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Corporate Governance of Nonprofit Organizations

This chapter deals with organizational governance, and thus outlines a fundamental aspect of nonprofit organization management. The governance structure is decisive for aspects such as the organization’s fundraising capacity and its ability to adapt to environmental changes. The authors argue that already at the founding stage of the organization, the governing body’s roles and responsibilities should be considered carefully in terms of their impact on the organization’s development. Later on – especially before employing any professional executives – the subject has to be reconsidered to ensure a productive atmosphere of mutual trust between the board and that executive. The chapter discusses various aspects of nonprofit organization governance in order to give some advice as to which aspects ought to be taken into account to support an effective and efficient nonprofit organization. Both executive directors and board members will gain some insights into each other’s role and the specific requirements for effective nonprofit organization governance.

1. Issues and Elements of Corporate Governance

Since the 1990s governance has become a topic of increasing interest. In particular, the collapse of several well-known companies and fraud charges against their (mostly) inside directors attracted attention to topics such as accountability, performance monitoring by outside members of the board, and auditing standards for private sector companies. Different academic disciplines have formulated a wide variety of definitions and regard “governance,” or “corporate governance” when speaking of the private for-profit sector, from different perspectives: while “governance” is being used by the political sciences to describe a self-organizing network of governmental, nonprofit and for-profit organizations within the political process, the concept of “corporate governance” refers to arrangements of guidance and supervision within certain organizations and has been developed and discussed particularly

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1 The authors would like to acknowledge the support of Dr. Andrzej Juros, who provided the information on the specifics of Central European countries.
regarding joint stock companies. More specifically, corporate governance is “concerned with the procedures associated with decision-making, performance and control of organizations and with providing structures to give overall direction to the organization and to satisfy reasonable expectations of accountability to those outside it” (Hodges/Wright/Keasey, 1996: 7).

Several specific issues have been discussed within this context, among them the structural choice of the one-tier board (as in Anglo-Saxon countries and – varying a little in detail – most other countries all over the world) versus the two-tier board (as in some European countries, mainly Germany and Austria), forms of cooperation and control between inside and outside directors, as well as choice, composition, and responsibilities of the governing body’s members. In addition, aspects of accountability of the executive as well as the governing board and individual members of the governing board to the organization’s stakeholders are being examined. These discussions will be outlined later in this chapter.

Another – more general – issue regarding corporate governance is very important and very difficult to answer: in whose interest should the organization be governed? For private for-profit organizations there would be three general models: owner capitalism, corporate capitalism and shareholder capitalism (Malik, 1999: 106). As Malik (1999: 106-118) argues very persuasively, corporate governance should always be orientated towards the company’s interest, i.e., its long-term increase in value, depending especially on the creation of customer value and innovative capability as well as the development of its market position (Malik, 1999: 116). An unfocused stakeholder orientation leads to unproductive actions, as does a one-dimensional shareholder orientation.

All governing bodies, but especially those of nonprofit organizations, should develop a distinct picture of the organization’s policy as well as a strategic plan to make the organization’s priorities clear to those inside and outside of the organization. The issue of corporate governance is an especially fundamental topic for nonprofit organizations because of the exceptional diversity of their stakeholders (e.g., members of the organization, clients, and the government). Adequate governance structures and mechanisms are a highly important prerequisite for success and decisive for the survival of any nonprofit organization.

Axelrod (1994: 119) already noted increasing attention from the media and government towards nonprofit organizations’ governance issues. In order to avoid drawing attention towards a weak performance of the governing board and, as a result, losing the public’s confidence, governance has become a central issue for board members (Axelrod, 1994: 119). All the same, as Gibelman and Gelman (2001: 58) found in their study, not too much has changed since the mid-1990s. Governance still has to be dealt with as a topic
of high interest, since many allegations and findings of wrongdoing within nonprofit organizations suggested governance failures. These included failure to supervise operations, improper delegation of authority, neglect of assets, failure to ask the ‘right questions’, lack of turnover of board members, lack of oversight of the Chief Executive Officer (CEO), failure to institute internal controls, absence of ‘checks and balances’ in procedures and practices, and isolation of board members from staff, programs, and clients” (Gibelman/Gelman, 2001: 58).

Talking about governance of nonprofit organizations means discussing fundamental questions about the organization. For instance, as the responsible decision-making entity, the governing body must discuss aspects such as the organization’s mission and whether it corresponds to its actual needs and fundamental aims and in whose interest the organization should be governed – the board’s, any specific board member’s, the executive director’s, the government’s (when it is the funding agency), or specific stakeholders’ (e.g., clients).

In most nonprofit organizations the governing board will make decisions about the way the organization should be governed. But as this does not always correspond to real-world experience, nonprofit organization governance also touches on issues surrounding the board’s (legal) responsibilities, the corresponding responsibilities and tasks of the executive director, and accountability. Governance strongly corresponds to the nonprofit organization’s strategy. Since a recipe for setting up an effective governance structure that would be applicable to all nonprofit organizations does not exist, this chapter will outline possible choices and show some problems and pitfalls that may arise. Ultimately, the decision for a specific governance structure should correspond to the organization’s specific requirements – according to its environment, its area of engagement, its size, and its aims and target group. Other aspects of the choice will be whose interest the organization wishes to serve and which role volunteers are supposed to play within the organization. Since there are many interrelated aspects and limited space, the chapter will describe the advantages and disadvantages of some of the choices and present the research of various scholars pointing out aspects of good governance in nonprofit organizations. Special attention will be given to the type of organization and the organization’s stage in its life cycle since these aspects allow some general description of their impact on governance.

