

13. Public Sector Management and Not-for-Profit

Interactive Session

**Governance challenges for not-for-profit organisations:
empirical evidence in support of a contingency approach**

ABSTRACT: This article presents evidence of the governance challenges faced by Australian not-for-profit (NFP) organisations. We find a key challenge for NFPs is recruiting individuals with appropriate skills, as directors are volunteers often elected by the membership and frequently lack relevant experience. Another issue is balancing the needs of a diverse constituency with competing demands. We find that the often proposed solution to this challenge – stakeholder representation on boards – can further hinder the recruitment of suitable directors and create tensions detrimental to board effectiveness. We argue to shift focus away from normative governance models towards a contingency approach and posit a role for a national NFP sector regulator in assisting to develop appropriate governance systems according to contextual factors.

Keywords: Not-for-profit, governance

PAPER TEXT

Multiple definitions of not-for-profit (NFP) organisations and the NFP sector can be found. In this article we follow Hansmann, who describes an NFP organisation as "[...] an organization that is barred from distributing its net earnings, if any, to individuals who exercise control over it, such as members, officers, directors, or trustees" (Hansmann 1980) (p. 838). The Australian NFP sector comprises more than 600,000 non-commercial and non-governmental organisations with a wide range of purposes that range from hospitals to community services, universities, sports clubs, aged care facilities and environmental groups.

The Australian regulatory environment in which NFPs operate has long been recognised as being overly complex (Australian Productivity Commission 2010). Established in December 2012, the Australian Charities and Not-for-Profit Commission (ACNC) is the first national independent regulator of charities in Australia and the latest initiative focusing on NFP governance and reform. Its objective is to deliver smarter and more effective regulation of the sector. The advantage of the ACNC as a single national regulator is that once registered, organisations will be freed from supervision by other Commonwealth and state agencies. An entity can only be registered, and continue to be registered, once it meets a number of governance standards: basic requirements that cover the fundamentals of governance, while encouraging governance beyond these minimal standards.

NOT FOR PROFIT GOVERNANCE

Ostrower and Stone (2006) observed that governance is rarely unambiguously defined in literature concerning NFP organisations and that research has mainly focused on boards of directors. Indeed, there are many studies concerning NFP governance that have concentrated on boards and their composition, the roles and responsibilities of their members and the relation between board effectiveness and organisational effectiveness (for example: Herman and Renz 2000; Callen et al. 2003). BoardSource describes the roles of NFP boards as follows: (1) setting organisational direction and strategy, (2) monitoring or providing oversight of the CEO, assets and programs of the organisation and (3) ensuring necessary human and financial resources (BoardSource 2010).

Accompanying these specific roles are a number of theoretical perspectives. For example, in relation to the first mentioned role, a stewardship theory perspective would be most relevant as “[...] stewardship theory emphasises the role of the board in driving forward organisational performance through adding value to the organisation’s strategy and top decisions” (Cornforth 2001) (p. 7). The second role, which states that it is the board’s role to monitor management, is closely aligned with agency theory. This theory sees the board as the instrument to ensure that management acts in the best interests of shareholders or members, as it assumes that management is likely to act in their own interests rather than to the benefit of investors or beneficiaries (Miller 2002). Thirdly, the board’s role to provide resources aligns with resource-dependency theory, which argues that organisations depend on other organisations and actors for survival (Cornforth 2001, citing Pfeffer and Salancik 2003).

Resource-dependency theory sees the board as a means of finding or providing these resources

Cornforth and Brown (2013) recognise the board of directors as the body with the main responsibility for governance, but emphasise that other stakeholders also play an important role. For Cornforth, key actors such as managers, members and advisory groups also contribute to the governance of a NFP organisation. The need to involve the stakeholders of NFP organisations in governance processes is increasingly recognised (Freiwirth 2013). As the purpose of NFPs is to advance its mission and fulfil the needs of its constituency, the exclusion of stakeholders from governance and decision-making processes can compromise service delivery (Freiwirth 2007). In these cases a stakeholder theory approach to governance is most relevant, as it states that the board’s role is to mediate between stakeholders and balance their interests (Edward Freeman and Evan 1991). However, the extent of stakeholder involvement will vary: some organisations will engage with stakeholders where others will have stakeholder representatives as board members.

Board Composition and Stakeholder Representation

Stakeholder theory posits that by including diverse stakeholders on boards, organisations are more likely to address broad societal interests rather than the interests of a single group (Hung 1998).

