Introduction to Not-for-profit Governance

Pre-reading

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Background

The 2010 Australian Productivity Commission research report titled *Contribution of the Not-for-profit Sector* found that the sector was 'large and diverse', comprising around 600,000 not-for-profit (NFP) organisations.

The Productivity Commission found that:

- The ABS had in 2006–07 identified 59,000 'economically significant' NFPs, which together contributed $43 billion to Australia's gross domestic product
- The sector had grown strongly, with average annual growth of 7.7% from 1999–2000 to 2006–07
- 4.6 million volunteers worked with not-for-profit organisations, contributing a wage equivalent value of $15 billion
- More Australians were volunteering, but for fewer average hours, so total hours grew only slowly (2% per annum over the seven years to 2006–07)
- Most areas had seen a decline in volunteering, although there had been strong growth in volunteers with culture and recreation organisations
- Organisations delivering community services faced increasing workforce pressures and long-term planning was required to address future workforce needs
- Less than full-cost funding of many services had resulted in a substantial wage gap for not-for-profit staff, creating staff retention challenges and threatening the quality of services.

"Greater clarity about funding commitment is an important step in addressing these issues," the commission concluded, adding that volunteers played a critical role in delivering services but rising costs were "affecting the viability of their engagement".

These findings highlight a significant challenge for not-for-profit organisations, and those who lead them.

While the Productivity Commission recognises the contribution of the sector, it indicates that the pressures are likely to continue.

Governance defined

Most definitions of governance are laid out from a corporate (for-profit) perspective, but they are useful to us nonetheless.

The Australian Securities Exchange's Corporate Governance Principles and Recommendations, quoting Justice Owen in a 2003 speech, defines corporate governance as "the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations. It encompasses the mechanisms by which companies, and those in control, are held to account."

Adding a practical element to our understanding of the term, corporate governance website CorpGov.net says corporate governance "influences how the objectives of the company are set and achieved, how risk is monitored and assessed, and how performance is optimised".

Or, as the Australian Stock Exchange puts it: "Effective corporate governance structures encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and control systems commensurate with the risks involved."

Consider these definitions, particularly as they relate to risk, in the context of the not-for-profit sector. While the sector has become increasingly entrepreneurial it remains largely risk averse and in many situations very reluctant to change. While most of us know we should take risks – it is only through risk that we can achieve change – of course we must also ensure that such risks are balanced and considered. This creates an inherent tension for not-for-profit boards, in that reforms in the sector (particularly as they relate to government-funded agencies) are driving consolidation and collaboration. If we aren't responding to this change there is danger of being 'frozen out' (of funding, of influence, etc).

A board must be conscious of the need for change and reform and tailor its cloth to suit the organisation.

The definitions of governance provided above also challenge us to optimise the performance of the organisations we govern. But how do we measure success? Our assessment must be both internal and external. Internally, are we achieving our aims and purposes? Are we exceeding them? How are we placed to deal with what's coming up? Looking outside, how do we measure up to our competitors? With 600,000 not-for-profit organisations spread throughout Australia, it's likely that somewhere most of us could find another outfit (if not several) doing similar work. How effective are we in comparison to the others? What are we doing that could be considered innovative?

The Institute of Chartered Secretaries and Administrators provides an alternative definition of governance, describing it as "the way in which an organisation is steered and stewarded". The nautical allusion is useful – the board is the captain of the ship, setting the direction and ensuring the organisation keeps on the right course. But just like the ship's captain, the board rarely works alone. Others have much to contribute. They must be trusted and empowered to make their own contribution during the journey, and brought back on course if they venture too far in the wrong direction. Information must be constantly flowing inwards and outwards to ensure the best results are achieved.

Models of governance

You will encounter numerous governance models as you move through the not-for-profit world. A critical point that needs to preface this discussion is that no single model is the 'correct' or 'true' or 'best' model. The important thing is to have a model that will work for your organisation. Hence, the model you have today could be quite different from the model you will require in 10 years.

Some of the governance models most relevant to not-for-profit organisations are outlined below.

Tricker model

Robert Tricker proposed the so-called Tricker model in his 1994 book *International Corporate Governance*.

