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Assessing the self-governance and value creation in non-profit organisations

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Abstract

The purpose of this study is to examine the relationships between self-governance through board members and firm performance. Results of this study revealed significant relationships only between some board characteristics and some measures of financial performance. Overall, the findings indicate that board members are not promoting good governance in their organizations. This indicates the need of a specific governance framework to guide board members of nonprofit organisations (NPOs) to engage in good self-governance for the benefits of the NPOs and their relevant stakeholders.

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Keywords: Self-governance; Value Creation; Non-profit Organisations; Board Characteristic.

1. Introduction

In the current economic environment, many non-profit organizations (NPO) are facing funding cuts and reduced voluntary donations. While many NPOs are facing the reductions in income, the demand for their services continues to grow (Cornforth, 2012). In this context, Charity Governance Review (2013) by Grant Thornton proposes that good governance practice is crucial as it can facilitates NPOs to respond effectively and timely to meet emerging challenges and in turn continue to deliver their social objectives. At an organizational level, the board or the trustees are responsible to ensure that good governance is being practiced. Good governance promotes compliance with the law, transparency and the overall effectiveness of the NPOs (e.g. Cornforth, 2012 and Ostrower, 2007). This infers an important link between the governing body of the NPOs, the board and organizational effectiveness. From a resource

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dependence theory (RDT) perspective, organizational effectiveness can be achieved through effective boards. The RDT literature contends that board members are associated with various skills and expertise that will enable them to manage the flow of resources and reduces the uncertainty in their environment (Pfeffer and Salancik, 1978). Hence, this study aims to examine the relationship between board composition and organizational effectiveness as a measure of value creation in non-profit organizations.

While good governance has been recognized to be an important element for effective functioning of the NPOs, the current governance framework in many countries are not legislated (Cornforth, 2012). Nevertheless, Cornforth (2012) argued that the contemporary thinking about non-profit governance originated in legislation aimed at businesses. Hence, this study contends that good governance through self-governance in NPOs is expected to influence organisational effectiveness. In line with the current proposition, good governance in this study focuses on board composition. Findings from this study contribute to policy formulation by regulators in promoting self-governance in the non-profit sector.

This paper will proceed with the review of past literature from which hypotheses will be developed. The paper will then proceed to the empirical stage of variable measurement, sampling, data analysis and discussion of results. The final part of this paper presents the conclusion, limitations and suggestions for future research.

2. Literature Review and Hypotheses Generation

2.1 Resource dependence theory, board composition and firm performance

The growing number of NPOs and the current economic environment has lead to reductions in income to many NPOs around the world. According to resource dependence theory (RDT), an organization operating in this environment will survive if they can reduce the uncertainty in their environment (Pfeffer and Salancik, 1978). The RDT contends that board of directors enable organizations to minimize dependence on resources or gain resources in ensuring optimal delivery of their social objectives. In other words, the boards are exercising good or strong governance in overseeing the delivery of the organisation's strategy as well as safeguarding the assets of the NPOs. Prior empirical evidence suggests that characteristics or compositions of board members are associated with organizational effectiveness (e.g. Pfeffer, 1973 and Sanders and Carpenter, 1998). Hence, this study focuses on four types of board composition: board size, board professionalism, board members with political connections and ethnic minority on boards.

2.1.2 Board size and firm performance

The RDT literature suggests that board size in NPOs is likely to vary with the amount of complexity and uncertainty in the external environment (Boyd, 1990; Dess and Beard, 1984; Pfeffer, 1972, 1973; Pfeffer and Salancik, 1978). For example, more board members with link to important resources in the external environment will be recruited on the boards of NPOs. This suggests that the size of the board in NPOs is likely to be fairly large. Proponents of small board size argued that large board size reduces effective communication, coordination, decision making process and the ability to control, monitor and supervise organisational activity (e.g. Yermack, 1996 and Mak and Kusnadi, 2005). However, this study argues that in order to effectively sustain an organization in meeting the current challenges facing the NPOs, larger boards are more likely to be able to fulfill these obligations as they are more likely to be comprised of members with various experience, expertise, knowledge and experience. Based on this reasoning, the following hypothesis is developed:

H1: The size of the board is significantly positively related to firm performance.

2.1.3 Board professionalism and firm performance

The human capital of the board members consists of experience, expertise and reputation (Brown, 2005) and this can facilitate them to guide the strategic direction of the NPOs. Mwenja and Lewis (2009) argue that these board members

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