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2 The term “executive director” or “chief executive officer” (CEO) will be used in this chapter, but these terms refer more generally to the highest ranking staff position within the organization. The term “president” or “chair” refers to the highest ranking volunteer position chairing the board of directors or trustees.
2. Governance Structure in Nonprofit Organizations

General Structures for Organizational Governance

The choice of an organization’s governance structure is essential for the exercise of management oversight as well as the organization’s ability to act and react upon possible demands. The following two basic organizational structures will be discussed here since most nonprofit organizations choose to adopt one or the other:

- a governing board with outside directors and executive director(s) (one-tier model)
- a governing board with outside directors only and a separate board of executive directors, which in nonprofit organizations usually consists of a single executive director (two-tier model)

Unlike in most for-profit companies in Anglo-Saxon countries, where boards usually combine inside and outside directors and therefore choose the one-tier governance structure, nonprofit boards typically consist only of outsiders who are not employed by the organization (Oster, 1995: 75). According to Fama and Jensen (1983: 319), the mixture of inside and outside directors in one-tier boards works for for-profit companies due to the existence of an active market for shares, providing the necessary discipline. According to this argumentation, nonprofit organizations limit the role of insiders on their boards because they face a higher potential for conflict of interest on the part of insiders since there is no other outside force, e.g., a takeover market, providing a discipline similar to that felt by for-profit. The final two parts of this section of the chapter will discuss the general influence of different legal forms, as well as the type of nonprofit organization, on an organization’s governance structure.

One-tier Model

In the one-tier model the board of directors consists of trustees and inside directors that govern and manage the organization (see Figure 1). Usually within that entity there are executives who are engaged in the organization’s operations as well as outsiders who are to represent the organization’s stakeholders and participate in policy setting and the assessment of management performance.

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3 However, some boards, e.g., General Motors, have begun to have board meetings with outside directors only in order to increase the board’s ability to monitor the inside directors’ performance and avoid conflicts of interest.
The one-tier model has one striking advantage: the board as a committee has very good access to all information concerning the organization – communication between staff and trustees is simplified (Martens, 1999: 32; Block, 1998a: 19). However, it is harder for trustees (as outside directors) within the board to supervise the members of their own committee who are inside directors. The ability to conduct an independent review of management performance will grow as the percentage of outside directors on the board increases (Martens, 1999: 33; Hopt, 1997: 12).

Figure 1. One-tier model of governance structure

For inside directors the responsibility for supervising their own actions will inevitably lead to a clash of interests within the board since decisions made by the board might personally benefit the inside director(s). Therefore the executive director might influence the direction of the board and organization to maximize his personal benefits (Oster, 1995: 78). Obviously, especially if one person jointly holds the chair of the board as well as the CEO position, this also leads to a conflict of interests regarding the board’s oversight responsibility. Consequently, the Cadbury Committee recommended that
corporations separate these functions within for-profit organizations (Com-
mittee on the Financial Aspects of Corporate Governance, 1992: lit. 4.9). To
avoid a conflict of interest for (outside) board members, U.S. law even
prohibits self-dealing of nonprofit organization directors (Oster, 1995: 80). In
Germany, an association’s board member may not partake in voting if the
board’s decision concerns an arrangement between that member of the board
and the association (§ 34 BGB).

Two-tier Model

In most nonprofit organizations the board consists only of volunteers who are
not employed by the organization. The board does not include the
organization’s executive director (see Figure 2). This corresponds to the two-
tier model applied by for-profit companies in some European countries. The
supervisory body’s independence is supposed to be one of the greatest
advantages of this model. In most cases the board’s members do not receive
individual benefits as a result of taking a certain action or making a particular
decision. As will be outlined later, the advantage of greater independence will
apply mainly regarding personal benefits; however, it may not apply to
nonprofit boards’ decision-making processes because of the strong depen-
dence on the executive director and the information provided by her. The
greatest disadvantage of the two-tier model, therefore, is a lack of information
since none of the supervisory board’s members is involved in operating the
organization – they cannot fall back on their knowledge gained from the
organization’s day-to-day business. In order to be able to monitor the
executive director’s performance, the outside directors have to be experts in
relevant areas and have to decide on which basis to monitor that performance.
3. Legal Forms Versus Ideal Types of Nonprofit Organizations

The existence of different legal forms suggests that an organization’s governance might depend on the chosen legal form. Although the legal provisions are of some influence on governance structures – e.g., the German regulations of the association’s law (German: Vereinsrecht) that require a general assembly and an elected board – most details of the governance concept of an individual nonprofit organization are determined by the articles
of incorporation (mostly constitution; German: Satzung). The articles of incorporation and bylaws are used to formalize and institutionalize the governance structure and procedures within an organization. The articles of incorporation must state the organization’s purpose(s) and basic affairs such as the liquidation procedure and whether the organization will have members. In addition and more important for ongoing governance, they should also contain the terms and conditions of board membership as well as the duties and selection of trustees and officers, voting requirements, and procedures for forming committees (Hopkins, 1998: 81).

