

9 Corporate Governance in non-commercial organisations

9.1 Introduction

It is important to consider the nature of the sector. The not for profit (NFP) sector is one which is growing in importance all over the world. Moreover it is much bigger than people generally realise. In Europe for example it is estimated that the sector comprises around 40% of GDP. In this chapter we will explore the distinctive nature of the sector and consider the implications for governance.

There is a growing movement within the “non”-profit and “non”-government sector to define itself in a more constructive, accurate way. Instead of being defined by “non” words, organisations are suggesting new terminology to describe the sector. The term “civil society organization” (CSO) has been used by a growing number of organisations, such as the Center for the Study of Global Governance. The term “citizen sector organisation” (CSO) has also been advocated to describe the sector — as one of citizens, for citizens. This labels and positions the sector as its own entity, without relying on language used for the government or business sectors. However some have argued that this is not particularly helpful given that most NGOs are in fact funded by governments and business.

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9.2 Definitions

First we need to start with some definitions:

A not for profit organisation is one whose objective is to support or engage in activities of public or private interest without any commercial or monetary profit. In many countries some will be charities but there will also be many which are not. Their distinguishing feature is not that they seek to provide benefits to less advantaged (although many do) but rather that they do not seek to make a profit to return to investors. They tend therefore to have a different ownership structure.

A non-governmental organisation (NGO) is a legally constituted organisation which operates without any participation or representation of any government. In the cases in which NGOs are funded totally or partially by governments, the NGO maintains its non-governmental status insofar as it excludes government representatives from membership in the organisation.

9.3 The role of NGOs

Non-governmental organisations (NGOs) fulfil a vital role in society, filling the gap often left between civic responsibility undertaken through an agency of the government and personal responsibility often undertaken through the family. Indeed the modern streamlined and reduced state very often deliberately relies upon such NGOs to undertake responsibilities previously undertaken by the state, such as health, welfare and educational roles, which can no longer be undertaken due to the twisted logic of privatisation. To fill the gap states often rely upon NGOs and provide funding accordingly – a state obligation undertaken by proxy. The role and significance of NGOs has therefore risen accordingly; commensurate with this we have seen an explosion in the number of NGOs and a concomitant explosion in the spheres of influence of such organisations and in the roles which they claim for themselves.

In many ways this has been brought about by the retreat of the state which has caused the number of NGOs to increase to fill the gap left by this retreat (Kajimbwa 2006). This retreat means that the current situation is reminiscent of the situation in the middle of the nineteenth century with the rich being expected to donate some surplus to the poor but with a clear distinction between the deserving poor and the undeserving poor, with the distinction of course being dependent upon the acceptance by the receivers of the norms of the givers. Any further retreat would take us back to the medieval world of charity being inseparable from religion, but at least such charity was available to everyone as religious organisations tend not to discriminate in this manner! Thus the role of NGOs has increased very significantly in recent years.

It is uncertain how many NGOs exist in the world but there are many millions. It is estimated for example that in India alone there are 2 million such organisations. Some are very large international organisations and there are a few thousand²⁸ of these while many are national organisations or even very local organisations. Some of these are very small indeed and not all are active at a particular point in time. One thing which is certain however is that the number continues to grow as new ones are established for new purposes and this provided us with a rationale for our analysis, which is concerned with the growth in the number of NGOs existing and the ensuing problems.

9.4 Inflation and NGOs

It is very easy to establish an NGO; almost no regulatory requirements exist and almost no control is exercised. In many countries the establishment of an NGO is completely free of regulation.²⁹ All that is necessary is to decide a purpose for the NGO. This can be very broad and general such as the Worldwide Fund for Nature (WWF) or Medicine Sans Frontieres. Or it can be very narrow and specific such as Brinsley Animal Rescue³⁰, UK or the Temple Trust³¹, Sri Lanka. All that is necessary is that the NGO has a purpose and does not seek to make a profit. Indeed it is easier to set up a new NGO than it is to close one down. One consequence of this is that the number of NGOs is increasing all the time, arguably at an exponential rate. We can describe this as an inflationary situation and therefore have coined the term NGO inflation. In many respects this is laudable as the need is almost infinite for organisations serving charitable purposes or even serving PR or lobbying purposes. In other respects however there are, or can be, problems associated with this inflation. It is these problems which are the focus of this chapter.