The Tricker model broadly summarises the main governance roles of boards and organisations as shown in the diagram below, which is adapted from Tricker's book:

	Compliance roles	Performance roles
External roles	Provide accountability	Formulate strategy
Internal roles	Monitor and supervise	Formulate policy
	Past and present orientation	Future orientation

Achieve mission working through CEO

The Tricker model proposes that boards must ensure that simultaneously they are:

- Conforming – keeping on top of the key issues for managing the organisation's best interests and ensuring the board engages with relevant stakeholders and complies with all relevant laws
- Performing – the board must have a plan with clearly defined goals and objectives developed with stakeholders, and strategies for implementing the plan. These goals and

objectives form the basis of performance management of key staff. It is via these goals and objectives that the board ensures the organisation stays on track and delivers on its mission.

In addition, boards must simultaneously be:

- Externally facing – delivering results and accountabilities to external stakeholders (e.g. funders, members, clients, the law)
- Internally facing – ensuring the organisation is operating appropriately (that there are systems in place to ensure the organisation is sustainable).

The external perspective addresses how the organisation appears to external stakeholders, especially those that have specific requirements of the organisation (eg legal requirements enforced by state government; expectations of donors; reporting requirements of funders).

The internal perspective ensures that the organisation establishes proper processes to minimise risk – this could be the risk of not being able to deliver a program, or the risk of not being able to deliver it within budget.

Without proper processes, many organisations end up courting the classic "she'll be right" attitude – "We've been operating for 40 years like this and we've never had a problem." That may be true, but how do you know if your current good fortune is due to good practice or good luck?

Boards have a lot on their plate. The key to good governance is to ensure that a proper balance is established – if we go too strong on compliance at the expense of our stakeholders we could lose their support; if we ignore compliance altogether because that's the easier or more popular route to take, the organisation will suffer in other ways. Communication is an important ingredient in getting the balance right.

Boards deliver results through their delegation to the CEO and staff. The overall performance of the organisation is the board's responsibility – the board may set expectations and boundaries through delegations but it cannot and should not delegate responsibility for success or failure.

Of course, many community organisations have no staff or very few staff. In such cases, there still needs to be some separation of operational activities from governance activities.

Carver model (Policy Governance® model)

The Carver model is among the most commonly cited governance models for not-for-profit organisations.

Developed in the 1970s by John Carver, the model sets out 10 principles of governance.

In a 2002 report for the Queensland University of Technology's Australian Centre of Philanthropy and Nonprofit Studies, not-for-profit governance expert Alan Hough sets out a practical summary of these 10 principles:

> First, the board governs on behalf of people who are not at the board table. As trusteeship forms the foundation of governance, the board must establish, maintain, clarify and protect the relationship of trust with the legal and moral owners of the organisation.
>
> Second, the board should speak with one voice. The power of directors is not as individuals, but as a corporate entity.
>
> Third, board decisions should predominantly be policy decisions. Even in very small organisations, it is not possible for the board to control every interaction between the organisation and the world. Policies give the board the best means to frame the organisation's interactions.
>
> Fourth, boards should formulate policies in layers, starting from broad statements and working down in logical succession. By starting broad, Carver argues that there is never a policy vacuum.
>
> Fifth, the board should 'define and delegate, rather than react and ratify' (Carver & Carver 1996a, p. 9).
>
> Sixth, the main game is the ends to be achieved, that is, the outcomes not the process.

Seventh, the board's best control over the means used by staff is to proscribe, not prescribe. Thus the board maintains prudent control of the organisation by putting certain actions off limits, while not unduly interfering in the work of staff.

Eighth, boards should explicitly design their own products and process.

Ninth, the link between the board and the CEO must be empowering and safe. It should be empowering, in that the CEO should not be subject to second-guessing about individual decisions, provided his or her decisions are consistent with any reasonable interpretation of the board's policy (Carver 2002, pp. 347 –352). The link should be safe, in that the CEO's decisions and actions must be within policy.

Tenth, CEO performance must be monitored rigorously, but only against policy criteria explicitly established by the board.

