THE EFFECTS OF ACCUMULATED WEALTH AND CORPORATE GOVERNANCE QUALITY ON NONPROFIT PERFORMANCE

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by
Ronald M. Hetrick III
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Examining Committee Members:
Kose John, Advisory Chair, Finance
Ron Anderson, Finance
T.L. Hill, Strategic Management
Sudipta Basu, External Member, Accounting

ABSTRACT

This dissertation explores the relationship between governance quality, accumulated wealth, and organizational performance in U.S. nonprofits. Accumulated wealth in nonprofits has been previously shown to reduce overall support contributions because donors perceive less need for financial resources. Further, the absence of owners leads to weaker monitoring mechanisms and greater agency problems. Despite the size of the nonprofit sector (5.5% of GDP and 9% of employment), the impact of governance in organizations with accumulated wealth has not been studied much. Using recent data on governance practices at nonprofits reported on IRS Form 990's and structural equation modeling/partial least squares analysis, this study finds that the strength of governance practices in nonprofits reduces the negative impact of accumulated wealth in Arts, Education, Environment, Health, Higher Education, Hospitals, Human Services, International, and Religious organizations. This paper demonstrates how agency theory and stakeholder theory complement each other when the nonprofit business model has a traditional revenue structure similar to its for-profit counterpart. For practitioners, it shows that combining a strong governing body, governing policies, compensation policies, and transparency policies, helps hold management accountable. This is necessary for the more efficient and effective execution of a nonprofit's mission.

DEDICATION

This dissertation is dedicated to my wife, Beth, and two daughters, Campbell and Kira, who have supported me during my pursuit of this doctorate. This research is also dedicated to the Temple University Fox School of Business faculty who have created this program and to my committee members who work tirelessly with first time researchers, such as myself, to hone our research interests into quality academic research. Finally, I wish to thank my classmates and fellow public media colleagues who have provided encouragement along the way.

ACKNOWLEDGEMENTS

Data used in this dissertation originated from the National Center for Charitable Statistics (NCCS) Statistics of Income (SOI) sample files for the years 2008-2012.

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CHAPTER 1 – INTRODUCTION AND LITERATURE REVIEW

1.1 Introduction

Nonprofit organizations affect all of our lives. We visit nonprofit hospitals; connect to nonprofit schools and colleges as alumni, parents and students; participate in religious organizations; listen to public radio; watch public television; and visit museums. Many people volunteer, donate, or serve on boards of nonprofits. Further, nonprofit organizations can be complex businesses that compete alongside for-profit companies in several sectors including Health, Education, and Human Services.[1] Nonprofits accounted for 9.2% of all wages and salaries in 2010 (Roeger, Blackwood, & Pettijohn, 2012), and in 2014, United States public charities reported over $1.74 trillion in total revenues and $1.63 trillion in total expenses that represented 5.3% of the U.S. GDP ("Quick Facts about Nonprofits," 2016). Notably, from 2015 to 2016, giving by Americans to nonprofits increased 2.7% to a total $379.89 billion (Giving USA*,* 2017).

The continued growth of donations has allowed some nonprofits to jump from financial resource scarcity to abundance, which increases the responsibility to effectively manage and grow programs and services. An organization's mission-based work must attract philanthropic support while not violating the private inurement rule governing its tax-exempt status. The inurement prohibition restricts the use of income or assets of a

[1] The National Center for Charitable Statistics has created a National Taxonomy of Exempt Entities (NTEE). Nonprofit Organizations are divided into 26 areas in 10 major groups: Arts, Culture, Humanities; Education; Environment & Animals; Health; Human Services; International, Foreign Affairs; Public, Societal Benefit; Religion Related; Mutual/Membership Benefit; Unknown, Unclassified. http://nccs.urban.org/classification/national-taxonomy-exempt-entities

charitable organization to directly or indirectly unduly benefit any person that is related to or controls the organization.

The value of nonprofits is expressed and measured in many ways. Often the focus is on outcomes such as the statistics of a graduating class from a university, the number of people served by a food bank, or the health outcomes of a hospital. Some donors hold nonprofit organizations to high standards and expect that their funds will be used efficiently to enhance and expand services. A large body of research finds that donors reward nonprofit organizations that are deemed more efficient (i.e. lower overhead costs) with increased contributions (e.g. Calabrese 2012). A practical application of this research can be found in sites such as Charity Navigator which score nonprofits on a variety of financial health measures to aid donors.

At the same time, endowments have grown rapidly at large universities like Princeton, Harvard, and Yale. In these cases, success appears to drive success and contributions to their endowments reach new highs every year. Additionally, thirty public media organizations received over $1.9 billion in 2017 as a result of the FCC's broadcast spectrum auction (Janssen 2017). Endowment growth continues to be an important part of nonprofit survival strategy.

Management decisions regarding how best to invest accumulated wealth can have a material impact on the financial performance of the nonprofit. For example, nonprofits with excess holding of liquid assets have lower program expense ratios and lower cost efficiency (Hughes 2013), which make them less attractive to donors. Although donors generally trust that the board and management of nonprofits are administering and investing their funds in a way that has the greatest impact, a 2015 study by Stanford

University revealed that nearly one-third of nonprofit directors lacked the critical skills necessary to govern and measure a nonprofit organization's performance (Larcker, Meehan, Donatiello, and Tayan, 2015).