It is important to start by considering the nature of the sector. The not for profit (NFP) sector is one which is growing in importance all over the world. Moreover it is much bigger than people generally realise. In Europe for example it is estimated that the sector comprises around 40% of GDP. As the state reduces its activity this sector can be expected to grow in compensation – indeed some would argue that governments are relying on this happening in order to satisfy their ideological requirements.

9.5 Distinguishing features of sector

The first thing we must remember about this sector is that there is no profit motive and decisions must be taken according to different criteria. Instead the emphasis is upon the provision of a service, which is the essential reason for the existence of such an organisation. Additionally there is normally a disconnection between the acquisition of resources and their use – in other words the money to provide the services normally does not come from the recipient of those services. Moreover the need for those services frequently outstrips the ability of the organisation to satisfy those needs and it is forever operating under a situation of resource constraint.

This means that there are different motivations operating in the NFP. It also means that the stakeholders are different – something which we will return to as it is important for our consideration of governance in such organisations.

9.6 Types of NFP organisation

We can classify NFPs into various types, each with different purposes:

9.6.1 Public bodies

These are related to government in some way and include such things as a local authority and a health authority. These all have the function of providing services to members of society and receive their funding and powers directly from the national government.

9.6.2 Quasi public body

These are also often known as Quangos (quasi autonomous non-governmental organisations) and serve a public or civic purpose without having any direct relationship with the government. Many civic societies are like this and other examples include such things as housing associations. These too often get some funding directly from the government.

9.6.3 Educational institution

As the name suggests these serve an educational function and include such organisations as schools, further education colleges and universities. These may be publicly owned organisations or privately owned and the norm differs between countries.

9.6.4 Charity

We will consider these in detail later but here we need to recognise that a charity exists to fulfil a particular function which involves providing a service.

9.7 Motivation for NFPs

The motivation for the existence of NFPs is important to consider as it tends to be different to profit seeking organisations and this has implications for governance. Firstly a NFP organisation is motivated by some kind of societal concern. Normally this involves the provision of a service to some part of that society and this service provision is normally unrelated to payment for that service.

One motivation for an NFP therefore is the acquisition of resources in order to undertake the provision of those services. Thus there is a concern with the optimising of the utilisation and allocation of what is inevitable scarce and restricted resources. Similarly there is a concern with transaction cost minimisation. These issues are similar to those of profit seeking organisations but the way in which they are decided and the way in which effectiveness is measured tends to be quite different.

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Because there is no profit motive then this way of providing motivation to managers and rewarding them for their performance does not exist and alternatives must be sought. Another factors which must be borne in mind is the matter of who decides what is good performance. For a profit seeking organisation the customer will ultimately decide by choosing to buy or not buy. In a NFO there is no customer and the service beneficiaries do not pay (or at least not full cost) for the service received.

Thus the determining of measures of performance is important for these organisations. So too is the setting of standards and the reporting of performance. This is normally done through the development of performance indicators. Often a variety of measures are used including:

- Budgetary control / cash flow
- Performance indicators
- Non-financial measures
- Qualitative factors

For the evaluation of performance then there is less relevance of accounting measures and a correspondingly greater importance of non-financial measures. This inevitable involves problems of quantification and a necessity for deciding between alternatives. One technique which is particular to this environment is that of cost benefit analysis. And one concern of such organisations is to demonstrate efficiency by minimising the proportion of costs which are used as administration – indeed this can lead to manipulations of accounting information as efficiency has consequences for attracting new funds.

