Nongovernmental Organizational Governance and Corporate Governance: A Comparative Analysis

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Abstract: In an organizational setting, the board members are the persons in whom power is entrusted by the principals to act as fiduciaries and to guide the organization. A main cause of concern originates from the classical problem of the separation of ownership and control. Although agency theory, the dominant approach to research on corporate governance in particular, holds that the separation of ownership and control constitutes an efficient division of labor, there is widespread awareness that managers and boards may take actions that hurt principals or constituencies they are meant to serve. An agency problem can manifest in several ways. First, managers and boards exert insufficient effort while overcommitting themselves to external activities. Second, they might reap private benefits in the form of perks. Last, they may take unnecessary risks by committing to mature projects. This basic agency problem suggests a possible definition of corporate governance and nongovernmental (organizational) governance as addressing both an adverse selection and a moral hazard problem. A good governance structure is then one that selects the most able managers and makes them accountable to relevant constituents. Moreover, strengthening board performance in NGOs and thus their governance structure is widely recognized as being a major requisite for the improvement of community services that NGOs provide.

This paper seeks to address the following recurring questions:

1. What are the fundamental similarities and differences between corporate governance and nongovernmental governance?
2. What lessons can these forms of governance draw from each other in terms of recent governance reform efforts in both sectors?
3. What constitutes an efficient NGO accountability structure?
4. Should institutional constituents such as large donors interfere with management?

Clearly, such questions lead observers to examine the comparative merits of var-

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ious legal, fiscal, and regulatory environments. In this paper, I examine recent advances in both agency theory and stakeholder theory in the organizational governance context. This is because many have advocated moving from traditional principal value to the broader concept of the stakeholder society, in which the interests of various community groups would be better represented.
This paper suggests that the traditional agency theories of organizational governance are fundamentally inadequate to build trust. We propose an alternative theory and approach based on stakeholders and managerial stewardship. We briefly compare agency theory, stakeholder theory, and stewardship theory as models of organizational governance. We conclude by providing insights into the key implementation steps that are important in implementing an ethically consistent stakeholder model—key steps for restoring and rebuilding public trust.

Keywords: Governance, NGO, Corporations, Comparative Studies

INTRODUCTION

Public and private organizations around the world are faced with a serious problem: the loss of public confidence. Several well-publicized scandals and the decline of public trust have propelled governments around the world to introduce regulatory measures aimed at institutionalizing good organizational governance and strengthening stewardship of the organizations in question. In addition, there is a growing expectation among relevant stakeholders for not only improved organizational performance, but also increased accountability for managers' actions (Alkhafaji 1989).

Economists and legal scholars often define corporate governance as the defense of shareholders' values or the ways in which shareholders assure themselves of getting returns on their investment (Shleifer and Vishny 1997). On the other hand, nongovernmental organizations (NGOs) are governed by boards of trustees that act on behalf of the interests and values of the community, constituents, and donors (Golden-Bidddle and Rao 1997) or represent "the voices of society" (Hertlinger and Krasker 1987, 104).

The need to improve organizational governance has occupied the attention of government regulators, organizational managers, shareholders, and other stakeholders. How an organization should managed to optimize performance and who should be involved in governing have been intensely debated among academicians and practioners. At risk is the investor's (donor's) trust in not only managers but also the institution of governing. Recognizing that the form of the relationship between parties directly influences the willingness to trust, recent debates on governance systems seek to

address the need to balance trust and accountability (Sheppard and Sherman 1998).

The state, the market, and the voluntary nonprofit sectors can be seen as each being characterized by a distinctive governance regime. Goodin (2003) noted that these regimes focus on different subjects of accountability (actions, results, and intentions, respectively) and on different mechanisms of accountability (hierarchy, competition, and cooperative networking, respectively). Different regimes can complement one another, enhancing the democratic accountability of the system overall.

Despite these similarities, there exist unavoidable differences between corporate governance and nongovernmental governance, from the number of constituents involved to the principals' objective functions, to managerial incentive schemes, to monitoring schemes. However, close inspection of the literature on organizational governance reveals little research comparing organizational governance structures between nongovernmental (nonprofit) and corporate sectors. In addition, the literature fails to provide any systematic, empirically tested basis for setting governance standards, measuring performance, or the extent to which board performance may affect the operation of the organization.

This article suggests that application of the traditional agency theory is fundamentally inadequate for building trust in nongovernmental organizations (NGOs). We propose alternative theories and approaches based on managerial stakeholders and stewardship. We briefly compare agency theory, stakeholder theory, and stewardship theory as models of organizational governance. We propose that stewardship theory offers a system of governance that is ethically consistent with the needs of NGOs in today's operating environment. In addition, by comparing corporate governance and nongovernmental governance structures, we seek to differentiate and disseminate relevant information on governance. Furthermore, the OECD Good Governance Principles are analyzed in order to garner lessons for NGOs. We conclude by providing insights into the key ingredients for good nongovernmental governance and an ethically consistent stewardship model-key steps for restoring and rebuilding public trust in NGOs.

