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# Effective governance in nonprofit organizations: A literature based multiple stakeholder approach <sup>☆</sup>

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## KEYWORDS

Effectiveness;  
Nonprofit organizations;  
Perceptions;  
Stakeholder approach

**Summary** Nonprofit organizations (NPOs) are increasingly required to become (more) effective. This review summarizes and integrates the results of studies focusing on NPOs' governance effectiveness. It proposes an extension of stakeholder theory to NPOs concerning governance involving diverse stakeholder groups. What makes this paper innovative is that it aims to identify more than effective board governance, and takes the perspectives of multiple nonprofit key stakeholders into account. This approach is particularly valuable as numerous researchers argue that the likelihood of NPOs being perceived as effective increases when they manage to align the, possibly very diverse, expectations of stakeholders on good governance. We consequently focus on the relationship between (1) the needs and objectives of key stakeholders and (2) (expected) governance (structures) in NPOs. The stakeholders we consider are government, beneficiaries, private donors, board members, management, volunteers, and non-managerial staff members. Results not only show the lack of attention some stakeholders have received in the literature, but also the governance related conflicting needs and objectives between stakeholder groups. In addition, even in the same stakeholder groups it is not rare that opposing findings are reported. Several studies indicate the (unforeseen) negative impact on (being accountability to) other stakeholders when NPOs try to be responsive to the needs and objectives of a particular stakeholder group. The value of this review lies in the fact that it reveals both the complexity of and the need for stakeholder management in NPOs, if they want to be perceived as (more) effective by their numerous stakeholders, and related to that gain insight in how to improve their governance practices. Numerous directions for further research are suggested.

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## Introduction

Since the publication of Freeman's landmark book (1984), stakeholder theory has been increasingly debated in the literature (Donaldson & Preston, 1995; Hyndman & McDonnell, 2009), with a growing interest shown by nonprofit

<sup>☆</sup> The paper is part of the Strategic Basic Research Programme 'Effective governance in private organizations', co-ordinated by Professor A. Jorissen (University of Antwerp).

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researchers. Stakeholders are defined as “any group or individual who can affect or is affected by an organization’s achievements” (Freeman, 1984, p. 46). Stakeholder theory argues that (the manager of) an organization has obligations to a group of stakeholders, and that the development of an organization may be influenced by the way in which diverse stakeholder relationships are managed. A suitable stakeholder management policy might strengthen the well-functioning of an organization (Donaldson & Preston, 1995), which consequently might lead to a competitive advantage (Bouckaert & Vandenhove, 1998).

This review proposes an extension of stakeholder theory to NPOs (nonprofit organizations) concerning governance involving diverse stakeholder groups. We argue that as the well-functioning of an NPO is influenced by the way in which diverse stakeholder relationships are managed, an important step in relation building is to become aware of the expectations with respect to governance of diverse stakeholder groups. This reasoning is supported by the fact that several researchers find that the likelihood of nonprofits being perceived as effective increases when they manage to align the, possibly very diverse, expectations of stakeholder groups with respect to good governance (Abzug & Galaskiewicz, 2001; Balsler & McClusky, 2005; Brown, 2005; Herman & Renz, 2008; Hsieh, 2010; Kilby, 2006; Ospina, Diaz, & O’Sullivan, 2002; Studer & von Schnurbein, 2012). Brown (2005), among others, has suggested that including stakeholders’ perceptions in measuring effectiveness will improve understanding of NPO governance and therefore the quality of governance practices.

To our best knowledge, there have been no previous attempts to provide an overview of the needs and objectives of diverse NPO stakeholder groups in relation to corporate governance. Providing such an overview will help to gain insight into how NPOs can be perceived as more effective by diverse stakeholder groups, with a possible positive impact on the stakeholder relationships and overall well-functioning of the organization. Such knowledge can be of particular importance as NPOs are increasingly expected to operate as effectively as possible. Some important reasons for this need to be more effective stem from growing consumer awareness, the consequences of the recent global economic downturn, and the widely publicized scandals some NPOs have been involved in (e.g. Radbourne, 2003; Waters, Burnett, Lamm, & Lucas, 2009).

An overview of needs and objectives of diverse NPO stakeholder groups in relation to corporate governance can also be seen as a preliminary step in the development of a “multiple principals” framework. A principal is someone who “engages another person (agent) to perform some services on his/her behalf which involves delegating some decision making authority to the agent” (Jensen & Meckling, 1976, p.308). When going through the NPO literature, it becomes clear that in the context of the principal-agent theory, the most frequently studied principal-agent relationship is the one between the board, acting as the principal, and the manager, being the agent. There have been only an occasional references to the organization’s beneficiaries and donors as principals, let alone in depth analyses of these principals and their combined impact on the NPO (Jegers, 2011). We are not claiming that the classic

“board-manager principal-agent view” is not valuable, but using a multiple principals framework (as opposed to the standard “one principal” approach) will provide a better picture of reality. When looking back at Jensen and Meckling’s definition of a principal, different persons (e.g. board members, managers, volunteers, beneficiaries) indeed can act as a principal in a principal-agent theory of NPOs, which also fits with stakeholder theory claiming that an organization has obligations to a group of stakeholders. Jegers in particular states that: “because there is no reason to believe that stakeholders all have identical objectives or for that matter identical perceptions of effectiveness, a comprehensive principal-agent approach would imply a “multiple principals” framework” (Jegers, 2009, p. 146). As of this writing, such a nonprofit theory has not been developed, and can be seen as a specific application, and combination of stakeholder theory and principal-agent theory adapted to the nonprofit industry.

The above-mentioned considerations brought us to focus in this review on NPOs’ effective governance. In contrast to numerous other studies, we transcend an exclusive focus on effective board governance practices and seek to take the perspectives of multiple nonprofit key stakeholders on good governance into account.

We expect to find a wide diversity in needs and objectives of NPOs’ stakeholders in relation to effective governance as they go “into partnership” with an NPO for different reasons (Herman & Renz, 2004). This expected diversity in needs and objectives between stakeholder groups can be rephrased as the expectation that several needs and objectives of different stakeholder groups can be conflicting, sometimes even mutually harmful. Not only across stakeholder groups we expect to find a diversity in needs and objectives, but also expect this within some particular stakeholder groups.

Combination of a first literature review using the words “stakeholder” and “NPO”, and discussions with numerous academicians and NPO practitioners, lead to the following list of crucial stakeholders (that will be discussed in this paper): governments, beneficiaries, private donors, board members, management, volunteers working at the grassroots level, and non-managerial staff members. When looking back at this review’s first paragraph, and more precisely to Freeman’s definition of stakeholders, it becomes clear that each of the abovementioned seven categories can affect and/or is affected by an organization’s achievements, making it appropriate to call them stakeholders. For each of these stakeholders we provide a literature overview focusing on the relationship between (1) their needs and objectives and (2) (expected) governance (structures) in NPOs. It became however clear from the outset that only a limited number of studies have focused on this relationship. Therefore, we expanded our study to more general organizational effects that arise from the contacts/relationships between primary stakeholders and NPOs. As organizational effects might be inconsistent with (some) stakeholders’ intentions and their actual needs and objectives, reporting on them not only points a more holistic picture of governance (practices), it also increases the awareness on the relevance of considering stakeholders’ perceptions in policy making.

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