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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