The effective management of nonprofit resources highlights the governance of nonprofit organizations. Funders, beneficiaries, and suppliers are labeled as external stakeholders while managers, employees and volunteers are labeled as internal stakeholders (Van Puyvelde, Caers, Du Bois, & Jegers, 2012). The organization is guided by the board of directors, but without a sole proprietor, owners, or partners, who holds the board and management accountable for their decisions and actions? Although it is tempting to apply agency theory, for-profit businesses models do not map neatly to the nonprofit organizational structure as described above, and therefore agency theory may not fully or accurately explain the dynamics between the principals defined as users of services, donors and volunteers, and the agents defined as the board, management and other employees.

In summary, with more money comes a greater need for monitoring given the opportunities for malfeasance by decision makers. This dissertation will explore how this problem manifests itself in 501 (c) (3) nonprofits and will look at corporate governance mechanisms that can mitigate this effect.

1.2 Literature Review

1.2.1 Nonprofit Governance

The board of directors is at the core of nonprofit governance and ultimately has a fiduciary responsibility to assure proper fiscal oversight (Barrett, 1996). The role of boards in nonprofits versus for-profit companies has been researched sparingly.

Cumberland, Kerrick, D'Mello, and Petrosko (2015) coalesced several streams of research and suggested that the nonprofit board is responsible for the following:

- Monitor the organization, whereby they evaluate the CEO and staff, as well as provide financial and legal oversight
- Support the organization by securing philanthropic and commercial financial resources and legitimizing the organization mission to the external world
- Partner with the organization by assisting in strategy and planning, both in setting the mission and values and in providing long-range thinking
- Represent nonprofit constituencies by advocating on behalf of constituent groups

Similarly, *Principles for Good Governance and Ethical Practice* (Independent Sector, 2015) provides a succinct guide to the appropriate policies and procedures in the areas of legal compliance and public disclosure, effective governance, strong financial oversight, and responsible fundraising.

Through each of these items, a governing board member directly impacts the strategic direction and financial performance of an organization, and both individually and collectively influences a nonprofit's performance. Brown (2005) found that strategic contributions from the board are more robust in organizations with higher financial performance and that organizations that are high performing also have higher performing boards across all dimensions. Further, the way directors monitor the nonprofit organization is related to how individual board members define their relationship with the chief executive and how well they understand the scope of the monitoring function (Miller, 2002). When the performance measures and the accountability rules are unclear, board members tend to monitor in ways that reflect their own personal and professional competencies rather than measure progress towards organizational goals and initiatives (Miller, 2002).

1.2.2 Agency & Stakeholder Theory Insights into Principal-Agency Challenges for Nonprofits

Agency theory is a theory that explains the relationships between principals and agents in business (Jensen & Meckling, 1976). Agency theory predicts that organizational performance will be improved when boards monitor the chief executive's tendency to act with self-interest. This is because the chief executive's interests may not align with the nonprofit's mission. Managers may not always act in best interest of principals due to information asymmetry. Information asymmetry can be addressed in the contractual relationship between a board and chief executive by separating duties whereby managers make and implement decisions and boards ratify decisions and monitor implementation (Fama & Jensen, 1983). For example, Newton (2015) examined CEO pay relative to governance mechanisms and firm performance and found a negative relationship between CEO-to-employee relative pay and organizational performance at nonprofits and that this relative pay is negatively related to the quality index of the nonprofits' governance. Newton demonstrated that good governance quality is associated with the undesirable consequences that accompany ineffective or insufficient monitoring mechanisms.

The key difference between for-profit and nonprofit organizations is their ownership structures. One agency conflict arises in for-profits between their agents (managers) and principals (owners), particularly when management fails to maximize shareholder wealth (Jensen & Meckling, 1976). Nonprofit organizations have no owners and are legally bound by a non-distribution constraint that prohibits the distribution of net earnings to individuals who oversee the organization, such as board members, staff, and directors. Weisbrod (1989) identified the non-distribution constraint as one of the nonprofit structure's principal weaknesses because it has the adverse effect of reducing managerial incentives to minimize costs, seek out new markets, and to innovate. While incentive pay can be offered, it may not be competitive with that at for-profit organizations and stock options are not feasible. Corporate governance systems cannot fully offset these adverse effects, and they are weaker in nonprofits than their for-profit counterparts (Glaeser, 2003).

When the owner is not easily identified, it is hard to determine if owners and managers have conflicting roles which can also create inconsistency in accepted measures of performance (Fama & Jensen, 1983). For example, nonprofit boards have a responsibility to donors to ensure that the organization will use their contributions efficiently and that the organizations' decision makers will not expropriate the funds to other areas. In this case, the donor becomes another principal in the relationship. This ambiguity around ownership further impedes true monitoring (Fama & Jensen, 1983).

To effectively navigate this landscape of multiple principals and agents, Miller (2002) identified three ways to maximize the nonprofits' impact. First, the board must recognize the chief executive's potential for self-interested behavior. Second, the board members must agree to whom the organization is accountable. Finally, all parties must fully understand the full range of programs and services that the organization offers and their contributions to the mission. Confirming that there is no goal conflict between the chief executive and the organization mission ensures goal alignment between the organization and the principals.

