Balancing the Risks and Benefits of Continuity and Change: A Case Study of Policy Governance

Boards and Beyond: Understanding the Changing Realities of Nonprofit Organizational Governance
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Abstract

The management of change has become an important theme in nonprofit literature. Thought to be irrelevant in an uncertain environment, the value of continuity and tradition is often ignored. This case study focuses on experience of one board in balancing continuity and change in a large human service nonprofit organization in the Midwest. The adoption of policy governance, among a number of change strategies, is evaluated as a source of risk. The authors provide recommendations and caveats for nonprofit organizations considering the adoption of policy governance and other organizational changes.

Introduction

Nonprofit organizations enjoying long-term financial stability have become the exception rather than the norm in recent years. In a 2003 survey, approximately half of nonprofits responding reported experiencing severe or very severe fiscal stress during the year (Salamon & O’Sullivan, 2004). Human service organizations that serve the poor or unpopular clientele have found themselves in an especially vulnerable position as government funding has been reduced, service contracts have replaced grants, and the competition for corporate, foundation and donor support has intensified (Alexander, 2000). The devolution of responsibility for federal programs to lower levels of government has been part of a larger movement to make government more effective and efficient (Terry, 1998). This “new public management” (Hood, 1991; Kettl, 1997; Terry, 1998) assumes that competition improves the organizational performance, and that all organizations can be improved by adopting generic management practices that maximize efficiency and productivity (Kaboolian, 1998). The new public management was not imposed on a public hostile to its assumptions. The benefits of efficiency and competitiveness are accepted not only as general values in modern organizations (Seibel, 1996), but as a cultural model of the way the world works (Carrier, 1997).
The highly prescriptive policy governance model (also called the Carver model), developed by John Carver (1990), is very much in the spirit of the new public management. Carver claims that “if its tenets are strictly honored” (1999: xviii) board effectiveness and efficiency can be improved by leading the organization through policies developed in four key areas. The model invests the board with responsibility for long-term policy planning, and the CEO with responsibility for managing the agency within the policies developed by the board (Carver and Carver, 1997).

**Literature Review**

Although there are numerous publications prescribing the responsibilities of boards (see Eadie, 2001; Zander, 1993; Carver, 1990; Duca, 1986; Gelman, 1983), assessments of board performance are for the most part unflattering. They range from complaints about an over-emphasis on the social experience to allegations of negligence (Giebleman, Gelman & Pollack 1997). Until recently there has been little empirical data regarding board practice and behavior (Nbbie & Brudney, 2003; Brudney & Murray, 1998). Miller-Millesen notes, “Until actual behavior is observed and explained, linking board activity to organizational performance will continue to yield ambiguous results. It is time to supplement our knowledge of what boards look like and what they should do with more empirical evidence of their actual behaviors” (Miller-Millesen, 2003: 543). This case study examines the board practices of a nonprofit organization in financial crisis in the context of broader organizational considerations, with special attention to the impact of the adoption of policy governance methods.

**Methods and Research Purpose**
Beginning in the summer of 2003, the author undertook an ethnographic research project with The Center, and during the first half of 2004, volunteered at The Center, attended meetings of the board of directors and board committee meetings, and continued to interview volunteers, past and present employees, and professional consultants working with the agency. The board chair from the period has collaborated in the preparation of this paper, sharing her experiences and insights about the practices of the board, and the activities of the organization.

In early 2004, the board and the CEO of The Center are focused primarily on taking practical action to save the agency, but conversations with board members often include reflections on the events of the last two years. While a slowdown in the economy is acknowledged as a factor contributing to the agency’s financial difficulties, the board members feel that the severity of the situation could have been mitigated, at least to some extent, if the board had recognized the looming financial crisis earlier. Some of the women blame the policy governance model (Carver, 1990) that had been adopted in 2000, others blame the former CEO, and some of the women blame themselves. Could the board have prevented the financial crisis? Was the policy governance model at fault?

The purpose of this paper will be to: 1) to illuminate the role of the board in the financial difficulties of the agency, 2) to examine the impact of the implementation of the policy governance model, as well as other structural changes in the agency, in the context of theories concerning organizational risk, and continuity and change (Hager, 2004; McKenna, 2001; Salipante & Golden-Biddle, 1995), and 3) to make practical recommendations on how the adverse financial situation now threatening the agency’s survival might have been mitigated by board action.
The Case

The Center, a nonprofit human service agency, which has been offering services to women of a medium-sized city in the Midwestern United States for more than a century, is in financial crisis. The last two years has brought the venerable women’s organization, an affiliate of a national nonprofit, to “the brink,” as some of the board members like to say, of bankruptcy.

Focusing primarily on educational and employment-related programs for women, The Center has followed the funding trajectory of most nonprofit human service agencies. In the 1990s, human service nonprofits received on average more than 40% of their budgets from the government (Gronjberg, Kimmich & Salamon, 1995; O’Connell, 1996). The Center’s dependency on government funding had grown from approximately 10% in the late 1980s to more than 75% of its budget in the late 1990s. The organization had also taken advantage of funders’ enthusiasm for social entrepreneurship projects (Weisbrod, 2001) by establishing a charter school, two light manufacturing operations designed to provide job training, and investing heavily in the commercialization of an internally-designed computer software program. It was during this period of rapid growth and change that the agency adopted the policy governance model.

