Seven Warning Signs that Something May Not Be Right in Your Nonprofit

A really effective executive can make a nonprofit successful. But, a really ineffective or even incompetent (e.g. rising to your highest level of incompetence but a really good practitioner) executive can destroy a nonprofit. And, while there is a modicum of literature about what makes a great exec, there is little literature that describes the institutional changes that should call a board to action when there are signs that change is necessary. Neither is there literature about what these signs might be.

This article is based on a four year consulting practice focused on helping nonprofit boards determine when and how to address one of the biggest institutional changes a nonprofit's board can experience: deciding if the exec is the right person for the current life of the nonprofit.

Four assumptions are central. First, nonprofit board members are the legitimate owners of a nonprofit and are responsible for ensuring optimal outcomes. Second nonprofit executives are a nonprofit board's "pinch hitters" tasked with caretaking and ensuring that the day-to-day systems, resources and work are all focused on mission. Third, a nonprofit board must act when signs indicate that "something" is not "right". Action generally begins with suspicions or beliefs and is followed up with data collection to ensure full understanding of what is not "right" and what responsibility the exec has in the findings. And fourth, there are seven signs or indicators that provide insights into when action should begin.

The seven signs where action there may be needed are:

1. Staff turnover and/or much complaining to the board;
2. Funders and donors questioning the use of funds or quality of work or..;
3. Board/CEO rocky relationship (where trust is on the decline or absent;
4. Clients expressing dissatisfaction with or not using services;
5. Community and peer group gossip or lack of partnering;
6. Regulator challenges; and,
7. Professional advisors advising that change must occur.

The remainder of this article describes these signs in more details. The article concludes with some observations about what steps a board might take.

1. Staff Turnover and/or Complaining

One clear sign that problems may be present is when nonprofit board members, the volunteers, begin to hear from line staff or everyone but the top official that life at the nonprofit sucks.

Let's be clear: line staff often complain and usually complain to their exec or other managers. Grumbling is part of the DNA of being an employee if not a human being. And, because grumbling is a natural human behavior, board members in particular have to be pretty clear about when they should listen and what they should listen to and perhaps, whether they should even be accessible to line staff cause a widely held belief by most experts and execs is that line staff talking directly to the board about inside issues is taboo.

Management is actually established in part as a buffer between line staff and the board and for the most part for good reason. Management does the daily supervision and "knows" what's going on internally. Nonprofit board members spend about 24-40 hours a year providing whatever they provide to a nonprofit. It is unlikely they can be that familiar with the day-to-day, even with the best reporting by the exec. However, when conditions are perceived "bad" and the exec is not perceived as responsive, there may only be one place to go and that's the board.

And what are the conditions that drive staff to go straight to the board? Conditions include: bad working conditions (e.g. hours, physical challenges, not enough training); firings that don't seem un-warranted or occur with the least infraction; favoritism and unjustly applied rewards (like raises or bonuses) or "punishments"; inconsistent application of policy; bad or inadequate treatment to customers and more, to name a few. All of these conditions are enough to drive staff to unionize or quit (creating frequent shortages of staff) and making big headaches for management and questionable ability to deliver quality services.

If the board has established a "score card" or "dashboard" system, they will have some degree of understanding about how well life is progressing from the view of the exec. These systems outline specific expectations and then report the progress against these expectations. But of course, these systems rarely capture working conditions. And, good working conditions are a management responsibility and badly managed can ensure institutional failure at many levels.

2. Funders

Now generally, funders don’t call up board members individually and say “hey, your nonprofit’s got problems!” This has however been known to happen, particularly from a community foundation or a major donor/family foundation member.

No, the most common approach for a funder to let a nonprofit board know they are unsatisfied is to turn the spigot. Yes, just not give any more money. The feds and states do this all the time. Oftentimes though their action is not an indicator of performance but when they take this step mid grant cycle or don’t renew, there may be a problem.

Funders are also informative when they don’t fund. Not giving money is not singularly an indicator but it certainly can be, especially if every funder ever approached says “no.” And, even if it’s just badly written proposals, that’s a sign all is not right. Research might have incorrectly indicated this was a potential source -- that’s a sign, all is not right.