Van Puyvelde *et al.* (2012) used stakeholder theory to develop the framework in Figure 1, which identifies the multiple principal-agent relationships within a nonprofit.

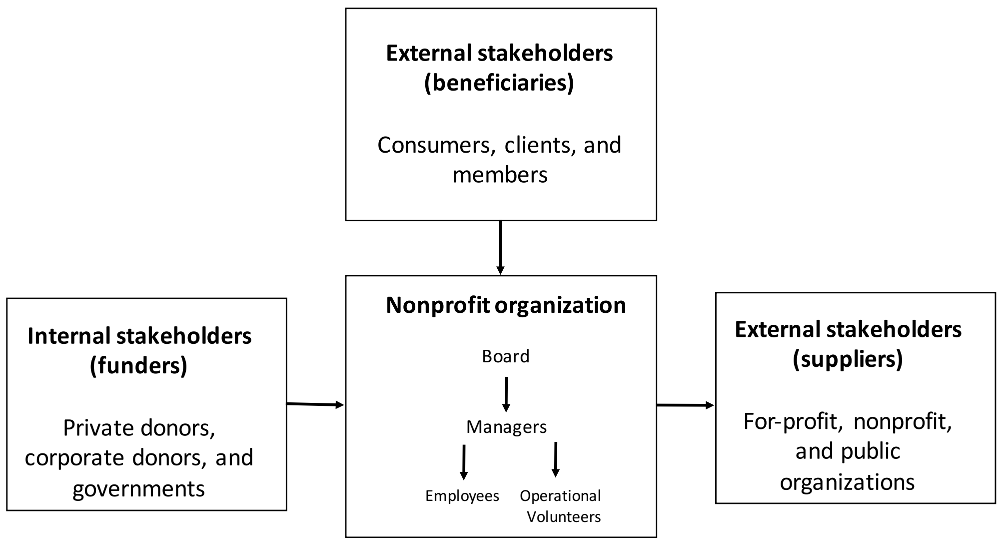


Figure 1: Nonprofit principal->agent relationships. From Van Puyvelde *et al.*, 2012

When there are multiple principals, board independence is a key method of ensuring that the principals' and agents' interests align (Fama & Jensen, 1983).

In many Anglo-Saxon countries such as the US and UK, there is wide agreement that corporate governance is a separation of ownership and control. The law is clear that the managers have a fiduciary responsibility to act in the owners' interest. Beyond Anglo-Saxon countries, shareholder value maximization objectives can vary significantly and include situations where shareholder wealth maximization is not the only goal of the board of directors. For example, German firms are required to pursue multiple stakeholder interests through a system of co-determination where employees and shareholders of large corporations have an equal number of seats on the supervisory board of the company (Allen, Carletti, & Marquez, 2009). Nonprofits fall somewhere between the traditional principal-agent model of traditional for-profits and these for-profit and nonprofit organizations that are accountable to multiple stakeholders.

Furthermore, there has been little research on the effects of legislation and policy decisions on nonprofit governance. Nonprofits have implemented some provisions of the Sarbanes-Oxley Act of 2002 including the introduction of independent audit committees, certifications of financial documents, and internal controls, while fewer have formalized codes of conduct and whistleblower policies. Andres-Alonso, Cruz, and Romero-Merino (2006) found that active institutional donors are more likely to monitor managers' activities given their large stake in the entity.

The existence of multiple stakeholders and the gaps between these stakeholders and management creates the opportunity for the mismanagement of financial resources. Traditional monitoring and alignment of interests between principals and agents does not work well because of the multiple stakeholders and lack of good monitoring and alignment mechanisms, such as pay. Good governance practices provide a chance to balance these conflicting needs and close gaps.

Preliminary evidence suggests that getting governance right is important for improving the financial performance of nonprofits. Aggarwal, Evans, and Nanda (2012) concluded that board size is positively related to nonprofit performance. Harris (2014) concluded that board diversity and expertise is positively associated with performance among higher education nonprofits. Diversity was defined as racial and gender diversity and expertise was defined as a director who worked in a nonprofit, was a financial expert, and/or served on other nonprofit boards. Harris (2014) also looked at nonprofit governance using six governance factors (Policies, Audit, Compensation, Board, Management, and Access) and found that they were all positively associated with total donations to a nonprofit. Each of these governance factors had some incremental explanatory power.

Although these findings are suggestive, there are numerous gaps in the studies tying the governance models to the performance of the firm. Additionally, the limited definition of board capital (size and diversity/expertise) leave several important traits of board directors unexplored relative to firm performance, strategic intent, and competitive advantage. And finally, there seem to be few studies exploring the impact of other governance mechanisms on performance. This dissertation attempts to close some of these gaps.