THREE MODELS OF GOVERNANCE

Agency Theory

Agency theory, often known as the principal-agent theory, essentially formalizes an idea that when ownership and control of organizations are not fully coincident, there is potential for conflicts of interest between owners and controllers.[1] The conflicts of interest, combined with the inability to costlessly write perfect contracts or monitor the

controllers, ultimately lead to a reduction in the value of the organization. These ideas form the basis for research on corporate governance. How do entrepreneurs, shareholders (principals), and managers (agents) minimize the loss of value that results from the separation of ownership and control?

According to agency theory, shareholders represent the interests that managers should be concerned with when making corporate decisions (Jensen 1988; Jensen and Meckling 1976). Managers, on the other hand, are presumed to be self-interested economic actors who often behave in ways that do not maximize shareholders' wealth (Canella and Monroe 1997). For instance, managers have incentives to cause their firms to grow beyond the optimal size, because growth increases managers' power by increasing the resources under their control. Managers also prefer growth over profitability, because changes in compensation are positively related to the growth in sales (Murphy 1985). Alternatively, they may consume excess perks or may initiate actions that make it difficult for the firm to remove the perks. Costs associated with the separation of ownership from control are known as *agency* costs (Eisenhardt 1989).

Williamson (1975) noted that opportunistic behaviors by managers arise because principals (shareholders) and agents (managers) have differing risk preferences and have conflicting interests. When agents misrepresent their abilities (*adverse selection*) or put in less effort than is required to achieve their principals' objectives (*moral hazard*), principals must allocate resources to monitor agent performance or create performance-based compensation schemes to achieve desired behaviors (Hendry 2002). Hart (1995) argued more broadly that corporate governance issues arise whenever two conditions are present: First there is an agency problem, or conflict of interest, involving members of the organization; these might be owners, managers, workers, or consumers. Second, transaction costs are such that the agency problem cannot be dealt with through a contract.

Agency theory was developed in response to unrealistic assumptions made under the neoclassical theory of the firm. The neoclassical theory treats the firm as a "black box" and predicts how the firm's production plan varies with input and output prices, while saying little about how this production plan comes about. The neoclassical theory assumes that because all individuals associated with an organization do not care about the outcome of the organization's activities, they can be instructed to maximize profit or net market value or to minimize costs. More specifically, the neoclassical theory assumes that effort choices and costs are observable. Agency theory departs from this assumption by noting that some costs are private information. For example, in a

1. There are also benefits to separating ownership and control, namely the specialization of labor.

typical agency problem, an owner hires a manager to run his firm for him. The firm's performance, represented by gross profit, Π, depends on the manager's effort, *e*, and also a chance variable, ε, determined after e is chosen.

$$\Pi = g(e, \varepsilon)$$

It is supposed that the manager's effort choice is observed only by him. Thus, a contract that makes the manager's compensation, I, a direct function of *e* cannot be enforced. Instead the manager's compensation must be geared to realized profit:

$$\Pi : I = I(\Pi)$$

This model generates a classic trade-off between incentives and risk sharing. On the one hand, to motivate the manager to work hard, it is necessary to give *him high-powered* incentives, that is, to make I very sensitive to Π. On the other hand, to protect the manager from risk, it is necessary to give him *low-powered* incentives, that is, to make I insensitive to Π. A large part of the principal-agent literature has been concerned with determining the optimal balance between efficiency and risk-bearing. Also, the model has been generalized to allow for multiple agents, multiple principals, many dimensions of action, and many periods.

Although agency theory provides useful insights into how managers' objective functions might be aligned with those of the principals through some form of performance-related compensation scheme, it says little about the role of governance structure. This is because governance structure matters when some actions have to be decided in the future that have not been specified in an initial contract: governance structure provides a way for deciding these actions. However, in a comprehensive contracting world, everything has been specified in advance and there are no residual decisions.

Stakeholder Theory

Stakeholder theory takes a broader approach to how managers should articulate management policies and managerial attention among diverse constituencies. It was originally proposed as an alternative theory to the traditional agency theory (Donaldson and Davis 1989, 1991). Stakeholder theory posits that managers should pursue the best interests of organizational owners while considering the needs of other stakeholders. The term *stakeholders* often refers to persons, groups, or organizations whose view must be taken into account in the decision-making process. This definition is consis-

tent with that of Freeman (1984), who defined a stakeholder as "any group or individual who can affect or is affected by the achievement of the organization's objectives." The stakeholder is also a claimant toward whom others may or may not have a fiduciary responsibility. The definitions from the public and nonprofit management literature differ in how inclusive they are. The decision about how to define stakeholders, therefore, is consequential, as it affects who and what counts (Mitchell, Agle, and Wood 1997).

Winn and Keller (2001) posited that traditional stakeholder theories focus on the achievement of traditional corporate objectives, which often seek to balance the needs of owners with those of various constituencies. The stakeholder theory concept is based on the ethical premise that ''the task of management is not only to deal with the various stakeholder groups in an ethical fashion but also to reconcile the conflicts of interest that occur between the organization and the stakeholder groups" (Carroll 1996, 23). It is also interesting to note that the view is also shared with advocates of expanding the role of corporate social responsibility, who recognize that organizations must pursue both profit and (public) service (Carroll 1996).