(Young 2011) suggests that NFP boards should have representatives from each funding source in proportion to contribution, as donor representation has been shown to improve organisational

performance. This suggestion is opposite to recommendations for commercial boards which emphasise director independence from investor groups. It acknowledges that links to resources are more important to NFPs than independent monitoring. Young further argues that there is natural independence on the part of NFP directors due to their volunteer status, while recognising that this status provides little financial incentive to exert effort (Young 2011). Indeed, because of this volunteer status, the process of recruiting new directors is completely different in a NFP compared to a commercial organisation (Hendricks and Wyngaard 2010). NFPs are often challenged when ensuring the board has the right skills to fulfil its responsibilities (Spear et al. 2009). These differences mean that governance designed for commercial entities cannot simply be imported into the NFP sector.

Perhaps the most common NFP governance challenge identified in the literature is the need to balance different stakeholders' interests. Unlike a commercial entity where the aim is to create profits for shareholders (arguably whilst also taking other stakeholder interests into account in order to ensure long-term sustainability) a NFP board will have to choose between the needs and desires of different groups. For example, donors to charities can impose limitations on ways in which money can be spent by designating specific themes, which may not be in the interests of all beneficiaries. This forces NFP organisations to 'go where the money is', thereby creating a situation where donor dependency can undermine the organisation's mission (Alymkulova and Seipulnik 2005). This can result in 'asymmetric accountability' (Jordan and Van Tuijl 2000; Schepers 2006). In cases where goals of funders are not identical to those of the organisation receiving funding, upward accountability towards donors can become misaligned with downward accountability towards beneficiaries. Speckbacher concludes that one of the most important factors in the success of NFPs is having a common understanding of the organisation's mission such that all stakeholders can cooperate (2008).

Contingency Approach

It is increasingly suggested that the use of a single theory describing NFP governance might be inadequate, as it is an "[...] increasingly untenable view that best practices exist for a wide range of non-profit governance situations" (Salipante 2013) (p.283). The intricacy of the sector and the distinct governance challenges that NFP organisations can encounter also explain why corporate governance

codes can be inappropriate for NFP governance (Spear et al. 2009) and why there is no agreement on an ideal NFP governance model (Miller-Millesen 2003; Ostrower and Stone 2006).

The usefulness of a contingency approach in relation to governance is the acknowledgement that governance processes are likely to work differently according to changes in the nature of an organisation and its circumstances, and consequently effectiveness is connected to the ongoing refinement of governance systems in line with these contingencies (Bradshaw 2009), although Bradshaw cautions that a move away from “one best way” or normative approach to NFP governance can turn into “anything goes” (p. 61). Bradshaw finds that “[...] the boards engaged in debate and exercised strategic choice in selecting the best governance configuration according to their perceptions and values [...]” (p. 77), which suggests that in practice NFP boards operate in ways a contingency approach predicts. Bradshaw suggests that more empirical research on contingencies in the NFP sector is needed to help organisations adapt governance systems (2009).

A number of academics have taken a contingency approach in NFP governance research. They take into account the contextual factors that shape NFP board characteristics and influence the ways in which they operate (Cornforth 2003; Brown and Guo 2010; Iecovich 2005). Ostrower and Stone (2001) created a framework modelling the internal and external contingencies that influence board characteristics. They include external contingencies such as power in society, turbulence and the legal and institutional environment – labelled as ‘broad’ dimensions because they are the same for all NFPs. External contingencies such as stakeholders, industry and funding sources are labelled as ‘specific’ dimensions because they are unique to each NFP. Internal contingencies include age, size, phase of development, and complexity of the organisation. This model has been adapted by Cornforth to map contextual influences on boards found in other studies. It features social pressures, government legislation and policy, regulation, and the sector of the NFP as broad external contingencies, while the field of activity of the NFP is labelled as a specific external contingency. Cornforth identifies the size of the organisation and relationships with management as internal contingencies. It is argued that all contingencies influence the characteristics of the board, specifically the composition, relationships, and processes, which consequently affect board roles and effectiveness (Cornforth 2003).

RESEARCH OBJECTIVES AND METHODOLOGY

We have explored what NFP leaders believe are the key governance challenges they face, how these might be ameliorated and how they visualise the role of the ACNC. Based on survey and interview data, our research will demonstrate that NFP organisations are influenced by a number of internal and external contingencies that affect governance systems and processes. Data gathering consisted of two parts, namely an online survey. The survey link was circulated through networks of NFP professionals using LinkedIn and email marketing. Representatives of 53 NFP organisations completed the survey. Using survey data is a proven method to perform research into NFP sector governance (O'Regan and Oster 2005). There is also a growing tendency to use case studies and in-depth methods to research non-profits and their boards (Bradshaw et al. 1998). Therefore, survey data was complemented with twelve interviews, which were recorded, transcribed and coded in NVivo.