1.2.3 Agency & Stakeholder Theory Insights into the Challenges of Accumulated Wealth

The concept of accumulated wealth in a nonprofit has been primarily studied in two different ways. Accumulated wealth has been modeled (1) as the accumulation of operating profits over time that collectively increase the net assets of a nonprofit (Calabrese, 2012), or (2) the ratio of endowment (sum of cash, savings, and investment securities) to total expenses (Core, Guay, & Verdi, 2006; Hughes, 2013). However, neither model distinguishes between the three types of nonprofits endowments: (1) unrestricted net assets (wealth that can be used at the nonprofit's discretion), (2) temporarily restricted net assets (wealth that is restricted but generally available for use), and (3) restricted net assets (wealth that must be used as requested by the donor). Calabrese (2012) attempts to address this issue by only including temporarily restricted net assets and unrestricted net assets when creating an endowment to expense ratio.

Bowman *et al.* (2012) suggest a framework for evaluating both nonprofit surpluses and endowments to ensure that data gathered from Internal Revenue Service (IRS) financial reporting form 990's is consistent and useful. They argue that operating surplus, defined as the excess or deficiency of unrestricted operating revenue over operating expenses, enables comparison of the performance of endowed and non-endowed organizations.

The concepts of "modest wealth" and "excessive accumulation of wealth" differ meaningfully. Existing theories on the effects of wealth on donations treat all small changes in wealth equally (Calabrese, 2012). They do not differentiate between a nonprofit that is increasing its wealth from a small asset base versus a nonprofit that is increasing its endowment from a large asset base, like a university. Both Advisors in Philanthropy (AIP) and the BBB's Wise Giving Alliance find reserves of less than three years' spending are reasonable for public charities They suggest that excessive wealth – and not just the existence of wealth – may result in reduced charitable contributions.

Calabrese (2012) explains why accumulated wealth might reduce individual contributions:

> *"Organizational slack (in the form of wealth) allows nonprofit managers to maximize their own preferences (such as prerequisites or budget maximization, among others), which are different from donor preferences (maximization of current output). In addition, accumulated available wealth may reduce organizational incentives to contain costs (because managers either can spend the savings or invest it to generate additional revenues)."*

This is consistent with the findings of Core *et al.* (2006) that nonprofits with excess endowments have greater agency problems. Financial vulnerability is not affected because reserves can protect programmatic output from economic cycles. As such, Core *et al.* state:

> *"Managers of NFPs have four primary options when faced with excess endowment assets: (1) continue to hold the excess endowment assets; (2) invest in fixed assets that expand the production capacity of the firm; (3) increase program expenditures; or (4) consume assets for their private benefit in the form of excess compensation or perquisites."*

Both Calabrese's and Core *et al.*'s insights provide context to the importance of stakeholder perception of accumulated wealth along with the critical role managers play in deciding how to utilize these assets.

The degree of "extra" wealth is not an easy figure to obtain without digging into financial statements, tax filings, charity ranking sites, and annual reports. Depending on the connection of the stakeholder to the organization, access to this information may be limited. Nonprofit boards have the most direct access to the information. Donors and beneficiaries of the nonprofits must rely on how transparent the nonprofit is with financial information or seek out information through charity ranking sites.

1.2.4 Nonprofit Performance

There is no home discipline or approach to guide nonprofit research. Research on nonprofit organizations is spread across multiple fields depending on what aspect of a nonprofit organization is being studied. These fields include marketing, management, finance, economics, and accounting. Nonprofit research also frequently clusters by industries such as health, education, and public policy where nonprofit organizations operate. There is not one discipline that it can call 'home.' Harris (2014) summarized the measurement landscape by stating:

"The nonprofit sector has no accepted universal measure of success. Rather, outcomes vary according to the organization's mission, model, and issue area."

A summary of nonprofit performance definitions and measures by author and discipline can be found in Table 1.

Table 1: Nonprofit Performance Measures

Definition	Disciplines	Measures	Authors
Nonprofit effectiveness encompasses nonprofit performance, but focuses on the balanced input and output achieved through the combination of processes, projects, and programs implemented by the nonprofit to reach its predefined goals. Nonprofit performance encompasses financial performance, stakeholder performance, market performance, and mission performance	Management Finance Economics Marketing Education Public Policy	-Effectiveness of Strategy (Likert) -Effectiveness of Financial Sustainability/Legitimacy and Reputation of Organization	Willems *et al.*, 2014 Willems *et al.*, 2016 Andersson & Self, 2014 Cumberland *et al.*, 2015
Nonprofit performance /efficiency strictly as a measure of specific financial variables	Finance Economics Education Public Policy Health Management	-Total Contributions	Harris, 2014; Yermack, 2017; Ramirez, 2011; Aggarwal *et al.*, 2012
		-Program Expense Ratio (program expenses/total expenses) - Fundraising Efficiency (Fundraising expenses/total expenses)	Core *et al.*, 2006; Ramirez, 2011; Aggarwal *et al.*, 2012; Harris, 2014
		- Administrative Efficiency (Administrative expenses/total expenses	Hughes, 2013
		- Operating Surplus - Operating Margin	Harris, 2014; Yermack, 2015; Tuckman & Chang, 2011; Bowman *et al.*, 2012; Hager, 2001; Chang & Tuckman, 1988
		- Traditional Financial Ratios - Public Support = Total Contributions/Total Revenue - Direct Public Support = Total Contributions / Total Assets	Chabotar, 1989 Ritchie & Eastwood, 2006
		- Net Fixed Assets - Revenue Diversification (sum of squared revenues / total revenue) - Expense Diversification (sum of squared expenses / total expense)	Adelino *et al.*, 2013 Shea and Hamilton, 2015
Nonprofit performance as a measurement of program outcomes	Management	-Outcome Measurement Index (OMI) = Number of Expected Outcomes *0.15; Expected Outcomes Supported by Assessment * 0.55; Actual Outcomes Supported by Assessment * 0.3	Thomson, 2010
Nonprofit Performance as measured through inputs, organizational capacity, outputs, outcomes, public value, and institutional legitimacy	Marketing	Input: Revenue/Expenses; Organization Capacity: Employee Satisfaction, Retention; Outputs: Frequency/Hours of Services Provided; Outcomes - Increased Skills/Learning; Market Share, Retention; Public Value: Quality of Life; Network/Institutional Legitimacy: Funder Relations/Satisfaction/Compliance	Lee & Nowell, 2015
Nonprofit effectiveness as measured by the capacity of the NPO to become market oriented and to build and effectively manage relationships with relevant stakeholders over the long-term.	Marketing	Perceived Value by Beneficiaries/Customers, Donors, Partners, and Other Relevant Stakeholders; Value of Outcomes in Terms of Enhanced Trust and Commitment Leading to Long-term Impact;	Garcia et al,. 2012 Bryce, 2007