Carroll (1996) noted that the traditional economic model, based on Adam Smith's notion of the invisible hand, held that society determines its needs through the marketplace. He wrote that the marketplace may do a reasonable job in determining which goods and services to produce but that it did "not fare as well in ensuring that business always acted fairly and ethically (Carroll 1996, 29)." Carroll's model of moral organizational decision-making incorporates a standard of normative ethics that requires those managers to adhere to ethical business behavior that is consistent with the societal view (1996, 92-93). Those who are advocates of the stakeholder theory argue for its virtues to primarily be based on its normative value (Donaldson and Preston, 1995).

The stakeholder theory attempts to articulate a fundamental question in a systematic way: Which groups are stakeholders deserving or requiring management attention and which are not? Bryson (1995) offered a quick and useful way of identifying stakeholders and their interests: Whatever the magnitude of their stake, each stakeholder is a part of the nexus of implicit and explicit contracts that constitutes the firm. It is interesting to note, however, that as a group, managers are in unique positions as they are at the center of the nexus of contracts. Managers are the only group of stakeholders who enter into a contractual relationship with all other stakeholders. Managers are also the only group of stakeholders with direct control over the decision-making apparatus of the firm (Hill and Jones 1992, 134). This situation implies that the efficacy of the stakeholder theory depends on how managers pursue their managerial role in creating an enabling environment for different constituencies be heard in the decision-making process.

The stakeholder relationship imposes duties that Freeman and Evan (1990) described as a network of implicit contracts between each stakeholder group and management, proposing a set of heuristic or social contracts based upon normative principles of human conduct. Freeman and Evan upheld the ''firm as contract" notion, in which the manager oversees the contractual relationship with each stakeholder. Ultimately, Freeman and Evan saw stakeholder theory as redefining the purpose of the firm: to serve as a vehicle for coordinating stakeholder interests. Other scholars similarly argued that the duty owed to all stakeholders is the creation of long-term wealth (Hosmer 1986; Post et al. 2002; Selznick 1992).

Stewardship Theory

Davis et al. (1997) described stewardship theory in terms of a relationship in which managers are stewards whose motives are aligned with the objectives of many parties. In their model, the behavior of the steward is collectively or organizationally centered in terms of seeking and sustaining the objectives of the entire organization. They suggest that the role of the steward is to protect and maximize the wealth of shareholders and the organization and to avoid or prevent substituting individual self-serving behaviors for organizational behaviors that enhance organizational functioning and effectiveness.

Jones (1995) posited that under the stewardship model managers who are stewards are most effective when corporate governance structures give them high authority and discretion. However, this approach is likely to be viewed as dysfunctional and unrealistic under the agency theory, as principals and agents have conflicting interests. In describing the ethical role of the corporate steward, Davis et al. (1997, 26) provided clarifying detail by stating that "Given a choice between self-serving behavior and pro-organizational behavior, a steward's behavior will not depart from the interests of his or her organization. A steward will not substitute or trade self-serving behaviors for cooperative behaviors. . . . Because the steward perceives greater utility in cooperative behavior and behaves accordingly his or her behavior can be considered rational."

A specialized form of stakeholder model is a covenantal relationship, which is based upon "moral ordering" and "self-defining commitment" (Selznick 1992, 479). Pava (2001) also incorporated the concept of "shared community" in his definition of a covenant, noting that a covenant provides "a stable social location for the interpretation of life's meanings in order to help foster human growth, development, and the satisfaction of legitimate human needs" (86). This definition essentially takes into account that the duties of organizations are often perceived as implicit (ethical) contracts to various stakeholders.

Table 1. Summary of the Main Characteristics of Various Theories

	Agency Theory	Stakeholder Theory	Stewardship Theory
Overall ethical focus	Teleological or goal oriented and deontological or duty oriented	Focused on the utilitarian needs of all stakeholders with an ethics of balance	Virtue ethics based upon a commitment to society-based virtues and rights
Manager's role	Maximize short-term wealth for the Principal	Balancer of demands and advocate of collective interests	Integrator of shared interests
Time focus	Often short-term	Both short-term and long-term	Primarily long-term
Basis of trust	Competence	Equity	Integrity
Key value	(Financial) Results	Balance	Authenticity
Managers Primary Function	Profit producer/ Value maximizer	System maintainer	Steward
Organizational goal	Create highest possible short-term wealth	Create wealth and preserve relationships	Create long-term wealth and achieve best interests of all
Manager's personal goal	Preserve self-interest	Serve all parties fairly	Achieve potential
Motivational model	Economic model with extrinsic motivators	Mixed model with mixed motivators	Self-actualizing model with intrinsic motivators
Vision/focus	Protection of self-interest	Integrating shareholder and organizational interests Increasing organizational	Increasing organizational wealth to serve all interests
Assumptions about People	People seek rewards in an exchange relationship and are individualistic utility maximizers	People are concerned with equity and fairness and want to be dealt with justly. Utility is measured distributively	People are collective self-actualizers who achieve utility through organizational achievement