RESEARCH FINDINGS

Board roles

Both the interview and survey data confirmed the well-known role of all boards in setting strategy, also revealing that some boards struggle with this role. Other board responsibilities that were mentioned were monitoring, as well as attracting resources:

“Really their main job is a combination of thinking strategically on behalf of the organisation and monitoring performance [...]” [INT1]

“It is monitoring decision making. I would like to be more strategic [...]” [INT5]

“Strategy and attracting sponsors.” [INT6]

“It’s monitoring and advice, not strategic.” [INT11]

The online survey confirmed the multi-faceted role of the board, with no single role standing out as being more important in comparison to others (Figure 1). On a scale of 1 (not important) to 7 (very important), all board roles averaged a score between 3.8 and 4.2. The standard deviation for the

importance of board roles lies between 1.6 and 2.7, indicating that there is considerable variation in the importance of particular roles for individual boards.

Insert Figure 1

The differing importance of particular board roles for each NFP shows why a contingency approach to governance is desirable. For example, the following interview quote demonstrates that board members can have little experience in organisational planning or strategy while the fulfilment of this task is deemed to be important. To remediate this situation, board members with appropriate skills will either need to be recruited or existing directors upskilled through training.

“What I find is, as a board member [...] I have to end up doing a lot of stuff, so I write the asset management plan and I have also written the strategic plan, because the CEO could do it, but we are not able to kind of pay the big bucks for a high powered CEO so I could probably do it better, and there is just not a lot of time when you only have three staff and you have tenancies happening all over the place. Whereas say if I was on the board of [a large NFP], you wouldn't do any of that, you would purely be focused on governance in the sense of reviewing the work that your staff has done and giving that direction, and that is a whole different ball game.” [INT2]

Board composition, recruitment and skill sets

Our research provides evidence that recruitment of suitable directors is a significant challenge for NFP organisations, particularly those with membership-based governance models. The interview questions “how do you recruit board members” and “who qualifies for board membership” proved to be closely related because the constitution of NFP organisations often prescribes a specific pool of individuals from which board members must be sourced.

“[Our governance arrangements] are very inflexible, the constitution and the incorporation requirements are really premised on you being a community based organisation that is run by members, where there will be a vibrant contest for positions that govern the organisation, and it doesn't really work for the sort of work we do. We need people with skills and particular expertise, it

is quite hard to do that. We have been very fortunate that we have good people that have great expertise, but that is in spite of the governance, not because of it.” [INT11]

“There is a set of criteria in the constitution which talks about the skills they should have. So the constitution sets it up as a skills based board [...] In actual practice, because we are only a small organisation, with a lot of them it is like “who will join”, and they are elected by the members who are mostly tenants. If you look at the skills list and you look who is actually on the board, a lot of the skills are missing and quite a lot of the board members probably don’t have any of those skills to any great degree.” [INT2]

Ironically, there is evidence that existing governance arrangements in NFP organisations can impose constraints on the recruitment of suitable directors to enforce governance. This results in a situation where governance systems can have perverse and undermining effects. The incapacity of a number of NFP organisations to recruit directors based on skills, as well as the absence of financial incentives to join NFP boards, clearly sets NFP boards apart from commercial counterparts. As a result, training and development of existing board members is of vital importance to NFP organisations.

Development and Training

Seventy-two percent of our survey respondents responded affirmatively to the question “Does your organisation provide continuing professional training for its non-executive board members?” The interview respondents were also asked about initiatives that enable director skill development. They expressed more ambivalence and mentioned that although they were open to skills development of their directors, practicalities such as time, money and lack of interest on the part of board members had prevented any structured approach to skills development:

“[...] we tried a couple of times to get people trained up, so at least everyone feels confident and they’re all on the same level. But we never actually managed to make it happen. And people are like ‘ah, I don’t really feel like I need it personally.’ [INT5]

“I think they do the best that they can [...] but we’re running on no money, the board all have full time jobs as well have given their time, some of them, for many years. So to the best of their ability, I don’t think we are going to take days out to develop, or pay for, board members to go to courses.”

[INT12]

As can be seen, variance in available resources for development can potentially affect the functioning of the board and represents a contingency that can influence each NFP organisation differently.