Table 1: Continued			
Definition	Disciplines	Measures	Authors
NPO Effectiveness is defined by a multidimensional structure and is a broader construct that captures performance where performance focuses on financial value, market value, and share value performances. Effectiveness is the ability to achieve goals and implement strategies while using resources in a socially responsible manner.	Management	"Effectiveness: Board Effectiveness - Board Governance, Accountability; Managerial Effectiveness - Achieving Goals, Organizational Flexibility, Strategy, Professionalism; Resource Effectiveness - Tangible Resources, Intangible Resources, Capacity, Resource Management; Financial Effectiveness - Financial Performance, Financial Health; Environmental Effectiveness - Technical Environment, Social Environment; Program Effectiveness - Successful Programs and Projects, Service Quality, Outcomes"	Taysir & Taysir, 2012
Nonprofit health identified by a composite of multiple financial measures reported on Form 990	Practitioner	Program Expenses = % of Total Functional Expenses Spent on Programs and Services (higher is better); Administrative Expenses = % of Total Functional Expenses Spent on Management/General (lower is better); Fundraising Efficiency = Amount a Charity Spends to Raise $1 (lower is generally better); Primary Revenue Growth = Growth of Grants and Contributions, Revenue from Programs and Services, and Membership Fees over 3-5 years; Program Expense Growth = Growth of Program Expenses over the Past Three to Five Fiscal Years; Working Capital Ratio = Level of Spending Using Only Net Available Assets	Charity Navigator Site

Given the many different disciplines that research nonprofits, a variety of terminology has been used to capture nonprofit performance. This includes terms such as nonprofit effectiveness, nonprofit efficiency, outcomes, public perception, and legitimacy (Lee & Nowell, 2015). Nonprofit effectiveness and nonprofit performance are used synonymously in many academic disciplines. Within the management and marketing literatures, nonprofit performance is rolled up_into the term nonprofit effectiveness and is defined as “encompassing nonprofit performance, but focused on the balanced input and output achieved through the combination of processes, projects, and programs implemented that help a nonprofit reach its (predefined) goals” (Willems, Huybrechts, Jegers, Weijters, Vantilborgh, Bidee,, & Pepermans 2014). Nonprofit performance is further defined as specifically looking at financial performance, stakeholder performance, market performance, and mission performance.

Finance, economics, and management articles frequently define and measure nonprofit performance by looking at specific financial metrics derived from the Internal Revenue Service financial reporting Form 990's that all nonprofits complete annually. The most common measure is "Total Contributions" (Harris, 2014; Yermack, 2015; Ramirez, 2011; Aggarwal *et al.*, 2012), which reflects the level of public and private support for an organization's mission as measured by donations received. Large and growing donations can suggest success in a nonprofit's mission-based work. The program expense ratio (program expenses/total expenses) is the next most commonly used financial definition and measure (Tuckman & Chang, 1991; Core *et al.*, 2006; Ramirez, 2011; Aggarwal *et al.*, 2012; Harris 2014). This ratio answers the question "what percentage of our donation goes towards programming?" Closely tied to the program expense ratio are the fundraising efficiency ratio (fundraising expenses / total expenses) and administrative efficiency ratio (administrative expenses / total expenses).

Operating surplus and operating margin are studied as measures of nonprofit efficiency and effectiveness (Harris, 2014; Yermack, 2015; Tuckman & Chang, 2011; Bowman, Tuckman, & Young, 2012; Hager, 2001; Chang & Tuckman, 1988). Generating a surplus is not considered a bad thing when it is reinvested into new programs and services within the nonprofit.