Source: Author's own adaptations from Caldwell & Karri (2005)

GOVERNANCE MECHINISM

Denis and McConnell (2002) defined corporate governance as a set of mechanisms, both institutional and market-based, that induce the self-interested controllers of an organization to make decisions that maximize the value of the organization to its owners. This is in line with Shleifer and Vishny's (1997) view of corporate governance as a mechanism that "deals with the ways in which suppliers of finance to cor-

porations assure themselves of getting a return on their investment." The corporate governance literature often deals with mechanisms that are broadly characterized as being either internal or external to the firm. The internal mechanisms of primary interest are the board of directors and the equity ownership structure of the firm. The primary external mechanisms are the external market for corporate control and the legal (regulatory) system.

Internal Governance Mechanisms

Boards of Directors

The board of directors is the key institution that represents and protects the interests of owners. The board exists primarily to hire, fire, monitor, and compensate management. While the board is an effective organizational governance mechanism in theory, in practice its efficacy has been subject to intense debates. This is because boards of directors often include insiders who are to be monitored and CEOs often serve as the chairpersons of the boards, while the nature of the selection process for board members is such that management often has a strong hand in determining who the other members will be.

The primary corporate board-related issues that have been studied in the literature are board composition and executive compensation. Studies of board composition include research into the size and structure of the board: the number of directors that comprise the board, the fraction of these directors that are outsiders, and whether the CEO and chairperson positions are held by the same individual. Executive compensation research is concerned with ways in which managers are compensated that align their interests with those of their companies' owners.

The board characteristics that have been most extensively studied are the relative proportion of outside directors and the size of the board. Hermalin and Weisbach (2002) summarized the U.S. evidence as follows:

> 1. Higher proportions of outside directors are not associated with superior firm performance but are associated with better decisions concerning such issues as acquisitions, executive compensation, and CEO turnover.
> 2. Board size is negatively related to both general firm performance and the quality of decision making.
> 3. Poor firm performance, CEO turnover, and changes in ownership structure are often associated with changes in the membership of the board.

Consistent with the findings for the United States, there is some evidence that boards with more outside directors in other countries are more likely to dismiss top manage-

ment; there is also a negative relationship between board size and firm performance.

Dahya et al. (2002) addressed the effect of the Code of Best Practice, put forth by the Cadbury Committee, on board effectiveness. The Code recommends that boards of U.K. corporations include at least three outside directors and that the positions of chairperson and CEO be held by different individuals. CEO turnover increased following issuance of the Code and that the sensitivity of turnover to performance is stronger following its issuance. These increases are concentrated among those firms that chose to adopt the Code. Dahya et al. concluded that the increase in the proportion of outsiders on the board, rather than the separation of the Chairperson and CEO positions, is responsible for the turnovers. On the basis of an event study of stock prices, Dahya and McConnell (2002) reported that appointment of an outside CEO is good news for shareholders.

It is interesting to note that although boards of directors in Europe are mostly unitary, some European countries, including Germany and Austria, have a two-tiered system (Wymeersch, 1998). Two-tier boards often consist of a managing board, composed of executives of the firm, and a supervisory board. In Germany, representation of employees on the supervisory board is mandatory; this practice is known as *codetermination*.

There are some similarities between for-profit and nongovernmental sectors in terms of governance structure. Both have boards of directors, trustees, a chair, and regular meetings (McFarlan, 1999). In both cases, boards are responsible for setting the organization's mission, monitoring its progress toward achieving that mission, and selecting and evaluating its management. An important difference between a corporate board and a nongovernmental board is that whereas the former seeks to secure optimal financial performance, financial considerations form only one dimension of an NGO board's mission statements. Another, more critical variable is that an NGO tends to serve more diverse constituencies. Thus, finding a balance between financial considerations and other aspects of a nonprofit's mission, and a balance among different constituencies, are difficult tasks that a nonprofit board must address.

In terms of operational freedom, a for-profit CEO is given relatively free reign to set and implement a strategy, which is then reviewed by the board of directors. In many countries, most corporate CEOs are also board chairmen, which means that nonexecutive chairs are a rarity. However, it is normal for a nongovernmental CEO to report to a nonexecutive chair. Although the relationship between a CEO and a board is nominal, managing this important and sensitive relationship is the greatest leadership challenge a nonprofit CEO faces. In the typical for-profit two-tier system, found in some countries, *board* refers to the supervisory board, and key *executives* refers to the management board. NGOs have a more complicated system, whereby boards of trustees coexist with supervisory boards, management boards, executive boards, and

often core executive boards.

There are few areas in which the differences between non-governemntal and for-profits are so pronounced as in the structure of their boards. For-profits generally limit board numbers to between eight and fourteen directors, and this is possible because corporate boards are limited in their mission. The nongovernmental board tends to be much larger because it needs to represent many constituencies that have a stake in the organization, especially potential donors. Large boards need executive committees. For-profit boards also have executive committees, but these usually have limited responsibilities and are made up of insiders. Because boards in the nongovernmental sector are much larger, the executive committee often has a very different role. In addition, a nongovernmental board often has a committee charged with understanding and evaluating how well the organization and its professionals are achieving the qualitative aspects of their mission. This so-called operations committee, which does not have a for-profit counterpart, helps ensure that at least some board members have first-hand insight about what the professionals on the front lines are dealing with and what their concerns are.