Accountability and Stakeholder Interests

The table below illustrates dependence on government funds by organisations in our survey sample. We argue that funding sources represent contingencies that, for reasons of accountability, need to be considered in any governance model.

Insert Figure 2

The importance of service delivery in the decision to financially support a NFP organisation was evident in the survey sample. When survey respondents were asked to rank the factors influencing donors to back the organisation in order of priority, the activities of the organisation were by far considered the most important. The importance of these activities in obtaining funding also became apparent from the interviews:

“But it’s our activities and our output that is what gets people to support us and want to stay engaged with us.” [INT2]

“So beyond our members we also have customers and clients of this organisation who buy our services or attend our training and those sorts of things. About a third of our funding comes from the NSW Government through the department of housing, so government is a major stakeholder for us [...]” [INT1]

Considering that survey respondents defined the recipients of services, clients and/or beneficiaries as the most important stakeholders (figure 3), the fact that the majority of NFPs rely on government

funding creates a problematic dynamic. As governments are often the main funder, but are unlikely to be the direct recipients of services, donor dependency and asymmetric accountability form potential pitfalls. The interview quotes above reveal that these issues are likely to present a problem for all NFPs part of this research, albeit to different degrees depending on sources and quantity of funding. In reporting on activities and justifying spending, organisations are accountable to funders as well as to recipients of services, clients and/or beneficiaries. These groups will display varying degrees of overlap for each NFP organisation, which leads to different accountability mechanisms, suggesting that variations in funding circumstances represent contingencies that can affect governance models.

Insert Figure 3

The question of NFP accountability is closely related to the balancing of stakeholder interests. In the literature, balancing of stakeholder interests is identified as one of the key challenges for NFP boards (Young 2011; Dawson and Dunn 2006; Spear et al. 2009). Our interview findings confirm that NFP boards often have to balance the needs of multiple important stakeholders. The members and funders of the organisation are generally classified as being of the highest importance.

“[...] two main ones are our core members and our government funding body here in NSW” [INT1]

“[Tenants and] obviously the Department of Housing because they funded all the properties. They would probably be the two main ones.” [INT2]

“So to me the two critical stakeholders are our funders and our members.” [INT7]

The interviews indicate that the diversity of stakeholder groups and their differing expectations do indeed provide challenges for NFP organisations. When asked what the main challenges are that different stakeholder groups pose, interview participants responded:

“Primarily the diversity of it. It is a constant challenge for this organisation to identify what business we are in and what our members and stakeholders expect of us, and how to respond to that [...] Our job is to identify that our stakeholders are diverse in their expectations and can change almost on a

daily basis, but certainly on a weekly basis; to make prioritising decisions and strategic decisions about what we actually do and how we respond to our members and stakeholder's expectations; what work we can do; and how much they have to pay for it." [INT1]

"Expectations, the balance between a national focus and a state focus, and the challenge of local priorities taking precedence over national initiatives." [INT6]

In order to balance stakeholder interests, (Young 2011) suggests to establish membership-based boards with equal stakeholder and donor representation, while Freiwirth argues in favour of Community-Engagement Governance™, in which responsibility for governance is shared across the organisation rather being placed entirely on the board (Freiwirth 2013). Our findings concerning board composition, recruitment, skill sets, and development demonstrate that membership-based boards and stakeholder-based boards, despite having the advantages advocated by Young and Freiwirth, also have disadvantages, particularly in relation to the skill sets of board members, as recruitment processes and director development have shown to be problematic for NFP organisations

Impact of ACNC Governance Standards

The majority of online respondents considered the impact of the governance standards to be absent (30 per cent) or minimal (38 per cent), while a smaller amount of respondents saw moderate (13 per cent) or large (4 per cent) impact, and yet others found it difficult to assess the effects of the ACNC and the governance standards (15 per cent). A majority of interview and survey respondents expressed confidence in their current governance arrangements and felt that the ACNC and its governance standards would not significantly impact their organisation. At the same time, interviewees commented that the ACNC could be helpful by being a body dedicated to the NFP sector:

"I do think it'll be better, because I think it is set up to give more support and guidance specifically for not-for-profits, as opposed to ASIC [Australian Securities and Investments Commission] that is so big that it couldn't possibly spend all that much time writing guidelines [...] if they could provide training

I suppose, tailored advice, that would be useful. Because there is obviously no point in doing the same thing as ASIC, but they give an impression of being a lot easier to deal with.” [INT5]

Discussion of Findings

It was found that no particular NFP board role stands out compared to others, rather the empirical data indicates that there is considerable variation in the importance of particular roles for individual boards, whether this concerns strategic direction, monitoring or obtaining funding. This has consequences for theoretical perspectives that are applied to NFP governance, as the usefulness of stewardship theory, agency theory, resource-dependence theory and stakeholder theory varies according to the different directives of NFP boards. This provides empirical evidence in favour of taking a contingency approach towards theories concerning NFP board roles (Figure 4).