The bylaws should be used to identify the limits of action for the executive director. These bylaws may also outline specific operations the board would have to approve before they may be set into action. This would provide guidance for the executive director and determine the portfolio of independent decisions without having to consult the board, thus clarifying the entity’s responsibilities. A code of conduct could also – as a bylaw – outline what is expected of the various actors within the governance process.

As pointed out previously, the constitution is the most important building block of the nonprofit organization’s governance structure. However, differences may exist according to the chosen legal form.

Usually the boards of nonprofit organizations consist of elected members who are nominated by the general assembly of members, an appointing committee, the executive director, or other board members. Generally, choices are made to ensure that the elected bodies reflect a diversity of opinion and the diversity of at least the nonprofit organization’s members, if not its stakeholders. Democratization through election processes also supports the stakeholders’ demand for co-determination. Elections cause some unpredictability concerning the composition of a board, but reflect the stakeholders’ interests and ensure a reasonable inclusion of divergent interests.

Some legal forms require the appointment of the governing body’s members instead of an election. While elections present certain disadvantages, appointments do not guarantee a better result with respect to diversity and representation of interests. The quality of appointments depends strongly on the abilities of the person(s) designated to appoint the board member. After all, appointments tend to encourage the creation of homogenous boards.

There is some evidence that in Central European countries nonprofit organizations depend strongly on leaders who influence the selection of future board members. Therefore elections may resemble appointments that are approved by the organization’s members. With regard to the organization’s corporate governance a weakened oversight may result. The discussion of aspects that should be taken into consideration before choosing suitable board candidates will apply to both elected and appointed boards. These aspects will be discussed later in this chapter in the context of board composition.
If a particular legal form does not call for any outside directors at all, the above-mentioned aspects of regulatory power and its exercise do not apply. The nonprofit organization should therefore develop a set of instruments to ensure that the supervision of the executive director(s) or secretary is guaranteed. One possibility could be the intensification of auditing activities, which is not explicitly discussed in this chapter. Some of the aspects outlined in the section on board composition will apply to a board with inside directors only as well. For nonprofit organizations, this case appears generally in small or very young nonprofit organizations, in which the founders still manage the organization and are heavily involved in its day-to-day operations. This situation applies to about 80 to 95 percent of the existing nonprofit organizations within Central European countries. The key issues of nonprofit organization governance such as the interaction between different governing entities do not apply under these circumstances. With regard to the influence of the type of nonprofit organization on the organization’s governance, it will be of some importance whether the organization is a membership organization, a service provider, or an advocacy or support organization. Although real-life nonprofit organizations normally do not represent any type exclusively, some aspects that might have an impact on the organization’s governance may be discussed. Membership organizations, for example, usually organize themselves and often do not need a lot of professional staff. They also are rather independent of their environment and more eager to meet democratic standards, which will be of some influence regarding the board’s election. Volunteers usually work within the organization’s hierarchy and gain detailed knowledge about the organization. Board members that are being recruited after having worked as volunteers within the organization usually are not as dependent on an executive director as they are in other types of nonprofit organizations.

Service providers usually have to meet legal standards and need some expertise volunteers might not be able to provide. Therefore the influence of professional staff may rise in these organizations. Aspects of liability may become more important, and management capabilities and abilities usually increase in comparison to membership organizations. If volunteers take part in these organizations, they usually do so only to assist in the organization’s professional service or as members of the board.

Support organizations usually rely on professional staff as well. Even though volunteers can still serve as members of the organization’s board, the choice of board members in support organizations will usually tend toward large donors or persons with specific expertise rather than those who represent a specific group of stakeholders.

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4  This chapter will not deal with organizations without any supervisory body.
4. Roles and Responsibilities of Governing Bodies

It is interesting that even though an organization’s fate is determined much more by the executive person or body than by the advisory or supervisory body, most authors thoroughly discuss the roles and functions of the supervisory body and only touch on the roles and functions of the CEO or executive board (Peltzer/v. Werder, 2001: 2). For nonprofit organizations this might be due to legal requirements and the fact that, in line with the organization’s hierarchy, the executive’s role is primarily being interpreted as that of the board’s assistant (Herman/Heimovics, 1994: 138). There is, however, much evidence – especially for nonprofit organizations – that the relationship between the executive director and the board is crucial for the nonprofit organization’s performance. Therefore, the board’s role should be discussed in relation to the executive director’s role, and a key issue has to be the interaction between the two. Because of its particularities compared to public or for-profit companies, special attention is dedicated to the board of directors and its role within the governance process before outlining the executive director’s role. The interdependence of the two merits a discussion of issues relating to the interaction between the board and the executive director, such as aspects of supervision, accountability and evaluation.

Depending on the legal form, there are additional legal entities that have to be considered when constructing governance structures. In the case of associations, for example, the general assembly of members has some mandatory rights and competencies, such as the election of board members, or any change in the organization’s constitution.