Table 2. Characteristics of For-Profit Versus Non-Governmental Governance

	For-profit sector	Nonprofit sector
Mission	• Grow market Capitalization through products and services	• Deliver services to key constituencies
Measure	• Financial performance	• Financial performance balanced with other measures
Leadership	• CEO is sole boss	• CEO reports to non-executive chair
Board Composition	• Small • Clear and simple structure • Nominating committee is relatively interactive	• Large • Executive committee -Operations committee structure complicated Nominating committee constantly at work
Board Members	• Predictable profiles, often senior business professionals • Predictable roles • Long service • Highly paid	• Diverse profiles, often incorporating potential financial donors • Diverse roles • High turnover • Expected to donate and seek funds

It is interesting to note that non-governmental boards consist entirely of outsiders whose function tends to align with those of management. With the exception of well-developed NGOs, organizations that are short on resources and directors are called

upon to aid the work of management to secure funding. This helps to explain the relatively large size of boards in NGOs. Often NGO boards function more as resource seekers than monitors, and more as guides than controllers.

The turnover on nonprofit boards is much higher than on for-profit boards, as the lack of compensation and the fast pace of nonprofit activities tend to restrict their tenure. Some have cautioned against a high turnover ratio, which can undermine the board's commitment to an organization's long-term strategy. Compensation is another significant difference between for-profit and nonprofit boards. As the legal responsibilities and the time demands placed on for-profit directors have grown, compensation packages have become very generous, often incorporating incentive-based components such as stock options. But for nonprofit groups, the exact opposite is true. From the outset, directors are expected to reach deep into their pockets to contribute to their organization's annual fundraising and to its capital drives. As their responsibilities grow, expectations about their contributions grow subtly but often dramatically.

According to Kim (2005), the roles of governing boards and trustees have been poorly defined in NGOs, especially in comparison to the for-profit sector; as a result, the boundaries between boards and management became unclear. Boards often consist of celebrities and social leaders who devote most of their time to fund-raising campaigns rather than their fiduciary duties as trustees of institutions. Because of the emphasis on growth in this sector, civil society around the world has failed to adequately deal with its internal governance structure.

Ownership Structure

The literature on ownership structure deals with the identification of an organization's owners, whose impact on organizational performance is an important research topic in corporate governance. Today's modern corporations have a widely dispersed share ownership; individual shareholders own very small fractions of an individual firm's shares. This gives shareholders little or no incentive to expend significant resources to monitor managers or to seek to influence decision making within the firm. Moreover, the free-rider problem reduces the incentives for these disparate shareholders to coordinate their actions. However, shareholders who have more significant ownership positions have greater incentives to expend resources to monitor and influence managers.[2]

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2. Holderness (2002) surveyed the U.S. evidence on equity ownership by *insiders* (the officers and directors of a firm) and *blockholders* (any entity that owns at least 5% of the firm's equity). He reported that average inside ownership in publicly-traded U.S. corporations is approximately 20%, varying from almost none in some firms to majority ownership by

Agency theory generally favors increased overlap between ownership and control, because such overlap leads to a reduction in conflicts of interest and, therefore, to higher organizational value. In reality, however, the relationships between ownership, control, and firm value are more complicated than that. Although ownership of a firm by its management tends to better align managers' interests with those of the company's owners, to the extent that managers' and shareholders' interests are not fully aligned, higher equity ownership can provide managers with greater freedom to pursue their own objectives without fear of reprisal. This is often described as the managerial ownership's trade-off between the alignment and entrenchment effects.

As with ownership by managers, concentrated ownership structure also has mixed results on corporation value. To the extent that large shareholders have both the incentive to monitor management and enough control to influence management such that cash flow is increased, all shareholders of the firm benefit. These are the shared benefits of control. However, there are private benefits of control as well. Large shareholders can use their control to extract corporate resources, and the private benefits they receive will lead to reductions in the value of the firm to other shareholders. Thus, the ultimate effect of large shareholder ownership on measured firm value depends upon the trade-off between the shared benefits of large shareholder control and any private extraction of firm value by large shareholders. Despite the existence of private benefits of control, which allow for control rights in excess of cash flow rights, private ownership concentration appears to have a positive effect on firm value.

Furthermore, ownership and control are rarely completely separated within any organization. The controllers frequently have some degree of ownership of the equity of the firms they control through performance-linked compensation schemes; some owners, by virtue of the size of their equity positions, effectively have control over the firms they own.

There are significant differences between corporate and NGO ownership structures and their impacts on operations of organizations. NGOs have more widely dispersed member (donor) structures, and although large donors do have disproportionate levels of influence on organizations, more diversely structured boards enable NGOs to balance the interests of small donors and other stakeholders. In addition, although NGOs have little means to reduce the agency costs arising from the conflict of interests between donors and management, the nature of self-selection in the managerial market enables NGOs to align the objectives of managers and donors.