Our study provides evidence that recruitment of suitable directors is a significant challenge for NFP organisations, particularly concerning those NFPs with membership-based board models, as the constitution often determines the specific pool of individuals from which board members must be sourced. This can result in a situation where NFP organisations are unable to recruit directors based on skills and increases the importance of training and development of existing board members. While nearly three quarters of the survey respondents stated that the organisation facilitates professional training for directors, interview responses indicated that, in practice, lack of time and resources are obstacles for director development. Considering the importance of skills development on NFP boards due to recruitment complications, we contend that lack of resources for training and development of directors represents a contingency that can negatively impact the functioning of the board.

Our findings furthermore indicate that funding circumstances represent contingencies that can impact the governance model of a NFP organisation. The data suggests that funding dynamics can negatively impact accountability and governance. Specifically the fact that the government is the largest donor of NFPs in the sample, while the recipients of services are classified as the most important stakeholders. The balancing of stakeholder interests is closely related to this finding. Some scholars argue for donor and stakeholder representation on NFP governance bodies (Freiwirth 2013; Young 2011), which may

help mitigate the negative elements associated with donor dependency and asymmetric accountability. However, we find that NFPs that have a membership-based board are often unable to recruit board members with appropriate skills, and that it can be challenging for NFPs to facilitate the development of the skills of their directors due to the lack of available resources, resulting in a conflicting dynamic between the demand for skills and stakeholder representation on governance bodies.

The majority of our survey and interview respondents expressed confidence in their governance frameworks and stated that the ACNC governance standards were unlikely to have a significant impact. While the vast amount of respondents felt they did not need the ACNC or the governance standards, a number of interviewees stated that the ACNC and the governance standards could prove to be helpful for other NFP organisations. The ACNC was also described as a potential advisory and ‘go-to’ body that can help establish basic regulation and increase public confidence in the sector.

Insert Figure 4

CONCLUSIONS

We argue that generic best practice governance standards for NFPs ought not to be further pursued. Instead the advancement of governance research will depend on working inductively from research findings towards theory and vice versa. Otherwise “[...] available theories may simply be too general and disconnected from the realities of boards” (Ostrower and Stone 2010) (p. 920). We argue in favour of a contextual approach that goes beyond the basics of governance. The inappropriateness of generic NFP governance standards does not mean there is no role for a body such as the ACNC in providing guidance on NFP governance – quite the opposite. The inability to impose a universal governance model on the diverse NFP sector means that outside bodies have an important role in guiding organisations in finding their own optimal governance structure. For example, the ACNC can remediate the conflicting dynamic between skillsets and stakeholder representation, by providing guidance on how to conduct formal assessment of the role of the board, and through offering training to those without relevant experience, the ACNC would contribute to the legitimacy of the NFP sector and would translate the contingency approach to NFP governance into a useful practice.

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FIGURES

Figure 1: Importance of the board in performing the following functions

(1) not important to (7) very important.

