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Why Nonprofit Governance is Different from For-profit Governance

By Gene Takagi (<http://www.nonprofitlawblog.com/author/gene-takagi/>) on May 4, 2015

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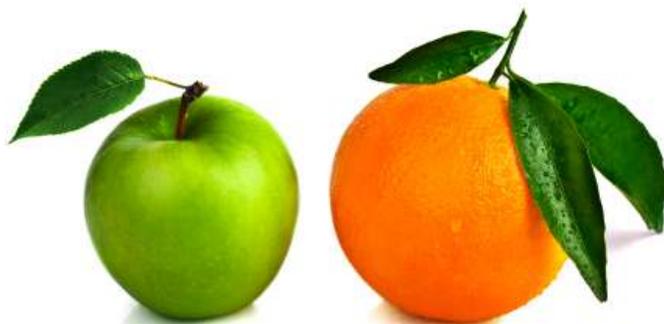


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The basic legal duties of care and loyalty apply whether you're a board member of a nonprofit or for-profit corporation, but what you're responsible for overseeing may be very different.

Fiduciary Duties



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The board of directors of a corporation, whether nonprofit or for-profit, is ultimately responsible for the management and direction of the corporation. Board members (or directors) are required to fulfill their duties of care and loyalty to the corporation in exercising their powers and meeting their responsibilities. The duty of care generally requires a director to act in a reasonable and informed manner under the given circumstances. The standard of care is typically expressed as that which “an ordinarily prudent person in a like position would use under similar circumstances.” The duty of loyalty generally requires a director to in good faith and in the best interests of the corporation. Accordingly, a director must place the interests of the corporation before her or his own interests or the interests of another person or entity and take appropriate steps wherever there is a conflict of interest or corporate opportunity.

For-Profit: Duties to Shareholders

Board members of a for-profit must consider the interests of the shareholders in exercising their powers and meeting their responsibilities. Attorney Douglas Park, in his article *Board of Directors’ Fiduciary Duties to Shareholders* (<http://www.dypadvisors.com/2011/10/03/board-of-directors-fiduciary-duties-shareholders/>), notes:

Just as board members owe a duty of care and duty of loyalty to the corporation, they owe the same duties to shareholders because they are considered to be fiduciaries of the shareholders.

It is important, however, to dispel the myth that shareholder wealth maximization is the *only* consideration for board members despite influential case law cited by respected academics (like my corporate law professor Stephen Bainbridge) stating:

“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end.”

Nonprofit: Duty to Further the Exempt Purpose

Board members of a nonprofit do not have to consider shareholders (there are none), but for practical purposes, they should fulfill their duties to the corporation with consideration of its exempt purpose, the qualifying purpose for its tax-exempt status.

For charitable nonprofits exempt under Section 501(c)(3) of the Internal Revenue Code, board members must consider whether their actions are primarily intended to advance the corporation’s charitable purpose. The charitable purpose of the corporation (which may be determined by statements in its articles of incorporation, bylaws, exemption application, annual information returns, and other representations) impresses a charitable trust (http://www.nonprofitlawblog.com/charitable_trus/) upon the assets of the corporation. Accordingly, the board members must act to protect such charitable assets from misuse and unlawful diversion. Although rarely enforced, board members may be held personally responsible by the state’s Attorney General or the Internal Revenue Service for misuse of charitable assets, particularly in egregious cases and cases in which the board members personally benefited from such misuse (e.g., self-dealing, excess benefit transactions).

Benefit Corporation

The board of a benefit corporation, which must pursue the general public benefit in its corporate activities, must consider the impact of its business decisions on the entity’s employees, its suppliers, the environment, and the community at large. But how such considerations balance against consideration of the shareholders’ interests is still to be determined.

Stargazing

Governance expert Lucy Marcus eloquently describes one of the most important roles of a board member (whether of a nonprofit or for-profit) – planning for the future and developing strategies

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using blue-sky thinking or stargazing (http://www.huffingtonpost.com/lucy-p-marcus/future-proofing-the-board_b_822623.html):

This is where a board demonstrates its mettle in making sure their organization is ready and able to expand its horizons, strive to achieve more and stretch itself to become the robust and resilient business that is capable of responding effectively to the unknowns in its future.

For-profit governance has for practical purposes tended to focus on increasing short-term shareholder value, mitigating risks of lawsuits, and relying on an executive to stargaze under such constraints.

Nonprofit governance has also tended to focus on addressing short-term issues, but for different reasons:

- Limited resources and a desire to create immediate impact
- Lack of training, facilitation, and investment in the board to engage in such thinking
- Limited emphasis on recruitment of board members with the desire and capacity to engage in such thinking

When acting to best advance a nonprofit's charitable purpose, board members should each consider intergenerational equity. How are charitable resources best deployed to benefit not only those in immediate need but also future intended beneficiaries of the nonprofit? There are difficult trade-offs when investing for the future, but if a board fails to do so, the corporation's likelihood for survival and relevance are jeopardized. There are many examples of how such investments may take form:

- Endowment fund
- Technology improvements
- Impact assessments
- Employee, volunteer, and board training
- Fair pay
- Executive recruitment and succession planning
- Collaborations

Nonprofit board members should recognize the unique considerations associated with nonprofit governance. And without owners to hold them accountable, nonprofit boards must demand and create strong systems of self-accountability.

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