# When good turns to bad: An examination of governance failure in a not-for-profit enterprise

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# Objectives

- To compare NFP and FP both theoretically and practically

- To analyse the assumption that not-for-profits (NFP) are unlikely to exhibit the unethical governance behaviour seen in for-profits (FP)

# Governance theory: For-profits

- Shareholding model dominates (Letza et al 2004)
- Agency is the major challenge (Monks and Minow 2008)
- NFP theory less concerned with agency due to absence of shareholders (Dunn and Riley 2004) but increasingly aware of agency problem (Hayden 2006)

# Governance theory: Not-for-profits

- Stakeholding model dominates (Abzug and Galaskiewicz 2001)
- Stakeholder involvement is the major challenge (Iecovich 2005)
- FP less concerned about involvement but diversity of board membership has become an issue (Grosvold et al 2007; Higgs 2003)

# Case study: ABC

- NFP company established in 2000 in Huddersfield, UK
- Provided creative arts activities for young people behaving anti-socially:- music technology, break dancing and drama
- Transferable skills, confidence and motivation
- Initial focus - Afro-Caribbean young people, then white and Asian
- Community ownership with a lock on assets:

*‘If on the winding up or dissolution of the Co-operative any of its assets remain to be disposed of, these assets…shall be transferred instead to some other…non-profit organisation(s)’*

# Case study: ABC continued

- By 2001 ABC had premises - recording and dance studios, training rooms, office space
- Staff members recruited from among local artists, musicians and dancers providing positive role models
- Annual turnover growth - £38,000 in 2002 to around £300,000 in 2004
- Won a regional award in 2004 for being ‘On the Up’
- By January 2006 the organisation was in voluntary liquidation

# Agency failure

- Music industry trading arm
- Two dedicated staff members
- After two years, no income
- Acceptable in terms of risk-taking,
  - NFP have to balance social mission with sustainability through trading
  - Board were guilty of error but not unethical practice

# Stakeholder involvement

- Employees were restricted from membership and hence election to the board:

*4. All employees on taking up employment with the Co-operative…shall be admitted to Membership of the Co-operative, except that the Co-operative in General Meetings may by majority vote decide to exclude from the Membership:*

  – *newly appointed employees during such **reasonable probationary period** as may be specified in their terms and conditions of employment*

# Stakeholder involvement continued

- Employees challenged this restriction
- Won the right to membership
- Removed Managing (and Financial) Director
- In late 2005 had to instigate liquidation proceedings

# Conclusion

- A link can be made between agency failure and a desire by the board to restrict stakeholder involvement

- Governance in these two sectors may exhibit very similar behaviours in certain circumstances

# Further research

- Governance failure in NFPs
- Using a combined theoretical base
- Requires a greater synthesis of literatures (see e.g. Miller-Millesen 2003) to develop the beginnings of the framework that is offered in this paper

# Presentation references


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