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insiders in others. Mehran (1995) reported that 56% of the firms in a sample of randomly selected manufacturing firms have outside blockholders.

External Governance Mechanisms

The Market for Organizational (Corporate) Control

When internal control mechanisms fail, the gap between the actual value of a firm and its potential value tends to increase which, in turn, provides financial incentive for outsiders to seek control of the firm. The market for corporate control has both 'preventive' benefits as well as creative aspects. For instance, a mere threat of a change in control can provide management with incentives to keep firm value high, so that the value gap is not large enough to warrant an attack from the outside. Moreover, changes in the control of firms virtually always occur at a premium, thereby creating value for the target firm's shareholders.

As with other potential corporate governance mechanisms, however, the corporate control market has its dark side for shareholders. In addition to being a potential solution to the manager/shareholder agency problem, it can be a manifestation of this problem. Managers interested in maximizing the size of their firms can waste corporate resources by overpaying for acquisitions rather than returning cash to the shareholders.

Unlike other organizational governance schemes, NGOs rarely face the threat of takeover by other NGOs or (corporate) raiders. Donors' only threat to management other than their dismissal is the exit option where they implicitly or explicitly remove themselves from getting involved in NGOs.

The Legal System

The corporate governance literature has paid only scant attention to another external corporate governance mechanism, the legal system. This is because, as Jensen (1993) elaborates eloquently, the legal system as a corporate governance mechanism is a too blunt an instrument to deal effectively with the agency problems. Shleifer and Vishny (1997) argue that good corporate governance systems are rooted in an appropriate combination of legal protection of investors and some form of concentrated ownership. The US and UK systems rely somewhat more heavily on stronger legal protection, while the German and Japanese systems are characterized by weaker legal protection but more concentrated equity ownership.

LaPorta, Lopez-de-Silanes, Shleifer, and Vishny (1998) further emphasize that the legal system is a fundamentally important corporate governance mechanism. In particular, they posit that the extent to which a country's laws protect investor rights and the extent to which those laws are enforced are the most basic determinants of the ways in which corporate finance and corporate governance evolve in that country. They found significant differences across countries in terms of investor protection, and countries with low investor protection are generally characterized by high concentration of equi-

ty ownership within firms and a lack of significant public equity markets. They also find that the laws in common law countries provide the strongest degree of protection for shareholders, while the laws in French civil law countries provide the least protection. Enforcement of the laws is stronger in the German and Scandinavian law countries than in the common law countries, with the weakest enforcement observed in French civil law countries.

According to LaPorta, Lopez-de-Silanes, Shleifer, and Vishny (1998), concentrated ownership may be a reasonable response to a lack of investor protection. If the law does not protect the owners from the controllers, the owners will seek to be controllers. This essentially reduces or even eliminates the agency conflicts between managers and shareholders because large shareholders have both the incentive and the ability to control management. There are, however, equity agency conflicts between dominant shareholders and minority shareholders.

In their subsequent study, LaPorta, Lopez-de-Silanes, Shleifer, and Vishny (2000) find the positive effects of investor protection on economies are echoed for the individual firms within them. They find that firms in common law countries where investor protection is stronger make higher dividend payouts when firm reinvestment opportunities are poor than do firms in countries with weak legal protection.

With advance of globalization, increased mobility of labor, and increased competition to attract foreign investment, there is a functional convergence that is taking place in the world. Coffee (1999) and LaPorta, Lopez-de-Silanes, Shleifer, and Vishny (2000) note that the basic corporate form has already achieved a great deal of uniformity and that economies are approaching a world-wide consensus that managers should act in the interests of shareholders and that this should include all shareholders. They assert that there are three principal factors driving economies towards consensus: the failure of alternative models, the competitive pressures of global commerce, and the shift of interest group influence in favor of an emerging shareholder class. They acknowledge that convergence in corporate law proceeds more slowly than convergence in governance practices; however they expect that the pressure for convergence in law will be strong and ultimately successful.

In NGO setting, the laws and regulations governing registration and incorporation are varied and complex and, in most cases, outdated (Jung *et al*., 1999). Japanese and Korean NGOs, for example, face inconsistent responses from government depending on the size of their operations, and Bangladeshi NGOs face numerous laws, including the Trust Act of 1882 and the Way of Ordinance of 1962. This creates a "regulatory arbitrage" in which newly established NGOs can choose less stringent regulatory structures because of disparities in the regulatory standards applied to different types of organizations. At the other extreme, although Australian NGOs have received sub-

stantial government subsidies, they are subject to little governmental oversight.

Kim (2005) finds that NGOs urgently need practical mechanisms for aligning performance and accountability, and this often requires organizational, technological, and regulatory changes. Institutionalizing accounting, auditing, and reporting systems is a first step toward integrating new patterns of civil accountability and governance as the current legal system rarely provides protection against management abuses. Past experience and innovation in new governance schemes has enabled viable and effective methods to evolve and laid a foundation for future accounting, auditing and reporting standards.