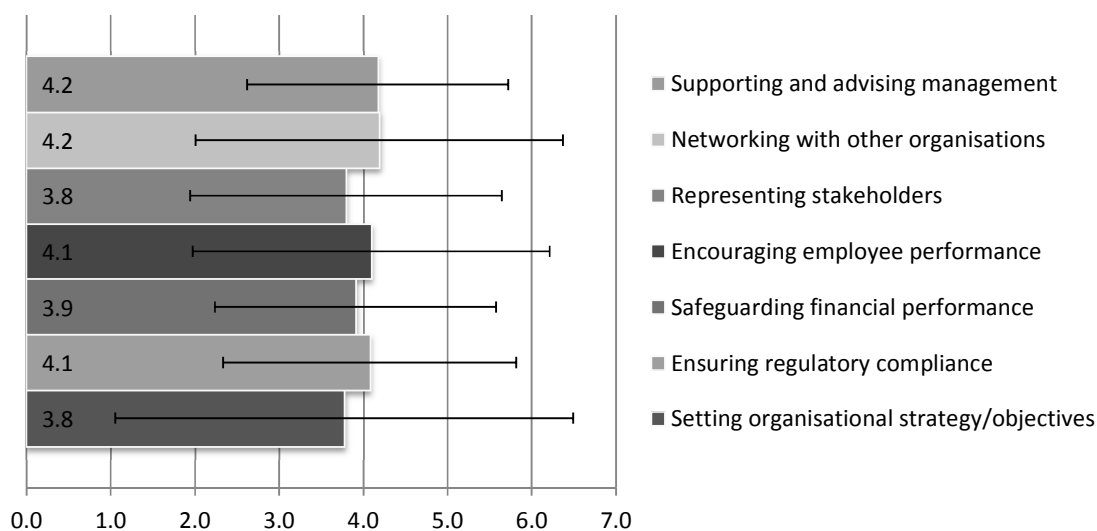


Figure 3: Sources of majority of funding.

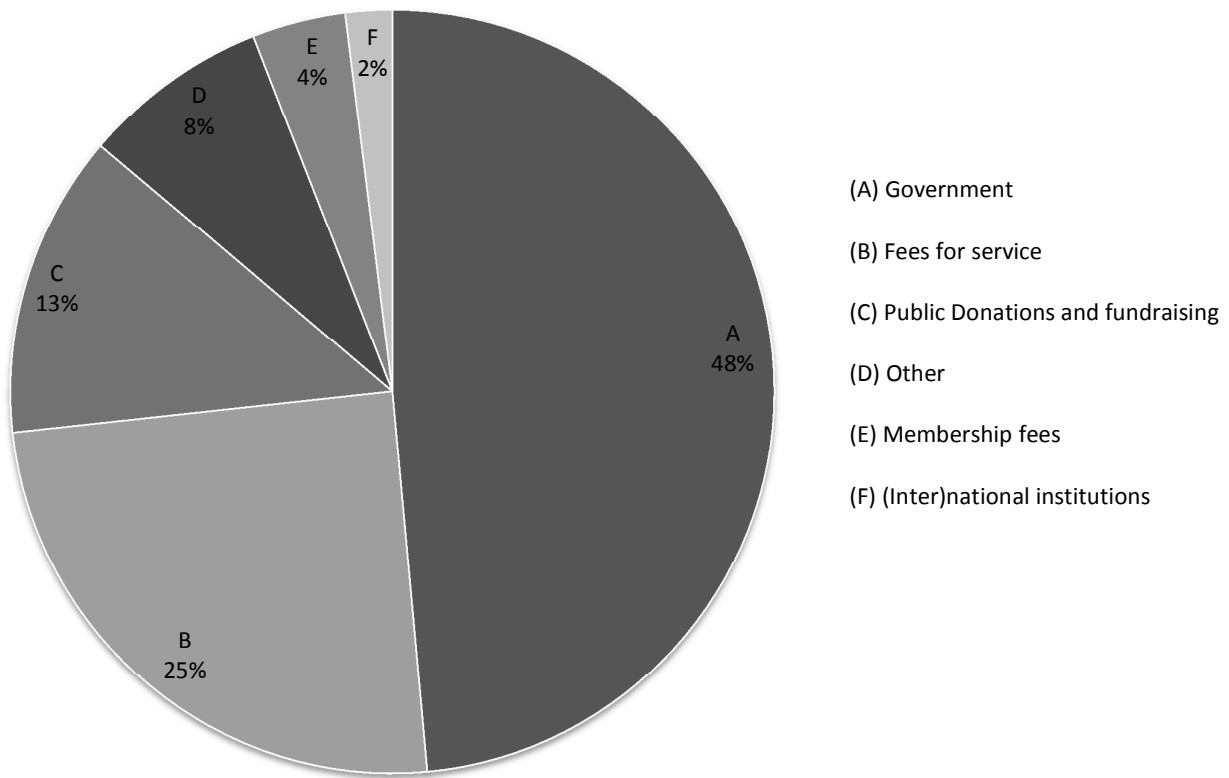


Figure 4: Stakeholder groups in order of importance

(1) most important to (10) least important.

1	(1.7)	Recipients of services/clients/beneficiaries
2	(3.0)	Employees
3	(4.9)	Government
4	(5.3)	Executives
=	(5.3)	Directors
5	(5.5)	Financial Supporters
6	(5.9)	Volunteers
7	(6.6)	Regulators
8	(7.7)	Suppliers/contractors
9	(9.4)	Other

Figure 5: Contingency framework (empirical findings in italic).