Effectively, four patterns should raise the eyebrows of the Board that they might have a problem with funders when:

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a. Applications for funding are rarely accepted;
b. Renewals of funding rarely if ever occur;
c. Written critiques or even warnings are offered;
d. Conversations that “flow” up to board members who have relationships with funders are full of negative content.

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3. Board/CEO Relationship

A rocky Board/CEO relationship in which, at worse, there is outright contentiousness or hostility by the Board to the CEO and visa versa is another indicator that all is not right. The nature of the relationship can then be at this extremely negative of a status or, on the continuum, be fully trusting, effective and efficient.

Behaviors that raise questions as to the nature of the relationship include:

a. The CEO's financial reports and/or budgets are filled with mathematical or other errors or just plain late,

b. The CEO's narrative program reports are filled with errors and/or are consistently late,

c. The CEO consistently presents "problems" or challenges, internally or externally, and no solutions.

d. The nonprofit CEO fails to pursue goals established by the board or observe policies (like HR) set by the board or even appear to be pursuing the Board's priorities

Consistency and compliance are two benchmarks nonprofit board members often use to gage how life in their nonprofit is going. Inconsistency and lack of compliance are clear an indicator all is not right. The board has the right and obligation to establish and maintain expectations. They have a responsibility to trust. When the CEO behavior is about disregarding the nonprofit Board, only dissatisfaction is certain. Action by the board will not be far behind and a period of discontent and risk of at least a period of failure for the nonprofit, certain.

Good nonprofit boards are trusting because they are satisfied that the CEO cares about them as the non-profit's "owners". Scorecards, dashboards, a strong executive committee to provide oversight, an annual performance review and regularly scheduled executive sessions following board meetings are all tools that can help with the Board/CEO relationship and certainly there is plenty of nonprofit literature that helps avoid disaster.

4. Clients express dissatisfaction

Another sign of a nonprofit's pending disaster is when a nonprofit's customers or clients start regularly complaining to the board and staff about service quality or availability.

Research by a number of consumer researchers (e.g. Penn State) have found in their studies that nearly 1 in 3 unhappy consumers do nothing about their complaints while fifty percent tell someone but not the "offending party" and another third actually do lodge a complaint. The "tip-of-the-iceberg" theory proposes that the consumers who do complain are actually a representative sample of the number of individuals who really are unhappy. As the number of complaints rise, an organization should begin to recognize patterns that suggest there are "way more" consumers unhappy than have been heard from. And, as the number of complaints rise, an organization should put themselves on warning that some kind of more serious problem exists with a product or service.

Because the focus of this series of writings is on nonprofit execs, I believe that one consumer complaint is illustrative or at lasts introduces the possibility that something is wrong within the nonprofit and multiple and rising frequency of complaints indicates a real problem lays somewhere within the nonprofit. And of course, given that the exec is the final arbiter of all that goes on within a nonprofit, if something is wrong as suggested by complaints, the exec should be questioned, no, challenged, and investigation should be pursued with action not far behind.

It's also important to note that the principle that is proposed around pursuing action as a result of complaints, especially to the board, is one that should be taken even more seriously by a board. If only 1 in 3 consumers on average complain to a for-profit where money has been exchanged for benefits, it is safe to say that consumers are even less likely to complain where services are "free". As such, one complaint takes on an even higher meaning when pertinent to a nonprofit. One complaint should be even greater cause for concern if there was unease at delivering the message through the board.

At the very minimum, consumers must be provided the means to express their feelings about a service or product; regular evaluations must be core to daily operation; and, the staff must be required to log and report all consumer complaints if these complaints came through them. Similarly, board members must also be required to log complaints and share these with staff as well as log-in. Giving consumers the understanding that their opinion counts is essential to strong customer relations. Responding to customers with a clear process and opportunity is equally critical. A process manual with policies and procedures is equally valuable for this task. And, the board must be ready to hear the issues from staff and respond responsibly to ensure the well-being of their nonprofit.