OECD PRINCIPLES OF CORPORATE GOVERNANCE (2004)

Realizing the importance of corporate governance in improving economic efficiency and and enhancing investor confidence, the OECD has published a report on "Principles of Corporate Governance" in 2004. The report seeks to clarify relationships between a company's management, its board, its shareholders and other stakeholders in order to institutionalize a structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. It starts by stating that good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The OECD asserts that an effective corporate governance system is critical in order to secure investor confidence. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently.

Although the corporate governance framework also depends on the legal, regulatory, and institutional environment, the OECD Principles build on common elements found among member countries and are formulated to embrace different models that exist. The Principles are set on six broad areas: 1) building an effective corporate governance framework, 2) protecting and facilitating the exercise of shareholders' rights, 3) ensuring the equitable treatment of all shareholders, 4) recognizing the rights of stakeholders, 5) ensuring timely and accurate disclosure of information, and 6) institutionalizing responsibilities of the board.

The OECD recognizes that corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. In particular, the Principles emphasizes the need to develop a framework with a view to its impact on overall economic performance, market integrity and

the incentives it creates for market participants and the promotion of transparent and efficient markets.

The corporate governance framework should protect and facilitate the exercise of shareholders' rights. According to the Principles, basic "shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation." In addition, it mentions that shareholders should have the right to participate in, and to be sufficiently informed on, decisions concerning corporate changes as well as be the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings. In addition, it recognizes the importance of external control mechanisms such markets for corporate control which should be allowed to function in an efficient and transparent manner. Finally, it mentions that the exercise of ownership rights by all shareholders, including institutional investors, should be facilitated.

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights. It also prohibits insider trading and abusive self-dealing while all members of the board and key executives are required to disclose to the board of any conflict of interest cases.

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. It also stipulates that information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure while annual audits should be conducted by an independent, competent and qualified auditor.

The corporate governance framework should also ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders. It stipulates that board members should act in the best interest of the company and the shareholders while fulfilling their certain key functions including: 1) reviewing and guiding corporate strategy and major plans of action; 2) monitoring the effectiveness of the company's governance practices; 3) selecting, compensating, monitoring and, when necessary, replacing key

executives; 4) aligning key executive and board remuneration with the longer term interests of the company and its shareholders; and 5) ensuring the integrity of the corporation's accounting and financial reporting systems.

GOOD NON-GOVERNMENTAL GOVERNANCE

Based on forprofit and non-governmental experience, it is critical that every organization should be led and controlled by an effective Board of trustees which collectively ensures delivery of its objectives, sets its strategic direction, and upholds its values. In the case of NGOs, there is an emphasis placed on ensuring equity, diversity and equality of treatment for all sections of the community (The National Hub of Expertise in Governance, 2003). Departing from the current 'inside' board functions, boards should place more emphasis on being collectively be responsible and accountable for ensuring and monitoring that the organization is performing well, is solvent, and complies with all its obligations. This implies that the board needs to have clear responsibilities and functions, and should compose and organize itself to discharge them effectively while the board needs to periodically review its own and the organization's effectiveness, and take any necessary steps to ensure that both continue to work well. Because of its complex structure within the board, it should set out the functions of sub-committees, officers, the chief executive, other staff and agents in clearly delegated authorities, and should monitor their performance.

Since it is common among NGOs to have various institutions with leadership responsibilities, NGOs need to clarify their respective roles and the lines of delegation and reporting among them (Wyatt, 2004). There are four types of bodies in NGO governance and they are the membership assembly, the board, the executive committee, and operations committee. It goes without saying that the membership assembly is the highest governing body where decisions that are crucial to the life of the NGO such things as the mission or dissolution of the organization are being made. The critical issue here is how to get diverse sets of members involved in the decision making process and where to draw a line in terms of delegation of authorities to other principal governing bodies. The Board often exercises ongoing governance functions such as setting the organization's policies and strategies. In addition, the executive committee that consists mainly of senior management team often executes the decisions of the highest and principal governing bodies and manages the NGO's everyday activities. In NGOs, this body is usually composed of senior staff. In foundations, one person, such as an executive director, usually performs this role. More often than not, NGOs have operations committee that function in specific areas to aid management teams. Often

these committees consists of both board and executive members in areas of specialties including funding, legal issues, auditing, and other areas that require the board's attention. This committee is usually dependent of the board and reports directly to the highest governing body.

Another important difference is that NGOs need to derive legal and moral legitimacy from their constituencies (Slim, 2002). NGO legitimacy is often defined as 'the particular status with which an organization is imbued and perceived at any given time that enables it to operate with the general consent of peoples, governments, companies and non-state groups'. At an ethical level, an organization derives its legitimacy legally and morally. In addition to gaining legitimacy by claiming their legality within regulatory and legal environment in terms of their status and operation, NGOs need to gain more broadly defined moral legitimacy. In particular, those advocacy organizations that seek to influence public policies based on the values of equality, justice, and freedom need a moral and ethical legitimacy to gain wide supports from their constituencies. Constituencies include those NGOs seek to help, their members, other supporters and admirers. Expression and recognition of this fundamental morality is essential to an organization's legitimacy.

