

IN THIS CHAPTER

- » Introducing the four aspects of good governance
- » Exploring key characteristics of a nonprofit
- » Touching on board function and makeup
- » Figuring out your board's stage of maturity

Chapter 1

Defining Nonprofit Governance

The United States has more than 1.8 million registered nonprofits in all sorts of fields: hospitals and shelters, schools and food banks, theatres and museums. They fill gaps the government can't and private companies won't, and at the helm of every single one is a board.

In this chapter, we define what makes for good governance. We explain what nonprofits are and what boards do and share a framework for understanding how the board's role evolves right alongside the organization.

Defining Governance

Governance is one of those words that gets used a lot but is rarely defined. Despite the many definitions the Internet or textbooks can provide you, no one agrees on a single explanation. Here are just a few:

- » "The act or process of governing or overseeing the control and direction of something." —Merriam-Webster

- » "The way the rules, norms, and actions [of a nonprofit] are structured, sustained, regulated, and held accountable." —Nonprofit Quarterly
- » "Nonprofit governance simply means how your nonprofit is administered." —Harbor Compliance
- » "Nonprofit governance is defined as the process of providing strategic leadership to a nonprofit organization. It entails the functions of setting direction, making policy and strategy decisions, overseeing and monitoring organizational performance, and ensuring overall accountability." —Boardable.com



REMEMBER

We define *governance* as the systems of rules and processes by which decisions are made, power is exercised, and accountability ensured at your organization. Good governance is the difference between an organization that struggles and one that thrives.

The rest of this book talks about the many aspects of governance, from the big picture elements of strategic planning and financial oversight to the day-to-day details of running effective committee meetings and writing policies that protect. In this section, we offer a framework to understand what *good* governance means: integrity, excellence, sustainability, and equity (see Figure 1-1).

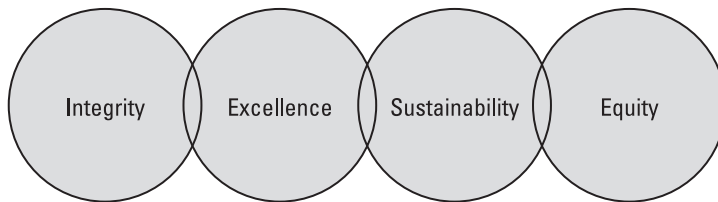


FIGURE 1-1:
The elements of
governance.

Doing right: Integrity

Good governance starts with integrity — doing the right thing — even when it's inconvenient or hard. Boards always need to operate with the highest level of integrity because it's the underlying foundation of your three legal duties. See the Online Appendix for characteristics of boards that operate with a high level of integrity.

Doing well: Excellence

Boards have a responsibility to their communities to set high standards for performance, hold leadership accountable, and ensure the organization does its very

best in pursuit of its mission. See the Online Appendix for characteristics of boards that aim for excellence.

Thinking long-term: Sustainability

Great boards resist short-term pressures, keep their eyes on the horizon, and recognize that the future relies on looking past the current budget cycle. Wishing for mission success one thing; marrying it with organizational stability and sustainability is another. See the Online Appendix for characteristics of boards that care about sustainability.

Being inclusive: Equity

Diverse perspectives lead to better decisions and more resilient organizations. Boards that center equity as an everyday practice are better positioned to serve communities because they become a more responsive partner. See the Online Appendix for characteristics of boards that value and practice equity across the organization.

Understanding What Defines a Nonprofit

What makes a nonprofit a nonprofit? Is it simply having a mission statement? Creating programming? Being run by a team of volunteers? The focus on community? Most people have a sense of what they think a nonprofit looks like, but a specific legal and tax reality lives behind the label. In the most basic and generalized sense, *nonprofit organizations* are typically *corporations* with a *special tax status* serving the *public good*. The following sections dig into each piece of that puzzle to help you understand a bit more.



REMEMBER

We want to emphasize that *nonprofit* is a tax status, not a business model. Nonprofits still need to make money, invest in their people and infrastructure, and operate with the same financial discipline as any healthy business.

