possible to bridge, however. For example, one medical researcher formed the Chicago Diabetes Project to network, pool resources and eliminate duplicative research with scientists around the world. Even though participants may be pursuing different hypotheses, they share the same goal of producing a functional cure for diabetes within five years.

POSITIVE STEP

There are as many types of alliances as there are nonprofit missions, and this overview can't cover all of them. If you think a strategic alliance might enable your organization to save money and achieve better outcomes, discuss the possibility with your board and legal and financial advisors. Though it may be a positive step forward, it's one you need to make carefully. *

How to keep bad apples from spoiling your board

Most nonprofit board members understand their roles and are dedicated to working in a cooperative spirit to achieve the organization's strategic goals. But you may have a member who consistently fails to do his or her part, violates your rules, and treats others disrespectfully. As difficult as it may be, you need to act, because one rogue member can easily hinder the effectiveness of your board — and your organization.

MINOR IRRITATIONS THAT ADD UP

Although there are as many ways to misbehave as there are individuals, most disruptive board behavior probably can be classified as more annoying or insensitive than directly harmful to your nonprofit's health. Examples include board members who:

Regularly miss meetings. In today's over-scheduled world, everyone will have a time conflict now and then. A chronically absent member, however, is a drag on your board's productivity and can lower morale among other members who have to pick up the slack.

Boards are better off being shorthanded than having a full slate that includes untrustworthy members.

Fail to accept or complete tasks. A board member who isn't willing to take on his or her share of the work causes the same problems as



one who's a constant no-show. Other members have to shoulder more work to compensate for the slacker.

Are unproductive discussion participants.

There's a happy medium when it comes to board discussions. Overbearing members who never let others get a word in edgewise stifle debate. Those who are too quiet, on the other hand, may not be fully engaged.

Treat others disrespectfully. When a member subjects board peers to insults, belittlement or other forms of unprofessional conduct, those members are likely to decide they have better — less stressful — uses for their time.

Unpleasant as this behavior is, you may be able to remedy it by having a heartfelt, private conversation with the offender to point out unacceptable conduct. In some cases, the board member may not even realize there's a problem until you bring it up. Work with the individual to outline specific areas of improvement and

define a timetable for change. If changes aren't made, it's time to consider asking the member to leave.

SERIOUS OFFENSES

Although you can generally use your discretion on how to handle irritating behavior, immediate action is warranted when a board member:

Betrays confidentiality. Trust is an essential component of the board-organization relationship. Boards are better off being shorthanded than having a full slate that includes untrustworthy members.

Doesn't disclose conflicts of interest. If board members are making decisions that benefit themselves over the best interests of the organization, or even giving that perception, you run the risk of eroding the trust of other board members and staff — as well as the general public.

Pursues personal agendas. Similarly, board members who pursue their own agendas and

spend considerable time trying to sway the votes of other board members probably aren't committed to your nonprofit's mission or strategic objectives.

Depending on the seriousness of the offense and whether the board member has repeatedly misbehaved, you may need to ask that person to resign. If you're unsure whether the behavior is serious enough to take such a step, discuss it with your legal advisors. When it comes to your nonprofit, it's better to be overprotective than to turn a blind eye.

RIGHT PERSON FOR THE JOB

As much as you may want to include big donors and other deeply invested individuals on your board, know that not everyone is suited to the role. Thoroughly screen prospective members and provide new additions with a comprehensive overview of your organization and expectations for board members. Finally, regularly monitor meetings so you can spot signs of trouble before they get out of control. *

Measuring effectiveness

Are overhead ratios becoming a thing of the past?

*F*or many nonprofits, the subject of overhead ratios is a sticky one. Although this ratio represents the percentage of funds spent on administration and fundraising vs. programs, charity watchdog groups traditionally have used it as a proxy for overall effectiveness. This has led some organizations to underreport their nonprogram costs and neglect making critical infrastructure investments.

But in response to growing discontent with overhead ratios, those who evaluate and rate nonprofits are beginning to change their tune.



SIMPLE BUT FLAWED

The traditional appeal of overhead ratios is obvious. They're easy to calculate using data from nonprofits' financial statements or Form 990s, and they provide a standard metric with which to compare even very different charities. Watchdog groups vary somewhat in the overhead ratios they advocate, but most agree that "effective" nonprofits spend at least 70% to 75% of their budgets on program costs.

Many people in the nonprofit world, however, are coming to the conclusion reached by Perla Ni, founder and CEO of GreatNonprofits: "Overhead ratios ... tell you nothing about the impact that the charity has and actually encourage charities to make decisions that make them less effective." Because watchdogs, donors, foundations and even government regulators have placed such a strong emphasis on this single metric, many nonprofits have felt pressure to undertrack and underreport actual administrative and fundraising spending.