5. Partners

In a nonprofit's 2006 world, "collaboration, partnerships and yes, even merger, are words often mentioned by a number sources but especially, funders. To some degree, there are just too many nonprofits. To me, new nonprofits are often the proving ground for making headway into new and better, or at least different and more creative, ways to provide services and save the world. Indeed, unexpected innovations have come about from the newborn "entrepreneurial" nonprofits. Take for example Benetech – an organization that could have been for-profit but persons with disabilities just aren't enough of a market incentive for the for-profits even though there are clear and present needs. Trade Fair has revolutionized the world and stimulated demand fair trade consumables that were once deemed undesirable by vendors who said the demand didn't exist. The list goes on.

But, while funders often complain about the "newbie's" they also complain about the groups that have been around awhile and really have just never proven a sustainable demand. Take a city of 500,000 plus people. Just how many youth service buildings (centers) can one city accommodate? Or soup kitchens or shelters or housing developers or….. It's true that one answer might just be: until all the needs are satisfied but bottom line, as funders see it, there would have to be a lot more public and private money to solve that need.

Meanwhile, funders are clear: we want outcomes and we want coordinated service delivery as an important approach to achieving outcomes. These funders then point to the "like" services and say: can't you just play together and each do what you do best and not duplicate? And this question, or questions like it, precipitates the original point of my message. Play together!

But what if no one will play together? What if everyone says: Ew! They don't play nice and always want to call the shots and always take all the money and sometimes, don't even provide good service? I believe that such claims are certain paths to near death for a nonprofit. Funders expect different conditions. Individual donors, although sometimes the reason there is a proliferation of nonprofits, also have expectations that a nonprofit will indeed focus on doing what it does best. And customers don't do all that well (well, most customers) with having to pick and choose between organizations that may offer similar services.

Today's environment really requires that nonprofits play well together. Nonprofits can't hog the turf or bully other organizations out of the turf or be all things to all people without consequences to, at the very least, their bottom line. And, at very worse, when the other nonprofits, funders and customers begin to complain, the future does not look good.

And speaking of complaints, while line staff could possibly be responsible for "bad will" in the community, unchecked it is unlikely this goes on without the "sign-off" by the ED. The ED is always responsible for the shape of the "face" in the community and when others say the organization doesn't play well, this egg is on the ED's face and no one else. It's up to the board though to determine if this behavior is acceptable and assuming it's not, seek a behavioral change or apply consequences.

Yes, a board can and or should know when the organization is perceived as not playing well with others. This is one more sign when all is not well and in particular, when the ED must be called to account.

6. Regulators

Who are the "regulators?" The "regulators" generally include local, state and national governments in addition to national and state certifying bodies. And, perhaps not so official, some state and national associations have been establishing standards that while not formally enforceable, can through group pressure and public embarrassment, become the equivalent of providing warning sights that an organization's behavior is not acceptable.

And what does each regulator have to say that should put both management and the board on alert? National regulators are the easiest to point to as to situations of concern. The status of an organization's tax exempt status is obviously a high priority. Without this status, institutions and individuals can not make donations to an organization.

Ways to mostly result in an economic penalty but could raise a threat to Federal status include:

a. Not filing an annual tax return (at all or on time) (see Federal rules to be sure your organization has a large enough budget to know you have an obligation);
b. Conducting activities not considered within the organization's mission. Many of these activities could just require a tax for these activities (UBIT where the activity generates revenue) but penalties and threats of loss of tax status could also be introduced if really unrelated and not contributing to mission;
c. Self-dealing or benefit activities where officers, board and/or staff have personal financial gain from the organization;

d. Failures in “duty of care” where board was grossly neglectful in ensuring the organization pursued its mission and used its resources appropriately; and,
e. Coming soon, new rules stimulated by the Sarbanes-Oxley legislation.

There are of course lots of nuances and peculiarities and special cases found in the annals of the IRS documented as federal law, agency rules and regulations, and case practice. Tax Exempt News is a great resource for understanding the issues and a good nonprofit corporate attorney or an area pro bono nonprofit legal service is a primary source of support.