Being formed as a corporation

The vast majority of nonprofit organizations are formed as corporations (sometimes they also choose to be unincorporated associations, trusts, or LLCs). That's because *corporations*, legal entities formed at the state level, provide liability protection and continuity benefits.

A corporation is legally separate from its owners and considered a distinct “person” in the eyes of the law. That means that if the organization faces a lawsuit or ends up with bad debt, board directors are generally shielded from personal liability. The organization (corporation) is responsible, not you individually.

It also means the organization can outlast any one person. Directors can rotate off or change leadership easily, making passing the mission on to future generations much easier. That’s the continuity benefit.



REMEMBER

Unlike for-profit corporations, which are legally accountable to shareholders, nonprofits don’t have an automatic legal obligation to donors in the same way. In nonprofits, no one owns it. But that doesn’t mean anything goes. Organizations still need to operate transparently and as good stewards of public money, and risk can quickly rise in the form of misusing funds, misrepresenting how donations will be spent, or violating terms of grant agreements. Check out Chapter 17 to find out more about organizational risk.

Receiving a special tax status

Nonprofit organizations are distinct from their for-profit counterparts thanks to a special tax exemption status granted under Section 501(c) of the IRS tax code, which relieves them from having to pay federal income taxes on revenue earned in service of their missions. The exemption is in place because nonprofits exist to serve the public good rather than generate profits for private individuals.

Organizations typically need to secure tax exemption at the federal and state levels, which requires two separate processes. Interestingly, the United States has more than 30 categories of tax-exempt organizations, spanning missions serving religious, educational, scientific, advocacy, and more causes.



WARNING

Nonprofit organizations aren’t free from paying *all* taxes. They’re still responsible for payroll taxes, unemployment taxes, and, in many states, business and occupation taxes. Chapter 15 has details on taxes and other financial concerns.

Serving the public good

A nonprofit exists to serve the public good. *Public good* means providing programs and services that improve people’s well-being, expand freedom of thought, enhance public life, and build stronger communities.

UNDERSTANDING THE TWO TYPES OF 501(C)(3)S

By far, the most common type of 501(c) organization is the 501(c)(3), with approximately 1.5 million registered in the United States as of the writing of this book. This category includes public charities, like your local food bank and art museum, as well as private foundations. Chances are the organization you serve, or are considering serving, falls into one of these two groups.

- **Public charities:** *Public charities* make up most of the registered 501(c)(3)s. The groups are focused on delivering programs and services directly to the community. They actively engage in running programs, providing health care, and offering other social services, and they need to demonstrate broad-based public support in their mission.
- **Private foundations:** *Private foundations* are established by a single individual, family, small group, or business and have a requirement to distribute a portion of their funds every year. You can find two types of private foundations. A *non-operating foundation* supports public charities' work by grantmaking. That is, it funds other nonprofits to do the work instead of running the programs itself. An *operating foundation* is a hybrid model that both delivers programming the way a public charity may and engages in grantmaking but doesn't have to demonstrate public support.

Identifying What a Board Is

A *board* is a group of individuals who've been appointed or elected to govern and oversee the operations of your nonprofit. Together, they're the legally accountable body responsible for the organization's integrity, finances, and direction. In brief, they're the volunteers with a fiduciary responsibility to the mission and the community.



REMEMBER

Boards are legally obligated to act in the organization's best interest. That means they must act with care and do their due diligence when making decisions, put the organization's interests above their own, and ensure the organization stays true to its mission and complies with the law. We break down everything you need to know about being a first-rate fiduciary in Chapter 3.

Board service also tends to be volunteer work. That may surprise you considering the serious nature of the work and the level of time, responsibility, and

commitment it requires. Yet the nonprofit sector has thrived, with millions of people freely giving their time, energy, and expertise to improve their communities and causes.