Nonprofit organizations vary widely in their mission as well as their size, their stage in the organizational life cycle, and their field of action. Therefore the exact governance structure and the responsibilities of the governing bodies will always differ, especially according to these context factors. Since every possible mission cannot be discussed and since problems tend not to occur in great intensity for small nonprofits, this section will first describe the board’s development according to the organization’s stage within its life cycle.

During the founding stage, the founder or a group of founders will form the first board. The board will manage the nonprofit organization without any staff. During this time the board members will be heavily involved in the organization’s day-to-day activities. Werker and Berman (2001: 19) speak of a “working board” during this stage of development.

There is some evidence that especially in Central European countries “legal boards” (boards constituted to meet legal requirements) exist, which are in many cases “leader’s boards” similar in their functions to “working boards.” This is due to the fact that social activity in Central European coun
tries is rather low, and social competence and management abilities are rather poor. Even if individuals are board members, their activity and effective competence might be low.

Rather often there will not be an executive director during the founding stage of development, and the roles and responsibilities of board members will not necessarily adhere to the rules of corporate governance. This situation may be – if there are strong leaders, e.g., the organization’s founder – very similar to that of a one-tier board.

As the organization matures the board will turn into a “managing board,” considering the executive director’s proposals as to policy, operations, and funding issues. Among mature nonprofit organizations the board typically takes the role of an advisory board giving guidance and supervising the executive director’s performance (Werther/Berman, 2001: 18f.).

The different functions and roles of the board during the organizational life cycle will also influence the terms of board members as well as the board’s composition and the frequency of board meetings. During the founding stage, for example, the board will meet more often, serve for longer and a larger number of terms, and consist of managers rather than supervisors or advisors. However, these aspects differ for more mature organizations, which are the focal point for the discussion below.

Terms of Board Members

During more mature stages board members usually serve for a tenure of between one and four years, with the opportunity to serve for another term. In many organizations the number of consecutive terms is limited because a change of board members is supposed to protect the board against capture by the executive director (Oster, 1995: 78) and to ensure the addition of new perspectives to the board’s discussions. Some amount of enthusiasm usually comes with new members as well.

On the other hand, a frequent change of board members will interfere with the continuity of the organization’s policies and mission. It also complicates team-building processes within the board and requires additional efforts in board education – both of which are crucial to efficient governance of nonprofit organizations. All board members’ terms should never end at the same time so that some measure of continuity of strategic direction can be maintained (Block, 1998: 22f.).

At the end of a board member’s term the board member as well as the electing or appointing committee has to decide whether or not the member should serve another term. The preferred rotation system enables the board to assess the performance of those members who rotate off the board within a continuing process. In addition, it is advisable to evaluate the board member’s attendance, participation, stewardship, and understanding.
In order to keep the board capable of acting, it should define procedures for the termination of board members who do not fulfill their duties or have violated the board’s code of conduct.

**Frequency and Organization of Board Meetings**

The frequency of board meetings should correspond to the nonprofit organization’s situation. It will range between three times a year (Drucker, 1990: 175) and several times a month. A higher frequency will be required if the organization has to deal with planning or policy issues, special threats, concerns about possible financial obligations, or changes within the organization (Block, 1998a: 22).

The board should establish a set of well-considered procedures for board meetings, especially regarding agenda and minutes. These procedures should also define the form of the board member’s notification about the next meeting’s topics and a stipulated period for the advance notification of a board meeting.

It is important to ensure effective governance by choosing a suitable number of meetings, but not to interfere with the executive director’s responsibilities. Even though the executive director’s task is to assist the board, the executive should not be completely occupied by preparing the board’s meetings, but also have enough time and resources to execute other duties.

**Size and Composition**

The board of a nonprofit organization typically consists only of persons who are not employed by the organization. These board members are usually volunteers from a wide variety of backgrounds (Axelrod, 1994: 119; Oster 1995:79; Block 1998a: 15).

The decision about the board’s size depends on different aspects, such as the required functions to be assumed by the board and the number of board committees to be formed (Smith Bucklin et al., 2000: 28). Other aspects include the diversity of stakeholder’s interests and the inclusion (or not) of large donors (eventually raising the organization’s fundraising capability). Networking aspects and the recruitment of experts that are to evaluate the management and advise the board are additional factors that are to be taken into consideration (Oster, 1995: 79).

Large boards will usually be able to mobilize a greater amount of financial resources due to the board member’s networking activities, their fundraising efforts and the funds provided by the board members themselves. However, such large boards usually become unwieldy, and their meetings
tend to become more formal.

Small boards usually face limitations concerning the supportive capacities of the board members, but they are more cohesive and usually act in a more informal way rather than following formal parliamentary procedures (Block 1998a: 20). To combine the advantages, some organizations decide to have a large advisory board as well as a small governing board or decide to form different committees (e.g., executive committee, nominating committee, fund-raising committee, financing committee, public relations committee) with fewer members to prepare the decisions to be made by the board.