After the Federal regulators there are State and Local regulators. The State first has an interest in ensuring that donative monies are used as they are supposed to. Note, just like with the Feds but perhaps more “felt”, nonprofit dollars are dollars taken out of the State and municipal budget. These are dollars worth watching out for. While States usually have some simple annual filing requirements and submission requirements when there are changes in by-laws or direction, States (attorneys generals or consumer complaint departments) tend to get involved thanks to whistle blowers – disgruntled staff or donors or customers. And, when state regulators do get involved, the process can be long and time consuming and public making it more difficult to raise money or do business in the future.

Local municipalities are more and more focusing on nonprofits as well. Their focus however tends not come from concerns about the behavior of the nonprofit as much as a desire to generate more revenue. In towns with declining revenues, the exemptions that have been granted look only like opportunity. Boards should ensure that the nonprofit is doing all it can to be public about how valued it’s presence and work is in the community.

Around the country, there is an array of certifying bodies or associations that have the authority and responsibility to set standards and ensure the nonprofit observes these standards. Some of these bodies are in effect, surrogates for state regulatory bodies. When a nonprofit is on notice that it has failed to meet one or more standards, action must follow or a certification can be threatened and a lost certification, in many instances can result in lost revenue and even, in the extreme, lost existence.

Finally, there are associations that do not have certifying authority but who pose standards for nonprofits. While there are no enforceable consequences for failure to meet these standards, there can still be consequences including public embarrassment, donor reluctance to make gifts and loss of confidence by consumers. Standards are an important source of informing behavior.

In conclusion, there are a number of sources of institutions that can hold nonprofit boards and staff responsible and accountable for their behaviors and activities. When these folks say something is not right, they can often impose consequences. It's up to the Board to ensure that policies and oversight practices are in place to reduce the risk of failing to meet both the formal and informal obligations that come from the regulatory sources. And, when the regulatory folk show up saying all is not right, it's the board that must determine where there was a failing and act to prevent a future failure.

7. Professional advisors

Professional advisors, including accountants, attorneys, governance specialists and development consultants among others are hired by a nonprofit as a resource to meet needs that are not otherwise available but needed by the nonprofit. Because of their "inside" knowledge and vast array of experience, often with similar types (size, age and/or mission) of nonprofits, professional advisors can provide more objective information than might otherwise be available. And, because of their position within the organization, these advisors may be aware of characteristics, behaviors or other indicators that can serve as indicators that the Board should consider its relationship with its executive.

Boards should indeed make the "space" available to listen to their consultants when "warnings" are issues. Warnings may be formal or informal and when they are issued, verbally or written, professional advisors are generally conservative in identifying issues which highlight the executive in less than a favorable light. After all, most are hired by the exec and should the word get out that the exec could be at risk, it may not bode well for the consultant. However, warnings from accountants (the audit) and attorneys, will likely stimulate attention while information from other advisors may need a board champion to be taken more seriously. At any rate, when the professional advisor says, "pay attention", paying attention can pay off for the nonprofit.

Conclusion

The nonprofit exec has many responsibilities and much is expected in how these responsibilities will be executed. However, not all execs are "right" for the life stage or needs of the nonprofit. There are at least seven indicators that can provide the exec's "boss", the board, with a call to at least look and see if action is required.

These signs include: Staff turnover and/or much complaining to the board; funders and donors questioning the use of funds or quality of work or..; Board/CEO rocky relationship (where trust is on the decline or absent; Clients expressing dissatisfaction with or not using services; Community and peer group gossip or lack of partnering; Regulator challenges; and professional advisors advising that there are "issues".

Remember, these are warning signs disaster may be pending. Retiring the exec is certainly not the only option nor may it be the right solution for the problem. More importantly, to fulfill its duty of care, the board must first have standards and expectations (a strategic plan?); have information that is reliable and complete (score card, dashboard?); a structure that effectively monitors; and, when patterns do arise, be ready to act quickly and responsively.