From a marketing perspective, nonprofit performance is defined and measured by looking at outcomes (Thomson, 2010) through an Outcome Measurement Index (OMI) which is based on data found in annual reporting. The OMI weighs the number of expected outcomes, the expected outcomes supported by assessment, and the actual outcomes supported by assessment in a composite score. Measurement of nonprofit effectiveness and performance with these broad definitions has sparked three authors to establish frameworks to encompass the multiple perspectives outlined in the academic literature.

1. Taysir & Taysir (2012) have developed an integrated nonprofit effectiveness measurement model outlined in Figure A1 in Appendix A. This model is the most elaborate and defines six key dimensions along with sub-dimensions and indicators (specific measures) that can be benchmarked and used to compare nonprofits and benchmark them against each other. The six key dimensions are: Board Effectiveness, Managerial Effectiveness, Resource Effectiveness, Financial Effectiveness, Environmental Effectiveness, and Program Effectiveness.
2. Rey Garcia, Álvarez González, and Bello Acebrón (2012) proposed a marketing-based framework for evaluating nonprofit effectiveness that first establishes the market orientation of the nonprofit by looking at its philosophical and behavioral perspectives on stakeholders (Figure A2 in Appendix A). Market orientation is then measured across satisfaction, trust, and commitment to define nonprofit effectiveness through organizational performance (efficiency and mission accomplishment) and social impact (social value creation and sustainable social change).
3. Lee & Nowell (2015) also provide a marketing-based framework for evaluating nonprofit performance, which is outlined in Figure A3 in Appendix A. This framework looks more abstractly at the notion of Inputs, Organizational Capacity,

Outputs, Outcomes, and Public Value of the nonprofit where Outcome is moderated by behavioral and environmental changes along with client/customer satisfaction. The Outcome variable feeds back into Inputs as the indicator that drives future growth and performance in the nonprofit.

Finally, the nonprofit performance construct warrants a practitioner's look at the Charity Navigator framework, which is frequently used by the public to inform philanthropic decisions. Charity Navigator defines nonprofit health as the composite of multiple financial measures reported on the IRS Form 990 ("How Do We Rate Charities' Financial Health?", 2016). Their algorithm weighs nonprofits on the following variables: Program expenses or the % of total functional expenses spent on programs and services (higher is better); Administrative expenses or the % of total functional expenses spent on management/general (lower is better); Fundraising efficiency or the amount a charity spends to raise $1 (lower is generally better); Primary Revenue Growth or the growth of grants/contributions, revenue from programs and services, and membership fees over the last 3-5 years; Program expense growth or the growth of program expenses over the past three to five fiscal years; and Working Capital Ratio or the Level of spending using only net available assets. As initially identified, there is no universally accepted measure of nonprofit success but rather a variety of tools that can be used depending on the scope of the inquiry and the intended audience of the research.

Nonprofit financial measures were selected to evaluate performance over marketing and impact measures given the need for financial resources to execute the mission. When financial resources are constrained, management's ability to fulfill the mission is reduced. More financial resources allow management to invest in expanding programs and services.

The definitions of accumulated wealth (generating a regular operating surplus versus having a large endowment) leave a great deal of room for interpretation. If accumulated wealth is having a large endowment, then one must consider the type of donations – unrestricted net assets, temporarily restricted net assets, or restricted net assets. Prior research studied data from 1998-2003, which was before the 2008 revisions to the IRS Form 990 that changed reporting requirements for governance, policies, and disclosure practices. Understanding how nonprofit management is incentivized with different types and magnitudes of accumulated wealth presents several research opportunities.

Having established the many ways governance and agency theory occur in nonprofits, the concept of accumulated wealth, and the mechanisms of nonprofit performance measurement, this dissertation evaluates how governance practices affect the relationship between accumulated wealth and performance. Governance will be measured using an index derived from measures available on IRS Form 990's. Efficiency and revenue will be used to evaluate financial performance and the ratio of endowment size to expenses will be used to gauge how much wealth the nonprofit has accumulated. Insights from the following two chapters help inform how agency theory manifests in nonprofit organizations and provide practitioners insight into effective governance practices to support an environment where financial performance is maximized.

CHAPTER 2 – THE EFFECTS OF CORPORATE GOVERNANCE ON NONPROFIT PERFORMANCE WHEN ACCUMULATED WEALTH IS PRESENT

2.1 Conceptual Model & Hypotheses

Accumulated wealth in a nonprofit reduces the philanthropic support of individuals (Calabrese, 2011), where "excessive" accumulated wealth is defined as having a ratio of endowment to expenses greater than one. Given the importance of individual giving, it is likely that accumulated wealth would reduce overall nonprofit performance as measured by operating surplus, program/expense ratio, administrative efficiency (i.e. lower overhead), and fundraising efficiency. Additionally, I expect the impact of accumulated wealth on nonprofit performance to be less when the ratio of restricted net assets to total endowed assets is greater, as the donors dedicate those funds for specific programs and services. In these organizations, management decisions on how to expend these funds are governed by the terms of the restricted gifts.

