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# UNDERSTANDING THE GOVERNANCE OF NON-PROFIT ORGANIZATIONS: MULTIPLE PERSPECTIVES AND PARADOXES

(A paper to be presented to the 30<sup>th</sup> Annual ARNOVA Conference, November 29 – December 1<sup>st</sup>, 2001, Miami)

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## Introduction

The paper has a theoretical orientation. Its main purpose is to present a new framework for understanding the governance of non-profit organisations in terms of multiple theoretical perspectives and a number of key paradoxes or tensions that boards face. The paper addresses two related problems.

First, the governance of non-profit organisations is relatively under theorised in comparison with the governance of business corporations. In addition, the literatures on corporate governance and non-profit governance have developed largely separately from each other (Middleton, 1987; Herman and Van Til, 1989, Hung, 1998). Noticeable exceptions include resource dependency theory and the study of elites (Middleton, 1987). In contrast a variety of competing theories have been proposed to try to understand the role of boards in the private sector e.g. agency theory, stewardship theory, stakeholder theory, and managerial hegemony theory. The paper briefly reviews each of these theories and discusses how they can be usefully extended to throw light on non-profit boards. A framework is presented for comparing and contrasting these different theoretical perspectives on boards.

However, this raises a second related problem. Taken individually the different theoretical perspectives are rather one dimensional, only illuminating a particular aspect of the board's role. This has led to calls for a new conceptual framework that can help integrate the insights of these different perspectives (Hung, 1998: 108-9; Tricker, 2000: 295). The paper argues that a *paradox* perspective offers a promising approach to providing this new conceptual framework. It argues that taken together these multiple theoretical perspectives are helpful in highlighting some of the important ambiguities, tensions and paradoxes that non-profit boards face.

Based on this framework the paper outlines some of these key paradoxes:

- The tension between board members acting as *representatives* for particular stakeholder groups and '*experts*' charged with driving the performance of the organization forward.

- The tension between the board roles of driving organizational *performance* and ensuring *conformance* i.e. that the organisation behaves in an accountable and prudent manner.
- The tension between the contrasting board roles of *controlling* and *supporting* management.
- The ambiguities that stem from accountabilities to multiple stakeholders.

Each of the paradoxes is discussed and illustrated by drawing on examples from recent empirical studies by the author and other researchers (Cornforth and Edwards, 1998; Cornforth, 2001). These will examine how the paradoxes manifested themselves in particular non-profit organisations, and the different patterns of behaviour that resulted.

Finally the paper concludes by considering the implications of taking a paradox perspective for future research on non-profit governance.

## **Competing theoretical perspectives**

Although theories like resource dependency theory have been developed at least partly in relation to public and non-profit organisations the governance of public and non-profit organisations is relatively under theorised. In contrast a variety of competing theories have been proposed to try to understand the role of boards in the private sector, for example agency theory, stewardship theory, stakeholder theory, and managerial hegemony theory. Below each of these theoretical perspectives is briefly examined and how they can be usefully extended to throw light on non-profit boards.

### **Agency theory – a compliance model**

Principal - agent theory, or agency theory for short, has been the dominant theory of the corporation and corporate governance arrangements. It assumes that the owners of an enterprise (the principal) and those that manage it (the agent) will have different interests. Hence the owners or shareholders of any enterprise face a problem that managers are likely to act in their own interests rather than to their benefit. While free markets are seen as the best restraint on managerial discretion, agency theory sees existing corporate governance arrangements as another means to ensure that management acts in the best interests of shareholders (see Keasey et al (1997: 3-5) for a more detailed overview). From this perspective the main function of the board is to control managers. This suggests that a majority of directors of companies should be independent of management, and that their primary role is one of ensuring managerial compliance – i.e. to monitor and if necessary control the behaviour of management to ensure it acts in the shareholders best interests.