WARNING

Board service isn't the same as general volunteering. Don't join a board if you're just hoping to be more involved in events or want to be on the ground with programming. Boards govern at the 10,000-foot level and are responsible for strategy, financial health, and other legal obligations. Though they're technically volunteers, they're *not* like the ones on the ground day-to-day.

Looking at who's qualified to serve

No single standard dictates who can serve on a board. Generally, directors need to be at least 18 years old, be of sound mind, and meet any other requirements the organization's bylaws set forth. Board directors aren't required to be U.S. citizens or residents, may live outside the state you're operating in, and don't even need to have a personal connection to the mission. See Chapter 6 for more information about how to recruit the best board for you.

Getting a handle on how boards govern

Boards govern by setting mission and direction while ensuring the organization has the resources needed to carry out those aspirations. They also are responsible for stewarding those resources and safeguarding the reputation and public image of their organization. We explore the legal responsibilities and duties of each director in Chapter 3 and then in Chapter 4 review other things boards may do, depending on the scale, complexity, and nature of their work.



TIP

Many groups participate in governance beyond the board of directors: the IRS, state regulators, volunteers, staff, and more all get a say. We look at the greater governance ecosystem, including how all the different internal and external stakeholders participate in accountability, in Chapter 2.

Governing Differently as You Grow

Many nonprofits start with a passionate founder or a small group of committee community members willing to do whatever is necessary to get things off the ground. The board is likely hands-on and in the weeds, and that's perfectly fine. But as your organization grows, the way your board governs must grow, too. What

worked when you were scrappy and small is no longer sustainable, or appropriate, after you have paid staff, multiple program sites, millions of dollars in donations, and facilities under the banner of your mission.



TIP

Ask yourself, where's my board currently? We don't mean location-wise or in size but in its maturity. Just like people, boards grow and mature over time. Answering this question helps you understand how to adapt our advice to your current situation.

In the following sections, we look at a simple framework, first created by Karl Mathiasen III, for understanding where your organization is in its governance journey. We also add some context to help you better understand the friction your board may encounter as you continue to grow.



REMEMBER

Board growth isn't a race. Some boards spend years (even decades!) in the organizing stage. Growth looks different for every nonprofit, and moving slowly isn't a sign of failure. What matters more is that your board is self-aware and functional.

Figure 1-2 shows the three stages of nonprofit maturity, from organizing to institutional governance.

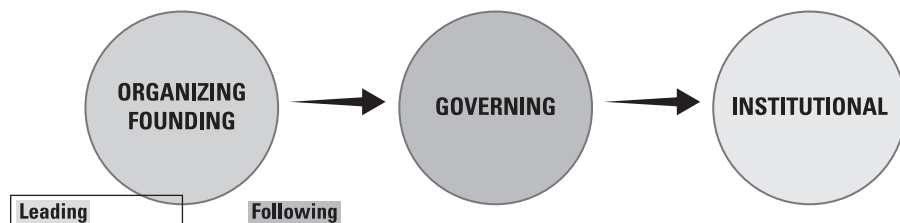


FIGURE 1-2:
The three stages.

Stage 1: The organizing board

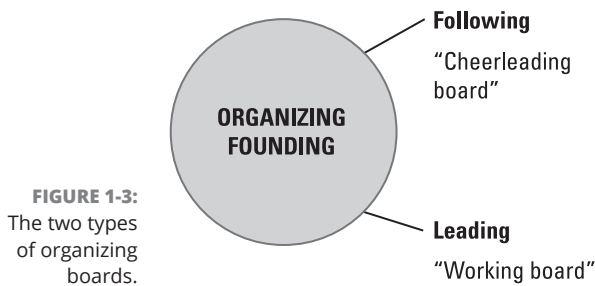
Though every story starts here, no two stories are exactly the same. Some boards are built around a visionary founding leader who fills the board full of friends, family, and folks from their personal network, and others emerge from a group of community members or neighbors who see a need and come together to act.

In this organizing stage (Figure 1-3), governance is more informal, relationships are close, and the energy is high, with everyone in the trenches figuring it out together.