In an analysis of the Carver model, Hough explains that policies are developed in four areas:

1. **Ends:** The board defines which human needs are to be met, for whom, and at what cost. Written from a long-term perspective, these mission-related policies embody most of the board's long-range planning.
2. **Executive limitations:** The board establishes the boundaries of acceptability within which methods and activities can be responsibly left to staff.
3. **Board–CEO linkage:** The board clarifies the manner in which it delegates authority to staff, as well as how it evaluates staff performance.
4. **Governance process:** The board determines its philosophy, its accountability, and specifics of its own job.

When the model works well, Hough points out, there are great benefits:

- There is increased clarity of roles and responsibilities
- The focus on outcomes and results leads to increased accountability
- An external focus connects the board with other boards and stakeholders

- The leadership role of the board creates satisfaction for board members
- The chief executive officer is liberated, empowered and supported
- The board becomes familiar with big-picture issues as well as major internal trends
- The board takes on the responsibility of ensuring adequate resources are available to accomplish the mission (through fundraising, for example).

The downsides of the Carver Model are becoming more evident as more and more organisations adopt its principles. Some of the drawbacks identified by Alan Hough include:

- A feeling of disconnection between the board and the staff due to the emphasis on separate and distinct roles
- A feeling of disconnection between the board and the organisation's programs and operations
- A tendency for mistrust to form around the board's ability to govern because of a perception that the board does not understand the organisation's operations – policies formulated by the board may have poor links to practices on the ground
- Emergence over time of a power struggle between the board and the chief executive officer, with power ultimately concentrated in the hands of a few.
- Stifling of evolution and change, with the policy framework making the status quo the default setting.

Hough points out that Carver himself has acknowledged that things can go "horribly wrong" under the model, and that Carver has identified several sources of potential failure, including:

- A focus on the short term, perhaps encouraged by a short term of office of the board or inappropriate anxiety about measurement
- Narrow vision and limited ambition when setting policies
- Insufficient constraint on staff (the opposite of micromanagement)
- Not monitoring often enough.

"Of course, this critique does not invalidate the model; it merely points out the limits of the model," Hough writes. "Given that many critics believe that Carver's view is that there is only 'one best way', Carver's explicit acknowledgement of the limitations of the model is welcome."

Constituency model (delegate model)

Note: much of the material in this section is derived from *Nonprofit Governance: The next Generation – Evolution of Structure and Function* (1998), by Ruth Armstrong, and has been rewritten from an Australian perspective.

In the constituency model there is a direct and clear link between the organisation's board and its constituents (e.g. members, clients). The constituents in many cases have the 'numbers' on the board (either as a majority or in making up the entire board) and therefore play an integral role in policy development and planning.

The presence of one many delegates on the board benefits constituents by offering them de facto control over policy decisions.

Some, however, see the idea of constituents on the board as one that inherently creates a major conflict. For example, if I am a teacher in New South Wales serving on the national body that oversees all Australian teachers, whom do I represent – my state or my country? Should clients be deciding who gets what carer? Should a nurse serving on a hospital board get more say over policy directions than a patient might? This is an issue that has caused (and continues to cause) major issues in not-for-profit governance settings.

Some constituency-model boards become very large (comprising 20 or more members in some cases), as more and more constituents are identified. This situation often leads to the development of a hierarchy (e.g. executive council).

Boards operating within a constituency model should ensure that the board's relationship with the CEO is clearly defined. Even so, that relationship is highly vulnerable to changing expectations with changing representatives on the board (some even allow different constituents at different meetings, depending on their availability).

On larger constituency-model boards, the board–CEO relationship tends to be similar to that in the Carver model; i.e., the board empowers the CEO to manage the operations of the organisation within the limitations set by the board. In any case, the roles and responsibilities of the board, constituents and management should be outlined in documents or policies.

The positive features of this model, when it is working effectively, include:

- A fully inclusive decision-making process, resulting in wide buy-in and support for decisions and directions
- Broad participation and a healthy spread of power, including, sometimes, decentralisation of power into action-oriented committees
- A ground-up perspective, as well as a good handle on big-picture issues, as a result of the broad-based input of constituents
- Improved communication between the board and constituents as each member returns to his or her constituency to debrief or seek views.

