

# Nonprofit Research Abridged



*Connecting nonprofit sector research and leadership*

## The Effect of Government Funding on Nonprofit Governance

*This issue of Nonprofit Research Abridged is based on research conducted by Professor Chao Guo at Arizona State University. To investigate the impact of government funding on nonprofit governance and community representation, he surveyed 97 Los Angeles-based nonprofit organizations in January 2002. Results showed that government funding affected two aspects of nonprofit organization governance: the composition of the board of directors and the authority of the board relative to the chief executive. This issue contains an abridged version of an article submitted for publication to Public Administration Review.*

Nonprofit organizations are often known for their fundraising efforts and for developing boards of directors with an eye toward acquiring philanthropic resources. However, many nonprofits today rely on government grants for all or a portion of their budgets. According to the National Center for Charitable Statistics, in 1999 over 44,000 nonprofits received more than \$53 billion in local, state, and federal government grants. About 45 percent of these nonprofits were those providing human services. In light of the growing importance of government contracts with nonprofit organizations in service delivery, a pressing concern is how this interdependent relationship affects the missions, autonomy, and organizational priorities of nonprofit organizations.

It is widely held that nonprofit organizations contribute to the democratic process by representing and serving the interests of their constituents in ways outside the purview or ability of government and corporations. They also give a unified voice to individual and small group concerns; another important function of democracy. However, nonprofit organizations serve these functions only to the degree they develop their representational capacities, that is, establish representative governance structures by which the views and concerns of the constituencies are represented in the leadership of the organizations.

Previous research has established two important mechanisms for establishing community and constituent representation into nonprofit governance: **board composition** and the **board-executive relationship**. Both mechanisms of representation have been found to benefit organizations in a number of ways, making them important tools for nonprofit success.

**Board composition** defines who participates in the governing process. Although boards often include key individuals for purposes of fundraising, legitimacy, and image, boards should embody and represent community interests and the composition should reflect community demographics. Community representation has been shown to increase a board's ability to reflect constituent and community interests in organizational policies, strategies, and operations. Conversely, a lack of community representatives on a board can seriously constrain the capacity of the organization to represent and serve community and constituent interests. Although some boards have a presence of community representatives, such as clients, volunteers, rank-and-file staff members, and neighborhood residents; many boards continue to be comprised solely or predominately of the corporate, professional, and social elite.

**Board-Executive Relationship** defines the patterns of leadership and the power of the board relative to executive director. It is the ability of the board to perform fiduciary responsibilities and maintain control over organizational direction. If a board lacks power, even if it is representative of its constituency, it has limited influence beyond its symbolic value. Nonprofit management literature and research advises that boards should have the ultimate leadership responsibility in organizations, including the right to provide direction in key areas such as financial management, policy-making, and service monitoring. Although this recommended approach is widely understood in the nonprofit sector, a number of nonprofits are still controlled by the chief executive, relegating the board to a rubber-stamp function.

When a board is both representative of the community and has organizational authority, the result is more community involvement and increased organization responsiveness. A nonprofit organization with a representative, community board that has authority over organizational direction is regarded as having the highest capacity to represent community and constituent interests.

### **How Government Funding Affects Governance**

To assess the impact of government funding on organization governance, 97 Los-Angeles based nonprofit organizations were surveyed in January 2002. Consistent with previous research, the findings showed that the more an organization was dependent on government funding, the less likely it was to have a board with both community representation and board power relative to the chief executive. Organizations

“When a board is representative of the community...the result is **more community involvement.**”

“Government funding tends to **shift power** from the board to the **chief executive.**”

dependent on government funding were more likely to have a board comprised solely or mainly of corporate, professional, and social elite. Organizations with a high proportion of government funding were also more likely to have a board that lacked power relative to the chief executive.

Why does government funding contribute to a board with less community representation and less power? There appear to be a number of contributing factors. One of the important factors is the trend of professionalization in the nonprofit sector. In the quest for legitimacy needed to obtain government contracts, organizations tend to develop a culture of professionalism, which includes having more professional, corporate, and social elite on the board. The development of such professionalism may not positively affect productivity or efficiency, but it signals to government agencies that the organization is legitimate.

Government funding tends to shift power from the board to the chief executive, for several reasons; one is the complexity of the government funding process. Government regulations, legislation, budget cycles, proposals, and contract requirements often result in an information gap between the board and the staff which favors the staff. Also, government funding often changes the scale of an organization, making it difficult for the board to monitor organizational activities.