The two most common flavors of organizing board are these:

- » **Following boards (cheerleading):** Where the organization was built around the vision of a central leader, with the board largely following their lead and cheering the founder on
- » **Leading boards (working):** Where the organization was built through effort, with the board sharing ownership of the vision from the start and working to bring the mission to life

We dig into these options in the following sections.



The following (cheerleading) board

You’ve likely seen it before: the passionate and charismatic founder with a vision of how to change the world. This kind of organization often has a following board that the founder has recruited from a personal network of family, friends, and professional colleagues. The founding board is less about governance and more about belief — belief and trust in the founder. Board directors’ whole job revolves around encouraging and validating (and sometimes resourcing) the founder’s vision. There’s little to no independent oversight or accountability of the executive, and the board trusts the founder implicitly.

Here are the signs you’re on a founding board:

- » The board is small and composed primarily of people the founder knows well and trusts personally.
- » Everyone is fully committed to the leader and their vision — but not necessarily to the mission itself.
- » Meetings are less frequent, informal, and focused on operations. The board sits and listens to the founder and then offers advice and encouragement.

- » Directors aren't involved in the organization, aren't task-oriented, and don't hold the founder accountable.
- » The board doesn't typically play a significant role in fundraising.

If you're serving on a following board, you need to watch out for some blind spots in governance:

- » Higher risk of compliance errors, financial mismanagement, and ethical lapses because no one is really asking hard questions
- » Lack of expertise in critical areas because of nonstrategic recruitment
- » Likelihood of conflicts of interest that may compromise the organization
- » Mission drift as the organization falls to the whims of the founder's evolving interests or personality
- » The founder as the single point of failure (their burnout, illness, or departure leaves no depth to back fill)
- » Organization growth that outpaces the founder's skill set, putting the board in the awkward position of having to performance manage a personal relationship



WARNING

Following boards face an inevitable reckoning: the moment the founder steps away. When that transition comes, planned or not, the board is forced to grow. Without proper succession planning, the moment can be deeply destabilizing. Don't wait. Head to Chapter 20 to get started on succession planning.

To transition to the next stage (governing), the board must do the following:

- » Step up and educate itself on what good governance at a mature organization looks like.
- » Self-structure and self-direct by creating a workplan, forming committees, engaging with finances and strategy, and assisting with fundraising.
- » Adopt foundational governance policies and financial controls, and update bylaws to reflect on the organization's needs to operate into the future.
- » Add new, independent voices with no relationship to the founder into the mix.
- » Redefine the line between governance and management and adopt a more neutral board-executive relationship.
- » Hold an honest conversation with the founder about the future and succession.
- » Exit directors who are unable or unwilling to make the shift.



Shifting away from being a following board can be painful. It means asking directors to give more time and take on more responsibility, which can feel uncomfortable. They may say things like “I didn’t sign up for this” as the original informal agreement of their service shifts from supporting a friend to taking on fiduciary authority. This shift can lead to conflict or disengagement, and at least a core committed group of directors has to be willing to navigate this friction.

The leading (working) board

The leading board is one built on shared ownership from the start. Not every organization forms around a single founder. Some of the most impactful nonprofits have been started by a group of community members or concerned neighbors who saw a need and bound together to make a difference. The vision, not a person, sits at the center. The work, the strategy, and responsibility belong to everyone in the room.

You may be on a leading board if:

- » The board is a bit of a hive mind, connected by similar values and ideas and a passion for the mission
- » Directors share a strong sense of ownership and a personal level of investment in the organization’s success
- » Board work is very hands on and involved with the nonprofit’s operations, and directors are willing to do whatever it takes to keep things moving
- » Meetings are operationally focused, with board directors reporting their work and tasks being assigned
- » The board is apprehensive or resistant to hiring staff, or only a limited number of non-executive staff members are in place

If you’re serving on a leading/working board, keep an eye out for these governance issues:

- » Higher risk of compliance errors and financial mismanagement because the board is too focused on doing the work to properly oversee it
- » Mission and strategy stagnation as the organization keeps doing what the board knows and loves rather than what the community has evolved to need
- » Governance bad behaviors, like side conversations, group chats, water-cooler decision-making, and general conflict avoidance, that make decisively addressing dysfunction or ethical concerns difficult

- » Directors feeling overwhelmed as they struggle to keep up with increasing assignments and operational demands as the organization grows (“I’m just a volunteer!”)
- » A power struggle emerging around ownership/authority after staff members are hired
- » Board leadership determined by popularity contest or availability rather than by expertise and ability



WARNING

The catalytic event that forces a leading/working board to grow up is the moment the organization hires its first paid staff. What follows can drag on for years: a prolonged power struggle between the board that built everything and the staff now being asked to lead. This muddy middle can be a dark age for an organization. But the reality is that you can’t really expand your impact and reach with a working board. You’ll always be capped by volunteer capacity. If you really want to grow, you have to let go.

To transition to the governing stage, the board needs to:

- » Step up and educate itself on what good governance at a mature organization looks like
- » Hire staff and trust it! Get out of the work of *doing* the work day-to-day, delegate operational authority, and build a professional relationship with clearly defined lanes
- » Restructure the board by sunseting operational committees, updating charters, and creating a workplan focused on strategy, oversight, and policy development rather than operational and programmatic execution
- » Actively recruit new, independent voices from outside the founding circle to break the insider/outsider dynamic
- » Check egos at the door and accept that no one owns your nonprofit; it’s going to change, and you need to change with it
- » Exit directors who are unable or unwilling to make the shift

Moving from a leading/working board calls for a fundamental shift of identity. Many directors join boards because they want to be hands-on, running programs, organizing events, and working alongside volunteers day in and day out to deliver on the mission. As staff take over that work, those directors are no longer needed in the same way, and the shift can feel like a real and unbearable loss. Resentment follows, and trust nose dives. The boards that make it through are the ones who recognize what they’re going through and embrace the change.

Stage 2: Governing

The governing board is the adult form of the organizing board, where the chaos of the early days has settled into something more intentional, structured, and sustainable. Governance is no longer informal or accidental. The board knows its role, respects the line between governing and managing, and has built the relationships and systems to back it up.

Signs that you're on a governing-stage board include the following:

- » The board is focused on strategy and oversight. It stays out of the weeds of operations, and directors respect the line.
- » A balance of power exists between board and staff, with the executive leading day-to-day operations and the board holding them accountable for results.
- » The board president and executive have a healthy, professional relationship and work together effectively to keep the organization on course.
- » Committees are in place and functional, regularly reporting progress against an overarching workplan for the board.
- » The board is diverse and intentionally recruits new directors with different skills and perspectives.
- » Fundraising is a normalized part of the work, and directors are actively, even if imperfectly, engaged in securing resources for the organization.
- » Essential governance policies are in place, bylaws are up to date, and directors have a shared understanding of the legal and chosen responsibilities of the board.
- » Self-assessment is a standard practice, as is ongoing education.



REMEMBER

Organizations who have reached this stage aren't homogenous and show varying levels of maturity. Rare is the governing board that's good at everything. What they all share is a strong foundation and a commitment to doing better.

If you're serving on a governing board, the danger is more angled toward complacency and blind spots that happen when things are going well enough. Here are some things that you may find you need to mitigate:

- » Governance that drifts into theatre, with the board going through the motions
- » Strategic drift or complacency, with the organization doing what it's always done without questioning whether that's still working
- » Committees that meet but don't produce anything

- » Policies that exist but either go without updating or aren't followed
- » A board that stops self-assessing, skips orientation for new directors, or deprioritizes education for other projects
- » Overreliance on a successful executive, rubber-stamping whatever they bring
- » Failure to keep the board's expertise in line with rapid growth in complexity
- » Allowing the same people to drive every conversation, leaving fresh perspectives unheard even when new voices are welcome
- » Long-tenured directors (nine or more years) with no term end in sight, stuck in how things used to be when you were still a working board (more on those boards in the earlier section "The leading (working) board")