However, even when strict policies govern the composition and election or appointment of board members, issues can occur as a result of the very nature of this model.

Some of the negatives were highlighted in the 2011 report *A Good Governance Structure for Australian Cricket*, prepared for Cricket Australia (CA) by David Crawford and Colin Carter. Cricket Australia features a constituency-based system.

"Even with goodwill, the system is complicated," the review concluded. "Most of the CA Directors who sit around the national Board are, or have been, Directors of their State cricket associations which guard their independence carefully.

"Decisions made at CA have to be negotiated through the politics of these arrangements, with many such decisions then having to be implemented through the State bodies that have their own agendas."

"*A great deal of energy is consumed in working within these arrangements* [emphasis added]."

Other potential drawbacks of the delegate model are outlined below:

- Boards tend to be large, leading to slow decision-making, difficulty in satisfying all interests and the tendency to create 'voting blocks' or factions
- Energy can be dispersed through use of committees, leading to loss of focus and lack of productivity
- Boards tend to be heavily skewed towards a particular type of person or skill set, particularly boards that require delegates to be chosen by subsidiaries rather than by election
- There is a tendency to pursue self-preservation rather than shared interests.

Does the model matter?

No one size fits all. You may adopt a particular theoretical model and develop processes to support it, but it is likely that the model will change or adapt over time. Clearly, whatever model you choose (or happen to buy into), the main thing is that the organisation should be aiming to achieve its mission, and the board has ultimate responsibility for this.

The structure and composition of the board will always be a delicate balance – should we have clients, carers, business people etc. on the board? Should our board have three or 23 members? Choosing a 'model' structure does not preclude this debate – the model only sets the framework – but the bones still need to be picked.

There is a range of elements that need to be enshrined in any governance model, regardless of its shape or label. Whatever governance model an organisation adopts, it must address:

- Determination and review of the mission and purpose of the organisation
- Selection, support and review of the CEO (if one exists)
- Approval and monitoring of programs and services
- Provision of the resources needed to fulfil the mission
- Effective fiscal management and legal compliance

- Processes for strategic planning
- Selection, induction and review of board members
- An understanding of the relationship between the board and the CEO and staff
- Enhancement and protection of reputation (brand)
- Effective operation of the board (good practice)
- Risk management
- Examination and challenging of the mission and the status quo.

Key factors determining success or failure

Just as there are some key, largely immovable factors that need to be addressed in order for a governance model to be considered a success (see above), so too are there a range of common factors that lead to the success or failure of a not-for-profit board.

In *Nonprofit Governance: The Next Generation – Evolution of Structure and Function* (1998), Ruth Armstrong cites the work of Leighton and Thain in identifying six key contributors to success or failure:

1. **Leadership** – independent from management and characterised by vision and commitment
2. **Legitimacy and power** – the recognition of legal and moral authority, preferably derived from active engagement of stakeholders
3. **Job definition** – clear purpose, functions and tasks
4. **Culture** – shared beliefs and norms
5. **Competence** – in knowledge, skills and attitudes
6. **Management of board processes** – planning and implementation of functions and processes for board effectiveness.

Refer to Ruth Armstrong's report for more detailed discussion of each of the factors above.

Structuring the board

Here are some points you should always consider when establishing or reviewing your board:

- Think about the composition of your board. You need the right mix of skills, experience and personality, as well as knowledge of your organisation and user experience. But do you need all of this on the board all the time, or can you get ready access to the knowledge in some other way – perhaps through a subcommittee?
- Be intentional about what you need. Look at your strategic plan, and consider what you'll need in the future rather than just here and now.
- Think about succession planning. How long is too long for anyone to sit on the board? Use a nomination or succession committee. The chair should take the lead on this.
- Consider a rotation policy, so you don't have someone doing the same job for 10 years.
- Use co-option powers, meaning you can bring on someone with expert skills or knowledge when the board feels it needs this expertise.

Some final points

- Small is good (e.g. seven to 11 board members)
- Take responsibility for succession, and balance with diversity
- Service your board and communicate between meetings
- Refresh and renew
- The chair is critical
- Have an annual agenda cycle

- Measure your performance and your values
- Get good advice when you need it. Don't think – know.