
# WHEN ROLES COLLIDE

## How boards influence organizational focus and results for better – or worse

***Social Economy Fact Sheet #24***

*By Geoffrey Kistruck, Ohio State University*

*E-mail: kistruck_1@fisher.osu.edu*

*Israr Qureshi, Hong Kong Polytechnic University*

*E-mail: msisrar@inet.polyu.edu.hk*

### Birds' Eye View

Based on previous studies, we developed and tested a hypothesis regarding the relationship between diversification and board size (see call-out, this page).

To test our hypothesis, we used both **structural equation modelling** (SEM) and **multivariant latent curve modelling** (MLCM) with AMOS 7.0 on data collected from official sources (see Methods, p. 2).

The use of *variable change* rather than absolute values minimized the risk of spurious correlations resulting from other factors.

MCLM allowed us to delve deeper into our hypothesized relationships.

*In recent years, a lot of energy has gone into trying to figure out how boards affect organizations' outcomes. By shifting the focus from their role as agents to how they contribute to obtaining resources, Kistruck and Qureshi have achieved some significant insights into their inherent plurality, noting that sometimes dependency on the board for resources can generate situations where, instead of keeping organizations on track, boards may become vehicles for detrimental behaviour.*

## Boards are both monitoring agents and fund-raisers

### Using the nonprofit context as a sounding board

Researchers have tended to follow two separate tendencies when studying the effectiveness of boards, examining them either as agents in ensuring good governance or looking at their role in obtaining resources. Seldom have they tried to determine if these are indeed separate or potentially intertwined.

We looked at these questions in a nonprofit context to explore these tensions, in the context of this sector's comparatively weak formal governance environment, integrating agency and resource dependency theory to examine how boards really affect outcomes. We found that in fact these roles are inter-related. In the context of relatively weak governance mechanisms, larger boards can bring in more donations, but also lead to more diversification that ultimately weakens the organization's overall performance.

> The hypothesis that we tested was that the relationship between change in diversification and change in efficiency would be negative: this is the more diverse the organization, the less efficient it will become.

This is a serious problem, because nonprofit boards are expected to prevent organizations from straying too far from their core missions.

Earlier studies assumed that larger boards could be associated with less effective agency, because of the difficulties inherent in keeping tabs on more executives and other actors. In contrast, we found that it is the board, rather than the executives who, as their power and influence grows, may lead the organization astray. This provides interesting insight into the relationship between agency – what organizations set out to do and what they actually achieve – and funding, which, as we all know, is complex at best.

## Methods

Our data came from Registered Charity Information and Public Information Returns (Form T3010), 1998-2001, from the Charities Assessing and Registration (CARE) database. All registered nonprofits are legally required to file these 12-page forms annually. Data includes organizational demographics, financial receipts and disbursements, and the number of board members.

In total, our sample consisted of 15,553 nonprofit organizations.

**We measured changes in:**

- *efficiency*: total spent on activities and gifts over total spent (2000-2001)

- *donations*: difference in funds received 2000-1999

- *diversification*: individual activities over total.

- *board size*: 1999-1998

*This series is an initiative of the Southern Ontario Social Economy Community University Research Alliance*

*Editor: Lake Sagaris*

*Design: Laurie Mook*
*sec@oise.utoronto.ca*

*http://socialeconomy.utoronto.ca*

## The debate about board size and agency

Many researchers have seen a clear correlation between board size and better performance, because they provide organizations with access to more resources, knowledge, ability and power to confront senior executives. This is based mostly on large US publicly traded corporations, however, with research on for-profit and nonprofits suggesting that the larger the board, the poorer performance.

They also tend to look specifically at the agency or fund-raising role, rather than how these (and other) board roles interact. Indeed, many researchers have found that larger boards may lead to negative outcomes, such as excessive compensation to CEOs.

In this sense, nonprofits' experience is revealing. They share many similarities with for-profit organizations, but juggle a set of complex relationships, acting as agents not for shareholders but rather a specific community. Nonprofit boards are seldom paid for their work and subject to less regulation and supervision. Typically they are larger too.

As available funding has shrunk in recent years, boards' relevance to fundraising has grown. Some researchers raise concerns that board members may find it hard to distinguish between their own personal interests and those of the organization as a whole.

## In short: Board roles as agent-fundraisers *intertwine* and *interact*

At first, results from our different tests proved contradictory, suggesting indirect rather than direct relationships. Ultimately we found that increased income from a larger board did not go into existing mission-related activities, but rather funded new activities desired by the board member. This supports the idea that board members leverage their power over resources to steer the direction of the organization in a self-interested manner, which tends to hurt efficiency.

This study suggests that boards' roles in obtaining resources and keeping organizations on track in terms of their core missions are intertwined rather than distinct, as many previous researchers have assumed.

By exploring this relationship in a nonprofit context, we have shown that a heavy reliance on the board as a conduit to key resources can translate into an increase in agency costs, as new resources go to self-interested activities.

Both nonprofit organizations and small for-profits share a tendency to rely more on external financing than, for example, cash-rich Fortune 500 firms. Although rarely studied, governance amongst nonprofits shares similarities with that of private for-profit corporations, both large and small.

Our study offers a different explanation for the relationship between large boards and higher agency costs within organizations. While prior research explained this effect by way of pluralistic ignorance or coordination problems, we suggest instead that board powers increase rather than decrease with size.

We suggest future research within this "middle-ground" and into what leads directors to act in this manner. While some may show "self-interest with guile", others may act this way due to choice dynamics, unawareness, or simply lack of sufficient information.

## To Find Out More

http://socialeconomy.utoronto.ca/english/project_pages/project_24.php