Worse, in some cases, they've neglected making capital investments — in human resources, facilities, information technology and donor outreach — that are essential to a charity's continued health and future growth. Ironically, pinching pennies to improve its appearance of fiscal responsibility can undermine an organization's long-term effectiveness.

CHANGING TIDES

Last year, some influential groups began to publicly doubt the exclusive use of overhead ratios. In mid-2009, the Charities Review Council revised its Use of Funds (essentially, an overhead ratio) standard to reflect that no one range is ideal for every charity and to encourage more infrastructure investment. And late last year, a coalition of charity watchdogs, including Charity Navigator, GuideStar and GiveWell, announced that it no longer believed that overhead ratios or executive salaries provided meaningful data to determine a nonprofit's impact.

Some watchdogs have proposed developing a new ratio to more accurately capture nonprofits'

program spending, but no one metric is being universally embraced to replace the current overhead ratio. Kate Barr of the Nonprofits Assistance Fund declared in a Dec. 16, 2009, blog post, "There is not a single, simple alternative method to evaluate the effectiveness of all nonprofits." She went on to highlight how some of the newer charity watchdog groups, such as Philanthropedia and GreatNonprofits, instead rely on consumer reviews, expert panels and in-depth research.

INPUTS VS. OUTPUTS

The weak economy may be playing a part in the nonprofit world's reevaluation of overhead ratios. But many have long advocated placing less emphasis on "inputs" (such as the percentage of funds spent on programs) in favor of "outputs" (a program's measurable impact). This means, for example, that instead of assessing a community food bank based on its overhead ratio, a prospective donor might focus on the fact that the charity recently expanded its storage facility, which enabled it to provide food to 500 more individuals per month.

But for your audience to understand the impact of your spending, you need to craft a clear and compelling message. Don't simply write up a few client profiles or provide glowing testimonials from community leaders. Instead, develop a method of measuring your success appropriate to your mission — for example, by the change in percentage of children vaccinated at your health clinic or the number that attended your museum's exhibit. Track these results and explain them clearly in the summary section on your Form 990 and marketing materials.

DON'T NEGLECT NUMBERS

Fiscal responsibility remains important for all nonprofits, of course. Even if overhead ratios aren't their primary means of measuring effectiveness, many charity evaluators will continue to include these numbers in their ratings formulas. Nevertheless, today's broader view of nonprofit effectiveness is likely to benefit most organizations capable of supporting their infrastructure spending with measurable results. *

Red Flags Rule applies to nonprofits, too

After several delays, the Federal Trade Commission (FTC) plans to begin enforcement of its “Red Flags Rule” on June 1. Why should you care? Although they typically don’t fall under the FTC’s jurisdiction, nonprofits that extend consumer credit are likely subject to the rule, which was developed to help prevent and detect identity theft.

ARE YOU COVERED?

To determine the rule’s applicability to your nonprofit, consider whether you act as a creditor in any capacity. For example, do you typically collect payments for goods or services upon delivery, or bill customers when goods or services are delivered? A creditor also may be an organization that regularly grants or facilitates loans, arranges for credit extensions, or makes credit decisions.

This broad definition can include colleges, universities, private secondary schools, hospitals, medical practices and even nonprofit bookstores. If your nonprofit falls into this group, you must next determine if you hold any “covered” accounts, or those that allow multiple or installment payments, such as loans



that are billed monthly. A one-time delayed payment generally isn’t considered “covered,” but any ongoing credit relationship probably is.

A creditor may be an organization that regularly grants or facilitates loans, arranges for credit extensions, or makes credit decisions.

COMPLYING WITH THE RULE

Organizations that meet the above conditions need to develop a written identity theft prevention program. It should include:

- ◆ Policies and procedures to identify red flags given the nature of your operations and the type of credit you extend,
- ◆ Actions that must be taken when identity theft is detected, and
- ◆ Procedures for regularly reviewing and updating your program to address new threats.

Further, if your nonprofit uses consumer credit reports for any reason, develop policies and procedures for acting on a credit agency’s notice of an address discrepancy. Such discrepancies are a warning sign of fraud.

TIME’S UP

The FTC’s compliance enforcement date is only months away, and the agency can impose financial penalties on organizations that are in violation and fall victim to identity theft. If you aren’t sure whether the rule applies to your nonprofit or what you need to do to prepare for it, talk to your financial advisor as soon as possible. *