9.8 Implications for managers

It will be apparent that there are a number of issues facing managers of these organisations. The first is concerned with the acquisition and utilisation of resources. There is considerable uncertainty regarding the acquisition of resources and this makes planning particularly difficult. The planning horizon therefore tends to be short even though the projects which some NFPs are involved in are inevitably long term in duration.

Other issues which concern managers include the setting of objectives and the measuring of performance. Finance, budgeting & control of course are particularly important in this environment. Another factor is concerned with the influence of stakeholders. Without customers and without shareholders and investors there are a range of other stakeholders who are important and have a great deal of influence. These will include such stakeholders as donors, recipients and society at large.

As far as the external environment is concerned then there are a number of issues which are important and distinctive. The first is the question of market identification; this is essential for planning but is not necessarily obvious. Then, as we have implied already there is the fact that service delivery is not evaluated by its beneficiaries who do not pay for its receipt. There are a lot of different stakeholders who all have a view about performance and some influence on its evaluation – a complex situation.

NFPs are – in theory at least – not in competition with each other: this is true as far as helping beneficiaries is concerned but there is an element of competition in the acquisition of resources. For the provision of services there are generally several organisations involved in providing the same services and it might be thought that collaboration – rather than competition – might be an effective way of providing such services. Certainly high profile disasters always attract assistance from several large charities which often collaborate and pool resources.

One of the factors in this sector however is that the largest NFPs are most able to acquire additional resources. Thus there is competition for market share because this leads to easier resource acquisition. In theory also NFPs exist to fulfil a particular purpose. Once that purpose has been satisfied there is no purpose to their continued existence. For both of these factors however the egos of the people managing the NFPs become a factor as each strives to extend its life, extend its purpose and extend its size and market share.

9.9 Available resources

For many NFPs the main source of funding comes from the government. This is certainly true for public bodies and for quasi public bodies. In most countries it is also true for educational institutions. For the largest charities it is also true as governments tend to use these charities to distribute their aid programmes.

Other sources of funding include borrowing but this is only really an option for capital projects when some security can be provided. So for many NFPs the other main source of funding is from fund raising. This can take the form of seeking donations or legacies or trusts. For the larger organisations then raising funds through trading is also a viable possibility and in the UK, for example, the shopping centres have a considerable number of charities represented.

9.10 Structure of a charity

As charities are a significant number of the organisations in the NFP sector then we need to consider their structure in some detail. The first point to make is concerning the legal environment in which they operate. This can be described *intra vires* rather than *ultra vires*. The difference is as follows:

9.10.1 Ultra vires

An *ultra vires* organisation has the power to do anything which it is not specifically prevented to do according to either the law or its founding legal articles of association. All commercial organisations are founded like this and can therefore extend and change their operations according to market needs and circumstances.

9.10.2 Intra vires

An *intra vires* organisation can only undertake those activities which it is specifically empowered to undertake. It is therefore much more difficult for such an organisation to extend or change its activities. All charities are established as *intra vires* organisations. This can be defined as its charitable purpose.

A charity has many tax and regulation advantages but in return there are certain restrictions on what it can do. Thus a charity is not able to act as a pressure group – at least not overtly. Politics are excluded from its sphere of operation. It can engage in fund raising of course but it is prevented from trading as a means of raising funds. This might seem surprising given how many charities are visibly engaged in trading. This is done either through a third party or by means of a trading subsidiary which then gifts the proceeds to the charity.

Thus these restrictions are legal restrictions to ensure that the benefits of being a charity can only accrue to an organisation with a genuine charitable purpose but they are interpreted fairly liberally for organisations which are recognised to be charities. The ultimate sanction of course is the removal of charitable status from such an organisation.

The final point to make about charities is that they make extensive use of volunteers as well as of paid employees. This keeps their operating costs down of course but also adds another stakeholder group with an interest in and concern for how the charity operates, manages its performance and services its beneficiaries. Moreover the relationship between volunteers and paid employees is sometimes a source of conflict.