These findings and previous research show that dependence on government funding can push nonprofit boards away from decision-making and distance the organization from the community. Previous research has also shown that government funding leads to less volunteer support, fewer private donations, and less advocacy for the community. Together, these results suggest that governmental dependence might eventually shrink the base of public support of nonprofit organizations and limit their representational functions.

### **Volunteers: A Mediating Factor**

The findings revealed an important factor that contributes positively to a board having community representation and organizational authority: involvement of volunteers. Organizations that were more dependent on volunteer labor to accomplish the mission were more likely to have a representative, community board with increased power relative to the chief executive.

Volunteers are an important group of community representatives. Volunteers are often from the local community or are former (or existing) beneficiaries of the services provided by the organization. Volunteers help nonprofit boards establish stronger ties with the community and foster democratic values, including the importance of representing the community's interests. Volunteers also tend to have more power and control in an organization when it is reliant on them to accomplish the mission; this includes representation of rank-and-file volunteers on the board of directors.

Organizations that carry out their mission through volunteers must strive continually to keep volunteers motivated and engaged. A common and effective way organizations motivate and reward volunteers is through opportunities to be more involved in the governance and management of the organization. Board appointments are the highest level of such reward, giving volunteers the opportunity for increased participation and influence over the direction of the organization.

The more an organization relies on volunteers to accomplish the mission, the more likely it is to have volunteers intimately involved in the direction of the organization, including as board members. The active involvement of volunteers throughout the organization and on the board of directors may counteract some of the effects of reliance on government funding.

### **Implications**

These findings have implications for both policy makers and nonprofit leaders. Policy makers who advocate for privatization and contracting with nonprofit agencies need to understand the unique purposes of nonprofits, such as their importance to community and democracy, and should be aware of the potential damage that government funding might cause to nonprofits' representational capacities. Policy makers should make a concerted effort to help nonprofits sustain their community orientation and base of public support. For instance, policy makers can design and

### *About the Researcher*

**Chao Guo** is an assistant professor in the School of Community Resources and Development and an affiliated faculty member of the Center for Nonprofit Leadership and Management at Arizona State University. Guo's research interests include governance and management of nonprofit organizations; collaboration within and across sectors; organizational decision-making processes; and organization theory. Guo obtained his Ph.D. in public administration from the University of Southern California.

implement funding policies that encourage the inclusion of more community representatives in the decision-making process. Such a more precisely focused policy might help the emergence and prosperity of more nonprofit organizations with better representation of community interests.

Nonprofit organizations, on the other hand, need to maintain a workable balance between their needs for government funding and their equally compelling needs to retain a community orientation. Due to the positive association between volunteer involvement and the likelihood of an influential, representative board, increased volunteer involvement at all levels of the organization is an effective strategy to counter-balance the undesirable effects of government funding.

The full research report, bibliography and notes, and additional resources for nonprofit governance are available at <http://nonprofit.asu.edu> under *Research that Matters*.

**Center for Nonprofit Leadership and Management**

Improving the quality of life in communities by providing knowledge and tools that enhance nonprofit effectiveness.

*Research That Matters  
Nonprofit Leadership Education*

*Assistance to Nonprofits  
Conferences and Convenings*

**CENTER NEWS**

The **Nonprofit Management Institute** offers workshops and courses that provide the knowledge and tools needed to succeed in today's nonprofit environment. Programs include continuing education courses, a professional certificate in nonprofit management, the Nonprofit Excellence Enrichment Series, topical workshops and conferences.

Programs are offered in convenient locations and timed to fit the schedules of busy professionals. For more information, please visit the website at <http://nonprofit.asu.edu> or call (480) 965-1867 or e-mail [nmi@asu.edu](mailto:nmi@asu.edu).

**\*Save the Date\* 12<sup>th</sup> Annual Nonprofit Day - December 3, 2004**

*Nonprofit Research Abridged* is published by the ASU Center for Nonprofit Leadership and Management as a service to the nonprofit sector and contains summaries of nonprofit research studies. The full research report, related resources, and past issues are available on our web site. For questions, please contact Stephanie Hiatt, Editor, at [hiatt@asu.edu](mailto:hiatt@asu.edu).

Copyright © 2004 Arizona Board of Regents for and on behalf of ASU and its Center for Nonprofit Leadership and Management. All rights reserved.