Conflict of Interest in the Board Room?

New research points the way to solutions.

BY EUGENE H. FRAM & JUDY WITHERS

Ford and General Motors would never tolerate having the same director sit on their boards, yet the practice is fairly common in the nonprofit world. Is there a potential conflict when a person serves on two nonprofit boards that are in market contention for charitable funds or clients?

In the past decade, many nonprofit boards have developed and adopted conflict-of-interest policies. Typically these policies focus on preventing board members or their immediate families from reaping improper gains. These same policies may also restrict board members from receiving favors, gifts, or gratuities that would influence their judgment.

To date, there has been no analysis of the conflict that might exist if a person sits on two boards competing in the same arena. Examples are easy to find. Frequently an individual will serve on the boards of two universities that compete for donor funds or students. Similar situations often occur with health care agencies, nonprofit hospitals, and nonprofit nursing homes.

The potential for conflict in such situations raises a number of important questions:

- How should such board members handle competitive information?
- To which organization does the board member owe allegiance in soliciting charitable funds?
- How should these board members direct their own charitable gifts?

An even broader question to consider is this one: Should public policy support, or even encourage, nonprofit competition?

Research of nonprofit board literature by the authors indicates that this type of conflict and the related questions have never been publicly addressed in any detail. The reason seems to be that there is little possibility for improper gain in these situations. However, if a board member should unwittingly disclose competitive information that is detrimental to one organization while serving on a competing board, there is potential for serious competitive harm to one or both of the nonprofits.

There is also an attendant, basic question—one with public policy implications: Should charitable nonprofits be allowed or encouraged to compete, particularly when donated or tax-related scarce financial resources fund the competitive activity? An example would be two nonprofit day care centers, which compete for the same financial resources and participants, choosing to use some of their donated resources for recruitment advertising rather than children's services.

STUDY RESULTS

To assess professional reaction to conflict-of-interest issues when a person serves on two competing nonprofit boards, and the attendant question of competition, the authors conducted a small study. The study sample included 20 members of nonprofit boards and seven CEOs of nonprofit organizations, including four CEOs also serving as board members in other nonprofit organizations. All 27 interviewees reside in three upstate New York cities. They are currently involved with a wide range of charitable nonprofits, including social agencies, museums, and heath care organizations. Results of the study are as follows:

Should competing nonprofits share information? Most respondents didn't feel it was a conflict of interest for directors or managers of two contending nonprofit organizations to share information, but they did place limits on what should be shared. There should be sharing of operating information and activities (such as best practices and joint buying), they concluded. However, information sharing should be circumscribed so as not to give one organization advantage over the other.

A major concern for respondents was their fiduciary responsibility—keeping the organization fiscally sound and operating in a legal and ethical manner. Sharing critical financial information, personnel information, marketing plans, and donor lists would be a violation of fiduciary responsibility, they believed. All these reports contain information that, if shared, might place one organization at a disadvantage. Typical respondent comments were:

- "They should share information that is good for the whole community. Confidential client information and donor information should be kept private."
- "They should share information on what works and what doesn't work. However, they should guard their own 'throne.' "
- "No price fixing agreements."

Some of those interviewed said full collaboration among competitive nonprofits is needed because, "There are enough needy clients to go around." However, even these individuals usually placed a limit on collaboration. One, for example, would keep strategic plans confidential.

Sharing of financial information was singled out for special attention by respondents. Most concluded that funding information (such as donor lists and development strategies) should never be shared with a competitive organization. If a director encouraged such sharing it would constitute a conflict of interest, respondents said. One interviewee noted, "There is a natural competition for dollars and program...information in all nonprofits."

Should directors serve on competitive boards? There was nearly unanimous agreement that it is not desirable for one person to serve on the boards of contending nonprofits. The consensus was that it was difficult or impossible to serve two masters. Typical comments were as follows:

- "It's a conflict of interest in and of itself. You can't effectively serve on two bank boards or two hospital boards. It's something you wouldn't want to do because it would tax your loyalties."
- "I would never permit that to happen. Board members need to have 100% loyalty to one institution. Disclosure would be required constantly."

A few respondents took a different position. They felt that serving on two competing nonprofit boards presented little, if any, conflict. These individuals concluded:

- "[Conflict] seems apparent, but few worry about it. [The same people] serve on university boards fighting for dollars within a community. Both boards are inherently in conflict and tuition-dependent [and find it] hard to fill up classes…"
- "[There is no director conflict] if they don't talk about the institutions. I have seen it occur. The director can make a differentiation between organizations. It is critically important to keep the organizations separate."
- "Some people can handle more than one board. Those who are emotionally charged may not be the best, but those who are less emotionally involved and can focus may be able to do it."

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Having individuals serve on competing nonprofit boards is a fact of life in many communities. One respondent put it this way: "Locally you trip over the same people on similar cultural boards." Some of those interviewed saw board members as public overseers and said this function is not related to the competitive stance of the institutions they are monitoring.

