Deals

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**Problems Sheet # 6: Nonprofits:**

**Better Management & Disclosure as Responses to Info. & Incentive Problems**

1. Planning
2. What is a planning process? Do you think it can help with either goal? With both goals?
3. Why did JDC need a new planning process? What was the first step in launching it?
4. Adele is a new CEO of Community Center (CC), which hosts various cultural and athletic activities for members and also runs CC Academy, a private elementary school. Some of the largest donors (including board members) began their relationship with CC because they sent their children to CC Academy. Since CC Academy was launched 15 years ago, CC has subsidized its budget. But now CC Academy gets many applications, brings in significant tuition revenue, and also attracts a lot of philanthropic support. Bart, who is CCs chief planning officer, has told Adele that he thinks the subsidy should be discontinued, especially because CC is struggling a bit financially. In particular, the cultural activities department (“CCD”), whose lecture series and concerts are core to CC’s brand, are struggling financially.
5. Assume that Adele is persuaded by Bart’s claim that the best thing for CC overall is to phase out the subsidy for CC Academy and redirect funds to CCD. Since Adele is the CEO, can’t she just make this decision on her own? In answering the question, please highlight the importance of incentives and information.
6. Is this an issue that would appropriately be addressed in CC’s annual planning process?
7. Carlo is Nonprofit’s head of fundraising. He hears about Bart’s idea to shift resources away from CC Academy, so he comes to see Adele. “You realize that most of our large donors now came to us through the school,” he says, “and that includes three-quarters of the board.” What concern is Carlo expressing? How can Adele use the planning process to address this concern?
8. To reallocate money from CC Academy to CCD, Adele wants to get buy-in from a number of people, including the head of CC Academy, the head of CCD, the head of fundraising, key donors, and the board.
9. Is there a benefit of having separate meetings, instead of having everyone together at one meeting?
10. If she has separate meetings, who do you think she should start with and why?
11. True or false: An effective planning process helps a nonprofit allocate resources where they are needed the most.
12. True or false: An effective planning process helps build support internally among a nonprofit’s professionals, the board, and the nonprofit’s donors.
13. Silos
14. What is a “silo” and why is it a problem?
15. Adele consults a Mark, a management consultant, about silos. “How do I get people in different departments to share information with each other and work together?” Mark mentions something they do at his firm: “We require people to have a 15 minute conversation (assigned at random) every two weeks with someone who works in another part of the organization.” What do you think is the rationale for this idea? What limitations (if any) do you see with this approach?
16. The reading mentions “peer review.” What is it and why was it used in JDC’s planning process?
17. Recall that Bart is the head of CC’s fundraising. Erin and Pam each have innovative plans for the coming year.
    1. Why is it important for Bart’s team to have current information about these plans, including the reason for launching these new initiatives, their goals, and the strategies for pursuing them?
    2. Why might Bart’s team not have access to this information?
    3. Can Adele use a planning process to help them get this information?
18. Assume that Adele expects CC’s overall budget to increase by 3% next year. Adele asks each of her direct reports to prepare a draft budget. She asks them to prepare three different scenarios. In one, they have a 1% increase over last year. In a second, their budget increases by 10%. In the third, their budget contracts by 5%. She asks them to attach a memo explaining the relevant changes in the second and third scenario. Why did they choose the increases and cuts that they are recommending? What information problem is this exercise seeking to address?
19. What is the potential value of requiring 3 scenarios?
20. A theme of this course is that sometimes an effort to solve an information problem creates a new incentive problem, and vice versa. What incentive problem can undercut the exercise in “a”? Put another way, how might a self-interested member of Adele’s team try to manipulate this process? What (if anything) can Adele do to address this issue?
21. Ned, who is the head of CC’s board, calls Adele and says: “I am hearing some grumbling about the multiple budget scenarios. Some of your colleagues feel that their time is being wasted. I am not saying that I agree with this criticism, but I wanted you to know that it’s out there.” How do you answer him?
22. *How to Save the World* suggests allocation resources based on three questions. What are these three questions supposed to help a nonprofit measure?
23. The first question
24. What is the first of the “three questions”?
25. When Lee Goldman started as dean of Columbia Medical School in 2005, how important was the challenge of responding to pandemics? When he concluded his service in June of 2020, how important was this challenge? What is the general lesson here?
26. Is it more important to shelter the homeless or clean a polluted river? Why is this a hard question? If it’s not feasible to answer it, what suggestion does the reading make? What should nonprofits try to show instead?
27. Helen is the CEO of Help!, a humanitarian organization. She asks you to recommend whether to provide child care and medical care to children in Appalachia or in Westchester County (a suburb north of New York City)? What information do you need in order to answer the first question?
28. The second question
29. What is the second question?
30. What is the difference between an “output” and an “outcome”?
31. To help children, Helen’s team at Help! is deciding whether to invest in providing Covid vaccines. If they decide to provide vaccines, they will track the number of children vaccinated. Is this an output or an outcome? Assuming the vaccine works, how reliable a measure of social return do you think the number of vaccinations is? Why?
32. The reading uses the phrase “impact multiplier.” What does it mean?