The relationship between a nonprofit's asset composition (restricted versus unrestricted) and performance is reflected in existing corporate finance research on free cash flow theory and the agency problem. Jensen (1986) posited that managers endowed with free cash flow may invest in negative net present value (NPV) projects rather than pay it out to shareholders. Good managers will not, but others may succumb to temptation. External debt can play an important role in reducing these agency costs. Debt holders do not have a say in the operations of a company. However, debt is a strong form of commitment and may have provisions that constrain managers to meet payment terms. Management is therefore forced to make wise investments. In the context of a nonprofit, unrestricted net assets are analogous to cash on the balance sheet and restricted net assets, or assets that must be used as a donor specifies, are like debt. Therefore, nonprofit managers with unrestricted net assets may not use the funds as efficiently to create additional stakeholder value. Better governance could focus a nonprofit manager on maximizing the overall value from unrestricted net assets. I hypothesize:

Hypothesis 1: For a given level of governance quality, nonprofit performance will decrease as accumulated wealth, in the form of unrestricted net assets, increases.

Newton (2015) demonstrated that there was a strong negative relationship between nonprofit CEO pay and organizational performance, which suggests that both high pay and poor performance are associated with agency issues that governance at nonprofits fails to correct. High governance quality was not associated with extremely poor nonprofit performance. I expect governance quality to lessen or negate the impact of accumulated wealth on nonprofit performance, as defined by the efficiency and profitability measures. Agency theory and the strategic role of the board in nonprofit governance, including monitoring functions and CEO evaluation/incentives, supports this argument. Therefore, my second hypothesis is:

Hypothesis 2: When governance quality is strong, the relationship between accumulated wealth and nonprofit performance will be less negative.

Hypotheses 1 and 2 are summarized in the Conceptual Model outlined in Figure 2.

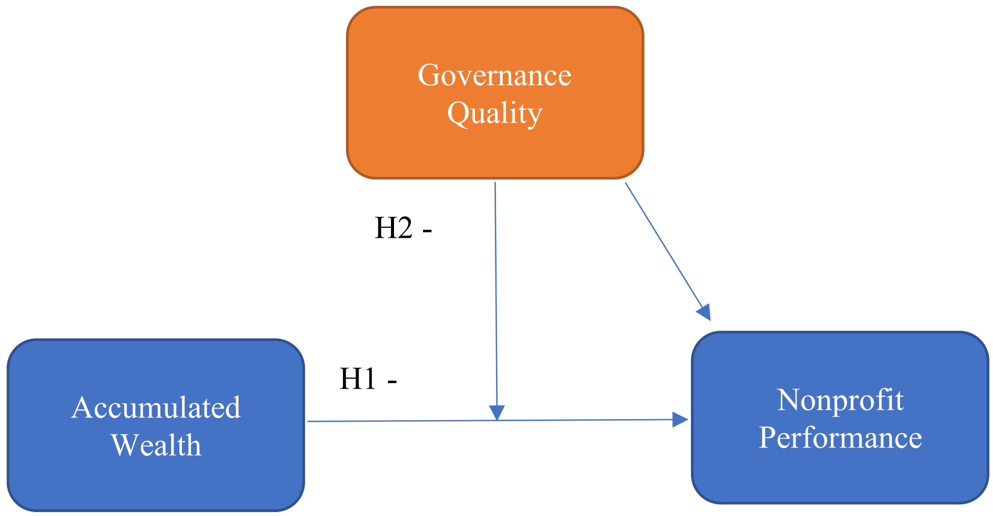


Figure 2: A Conceptual Model of Accumulated Wealth, Governance Quality, and Nonprofit Performance

2.2 Methodology

2.2.1 Constructs & Measures

This section outlines how the constructs of governance quality, accumulated wealth, and nonprofit performance are operationalized and identifies the measures used for analysis of the data set.

2.2.1.1 Governance Quality

Governance quality has not been measured consistently in the nonprofit literature. There are two studies with overlapping measures that most closely reflect the aspects of governance quality that are most relevant to this research project. Harris, Petrovits, and Yetman (2015) looks at twenty-one governance measures reported on the Form 990 and their impact on philanthropic giving. Newton (2015) looks at 16 similar measures, but creates a single "Governance Index" from them. I used only the Newton (2015)

Governance Index. For reference, the Harris *et al.* (2015) framework is included in Table B1 in Appendix B.

Newton (2015) operationalized the Governance Index variable from responses in the Form 990 in the areas of Governing Body, Governing Policies, Compensation Policies, and Accountability & Transparency. The cross-sectional standard deviations of each of the sixteen governance variables are used as weights in forming the governance index. The composition of this variable is outlined in Table C1 in Appendix C.

2.2.1.2 Accumulated Wealth

To address potential endogeneity concerns and to ensure internal validity, I lag the measures of accumulated wealth by one year. Since I am studying how much the presence of accumulated wealth reduces nonprofit financial performance, I measure the wealth before the period whose financial performance is being evaluated. I use three main measures of accumulated wealth.