The new century brought more change, this time contraction rather than growth. The economic downturn had the effect of shrinking government revenue, as well as limiting the amount of funding available from private sources. Instead of generating profits to support other service projects by the agency, one-by-one the agency’s social entrepreneurship projects failed financially, leaving the organization to maintain the loan payments on a number of buildings The Center had purchased and renovated at a
substantial cost. Although most of the buildings had been well maintained, restrictions on many of the loans, and difficulty in leasing and selling real estate in The Center’s economically depressed urban neighborhood made the real estate a continuing drain on The Center’s resources, consuming staff time and increasingly scarce funds.

The economic downturn resulted in funding reductions in The Center’s large government contract at a time that demand for services was increasing. Unknown to the board, the staff had struggled with how to handle government funding cutbacks during a somewhat contentious process of constructing the 2002 budget. It came as a shock to the board when the CEO announced a layoff of 50 Center employees in the summer of 2002, but she assured the board the layoffs were a one-time adjustment, and would remedy any revenue shortfalls. Although official audits later established that The Center drew down almost 70% of its substantial reserves during 2002, the board had no knowledge at the time of the deteriorating financial situation. Under the limitations the board had adopted as part of policy governance, the CEO was not required to seek board input or approval on most financial decisions, and she chose not to consult the board. Only after a number of board members were alerted by “whistle blowing” telephone calls from staff, did the agency’s financial status come to light. Unsatisfied with the information coming from the staff, the board finally hired its own financial consultant to get to the bottom of the matter. The CEO, who had been with the organization for more than a decade resigned in the fall of 2002 to take another position, leaving the remaining employees and the volunteer board members to sort out the problems.

Toward the end of 2002, lacking a CEO, and with the agency’s reserves rapidly dwindling, the board was forced to take a more active role in the management of the
organization. Believing that The Center needed immediate leadership to stem the “bleeding of red,” as one volunteer termed it, the board appointed the then board chair, a successful businesswoman and longtime volunteer, as the CEO. Working with the CEO, the new board chair suspended the use of the Carver method, and returned to a traditional governance model. As more lay-offs, both voluntary and involuntary, continued, the board became directly involved in the management of the agency, and it needed operating information. There is no provision for direct board involvement in organizational operations in the policy governance model.

The board members were rather shocked and bewildered by what seemed to them to be an abrupt reversal in the agency’s standing. Less than a year earlier, The Center had been lauded by both academic researchers and the popular press for its entrepreneurial innovations, frequently held up as model to be emulated by other nonprofits. Now, not only had The Center been publicly criticized in a series of articles in the local newspaper, but an even larger financial crisis, which would put the very survival of the organization at risk, was looming like a storm on the horizon.

In the summer of 2003, the new CEO learned that The Center’s largest source of funding, a State-funded contract to provide social welfare services, would not be renewed. The current contract, which the agency had every expectation would be renewed based on performance measures, would continue only until the end of the calendar year, when more than 75% of the agency’s funding would be lost. This would leave even more of the agency’s real estate vacant, and incur severance costs for the staff that would have to be dismissed.
Over a period of two years, the failure of entrepreneurial projects, the loss of the large government contract, combined with an economic downturn which made it more difficult to obtain all types of funding, had eroded the agency’s revenue from approximately $50 million in 2002 to an operating budget of less than $5 million in 2004. Perhaps most significant had been the expenditure of approximately two-thirds of the organization’s $12 million reserve funds without the board’s knowledge.

The Carver Method

The policy governance model was adopted by The Center in 2000 as a result of advocacy by the former CEO and former board chair. One of the board members recalls that some of the other Centers had also adopted it, giving the method some measure of legitimacy with the volunteers. Although policy governance passed the board, not all of the board members embraced the concept.

Based on the criteria defined by Nobbie and Brudney (2003), the board was thorough in its implementation of policy governance, which Carver (1990) prescribes as a requirement for success. It adopted both means and ends policies including: governance process policies, staff-board linkage policies, and executive limitations policies, and provided training for all of the board members. Board committees were discontinued, meetings were moved to every other month, rather than monthly, and the board was working to trim its number of members from approximately 30 to roughly the dozen prescribed by Carver (1990). A survey of board members in 2001 revealed that although the members who had been originally trained in policy governance reported having a good working knowledge of the model, newer board members understood it less well.

Results and Conclusions
The Center grew and changed dramatically in a relatively short period of time. From 1999 to 2002, its budget tripled in size to approximately $50 million. The Center had accepted a large government-funded social welfare contract (which the State admitted was an experiment in welfare reform), initiated four social entrepreneurship projects, and following the completion of a new headquarters building, continued to acquire real estate to house its burgeoning operations. The board of directors was restructured with the adoption of policy governance, and the staff was expanded and restructured to accommodate the larger and more complex organization. The agency’s mission remained the same.