One difficulty in applying an agency perspective to non-profit organisations is that there is much more potential ambiguity over who the principals or owners are. In the case of voluntary organisations for example is it the original founders of the organisation, its funders, its beneficiaries or members? In the case of quasi-governmental organisations (quangos) is it the general public, users, taxpayers or the

government itself? However, many aspects of this perspective still have relevance. The principles and regulations concerning charitable trusts, which affect many voluntary organisations in the UK, embody similar ideas on the role of governance. Under trust law the trustees of a charity are appointed to look after the money and resources donated by those founding the organisation and to see that their wishes, as set out in the trust deed, are carried out. It is enshrined in trust law that the trustees themselves can not benefit financially from the trust, and so employees of a trust cannot normally be trustees. Legally the key role of the trustees of a charity is to see that the staff or management of the organisation carries out the objectives of the trust and act in compliance with the law. As there is a complete separation of the board members from staff or management it could be argued that trust law is even more in line with an agency or compliance model of governance than company law. Given its origins in traditional ideas of philanthropy and charity Harris (1994) identifies this as the 'traditional' model for charity boards. Similarly, in quangos it can be argued that the public's or state's interests are at risk from managers pursuing their own interests, and so a key role of the board is again to monitor management and ensure there compliance in furthering the organisation's objectives.

### **Stewardship theory – a partnership model**

Stewardship theory (Muth and Donaldson, 1998) is grounded in a human relations perspective (Hung, 1998) and starts from opposite assumptions to agency theory. It assumes that managers want to do a good job and will act as effective stewards of an organisation's resources. As a result senior management and shareholders (or the mandators) of the organisation are better seen as partners. Hence, the main function of the board is not to ensure managerial compliance or conformance, but to improve organisational performance. The role of the board is primarily strategic, to work with management to add value to top decisions. In this context it is not surprising that management ideas and practices should be applied to governance. From this perspective board members should be selected on the basis of their expertise and contacts so that they are in a position to add value to the organisation's decisions; boards and managers should receive proper induction and training; they should know how to operate effectively as a team etc. Ideas such as these are common in much of the 'how-to-do-it' literature on non-profit boards, (see for example Kirkland (1994)).

This perspective is evident in various prescriptive models of governance in both the private and non-profit sectors. For example, Pound (1995) suggests what he calls the 'governed corporation model' of governance for public companies. In this model the board, and major shareholders, are seen as partners of management, and the prime function of the board is to add value to the organisation by improving its top decision-making. Carver (1990) in his policy governance model for non-profit organisations advocates that the real business of governance is to make policy, articulate the mission and sustain the vision of the organisation.

### **Resource dependency theory – a co-optation model**

Resource dependency theory (Pfeffer and Salacik, 1978) views organisations as interdependent with their environment. Organisations depend crucially for their survival on other organisations and actors for resources. As a result they need to find ways of managing this dependence and ensuring they get the resources and

information they need. From this perspective the board is seen as one means of reducing uncertainty by creating influential links between organisations through for example interlocking directorates. The main functions of the board are to maintain good relations with key external stakeholders in order to ensure the flow of resources into and from the organisation, and to help the organisation respond to external change.

The role of the board is very much a boundary-spanning role. Board members are selected for the important external links and knowledge they can bring to the organisation, and to try to co-opt external influences. For example it is quite common in the UK for local voluntary organisations to be at least partly dependent on local government for resources and support and to include representatives of the local authority on their boards.

### **A democratic or association perspective – a democratic model**

Democratic government is a central institution in Western societies. Key ideas and practices include: open elections on the basis of one person one vote; pluralism i.e. that representatives will represent different interests; accountability to the electorate; the separation of elected members, who make policy, from the executive, who implement policy decisions. Democratic ideas and practices have influenced thinking about the governance of many types of organisations. For example many voluntary organisations, co-operatives and mutual organisations are established as membership associations, where it is enshrined in the organisation's constitution that the governing body should be elected by and represent the membership in some way. Conversely, the governance of many quangos is often criticised for not living up to ideas of democratic accountability (Plummer, 1994; Skelcher, 1998).