9.11 Accounting issues

We have dealt with a number of accounting issues already in our consideration of planning and budgeting; of the measurement and reporting of performance; and of the evaluation of results. Another important point to make though is concerning the time horizon adopted by these organisations. Many projects are long term in nature but sources of funds are often short term in nature. So there is a long term horizon for expenditure but a short term horizon for income, this is problematic and a source of difficulty in planning for many of these organisations.

Many of these NFP organisation engage in fund raising, as we have seen. This itself causes complications for the accounting iof such organisations and can affect its operational procedures. Money can be given to one of these organisations either for its general activities or for a specific purpose. For example the larger charities frequently have appeals for a specific disaster relief operation. When money is given for a specific purpose then it can only be used for that purpose. Thus these organisations tend to have a number of funds for specific purposes.

This can be problematic when the need for such money has been completed and there is a surplus – it is difficult to use this for another purpose. A further difficulty is caused by the fact that some funding is needed for general administration. People are willing to give for a specific cause but not for general administration. Thus the accounting for these organisations is geared towards making as much expenditure as possible direct expenditure rather than indirect.

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9.12 Governance issues in NFPs

All of these factors have implications as far as governance is concerned. It is often thought that if an organisation exists for a public or charitable purpose then it must be a socially responsible organisation demonstrating good governance. Our consideration of issues throughout this book should have enabled you to understand that this is not necessarily the case. Governance is about how an organisation conducts its operations and deals with its stakeholders. For NFPs we can see that there is a different focus and we need to consider this in terms of governance implications. We can consider this according to these criteria:

9.12.1 Stakeholders

There are different stakeholders for a not for profit organisation and the different stakeholder groups have different amounts of power to a profit seeking organisation. It is inevitable therefore that dealing with these stakeholders will be a much more important function for a NFP. Moreover the sources of conflict might be different and the actions taken in resolution of this might also be different. Inevitable also the decision making process is likely to be different.

9.12.2 Sustainability

In terms of doing more with fewer resources (see Aras & Crowther 2009) then this is always an objective for this kind of organisation. In terms of affecting the choices available to future generations then an NFP actually seeks to do this and to redistribute resources more equitably. In terms of seeking a continual existence then really an NFP should strive to make its purpose of existence no longer relevant and should not seek sustainability.

Thus sustainability is an equally important issue for these organisations but its implications are very different in terms of both motivation and decision making.

9.12.3 Accountability

Accountability is an even more important issue for this kind of organisation and who it is accountable to can be very different. Without either shareholders or customers then accountability is to donors, beneficiaries and a wide range of other stakeholders. Moreover it needs to address this accountability – which can be different for different stakeholders – in order to be able to continue with its operations.

9.12.4 Transparency

With this diverse set of stakeholders groupings who all have considerable interest in the organisation and its activity then there is obviously a great need for transparency and all such organisations will strive for this. This is particularly exacerbated by the need to keep funds for specified restricted purposes. On the other hand it is in the interest of the NFP to seek to use its accounting system and procedures to classify indirect costs as direct and thereby to minimise the apparent administrative costs incurred. This is contrary to the principle of disclosure but completely understandable!

9.12.5 Disclosure

Increasing disclosure is a feature of corporate reporting as they seek to satisfy stakeholders through increased accountability and transparency. Disclosure has of course always been a feature of NFP activity as such disclosure is necessary to seek additional funds as well as to satisfy the diverse but powerful and vociferous stakeholder groupings. In this respect therefore it might be considered that profit seeking organisations are becoming more like not for profit organisations.

9.13 Conclusions

The environment in which not for profit organisations operate is somewhat different but there are still governance implications which are mostly concerned with sustainability and with accountability. Particular features of this environment are:

- Uncertain resource availability and its effect on long term planning
- Stakeholder power and involvement
- Conflicting priorities
- Legal environment
- Managing ambiguity

9.14 References

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9.15 Further reading

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9.16 Self-test questions

1. What is ultra vires?
2. What types of NFP exist?
3. What governance issues exist for NFPs?
4. What measures of performance are typically used by these organisations?
5. How can we define a NGO?