Competition among nonprofits—good or bad for the public? A few questions in the study addressed the value of competition among nonprofit organizations. The questions were:

- Since the cost of funding competitive activities (increased staff, competitive advertising, public relations, promotion) can be quite expensive, should public policy encourage or discourage competitive situations among nonprofits?
- Should charitable dollars be given to finance the deficit of a nonprofit organization (meeting its mission objective), if the deficit is the result of competitive activity from another nonprofit?
- What if the cause is competitive activity from a for-profit organization?

The perceived value of competition, or lack of it, related to respondents' basic economic viewpoints. The largest group of interviewees had a free market philosophy. This group concluded nonprofits should be able to compete freely, without public policy regulation or restraint. The other respondents supported a regulated market approach. Nonprofit competition, in the view of this group, needs to be regulated or eliminated to assure that resources are being used to the greatest benefit of the community. Let's look in detail at these two philosophies:

1. Free Market Philosophy. The vast majority of interviewees favored competition among nonprofits and argued that it keeps costs down. Lower costs, they concluded, ensure that the nonprofit operates efficiently. This efficiency, in turn, eventually eliminates costs associated with competition. Thus, a nonprofit organization is able to "earn its own way." Most important, competition helps to develop differentiated programs and keeps organizations "keen and sharp." In the words of one respondent:

"To discourage competitive activities will encourage price fixing and a monopoly of the market. Competition is necessary to ensure appropriate behavior, as long as it doesn't take away benefits. Competition prevents collusion and imposes control on the market."

Those holding a free market philosophy even suggest it is acceptable to spend charitable dollars to fund an organization's deficit resulting from competitive activity with another nonprofit organization. Typical responses were as follows:

- "Yes, given time, the deficit will decrease and the organization will be run more efficiently."

- "Competition is a cost of doing business just like office supplies or customer satisfaction."

Several respondents said that assessing the quality of management would be critical when reviewing the causes of deficits. They would not use charitable dollars to fund a deficit that was caused by incompetent management. Of course, determining this type of cause could be very difficult.

When respondents were asked what their positions would be if a nonprofit's deficit was caused by competition with a for-profit business, their answers were consistent with their answers to deficits caused as a result of competing with other nonprofits. A typical response:

- "It's no different. Nonprofits are businesses and need market share. Girl Scouts compete against for-profits in areas of youth recreational and social programming. There is a need to compete."

In summary, the survey uncovered substantial support for a free market philosophy in the nonprofit sector. Those holding this view conclude that nonprofit organizations must be able to compete against similar nonprofit groups and for-profit businesses. In addition, most have no reservations about using charitable dollars to help fund a deficit resulting from competition with other nonprofits or business organizations. Adam Smith, if still alive, would easily recognize the values of this group.

2. Regulated Market Approach. Those who favored a regulated market approach suggested, "Public policy should discourage competition to reduce excess services and encourage collaboration." According to this group, funding should be based on who is doing the best job for clients, not who is doing the best job at advertising. One respondent made comparisons with political campaigns in which the victor is determined by the amount of campaign advertising, not on the merits of the issues.

How public policy should be molded to discourage nonprofit competition was beyond the scope of the study. However, one person, a nonprofit executive who serves on the board of another nonprofit, pointed out that it is theoretically sound to discourage competition in the nonprofit environment, but the reality is that it is difficult *not* to compete. Since many strive for the same dollars, competition is inherently part of the picture.

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Obviously, respondents who prefer a regulated market approach are opposed to using donated dollars to finance a deficit caused by competition with a for-profit or nonprofit organization. If the competition is coming from a for-profit business, members of this group suggest the nonprofit leave the market to the business organization. As an example, they point to the area of health care where business organizations have replaced nonprofit health care institutions.

A NEED FOR MORE PUBLIC POLICY?

Based on the reactions of those interviewed, there is little need for public policy designed to restrict competition among nonprofits. The vast majority view competition in the nonprofit sector as leading to cost reductions that have long-term benefits for the community, much as competition in the commercial sector can lead to lower consumer prices.

On the other hand, there is a clear need to develop public policy statements recognizing the potential for conflicts of interest. Such conflicts occur when nonprofits directly bid for the same donor resources or the same clients. Conflicts of interest also arise when a person serves on two competing nonprofit boards.

Since much of their support comes from charitable and tax dollars, nonprofits are required to provide most of their operational information for public review. However, where nonprofits are in market contention, the respondents recognized that all information can't be viewed publicly. Consequently, disclosure of certain types of information (such as donor lists and strategic plans) can lead to conflicts of interest for managers and directors. The danger is especially significant when a director serves on the boards of two competing nonprofits and possesses confidential information about both organizations.

In the words of one board member, "In every nonprofit arena, no matter what type, you see the same people competing for the same dollars, for many of the same causes. With social needs growing, we've run out of time, ideas, and new blood."

The results of this study indicate that you can help your organization's board members and managers by developing conflict-of-interest guidelines. Everyone should have a clear idea of how to avoid serious conflicts of interest when such situations arise in the board room.■

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