A democratic perspective on governance suggests that the job of board is to represent the interests of members of the organisation. The role of board is to resolve or choose between the interests of different groups and set the overall policy of the organisation, which can then be implemented by staff. Central to this view is the idea of a lay or non-professional board, where anyone can put himself or herself forward for election as a board member. Expertise is not a central requirement, as it is in the partnership model.

### **Stakeholder theory – a stakeholder model**

Stakeholder theory as applied to governing bodies is based on the premise that organisations should be responsible to a range of groups (or stakeholders) in society other than just an organisation's owners or mandators (Hung, 1998: 106). By incorporating different stakeholders on boards it is expected that organisations will be more likely to respond to broader social interests than the narrow interests of one group. This leads to a political role for boards negotiating and resolving the potentially conflicting interests of different stakeholder groups in order to determine the objectives of the organisation and set policy.

Stakeholder theory has developed mainly in debates over corporate governance in the private sector, where there has been robust debate about its desirability and likely consequences (e.g. Hutton, 1997; Tricker, 2000: 295). The principles of stakeholder

involvement are less controversial in the public and non-profit sectors, and the practice more common, although not always discussed in terms of stakeholder theory. Some of the clearest examples in the UK are in the field of education where government reforms have specified the broad composition of governing bodies. For example, state funded schools are required to have governing bodies made up of people appointed or elected from various groups, including: parents, the Local Education Authority, teacher governors, and in the case of voluntary aided schools foundation governors representing the church or charity supporting the school. When further education (FE) colleges were taken out of local government control the Conservative government specified that at least half the governors should be from business broadly construed. Due to concerns about lack of balance and accountability the composition was broadened by the Labour government in 1999 to include representatives of staff, students, the local authority and community. In parts of the voluntary sector there have been important moves to involve service users on boards.

### **Managerial hegemony theory – a ‘rubber stamp’ model**

Managerial hegemony theory relates back to the thesis of Berle and Means (1932) that although shareholders may legally own and control large corporations they no longer effectively control them. Control having been effectively ceded to a new professional managerial class. A variety of empirical studies have lent support to this thesis. Mace (1971) in his study of US directors concluded that boards did not get involved in strategy except in crises, and that control rested with the president (chief executive) rather than the board. Herman (1981) came to similar conclusions but argued that managerial power was always in the context of various constraints and the latent power of stakeholders such as external board members. In a more recent study Lorsch and MacIver (1989) conclude that although the functioning of boards has improved since Mace’s study, their performance still leaves much room for improvement. Like Mace they distinguish between boards in normal times and during crises, and conclude that during normal times power usually remains with the chief executive. From this perspective the board ends up as little more than a ‘rubber stamp’ for management’s decisions. Its function is essentially symbolic to give legitimacy to managerial

Although this theory was developed in the study of large business corporations, many of the processes it describes seem just as relevant to public and non-profit organisations: for example the separation of those who found (‘own’) the organisation from those that control it, and the increasing growth and professionalisation of management. Indeed it could be argued that the largely voluntary nature of board involvement in public and non-profit organisations might mean that board power is even more limited than in the private sector. Murray et al (1992) identified five different patterns of power relations among non-profit boards in Canada. One of the most common was what they called the *CEO-dominated* board, where chief executive and sometimes other senior managers exercise the main power and the board plays a largely symbolic role, often rubber stamping decisions.

The main features of these different perspectives are summarised in Table 1.

-Table 1 about here-

## **A paradox perspective - towards a synthesis**

Taken individually these different theories are rather one dimensional, and have been criticised for only illuminating a particular aspect of the board's work. This has led to calls for a new conceptual framework that can help integrate the insights of these different perspectives (Hung, 1998: 108-9; Tricker, 2000:295). A paradox perspective offers a promising approach to providing this new conceptual framework. Taken together these multiple theoretical perspectives are helpful in highlighting some of the important ambiguities, tensions and paradoxes that non-profit boards face.