33. If Help! decides to vaccinate pediatricians instead, what “impact multiplier” would they seek to generate?
34. The third question
35. What is the third question?
36. The mission of HerJustice is to provide legal services to underprivileged women who otherwise don’t have access to legal services. HerJustice does child support cases, but the organization does not represent clients in housing court who have been evicted. Why? Is the idea that deadbeat fathers are a more serious issue than eviction?
37. Legal Momentum also provides legal services to women. Two of their main initiatives are impact litigation and a helpline. Why?
38. In focusing on the well-being of children, Help!’s professionals are quite concerned about the rhetoric of City’s mayor, where Help! runs a number of programs. He has been inflaming tensions and arguing (without evidence) that low-income families are the source of crime, when in fact they often are the victims. Ed, who is a board member of Help!, has urged Helen (the CEO) to make a public statement condemning the mayor. Why might Helen hesitate to make this statement? How (if it all) is this relevant to the third question?
39. A central theme of this class is that information asymmetry can undermine mutually beneficial transactions. In principle, a solution to this problem is disclosure. An interesting question is whether disclosure should be required. To analyze this issue, let’s assume that there is a ban on fraud and consider what (if anything) a rule requiring disclosure adds.
40. If disclosure is voluntary, can a firm remain silent? What if disclosure is mandatory?
41. Is information a public good? If so, does this tell us anything about whether the right amount of information is produced?
42. Without a rule requiring disclosure, would a firm have the incentive to disclose good news?
43. Without a rule requiring disclosure, why might a firm hesitate to disclose bad news?
44. If a firm always discloses good news, and decides to remain silent, how will investors interpret this silence?
45. Given your answer to “e,” does a firm have a reason to disclose bad news?
46. In analyzing the costs and benefits of mandatory disclosure, a famous article by Frank Easterbrook and Daniel Fischel said the following: “Imposition of a standard format and time of disclosure facilitates comparative use of what is disclosed and helps to create an efficient disclosure language. If every firm must disclose the same things, there will be reciprocal benefits to each firm's investors even though the firm will be compelled to disclose things of advantage to rivals.”
47. What is a “network effect”? (This is not in the reading.)
48. Are network effects when firms use the same format and definitions when disclosing information? Do these network effects offer a potential justification for mandatory disclosure?
49. What potential problem might there be with government requirements about the format and definitions in disclosure?
50. Adrian is the CEO of a nonprofit. Bob is her Chief Planning Officer, and Charlotte is the Chief Financial Officer. Bob and Charlotte would each like Adrian’s job. Adrian and Bob plan a new initiative, which does not go well. Diane is the donor who funded it. Adrian and Bob are deciding what to tell Diane about the unsuccessful experiment.
51. Could Adrian and Bob incur legal liability by saying, “The experiment was bold and really illuminating, and we couldn’t have done it without you”?
52. What if instead Adrian and Bob say, “The experiment showed us how to deliver service just as effectively for only ½ the cost” when this is not accurate?
53. Why might Adrian and Bob feel strongly that they need to tell the truth? Please offer reasons rooted in principle, as well as reasons rooted in self-interest.
54. Why might Adrian and Bob be tempted to shade the truth, giving a more optimistic picture than is warranted?
55. If Adrian and Bob do provide false or misleading information, please offer two reasons why Charlotte might tell Diane that she is being misled.
56. Even when nonprofit professionals and boards are tempted to offer misleading information, do they still have reasons not to do so?
57. Assume that Adrian and Bob want the information they share to be more credible. They approach Ellen, a professor at the local university, asking her to provide an analysis, which they will disclose on their website. Why might this sort of expert opinion add value? Why might it not?
58. Form 990
59. Does Form 990 require nonprofits to share information about the compensation of senior professionals and the board? About key governance issues, including whether they have conflict of interest policies?
60. Does Form 990 require nonprofits to provide a financial statement, which reports different types of income and expenses?
61. Does Form 990 require nonprofits to share information about the impact and cost-effectiveness of their programs?
62. Overhead Ratios
63. What are overhead ratios?
64. Why do rating agencies use them to evaluate the quality of nonprofits?
65. What is the argument for relying on them?
66. What is the argument against relying on them?
67. Penelope is the head of a humanitarian organization, which provides job training to single mothers. To track her organization’s progress, Penelope measures the income of clients before they enroll in the program and compares it with their income six months after they finish the program. Quincy is the head of Foundation, who is considering a grant to Penelope’s organization.
68. Quincy sends Penelope a draft gift agreement. It would require Penelope to do a survey asking people enrolled in training programs to describe how satisfied they are with the program, answering various questions about the quality of the teaching, materials, space, and the like on a scale of 1 to 10. Penelope has not been asking these questions. She calls you and asks whether she should agree to these terms. What do you tell her?.
69. You are on the board of Quincy’s foundation. Assume that you know about the questions he has asked Penelope to answer, and that Penelope has asked not to answer them, proposing the alternative described above instead (comparing incomes). Quincy tells you that he still wants Penelope to answer his questions. “We ask all of our grantees to do this survey, and we then compare the scores.” Do you agree or disagree with Quincy on this?