**Figure 3. Advantages and disadvantages of small vs. large boards**

<table>
<thead>
<tr>
<th>Small Boards</th>
<th>Large Boards</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td>Better mobilization of financial resources</td>
</tr>
<tr>
<td>More cohesive</td>
<td>Greater capacities for supportive activities</td>
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<tr>
<td>More informal</td>
<td></td>
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<tr>
<td>Limitations concerning supportive activities</td>
<td>Meetings more formal</td>
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<tr>
<td>Limitations concerning fund-raising capacities</td>
<td>Immobility</td>
</tr>
</tbody>
</table>

Source: Own Figure

Homogenous boards usually make more consensual decisions, whereas diverse boards encompass different values, leading to different opinions and more argumentation (Block, 1998a: 18). Heterogeneous boards will be able to build broader networks and attract a broader range of donors and volunteers, as well as governmental aid, if built properly (Oster, 1995: 83). They will also be more willing to change policies (Block, 1998a: 18), as dissension might increase the organization’s ability to react to vital, strategic problems (Oster, 1995: 83). In order to be able to form an effective board and function properly, they will have to find a common understanding and be content with differing interests, values and interpretations (Block, 1998a: 18).

**Figure 4. Advantages and disadvantages of heterogeneous vs. homogenous boards**

<table>
<thead>
<tr>
<th>Heterogeneous Boards</th>
<th>Homogenous Boards</th>
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<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td>More consensual decision-making</td>
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<tr>
<td>Broader networks</td>
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<tr>
<td>Ability to attract a broader range of donors</td>
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<tr>
<td>Greater willingness to change policies</td>
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<tr>
<td><strong>Disadvantages</strong></td>
<td>Limited ability to react to strategic problems</td>
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<td>Higher degree of controversial argumentation</td>
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Source: Own Figure
A board will usually be built taking into account the three Ws: wealth, work, and wisdom. “Wealth” stands for large donors who will also protect the interests of other donors. “Work” represents those members who are able to monitor the management’s activities and partake in the organization’s activities. “Wisdom” points to the experts from different areas who are to advise the board (especially if there are no insiders on the board) above and beyond the staff’s input (Oster, 1995: 79). As there will be only very few experts in the nonprofit organization’s specific area of action, it will be important to compose a board with members who complement each other’s expertise.

In order not to undermine the structural decisions behind the board’s composition, a board should under all circumstances avoid being dominated by one person, a group of board members or a group of stakeholders.

Responsibilities

As a governing body the board must assume various responsibilities, which are of course subject to the organization’s specific context. The board’s responsibilities include:

- policy setting
- strategic planning
- oversight of the organization’s financial situation
- supervising compliance of the organization with legal requirements and professional as well as ethical standards
- Regarding the executive director, the board must:
  - select
  - supervise
  - advise
  - support and
  - evaluate.

If necessary, the board has to terminate the executive director.

To fulfill its leadership role, the board should set limits of action rather than approve or veto the means chosen by the executive director (Carver, 1997: 25ff.). In order to ensure clear accountability structures within the organization, the board should supervise the executive director as a committee thereby avoiding contradictory orders being given by the various board members.

Nonprofit boards often assume responsibilities that would be within the responsibility of the executive board within for-profit entities. These responsibilities include especially:
• fund-raising
• representation of the organization and
• promotion of the organization’s mission.

In order to organize its own work, the board has to assume responsibility for recruitment and education of new board members as well as management of its own work including the definition of procedures to assess its own performance.

Obstacles to Board Effectiveness

Generally an organization’s board is expected to determine the organization’s mission and policy. Very often the trustees will depend on their executive directors or staff to advise them – the board may even adopt the policies the staff drafted in advance (Block, 1998a: 16). Therefore oversight might mean supervising the staff’s actions in relation to the policies the staff itself drafted earlier. It is difficult to work as a team with the executive director, even provide and receive his advice, put him in charge of the board’s educational and team building process, and at the same time maintain the distance needed to be able to evaluate the executive director’s performance and supervise his actions (Chait/Holland/Taylor, 1996: 3).

In addition, most board members lack any special expertise in the nonprofit organization’s specific domain and are largely unfamiliar with its culture. Even though most of them are experts in different areas, their expertise only applies in part to the nonprofit organization’s engagements or needs (Chait/Holland/Taylor, 1996: 3ff.).

Moreover, most board members are selected according to their abilities and achievements in other areas, e.g., prestige, influence, and connections. This leads to the fact that most of the time trustees will be leaders or very influential individuals who are not used to discussing their decisions. They are used to being involved in their organization’s day-to-day business and are not used to being team players. Therefore they tend to act individually and interfere with the nonprofit organization’s day-to-day business. Any operating activities, though, should be coordinated with the executive director and the other board members (Widmer/Houchin, 2000).

Individual board members often give contradictory advice or try to influence the outcome of particular issues according to their personal interest. If they do so and fail to build a team, they will not come to a common decision. The result is a waste of resources (Chait/Holland/Taylor, 1996: 3ff.; Werther/Berman, 2001: 19). There are few, if any, penalties for a board’s misgovernance. Individual board members will not be held accountable for, or attributed with, a negative outcome of a specific nonprofit organization’s engagement. Attribution will in most cases be with the executive director.
instead (Chait/Holland/Taylor, 1996: 6).

Finally, the board has to fulfill its role according to the organization’s needs. A board that is heavily involved in the nonprofit organization’s day-to-day activities could undermine the executive director and staff.