Most nonprofits never need to move beyond the governing board stage. For the vast majority, it's the destination, not a steppingstone to something better. That said, sometimes an organization finds itself being pushed toward something bigger. A few things that signal you need to evolve include the following:

- » Becoming a significantly public institution, where a higher level of public scrutiny requires more formalized oversight
- » Crossing into enterprise-level operations, meaning you have 250-plus employees, budgets over \$25 million, and/or programs or services being delivered across multiple sites or states
- » Managing multiple entities, subsidiaries, affiliates, or chapters under the same banner
- » Securing large government contracts or operating in a highly regulated environment
- » Competing for, or dependent on, major philanthropic investments that require a more credentialed or connected board
- » Increasing liability and risk exposure to a level that demands more sophisticated legal and financial oversight
- » Being unable to provide the financial capacity, expertise, or prestige from the board that the organization needs to compete at its level



REMEMBER

The question isn't "How do we become an institutional board?" It's "Is our current governance adequate for the organization we are today?" If the answer is yes, stay the course and govern well. If the answer is no, here's how to move from a governing board to an institutional one:

- » Formalize and professionalize your board structure, updating committees to reflect the risks you need to manage.

- » Bring on dedicated, paid staff to provide board support. Volunteer-driven governance is no longer sufficient.
- » Be more intentional about recruitment, assessing and addressing gaps in financial capacity, legal expertise, risk management, and public representation.
- » Transition directors on who no longer can support the organization at this level.
- » Formalize evaluation of both board and executive leadership, including annual reviews with metrics for performance.
- » Be ready for stakeholder activism. Employees, community members, funders, and many more people will have an opinion about the organization and will not hesitate to speak up.
- » Anticipate regulatory attention. Large nonprofits operating across multiple states face increased compliance and operating requirements.
- » Review and update all governing documents to support and reflect the complexity you need.

Stage 3: Institutional

The institutional board is the enterprise form of governance, where the organization has become a large scale or serious public institution. The shift typically begins after an organization approaches and crosses \$25-million-plus in operations and where the complexity of asset management, the scale of risk exposure, and the level of public accountability demands a much higher standard of professional expertise at the board level. Think hospital systems, large universities, international human services organizations, national disaster relief entities, and so forth. At this scale, the consequences of getting things wrong are public and can be life-threatening.

You may be on an institutional-stage board if:

- » The board is large and formally structured, with directors who bring substantial financial capacity, executive-level professional expertise, and public influence
- » Service carries public prestige and attracts civic, industry, and philanthropy leaders whose association gives the organization greater credibility

- » Fundraising is professionalized and fully led by staff, with sophisticated major gift programs, capital campaign plans, and board activation
- » Committees are fully functional and independently operational across all domains (finance, audit, governance, compensation, risk management, and so on), with a high level of vested authority
- » Performance expectations are set and proactively managed for board and executive leadership
- » The board-CEO relationship is defined by professional distance, with clear mechanisms for evaluation, escalation, and termination
- » Governance infrastructure is supported by dedicated staff, legal counsel, formal board management systems, and up-to-date policies and procedures

Here are some areas of risk exposure:

- » Directors who are there more for prestige and expect influence disproportionate to their role
- » Committees that operate too independently such that they create silos and the board loses visibility into critical decisions
- » Overly bureaucratic and rigid policies and processes that slow down the work beyond what's reasonable
- » Organizational growth so complex that no director really understands the whole picture
- » Such a wide gap between the board and the communities being served that the board loses touch with the mission

Reflecting on your growth

However your board is structured today — whether you're in the thick of organizing around your mission, coming into your own as a governing board, or navigating the complexity unique to institutions — the most important thing is to be honest about where you are. Not where you wish you were or where you think you should be, but where you actually are. Honest self-assessment helps you spot problem patterns faster, leverage expertise you find, and make better decisions.