Morgan (1986: 339) in his groundbreaking study of organisations argues that many theories and ways of thinking about organisations do not match the complexity and sophistication of the realities organisations face. In order to address this problem he argues that it is necessary to take a multi-paradigm or perspective approach in order to 'understand and grasp the multiple meanings of situations and to confront and manage contradiction and paradox, rather than pretend they do not exist'. At the same time there has been a growing recognition that many management problems and issues require a move from linear thinking and simple either/or choices to seeing them as paradoxes (e.g. Hampden-Turner, 1990; Handy, 1995). Managing paradox means embracing and exploring tensions and differences rather than choosing between them. As Lewis (2000) charts in her review of the literature the concept of paradox has been playing an increasing role in organisation studies.

A similar critique can be made of attempts to understand organisational governance. As Hung (1998: 108) observes in his review of the literature each of the theories of governance (discussed above) 'focus on a small part and no one is able to perceive the whole picture of corporate governance'. In a similar vein Tricker (2000: 295) notes 'At the moment various theoretical insights cast light on different aspects of play, leaving others in the shadow...'. He calls for a new conceptual framework that can 'light up the entire stage and all the players'.

One way of addressing this problem is to take a multi-paradigm perspective and focus more explicitly on the paradoxes, ambiguities and tensions involved in governance. As Lewis (2000: 772) discusses a multiple perspectives approach can be useful as a sensitising device to highlight what are likely to be important paradoxes, by contrasting opposing theoretical approaches. So for example contrasting agency theory with stewardship theory suggests that boards may experience pressures to both control and partner senior management. Next we examine some of the main tensions and paradoxes that the contrasting theories of governance suggest that boards are likely to face. The list is not meant to be exhaustive. A number of authors have also begun to study governance from a paradox perspective. Demb and Neubauer (1992) in their study of corporate board identified and examine three paradoxes which stem from the legal and structural aspect of the boards setting. Wood (1996) suggests a similar approach to studying non-profit boards.

### **Who governs -the tension between representative and professional boards**

The different theoretical perspectives have different implications for who should serve on boards. The opposition is clearest between the stewardship and democratic perspectives. Stewardship theory stresses that board members should have expertise

and experience that can add value to the performance of the organisation. The implication is that board members should be selected for their professional expertise and skills. In contrast the democratic perspective (and to some extent the stakeholder theory) stresses that board members are lay representatives there to serve the constituency(s) or stakeholders they represent.

This can raise an obvious tension for public policy makers – should the boards of public bodies be elected or chosen because of their expertise. Since the early 1980's successive Conservative governments in the UK introduced a variety of public sector reforms leading to a growth in the number of quangos and public bodies with appointed boards. This move to non-elected, expert boards in many parts of the public sector has been heavily criticised for its undemocratic nature and the danger of creating a new self-selected elite (Skelcher, 1998). While the recent Labour government has modified some of these arrangements and introduced greater stakeholder involvement, deep concerns over the democratic accountability of many of these boards remains (Robinson et al, 2000).

There is also a dilemma for voluntary sector boards - should members be chosen or encouraged to stand for election, because of their expertise or because they represent some stakeholder group? It also raises dilemmas for board members. Are they expected to represent particular stakeholders or to give expert guidance? The professional role also demands a close involvement with the organisation. This may conflict with board members' unpaid status in most non-profit organisations.

### **Board roles - the tension between the conformance and performance**

The different theories of governance put different emphasise on what are the main roles of the board. This is most apparent in the opposition between the agency and stewardship perspectives. What Garratt (1996) has called the 'conformance' versus 'performance' role of boards. Agency theory emphasises the conformance role of the board to ensure that the organisation acts in the interests of its 'owners' and to be a careful steward of their resources. In contrast stewardship theory emphasises the role of the board in driving forward organisational performance through adding value to the organisation's strategy and top decisions.