5. The Executive Director

Position and Role

The executive director – or the management board of executive directors – holds the highest-ranking staff position in a nonprofit organization. But in spite of the formal hierarchical structure that puts the CEO as subordinate to the board, the day-to-day reality – as it is experienced by CEOs, board members, and staff – is that CEOs are expected to accept the central leadership role in nonprofit organizations. This often requires that CEOs take responsibility for enabling their boards to carry out the board’s duties" (Herman/Heimovics, 1994: 138).

In addition to the executive directors’ leadership role, they typically have – maybe as a result of their day-to-day involvement – a greater stake in and identification with the nonprofit organization they lead than do the boards’ members. They also have – as all executives – a greater amount of information and specific expertise. In spite of these facts, the board has to assume the superior role within the organization (Herman/Heimovics, 1994: 139). Therefore, the executive director must focus on supporting the policies as well as the direction of the board (Block, 1998b: 101).

As there are some skills crucial to board effectiveness, there are also some skills crucial to the executive director’s effectiveness. The executive director must spend time on external relations and develop an informal information network. The executive director always has to know her agenda and be able to follow it; she should be flexible and be able to improvise and accept partial solutions as well (Herman/Heimovics, 1994: 143). Dealing with the board, she should be able to facilitate the board members’ involvement to make it a satisfying and productive experience, and show consideration and respect toward board members by being aware of their individual needs. Using her central position the executive director should also challenge “the board consistently to think and rethink the connections among mission, money (and other resources), and strategy” (Herman/Heimovics, 1994: 142). She should also provide the information the board needs and initiate and maintain the board’s structure. Therefore, the board’s accomplishments and productivity depend strongly on the executive director’s engagement, and the board members have to rely on her (Herman/Heimovics, 1994: 142).
Responsibilities

The executive director’s tasks (Brinckerhoff, 2000: 60f.) mainly entail providing information to the various volunteer committees, including the board, about new developments inside and outside the organization as well as advising the board about decision-making. In addition the executive director should develop an educational program for the board and provide support for board recruitment.

In return, he may use the board members as a resource. Of course, the executive director has to develop a sound understanding of the organization, maintain fiscal control, and strategically manage all aspects of the organization. He is also in charge of the organization’s communication system (Smith/Bucklin & Associates, 2000: 45ff).

Interaction

Contrary to what is expected of executive directors, some do not fulfill their role to provide the board information and often do not give the proper information. Gibelman and Gelman (2001: 59) argue that the board’s oversight duty has been breached if the executive director becomes a co-equal board member and is allowed more than advisory power in nominating board members or develops a personal relationship with those in charge of evaluating her. This would also be the case if the executive director were given permission to operate independently of board oversight or to commit agency resources without the board’s review.

Most if not all authors agree, though, that interaction between board and executive director should be more like a partnership than a superior-subordinate relationship in order to make sure the organization’s governance structure functions effectively as well as efficiently. But it is exactly this kind of partnership that might interfere with the monitoring task of the board if it is not understood in the proper sense – in this case the board would be willing to give the executive director the “benefit of the doubt” (Gibelman/Gelman, 2001: 62). The board’s supervisory duties would be very hard to fulfill especially if the board would be influenced strongly by the executive director or depended heavily on him because of, for example, a lack of experts on the board. As has been shown here, theory and reality in nonprofit governance differ significantly. In reality, the executive director is held responsible for the outcome of the nonprofit organization’s actions – no matter whether good or bad – and this attribution is being made by the board as well as the executive director (Herman/Heimovics, 1994: 140). This corresponds with the findings of Gibelman and Gelman (2001: 59), who point out that the immediate response to allegations against a nonprofit organization is to fire...
the executive director and hire a replacement.

In order to harmonize the executive director’s responsibility and influence with the nonprofit organization’s legal structure, Herman and Heimovics (1994: 140) propose two models: the “rubber-stamp” board, which acts according to the proposals of executive director, or the board that is also largely dependent on the executive director, but obligates the executive director to support the board in fulfilling its legal, organizational, and public role, since the board would be (legally) held responsible for mission accomplishment and public stewardship. According to recent research findings the central tasks for the executive director are to develop the board’s abilities and to enable the board to carry out its duties and responsibilities. Trust between the board and the executive director is a precondition for effective and efficient governance but at the same time imposes the danger of insufficient supervision.

**Figure 5.** Interdependencies and responsibilities of board and executive director

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Source: Own Figure
The executive director’s position is crucial for the organization’s success, but at the same time, she is dependent on the board because the board’s members supervise and assess the executive director’s performance. According to scholars’ findings this means that the executive director must lead the board and, at the same time, be subordinate to it. The executive director’s leadership may not go as far as to replace the board or the board’s decision-making process, but she has to advise the board about the consequences of specific decisions. This might be seen as influencing the board. Nevertheless, regardless of the experts included and the board’s training, the board’s members will never be able to gather as much relevant background information as an executive director who is involved in the day-to-day operations of the nonprofit organization. Even if trustees are highly qualified and well informed, they will not be able to gain an insight equal to that of the executive director.