In Salipante and Golden-Biddle’s terms, the organization underwent a “significant change” (Salipante & Golden-Biddle, 1995:12). An environmental change (the State’s decision to contract for social welfare services) forced the agency to decide whether it wanted to compete for a large government contract or remove itself, for all practical purposes, from the provision of employment-related programs for women. While significant, the decision to accept the large State contract did not change the organization’s mission or identity, a transformation which is theorized to be even more risky for organizations than changes in size and structure (Burke, 2002; Salipante and Golden-Biddle, 1995). The entrepreneurial projects also did not challenge the organization’s deep structure—its identity and its values. However, these endeavors did require the organization to move well outside of its “core expertise” (Salipante and Golden-Biddle, 1995:15); the organization had no prior experience with operating schools, manufacturing operations or software businesses, and some of these projects were, at best, only tangential to its mission.
In retrospect, the board neither recognized the mounting risk that the organization had assumed in a relatively short period of time nor took any steps to increase its oversight or involvement in the situation. McKenna’s conception of risk as a social construct, “the product of perceptions that are individually and socially produced” (2001: 54) provides some insight into why this misrecognition of risk may have occurred. Structures such as policy governance, strategic planning, and computerized reporting, may create a false sense of security that that risk has been reduced because rational practices have been adopted. In the case of The Center, a change in the governance structure likely had the effect of increasing risk, at least in the short term. The majority of the financial damage to the agency coincided with a period of time when the board believes it was not fully competent in the use of the policy governance model. Although the agency had shown a high level of commitment to the model, the board members tend to agree there had been some flaws in its initial policies. The current CEO and former board chair, who had worked on the limitations policies, commented:

[The former president/CEO] had been president for such a long time, when we started putting limitations together, I will say we had such a level of confidence (in her), I should say blind faith, because that’s what I think it was. It was off the charts. You set limitations so the president can take action up to a certain point, and then they have to come to the board. We had such confidence in [the former CEO] the limitations were off the chart. . . The limitations were almost, well, unlimited. We were feeling that all the decisions that she made were going to be the right decisions. We never really got involved.

The former CEO had been hired by the board as an agent of change more than a decade earlier, when The Center had been in slow decline. With the support of the board, she had successfully transformed the agency. While retaining its mission of serving women, the agency had changed its focus from providing
recreational opportunities to women to an emphasis on serving disadvantaged women and their families through an array of human service programs. The board trusted the CEO, and made little attempt to verify her claims that the organization was financially stable, and furthermore the limitations policies it had developed did not require this level of disclosure.

Golensky (2003) provides us with a case study of RSN, a human service nonprofit that found itself in financial crisis after undergoing an organizational transformation to a management service organization. The narrative and analysis regarding RSN is striking in its similarities to this study of The Center. A venerable agency, located in a Midwestern city, and led by an experienced and trusted CEO, RSN had also experienced rapid growth in the late 1990s. Unknown to the board, which had adopted the Carver model and was not receiving consolidated financial statements, RSN’s financial situation also deteriorated to an alarming level. Golensky concludes, as the authors have in this case, that the organization made too many changes in too short a time period.

Salipante and Golden-Biddle (1995), and Schwartz (1992) emphasize the value of stability as well as change in the survival of nonprofits. A framework of “gradual change within the context of continuity” (Salipante & Golden-Biddle, 1995: 14) is recommended. While it is well documented that older nonprofit organizations have a higher survival rate than newer ones (Bielefeld, 1994; Freeman, Carrol & Hannan 1983; Stinchcombe, 1965), and that periods of change pose the most risk for organizational survival (Hannan & Freeman, 1984), the value of continuity, history, and tradition is often ignored in rational models such as the policy governance (Carver, 1990), in favor of an ahistorical emphasis on efficiency, effectiveness and professional competency. While
not adverse to change, the authors conclude that the risk of displacing structures and practices drawn from the past should be considered carefully by nonprofit leaders when embarking on a course of change. While there was nothing inherent in the policy governance model that caused the financial difficulties of the agency, it was the timing of its implementation that exacerbated that organization’s difficulties. The board’s incomplete mastery of the model, which had the effect of distancing the board from the staff and major organizational decisions, prevented the board from becoming involved earlier in the financial reversal, when it may have been able to moderate the decline.

Recommendations

Based on case of The Center, the authors cite the following as “lessons learned” by the board of directors from the experience:

- Whenever possible introduce organizational changes in a manner that optimizes the mastery of new structures and practices by both the board and the staff.
- Evaluate the ability of the organization to bear the risk of the worst possible outcomes of proposed changes, in the context of the entire organization.
- Realize that the organization needs more oversight by the board during periods of rapid change, even if things seem to be going well.
- During periods of uncertainty and change, consider employing outside professionals to provide objective input and data.
- Board insistence on verification of performance is not inappropriate.
References:


