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Towards the development of an integrative governance framework for the third sector: a theoretical review and analysis

Murray E. Millar

University of Wollongong, memillar@optusnet.com.au

Anne Abraham

University of Wollongong, aabraham@uow.edu.au

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Keywords

Third sector, Governance, Integrative, Framework, Governing Board

Disciplines

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**TOWARDS THE DEVELOPMENT OF AN INTEGRATIVE GOVERNANCE
FRAMEWORK FOR THE THIRD SECTOR:
A THEORETICAL REVIEW AND ANALYSIS**

Murray E. Millar
Graduate School of Business
University of Wollongong
Australia

Anne Abraham
School of Accounting and Finance
University of Wollongong
Australia

Abstract

This paper reviews the theoretical approaches taken in the governance literature in order to assess the relevance of their application to the third sector and to develop an integrative governance framework to help guide third sector organisations as they seek to improve their governance practices. Governance has been studied extensively in the corporate sector, and also, to a much lesser degree, in the third sector. However, there is evidence that a large gap still exists between what is *prescribed* as good governance and what has been empirically *demonstrated* as good governance. Due to the complexity of governance and the current differing views on what constitutes best governance practice, this paper proposes that it would be appropriate to adopt a comprehensive framework built on current empirical and theoretical knowledge. The paper identifies and discusses prominent contrasts between the corporate sector and the third sector. A review of existing frameworks is followed by the proposal of a new framework to guide third sector organisations in their quest to improve current governance approaches.

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TOWARDS THE DEVELOPMENT OF AN INTEGRATIVE GOVERNANCE FRAMEWORK FOR THE THIRD SECTOR: A THEORETICAL REVIEW AND ANALYSIS

INTRODUCTION

Governance has been studied extensively in the corporate sector, and also, to a much lesser degree, in the third sector. However, there is evidence that a large gap still exists between what is *prescribed* as good governance and what has been empirically *demonstrated* as good governance (Holland 2002). Much of traditional governance research has focused on the Anglo-American model of corporate governance with ‘an excessive emphasis on the after affects of separation of ownership from control’ (Bhasa 2004: 8). Many of the theories associated with corporate governance are not holistic (Cornforth 2004; Hough, McGregor-Lowndes and Ryan 2004) and underlying assumptions often reflect a narrow paradigm of thinking (Tricker 1996).

While the majority of the studies on organisational governance relate to corporate business, the topic is also extremely relevant for the third sector. The next section defines the root of the term “governance”. This is followed by a discussion of the prominent contrasts between the corporate sector and the third sector. Existing frameworks of governance are then reviewed to identify their relevance for governance of nonprofit organisations. Due to the complexity of governance and the current differing views on what constitutes best governance practice, it is proposed that a comprehensive framework built on current empirical and theoretical knowledge would be helpful, and a new integrative framework is briefly presented as a tool to help third sector organisations (TSOs) in their quest to improve current governance approaches.

GOVERNANCE DEFINED

The root of the term “governance” originates in the Greek word *kybernan* and refers to the function of “steersmanship”. Beer (2004: 853) explained “at sea the long ships battled with rain, wind and tides – matters no way predictable. However, if the man operating the rudder kept his eye on a distant lighthouse, he could manipulate the tiller, adjusting continuously in real-time towards the light”. Operating the rudder was the function of the *kybernan*. This word transliterates into English as *cybernetes*. In Latin *kybernan* is transformed into *gubernator*, which in English is translated “governor”.

While today the branch of knowledge associated with governance of organisations is well known and extensive, a second branch of knowledge, not as well known, with its roots also in *kybernan* has developed in the area of cybernetics. Both governance and cybernetics have to do with “control”. The UK Cadbury committee’s definition of corporate governance is “the system by which companies are directed and controlled” (Cadbury 1992: par 2.5) and the first book on cybernetics was subtitled “communication and control” (Beer 2004: 857). From a cybernetics perspective, “governance of nested organizations is now a matter of autonomous networked organizations achieving cohesion” (Espinosa, Harnden and Walker 2004: 578). Out of the vast range of material written on governance, there is only limited evidence in the literature of linkages being made between these two bodies of knowledge. Management cybernetics and its associated viable systems model, however, has much to contribute to an

understanding of the governance of organisations (Turnbull 1997a; Turnbull 1997b; Kirkbride and Letza 2003; Beer 2004).

Recognising the complexity of governance, this review follows the definition of corporate governance provided by Turnbull (1997a: 181): “Corporate governance describes all the influences affecting the institutional processes including those for appointing the controllers and /or regulators, involved in organizing the production and sale of goods and services”. This definition covers all types of firms, whether or not they are incorporated under civil law, for profit and not-for profit as well as public and private. It is also consistent with definitions adopted by other third sector researchers (Cooper 2005; Lyons 2001).

THIRD SECTOR AND CORPORATE COMPARISONS

The third sector is comprised of a vast array of voluntary, nonprofit and non-governmental organisations that address a number of educational, welfare, charitable and membership purposes (Herman et al 2005), and is a significant component of society. In Australia alone, and considering only community service welfare organisations, the Australian Bureau of Statistics estimated that in 2000 there were 5938 TSOs providing community services compared to 548 government organisations and 2800 for-profit organisations (ABS 2001).

Objectives of TSOs

The governance of an organisation is closely linked to organisational objectives and TSOs differ significantly from for-profit organisations in respect to purpose. TSOs exist ‘to bring about a change in individuals and in society’ (Drucker 1990: 3). This is in direct contrast to corporate businesses in western societies that exist primarily for the purpose of increasing shareholder’s wealth (Paulsen 2003; Bhasa 2004). However, measuring outcomes associated with mission and service is much more difficult than measuring outcomes associated with wealth (Kanter and Summers 1987: 154).

Whereas TSOs focus on mission rather than profit, the management of assets is still a vital part of their operations. In order for TSOs to carry out their mission, material support in the terms of member’s fees, private donations or grants is required. Trust demonstrated in operational and ethical values such as ‘integrity, openness, accountability, and service’, is a key consideration in gaining and maintaining such support (Herman et al 2005: 212). This suggests that careful thought needs to be given to the design of governance structures and processes for TSOs, to ensure that organisational mission is the focus and that trust and ethical values are genuinely operationalised.

History of TSOs

Governance in the corporate sector has existed since the birth of the limited liability form of the corporation (Bhasa 2004: 7). This is in direct contrast to the third sector which, in its formal designation, is relatively young, although it is acknowledged that charitable, educational and religious organisations are thousands of years old. Since ‘the concept of “nonprofit organisations” as a unified and coherent “sector” dates back only to the 1970s...[and] over 90 percent of nonprofit organizations currently in existence were created since 1950’ (Herman et al 2005: 3), the third sector was still in its infancy when governance issues were rapidly becoming of increasing importance for the corporate sector.

Pressures placed on TSOs to converge

With globalisation there is increasing pressure within the corporate sector to find optimal convergence approaches to governance as it is assumed that global best practices exist (Noburn et al 2000; Bhasa 2004). It is well accepted that effective governance of organisations is related to organisational effectiveness (Jackson and Holland 1998; OECD 2004b; Brown 2005). However, there are considerable varieties of opinions as to where the emphasis should be placed as common approaches are sought. These differences often reflect the cultural and political characteristics of the countries involved, and the contrasting cultural, legal and political systems within different countries are currently making it almost impossible for convergence to be achieved (Bhasa, 2004).

TSOs are also experiencing increasing pressures to demonstrate accountability and justify their legitimacy. Such pressures embrace convergence with corporate sector governance practices (Alexander and Weiner 1998; Steane 2001). However, there are mixed indications of the way TSOs are responding to these pressures to improve their accountability and adopt corporate governance models. A number of studies have concluded that there is little evidence to suggest that TSOs have adopted corporate government practices (Alexander and Weiner 1998; Holland 2002; Green and Griesinger 1996) while others have observed that TSOs have enthusiastically adopted corporate governance reforms (Hough et al 2004; Steane 2001; Broude and Prebil 2005). Lyons (2001: 226) considers the challenge of balancing techniques and practices borrowed from business with characteristics that define the third sector as the 'paradox at the heart of the third sector'.

However, an important question still remains. If global convergence is not necessarily the best way for the future within the international business sector because of the wide diversity of cultural, political and legal differences amongst countries, is convergence of governance practices between the third sector and the corporate sector, even within the same country, the best way for the future? While there may be many areas where practices might overlap, caution is being advised by a number of scholars in expecting nonprofit organisations to be bound by the same governance laws as designed for the business sector (Hough et al 2004, Steane 2001; Alexander and Weiner 1998). They recognise that a TSO's mission, values and relationships with key stakeholders, as well as traditional values of volunteerism, constituent representation and stewardship may not be compatible with corporate governance models. Consequently, recognition of the diversity within the third sector is a further important consideration.

Diversity amongst TSOs

Many different categories exist within the third sector, and each brings its own unique challenge for governance. One of the major divisions is that between secular human service organisations and faith-based or religious human service organisations. Much less research has been conducted in respect to the latter (Johnson, Tompkins and Webb 2002; Fisher 2004), even though this sub-section receives more charitable support from both governments and the public than do all other nonprofit subsectors collectively (Stone and Wood 1997: S44). While significant differences exist between faith-based and secular human service organisations, Gibelman and Gelman (2002) suggest that faith-based organisations appear to be as likely as their secular counterparts to experience incidents resulting from managerial organisational inadequacies.

The fact that research into governance in the corporate sector has failed to identify consistent patterns of best practice, is possibly related to the complexity of corporate organisations and the environments in which they operate. Due to the complexity of organisations in the third sector, it would be presumptuous to assume that there is a single theory or one best way appropriate to governance within this sector even though the needs for governance might have a common basis. A framework will help to identify key aspects of this complexity that need to be taken into account.

Controlling Influences on TSOs

As organisations increase in size and complexity, it is reasonable to expect that issues of control also become more complex. In the Anglo-American corporate world, ownership is commonly diverse amongst many individual shareholders. Governing board directors are elected or appointed by corporate owners to ensure appropriate control of their financial interests. Today, in response to external pressures that come from laws, best practice codes and market forces, corporate boards are implementing internal changes to help in the control of the businesses for which they are responsible. In addition, external factors within the market are playing an increasingly important role (Shleifer and Vishny 1997). These factors include more than just the corporate laws such as the Sarbanes-Oxley Act, and include institutional shareholders such as pension and mutual funds, the existence of managerial labour markets, hostile takeovers and acquisitions, and the influence of the stock exchange regulations (Bhasa 2004).

However, within the third sector, while the profit motivated market forces experienced in the business world do not exist, other pressures do. TSOs that obtain funding support from major donors, such as governments or foundations face considerable external pressure due to contractual obligations. Furthermore, the public is demanding increasing levels of transparency and demonstrated efficiency in the use of donated resources. While competitive pressures for limited supplies of resources are strong in third sector, there are contrasting pressures for harmonisation and cooperation as major donors recognise that this will increase the efficient use of their funds (OECD 2004a).

These key differences between TSOs and their corporate counterparts indicate that for governance to be effective in the former, corporate governance frameworks may need to be modified before being adopted by TSOs.

FRAMEWORKS FOR GOVERNANCE

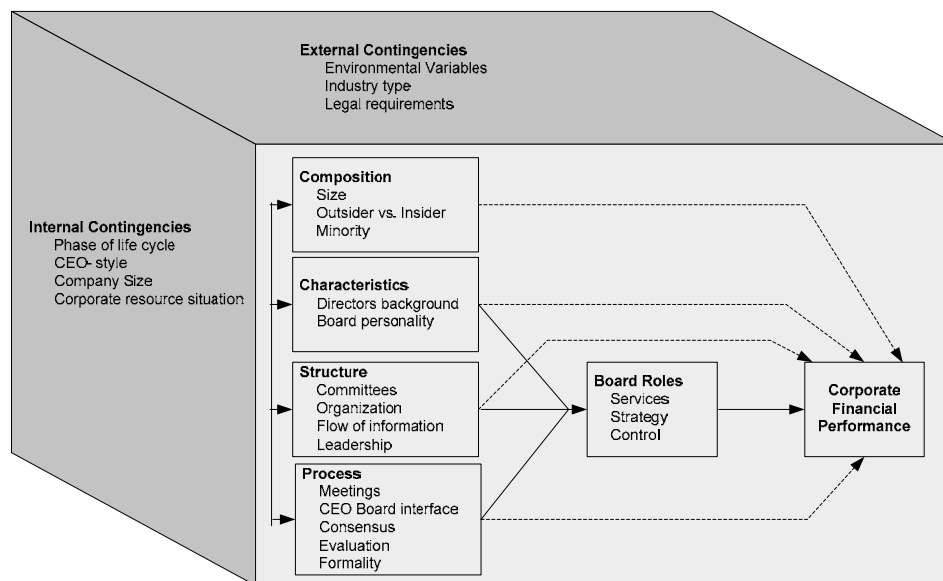
Recommendations are emerging of the need for multi-disciplinary and multi-theory approaches (Tricker 2000; Cornforth 2004; Hough et al 2004). It is suggested that the development of integrated frameworks to help inform the practical process of governance (Stone and Wood 1997). Many scholars have observed that there is an abundance of prescriptive materials on governance based on practitioner's experience but much less sound empirically informed guidance (Brown 2005; Chait, Ryan And Taylor 2005). A number of reasons could be given for this. First, it is possible it could indicate that effective governance is extremely complex and contingent on many different factors. Secondly, because of the complexity of social systems (of which governance is an example), and because limited research has been conducted, and because much of this research has been uni-dimensional, the understanding of the linkages and components within the governance system is still only partially understood. Four existing models will now be reviewed from a historical

perspective. These frameworks were developed based on analyses of empirical research and normative practices.

1. Zahra and Pearce's integrated model

The first researchers to present an integrated framework relevant to governance boards were Zahra and Pearce (1989). After an in-depth review of published empirical research on the contributions of boards of directors to corporate financial performance, they noted that at that point of time, four main theoretical perspectives informed research on governance: the legalistic perspective, the resource dependence perspective, the class hegemony perspective and agency theory. By proposing an integrated model (see Figure 1), Zahra and Pearce recognised that each theoretical perspective contributes something of value to understanding the complexity of governance, even though there are significant differences in the core concepts of each theory. They concluded that there were three important board roles: service, strategy and control. The emphasis placed on each of these roles and a particular role's relative degree of importance was found to depend on the perspective of those involved in the governing process.

Figure 1: Integrated model of board attributes and roles (Zahra and Pearce 1989)



Zahra and Pearce's integrated model of board attributes and roles helps to 'pinpoint the various dimensions of board roles, their multiple antecedents, and possible directions of relations among variables' (Zahra and Pearce 1989: 305). They did not consider the model to be complete and expected that future research will enhance what they had proposed.

This model made three important contributions. First, contextual contingencies were considered to influence the relationships among governance board's attributes and roles and the impact a board has on an organisation's performance. Secondly, the model separated board attributes (composition, characteristics, structure and process), board roles (service, strategy and control) and organisational performance (considered from both a financial and corporate perspective), and identified elements within each. Thirdly, organisational performance was seen to be multidimensional.

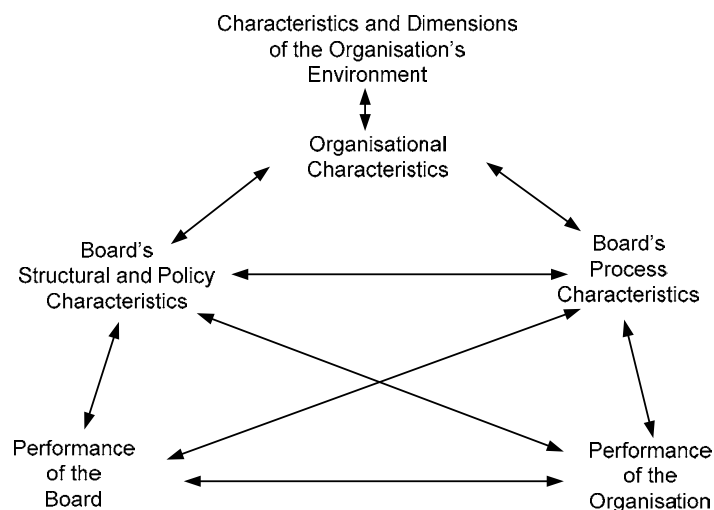
However, this model has a corporate basis and thus concentrates on organisational and structural issues. As such, it fails to address issues of specific of relevance to the third sector, namely, cultural, social and political phenomena. Bradshaw, Murray and Wolpin (1992) attempted to address some of these issues in their governance framework.

2. Bradshaw et al's Framework

In 1992, three Canadian researchers recognised the need to have a conceptual framework to guide their analysis of the contribution of board structure and process dynamics to board and organisational effectiveness in over four hundred TSOs in Canada. They considered a framework was necessary because their review of the normative literature found that 'ideal' structures and processes for third sector boards were being prescribed but there was limited empirical evidence to support the prescriptions, and the actual empirical findings related to third sector board governance was 'fragmented' and confusing (Bradshaw, Murray and Wolpin 1992). Their framework is shown in Figure 2.

As in Zahra and Pearce's model, Bradshaw et al postulated that the way a board was structured and the way a board worked dynamically were both contingent on internal organisational factors as well as external factors. However, in contrast to Zahra and Pearce, Bradshaw et al did not separately distinguish the board's role nor suggest that the impact of a board was achieved primarily through its carrying out of its roles. Instead, they incorporated a variable called 'board process characteristics' that was made up of a mix of both roles and dynamics. Specific elements within this included: the nature and extent of strategic planning efforts, how board meetings were conducted, what issues are presented to the board and how it deals with them, who dominates decision making, the extent to which a common vision of the organisation exists, the amount of conflict within the board or between board and staff. The arrows in the model indicate that board structure and board processes interact to both influence board performance and organisational performance.

Figure 2: Conceptual framework for the Analysis of Nonprofit Boards (Bradshaw, Murray and Wolpin 1992)



Although Bradshaw et al attempted to introduce social and political elements into their model as part of the board processes, there was little attempt to facilitate and understanding of the relationships between actual the board members and the contributions this make to overall governance. Further there was no place in the model for a consideration of personal value systems or various modes of thoughts, whether fiduciary, strategic or generative (Chait, Ryan and Taylor 2005).

3. Holland et al's Six Dimensions Framework

During the 1990s a team from the University of Georgia in the USA studied in detail observable practices that systematically distinguished effective third sector boards, laid the groundwork for developing a protocol to measure board performance, and formulated strategies to strengthen their performance (Chait et al 1996). While these researchers did not formulate a model to guide their work, they went beyond normative approaches and examined in-depth practices of boards using critical incident methodology and interviews with panels of known experts.

Table 2: Six dimensions of board competency essential to effective governance (Jackson and Holland 1998)

<p>Contextual</p> <ul style="list-style-type: none"> • Understand and take into account the culture, norms and values of the organisation governed
<p>Educational</p> <p>Ensure board members are well informed about</p> <ul style="list-style-type: none"> • the organisation governed • The professions working there • The board's roles, responsibilities and performance
<p>Interpersonal</p> <ul style="list-style-type: none"> • Nurture the development of board members as a group • Care for board's collective welfare • Foster a sense of cohesiveness
<p>Analytical</p> <ul style="list-style-type: none"> • Recognise complexities and subtleties in the issues faced. • Draw on multiple perspectives to dissect complex problems • Synthesize appropriate responses
<p>Political</p> <ul style="list-style-type: none"> • Develop and maintain healthy relationships among all key constituencies
<p>Strategic</p> <ul style="list-style-type: none"> • Envisage and shape institutional direction • Ensure a strategic approach to the organisation's future

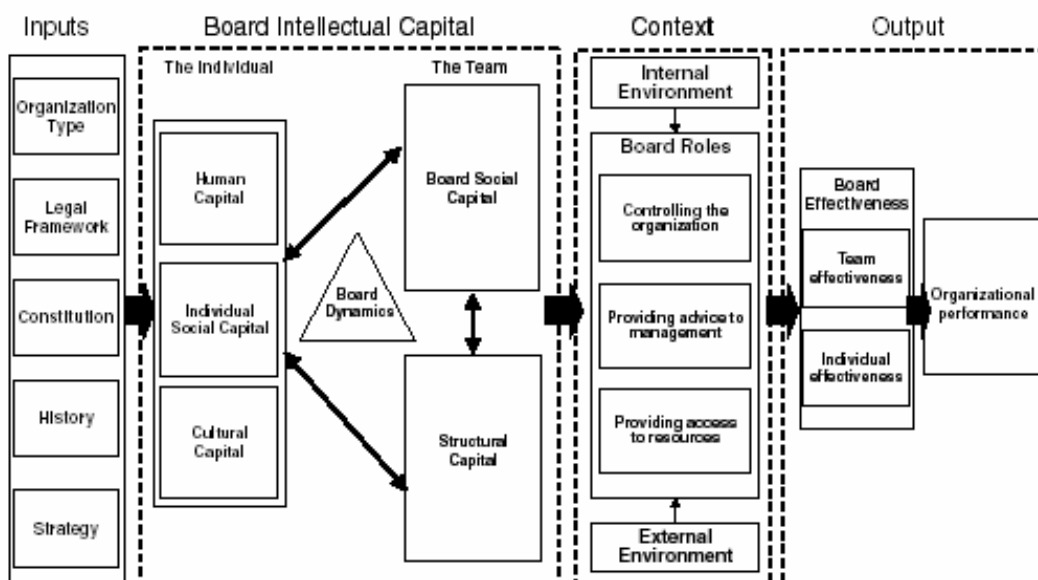
This work resulted in their identification of 'six dimensions' of board competency that captured what they considered to be the elements essential to effective governance. These six dimensions are shown in Table 2. Boards that demonstrated the competencies associated with each of these dimensions were highly correlated with indicators of highly performing organisations (Jackson and Holland 1998: 176).

This model was useful in that it extended the understanding of governance into interpersonal phenomena. However the research failed to demonstrate the actual relationships that existed between each of their six dimensions and the effect that one dimension might have on another.

4. Nicholson and Kiel's intellectual capital framework

Nicholson and Kiel (2004), building on the work of Zahra and Pearce, developed a more comprehensive framework for board governance which is shown in Figure 3. They combined their academic abilities with their practical corporate experience in producing this framework. They considered that agency theory has had a profound influence on both normative and legal perspectives on governance despite the lack of evidence to support assumed agency relationships and recognised that the predominant view of a governance board is 'a mechanism to monitor management and control agency costs' (Nicholson and Kiel 2004: 443). However, from a review of empirical studies, they concluded that boards can add value to an organisation in a much broader manner including: by reviewing key decisions, advising in the strategy process, counselling management, and providing access to key resources such as information, capital, or industry contacts.

Figure 3: Board Intellectual Capital Framework. (Nicholson and Kiel 2004)



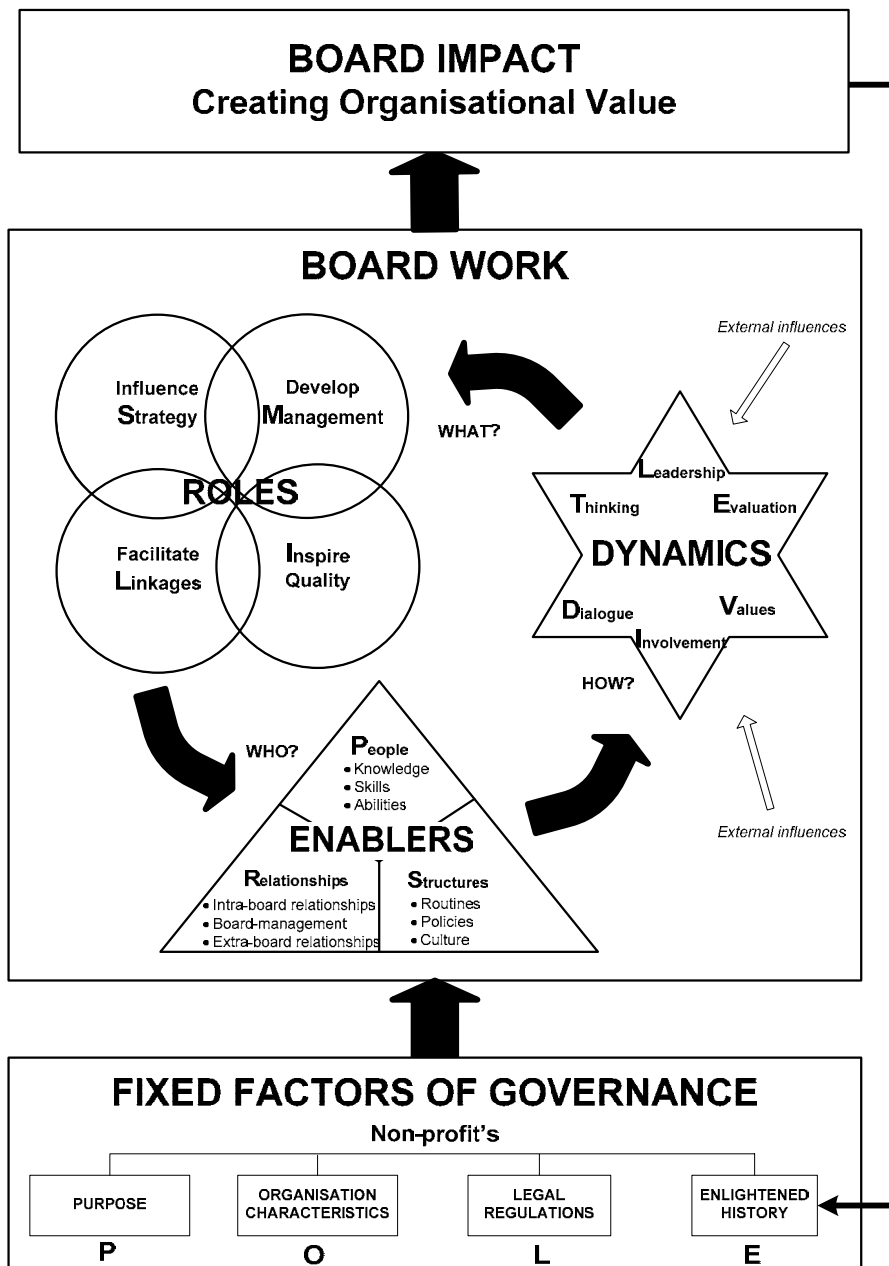
The 'intellectual capital framework' of Nicholson and Kiel included three valuable conceptual underpinnings that were absent in the other frameworks. First, they believed that boards are a social phenomenon. Secondly, the construct 'intellectual capital' (Stewart 1997; Bontis 1998; 1999) was considered to be the core of the transformational processes through which a board adds value to an organisation. Thirdly, they argued that 'an effective corporate governance system requires a series of components to be in a state of congruence or alignment' (Nicholson and Kiel 2004: 443).

The dynamics of the board reveals the degree of alignment or fit between the various elements of board intellectual capital. People with extensive experience and skills may be appointed to the board that have good credibility amongst local constituencies and policies may be in place that are based on best practices for group interaction. However, it is not this social and structural capital alone that will determine the effectiveness of a board. It is the dynamics of the system as revealed by the behaviours of individual directors that will determine whether the capital can be used in a way that adds value to the organisation.

CONCLUSION

This paper has identified that governance of organisations, while critical to organisational effectiveness, is extremely complex and that there is no one ideal approach to governance. Rather, there exist delicate blends of structural, procedural and human interactions. Experience gained within the corporate sector has relevance to the third sector, but needs to be considered with cautious recognition of the differences between the sectors. Governance is not just influenced by internal organisational attributes, but is also a cultural, social and political phenomenon.

Figure 4: Integrative Third Sector Board Governance Framework



M E Millar © 2005 - Adapted from Nicholson, G J and Kiel, G C (2004) "A framework for diagnosing board effectiveness" *Corporate Governance* 12 (4) 442-460

The frameworks that have been considered have demonstrated the value of having a broad conceptual basis informed by theory upon which to build practice. It would be helpful to have such a governance framework for the third sector. Figure 4 provides one such preliminary framework which adapts and extends the work of Nicolson and Kiel (2004). This framework acknowledges that the board governance unit of a TSO is a system within a system of systems where the human dynamic element is vital for ultimate effectiveness. The framework is based on the assumption that a board is “in some ways like a living organism” (Millar 2006: 10) and as such the model is an ongoing process moving from recognised governance factors through board work to board impact which ultimately involves creating organisational value. The basis consists of four major factors: purpose, organisation type, legal regulations and enlightened history. Resting on this base is the “board work” system which consists of three sub-systems: roles, dynamics and enablers. Together these create value in the organisation.

An area for future research is the application of this model to individual TSOs where the relationships between the various systems could be observed. It is expected that this empirical data would then lead to modifications or refinements of the model.

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