The result is a very ambivalent relationship between the board and the executive director with the executive director being responsible for making it a partnership. He will be responsible for informing the board about all relevant issues in order to avoid any surprises for the board.

Even though scholars agree that, in theory, the board’s actions should emphasize strategic goal setting, the development of the organization’s mission and the evaluation of the executive director’s performance (e.g., Carver, 1997: 108; Werther/Berman, 2001: 19), they also state that the board is often reluctant to empower the executive director to choose the means without consulting the board (Carver, 1997: 108). But one of the potential pitfalls of board governance is the board’s failure to withdraw from management as the organization grows more mature and, by doing so, the undermining of the executive director (Werther/Berman, 2001: 19).

In order to build and maintain the board-executive director partnership, the board chair should concentrate on educating and developing the board and mentoring the executive director, as well as fostering a mutual understanding between the board and the executive director. In return, the executive director should concentrate on assisting the chairperson in successfully carrying out the board leadership role and deepening the chair’s knowledge as to the field in which the nonprofit organization carries out its mission (Eadie, 2001: 103f).

Aspects of Supervision

Even though the board’s members are held legally responsible for any wrongdoings within the nonprofit organization, it has been pointed out previously that usually the executive director will be held accountable. In order to fulfill its supervisory tasks the board should decide to establish and maintain internal controls such as audits, periodic board turnover, recruitment
of outsiders without any history or interest in the organization (as part of the board), or hiring of additional competent staff (Gibelman/Gelman, 2001:62). A problem that might occur, though, if the board decides to compensate the chair financially, would be that a professional president might try to replace the executive director or at least compete with her (Schmitz, 1996: 240). This would also be applicable for any additional staff that would be employed in order to supervise the executive director directly. The installation of professional boards, which may supervise up to six boards of directors from different organizations, as proposed by Kraakman (1996: 142), could be another solution. This would be of great advantage increasing the board’s specific knowledge about the nonprofit organization’s field of action, but might interfere with the organization’s secrets vis-à-vis any possible competition.

Summarizing this aspect, the board will have to fulfill its task recruiting board members with specific knowledge about the nonprofit organization and its environment. The board members must always be aware of their supervisory and monitoring duty. This includes the requirement to keep themselves informed in a way that exceeds the information provided by the executive director. On the other hand, the board should not overlook the proposals presented by the executive director because of his deep knowledge of the organization and its surroundings. The interaction between board and executive director has to be based on mutual trust. The task of being a board member should not be accepted thoughtlessly nor should the board neglect its duty to recruit competent persons. Willingness to attend the board meetings should be a prerequisite for all board members.

**Accountability**

There are two types of responsibility: one is for individual actions within the NPO, the other is for the actions of subordinated individuals. The latter as the collective responsibility within an organization is to be called accountability in the following section.

Evaluators or supervisors do not have to deal with the individual actions of their subordinates, but rather should be concerned with gaining sufficient oversight on the whole business of the organization for which they are accountable (Carver, 1997: 105f.). The accountability of certain entities or persons should always correspond to the responsibility structure of the organization.

Even though it should be the board that is held accountable for the organization’s outcome, it is most often not. There is a common perception that the members of nonprofit boards do not face the same consequences for breaching ethical standards as do board members of organizations in the public or business sector. However, nonprofit organizations face a number of
stakeholders that should enforce board members’ accountability to regulators, the public and top officials (Belk/Daigneault, 1998: 120). Since it will always be difficult, if not impossible, to fulfill every possible stakeholder’s expectation, the board should define in whose interest the nonprofit organization is to be governed.

Even though the board will not be involved in the nonprofit organization’s day-to-day activities, it should be held accountable for the organization’s output – especially since the board’s members are accountable according to the law. As discussed earlier, the executive director is held accountable by the board, the staff and the executive director himself for the nonprofit organization’s outcomes, but this does not apply to the board in most cases.

Gibelman and Gelman (2001: 60f.) found that the clarification of board responsibilities would be crucial to improve nonprofit organization governance in general and would also increase accountability within nonprofit organizations’ hierarchy. They propose a mixture of internal nonprofit organization procedures, watchdog agencies and government oversight to increase the external accountability of nonprofit organizations. They propose this to avoid financial scandals as well as questionable business and ethical practices within nonprofit organizations. They state that external demands, e.g., in contract relationships with the government in which governments exercise the prerogative of demanding standards of management and oversight, have already imposed a growing need for accountability within nonprofit organization’s governing bodies. Because it is the board’s choice to avoid “leaky” accountability inside their organization, the demand that the board be held accountable by those outside the organization is reasonable.

On the other hand, the board must hold the executive director accountable for the organization’s outcome. To make sure accountability accumulates within the hierarchy, the board must ensure that it does not interfere with the executive director’s responsibilities. This task is also reflected by the board’s accountability for the integrity of governance or organizational performance (Duca, 1996: 17ff.).