An organization's most tangible form of legitimacy comes in the form of direct support from the people. Implicit and explicit support from members in particular are important as they provide is a strong source of legitimacy.[3] Systematically gaining supports from constituencies require NGOs to structure their governance system as to be accountable and legitimate. In addition, such accountability requires multi-dimensional approach. For instance, often (financial) performance, goodwill and trust are all critical to an NGO's legitimacy which requires NGOs to find convincing and transparent ways of proving the quality of its performance and prove how they are in a meaningful relationship with relevant constituencies. Accountability is much more about reporting on relationships, intent, objectives, method and impact. As such, it deals in information which is quantitative and qualitative, hard and soft, empirical and speculative.

The recent evolving trend on accountability has centered on the need to recognize a much broader range of people (living and not yet born) to whom any NGOs must be accountable. In order to identify these people, the methodology of stakeholder analysis has become one of the key tools of NGO and other organizations' accountability. The first step in any accountability process is to map and analyze an NGO's various stakeholders in a given situation. An NGO must then find ways to prioritize these stakeholders in some way as primary, secondary etc. This stakeholder analysis then becomes the

3. Note that there are non-member NGOs whose main source of legitimacy comes from outsiders.

key document with which to design the right accountability mechanisms—whether they be social audits, evaluations, external regulation, complaints procedures, membership systems, environmental impact assessments, specific stakeholder surveys etc.

Several people in the NGO world have produced simple accountability frameworks. For most NGOs, these simple frameworks might be summarized as having four main dimensions to them: accountability for what, accountability for whom, accountability how, and accountability to improve. First, an accountability process should start by identifying the rights and duty involved in any NGO program, the relevant rights-holders and duty-bearers related to that right. From this rights-duties analysis, an NGO can then identify its own specific duty and set out to account for it, while making clear the responsibilities of others. From these perspectives, it should then be able to report on the overall impact that this combination of people, relationships, money, things and time had on the rights concerned.

Second, an NGO will need to account to different groups of people as stakeholders and how they are differentiate must be taken into account. Third, different stakeholders will require accounting to in different ways. This involves setting different standards of information provision to different stakeholders. Accountability processes must also involve key stakeholders through representative meetings, research, representative assemblies or voting systems. But virtues common to all NGO accountability mechanisms must be veracity and transparency. Lastly, NGO accountability mechanisms must show clearly how the agency is responding to what it has learnt and what its stakeholders are telling it. The mechanisms chosen must demand and show responsiveness by informing people about, and involving people in, new action taken.

In addition, board and trustee integrity should be emphasized to ensure that conflicts of interest are properly dealt with. Finally, the Board should be open, responsive and accountable to its users, beneficiaries, members, partners and others with an interest in its work. Accountability mechanisms must be open for all to see. While this is a given in current accountability doctrine, it may pose certain problems for human rights organizations who may not always be in a position to reveal their sources and contacts - some of the 'how' of their operations. Nevertheless, any accountability system must recognize transparency as primary and identify specific (and transparent!) criteria for reserving certain information on occasion.

CONCLUSION

To remain competitive in a changing world, organizations must innovate and adapt their organizational governance practices so that they can meet new demands and

grasp new opportunities. However, as groups who make it their business to demand accountability in others, it could be said that NGOs and human rights organizations have a particular responsibility to lead by example in this area and shine as beacons of legitimacy and accountability.

In light of the fact that public and private organizations alike are struggling to gain public confidence, the principles upon which corporations and NGOs are governed seem to merit close examination and possible reform. The model of stakeholder presented in this paper offers an ethically solid alternative to agency theory and stakeholder theory. Although such model is unlikely to be implemented quickly, its assumptions and principles merit both careful review and practical testing. Strengthening the NGO governance scheme seems merited in light of the demand for a more socially responsible ethical and moral framework for the civil society.

Good governance is important not only for the sustainable growth of the NGO sector but also for securing public trust in civil society. To this end, governments and NGOs have made a concerted effort to shore up the internal governance and organizational effectiveness of NGOs in the region. Reforming NGOs' internal governance must be based on a long-term perspective, one that is linked to organizational mission and client service. Although self-regulation among NGOs is critical to securing the internal accountability of NGOs, strategic partnerships between the state and NGOs is also a key component. Because civil societies in the region are in the early phases of development, instituting an enabling environment without much heavy-handedness on the state's part will be critical to the institutionalization process, which includes both internal governance structures and management schemes.

The various models and governance issues presented a in this paper contains opportunities for a wide variety of future research. One potentially fruitful area to test is the continuing research being done that identifies outstanding and ethically successful organizations. Another potentially rich area of research is the exploration of the ethical mental models of executives, boards of directors, managers and staffs. Studying those models in the context of understanding the underlying theories of governance inherent therein can provide insights into what might be necessary to sustain comprehensive stewardship theory as a new system of NGO governance. Additional research opportunities exist through qualitative research in work units or organizations on an experimental or applied basis.

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