The conformance role demands careful monitoring and scrutiny of the organisation's past performance and is risk averse. The performance role demands forward vision, an understanding of the organisation and its environment and perhaps a greater willingness to take risks. Again, boards face an obvious tension concerning how much attention they should pay to these contrasting roles.

### **Relationships with management - the tension between controlling and partnering**

The agency and democratic perspectives stress the importance of the board monitoring and controlling the work of managers (the executive). In contrast stewardship theory stresses the role of the board as a partner to management, improving top management decision-making.

The need to both control senior management and be their support and partner in decision making can be a source of role conflict and tension for board members. To

what extent should board members push the interests of particular stakeholders if this is against the wishes of management? This tension is vividly illustrated by the following comment on an European Union report on parent participation in education by the convenor of the Scottish Parent Teacher Council:

*'Quite often the parents on school boards cease to take parental point of view and start to identify more with management...in some cases you can see parents on boards closing ranks around the head teacher rather than lobbying on behalf of parents'*

(From the Scotsman, Page 6, 27/12/95)

### **Multiple or ambiguous accountability**

There may be tension concerning to whom board members are accountable. The agency perspective suggests that board members are accountable to the 'owners' of the organisation. The democratic and stakeholder perspectives suggests that there are other stakeholders who have a legitimate interest in what the organisation does, and should in some way be able to hold it to account. Equally the legal framework of many public and voluntary bodies mean that board members are legally required to act in the organisations best interests rather than in the interest of particular stakeholders. Board members may experience tension because they feel accountable to more than one group, or because they are unclear or differ over who they are accountable to.

### **Conclusions**

The paper has shown how existing theories of corporate governance can be extended to help understand the governance of various types of social enterprise, but that by themselves each is too one-dimensional only highlighting particular aspects of the board's role. As empirical research suggests governance is an inherently difficult and problematic activity. A paradox perspective helps to explain some of the difficult tensions and ambiguities that boards face.

Another criticism that can be levelled at much of the theorising about boards (both descriptive and prescriptive) is its generic nature. Often little or no account is taken of contextual factors, such as organisational size or changes in public policy, that may influence or shape board characteristics or how they work. This is not something that is unique to the study of boards; similar criticisms have been levelled at much recent research in the field of organisational behaviour (Mowday and Sutton, 1993; Rousseau and Fried, 2001). An important avenue for future research on non-profit governance is to examine empirically the different paradoxes, tensions and contradictions boards face, and how these are shaped and influenced by contextual factors.

<b>THEORY</b>	<b>INTERESTS</b>	<b>BOARD MEMBERS</b>	<b>BOARD ROLE</b>	<b>MODEL</b>
<i>Agency theory</i>	'Owners' and managers have different interests	'Owner/mandators' representatives	Conformance: - safeguard 'owners' interests - oversee management - check compliance	<b>Compliance model</b>
<i>Stewardship theory</i>	'Owners' and managers share interests	'Experts'	Improve performance: - add value to top decisions/strategy - partner/support management	<b>Partnership model</b>
<i>Democratic perspective</i>	Members/the public contain different interests	'Lay' representatives	Political: - represent member interests - make policy - control executive	<b>Democratic model</b>
<i>Stakeholder theory</i>	Stakeholders have different interests	Stakeholder representatives	Political: -balancing stakeholder needs - make policy - control management	<b>Stakeholder model</b>
<i>Resource dependency theory</i>	Stakeholders and organisation have different interests	Chosen for influence with key stakeholders	Boundary spanning: - secure resources - stakeholder relations - external perspective	<b>Co-optation model</b>
<i>Managerial hegemony theory</i>	'Owners' and managers have different interests	'Owners' representatives	Symbolic: - ratify decisions - give legitimacy (managers have real power)	<b>'Rubber stamp' model</b>

Table 1: A Comparison of Theoretical Perspectives on Organisational Governance

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