In this context another aspect of the interaction between board and executive director has to be discussed. Even though the CEO is accountable to the board (as a whole), the relationship between any individual board member and the executive director should be collegial, not hierarchical, because the board should speak to the executive director with only one voice. By the same token, the board should regard only the executive director as its direct counterpart – not the rest of the staff. All this is to ensure clear structures and unambiguity regarding accountability issues within the nonprofit organization (Carver, 1997: 107f.).
Evaluation

In order to monitor an organization’s performance, standards for the evaluation of effectiveness have to be set. There are certain prerequisites of evaluation, starting from the existence of formal goals supplemented by the definition of means chosen to achieve those goals and the definition of the instruments chosen to evaluate the effectiveness of the chosen means (Murray/Tassie, 1994: 304f.). The definition of means, though, should not be undertaken by the board since it interferes with the executive director’s own best judgment to execute the board’s policies or strategies (Carver, 1997: 78f.). The choice of means by the board will also likely result in “leaky” accountability for the organization’s outcomes.

Because of the often-contradictory interests of a nonprofit organization’s stakeholders, the formulation of criteria for defining an effective organization and the setting of goals are considered to be very complicated (Murray/Tassie, 1994: 310f.).

Nonprofit organizations may use outside evaluators to monitor its performance. These external consultants should be used especially to assist in five aspects: asking questions, helping to design monitoring systems, drawing conclusions, facilitating a reflective progress, and reviewing and improving the whole process. All these actions can be taken more easily by outsiders simply because they are not part of the organization and may, therefore, take a fresh look at it. They can facilitate evaluation because of their background as well as their distance to the organization (Patrizi/Sanders, 1998: 141ff.).

An attempt to formulate the nonprofit organization’s goals could be made using the balanced scorecard model⁵ formulated by a board consisting of representatives of all important stakeholder groups. This would simplify the monitoring of staff activities as well as the choice of actions to be taken by the executive director. It would also avoid an excessive concentration on those outcomes that can be measured in quantitative terms but do not necessarily relate to the organization’s top goals and mission – a phenomenon that is quite common in nonprofit organizations (Murray/Tassie, 1994: 315). In addition, to ensure ethical standards are being met, Carver (1997: 79) proposes proactive constraints delineating ahead of time which actions of the different actors within the process would be seen as being unethical and imprudent.

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⁵ The balanced scorecard was developed by Robert Kaplan and David Norton (Boston, 1996). It is a management tool used to translate strategic vision into short-term goals using different perspectives and linking the formulated goals to one another.
6. Recommendations for a Well-functioning System of Corporate Governance in Nonprofit Organizations

In nonprofit organizations it is particularly important to establish a balance between formal and informal relations and procedures. The nonprofit organization’s basic task is to build harmony among its three main functions: service provision, advocacy and community building. While the effectiveness of nonprofit organizations in terms of service provision depends on institutionalization and formalization, their community role is based on informal potentialities and possibilities. In Central European countries, the operational capacities of nonprofit organizations as service providers are rather low, whereas their potential service-delivering role is quite high. Yet their community-building role is more important. In Western European countries, by contrast, the nonprofit organization’s role as service provider is well established, but in many cases the organizations have lost their community-building capacity.

In order to establish a well-functioning governance structure within a nonprofit organization, the board must establish a number of rules and regulations. At the same time it has to meet the requirements set in these rules and regulations. There are some formal aspects concerning the interactions between board members as well as personal requirements relating to each member of the board individually. A code of conduct set up for the board’s members as well as any other member of the organization should be developed in order to clarify the expectations laid out for every individual actor or entity. In addition, a system of checks and balances has to be set up to ensure a clear but balanced relationship between the board and the executive director.

In order to nourish the organization, all board members individually should participate in raising funds and in promoting the organization’s mission. The funding of the organization through its trustees can be seen as their commitment towards it (Wolf, 1999: 57f.). Involvement in fund-raising may also strengthen the willingness of board members to take their supervision responsibility more seriously. Therefore the donations of the board’s members can be a strong supportive argument for the organization’s fund-raising activities (Wolf, 1999: 57).

Because the board must monitor the organization’s performance, it should stay well informed. In order to do so and to be able to evaluate the executive director’s performance, the board’s members have to attend board meetings on a regular basis (Duca, 1996: 22). At the same time the executive director should avoid any surprises for the board and fulfill her duty to keep the board well informed. Both partners must be continuously aware of the reality that there is no such thing as perfect information. Even though the
relationship between board and executive director should be based on mutual trust, the board has to fulfill its duty to supervise the executive director and monitor her performance.

In order to enable the board to fulfill its task, the executive director should set up training for the members of the board, while the president or chair should take the responsibility to educate fellow board members as well and ensure that the board’s composition includes a maximum of the needed abilities. Therefore board recruitment and the choice of future board members deserve the board’s special attention. At the same time, one of the strategic tasks to be performed by the board is to set up performance evaluations on a regular basis, also evaluating the strategic goals of the organization and the board’s adherence to these requirements.

Of course it will be equally important to invest in the choice of the executive director. Feedback on the board’s perception of the executive director’s performance on a regular basis will help the executive director to evaluate the board’s needs and expectations. Although a board should never decide thoughtlessly about the executive director’s professional fate, it should at the same time be aware that, since the executive director is crucial to the organization’s fate, he has to fit the nonprofit organization’s needs and that these may change over time.

Suggested Readings


Carver, J. (1997): Boards that Make a Difference. San Francisco


References


Carver, J. (1997): Boards that Make a Difference. San Francisco