<u>Endowment to Expense Ratio</u> (Core *et al.*, 2006). Endowment to Expense is the sum of cash, savings, and investment securities over total expenses. It estimates how long the nonprofit organization can run without additional revenues. [(Part X, Line 1a BOY) + (Part X, Line 2a BOY) + (Part X, Line 11a BOY) / (Part I, Line 18a PY)]

<u>Endowment to Expense Ratio</u> (Calabrese, 2011). Available organizational wealth is defined as the sum of unrestricted and temporarily restricted assets divided by the sum of total expenses less fundraising expenses. This measure excludes restricted assets that cannot be used to cover general expenses. [(Part X, Line 27a BOY) + (Part X, Line 28a BOY) / (Part I, Line 18a PY) – (Part I, Line 16a PY)]

Endowment to Expense Ratio – Top quartile (Calabrese, 2011). The top quartile of organizations with accumulated wealth are coded with a one. This is a flag for the presence of excess holdings. The threshold ratio for the top quartile is an endowment with 2.67x expenses.

2.2.1.3 Nonprofit Performance

Six measures of nonprofit financial performance were reviewed in this analysis. To address potential endogeneity issues of having board members who significantly contribute and inflate performance results, additional measures of revenue and expense efficiency are included in the development of the nonprofit construct.

Program Ratio – the ratio of program expenses to total expenses in the current year. This is a measure of how efficiently the organization supports its mission. [(Part 9, Line 25b) / (Part 9, Line 25a)]

Fundraising Expense Efficiency – Fundraising expenses divided by total expenses. [(Part 1, Line 16a CY) / (Part 9, Line 25a)]

Cost to Raise $1 – The amount it costs to raise one dollar of revenue defined as fundraising expenses divided by total revenue from contributions and grants. [(Part 1, Line 16a CY) / (Part 1, Line 8 CY)]

Total Revenue (contributions and grants) – total revenue from individual contributions and grants. [(Part 1, Line 8 CY)]

Total Revenue (program services) – Total revenue derived from program services. [(Part 1, Line 9 CY)]

Total Revenue – The nonprofits' total revenue for the current year. [(Part 1, Line 12 CY)]

2.2.1.4 Control Variables

I use three control variables in this model.

NTEE5 Industry Classifications – A set of 5 groups defined by the national Taxonomy of Exempt Entities (NTEE): Arts, Education, Health, Human Services, and Other. Because the operating models of educational institutions, health care institutions, and others can vary greatly, I analyze them separately.

Number of employees – The number of employees receiving compensation (full-time or part-time). [(Part 1, Line 5)]

Total Assets – The total assets of the nonprofit organization at the end of the current year. [(Part X, Line 26b)]

2.2.2 Data Collection

A dataset consisting of 71,354 Form 990 filings from 16,884 unique organizations from 2008-2012 was acquired from the National Center for Charitable Statistics (NCCS). The initial dataset comes from the IRS Statistics of Income (SOI) files, which contains a stratified random sample of the organizations that file Forms 990. The dataset contains all large charities plus a random sample of smaller organizations stratified and weighted by assets level. The industry composition is 33% percent Health (22,801), 24% Human Services (17,360), 21% Education (15,061), 6% Arts (4,225) and 16% Other industries (11,367).

Descriptive statistics for the variables in the full data set and in each of the major NTEE categories are reported in Table 2.

Table 2: Descriptive Statistics

	Full Data Set		Arts		Education		Health		Human Services		Other	
Variable	Mean	SD	Mean	SD	Mean	SD	Mean	SD	Mean	SD	Mean	SD
# of employees	706	2260	204	570	918	2811	1258	3030	316	882	126	700
Total Assets (in millions)	17	881	90	278	291	1,573	237	783	41	106	116	500
Contributions & Grants (in millions)	13	85	12	49	21	104	8	55	6	34	25	145
Program Service Revenue (in millions)	67	407	6	36	51	193	162	690	11	49	9	55
Total Revenue (in millions)	85	438	20	81	80	307	176	711	18	72	37	172
Program Ratio	0.82	0.17	0.76	0.17	0.82	0.14	0.82	0.16	0.84	0.16	0.82	0.18
Fundraising Efficiency	0.03	0.06	0.06	0.08	0.03	0.06	0.02	0.07	0.02	0.06	0.04	0.07
Cost to raise $1	0.49	37.41	0.20	2.19	0.39	18.07	0.53	20.76	0.29	8.34	0.93	84.90
Endowment to Expense (Core)	23.99	1577.51	3.11	10.38	20.49	981.19	18.93	843.41	32.07	2723.77	33.81	1174.25
Endowment to Expense – Q1	0.25	0.43	0.51	0.50	0.25	0.43	0.15	0.36	0.21	0.41	0.42	0.49
Endowment to Expense (Calabrese)	79.99	6432.30	5.86	15.44	127.20	7710.79	95.93	8778.91	70.20	4039.82	29.40	1002.07
Gov Index	4.07	1.39	3.82	1.50	4.14	1.42	4.57	1.17	3.68	1.33	3.69	1.49

2.3 Data Analysis

I used Structural Equation Modeling (Partial Least Squares) using SmartPLS (PLS-SEM) to analyze the data. PLS-SEM was selected because the research objective for this analysis is prediction and theory development (Hair, Ringle, & Sarstedt, 2011). PLS-SEM is also appropriate because the goal is to identify key driver constructs, in this case accumulated wealth and governance quality, using formative measures on a large, non-Normally distributed dataset (Hair, Hult, Ringle, & Sarstedt, 2014).

The structural model is represented in Figure 3.

2.3.1 Structural Model

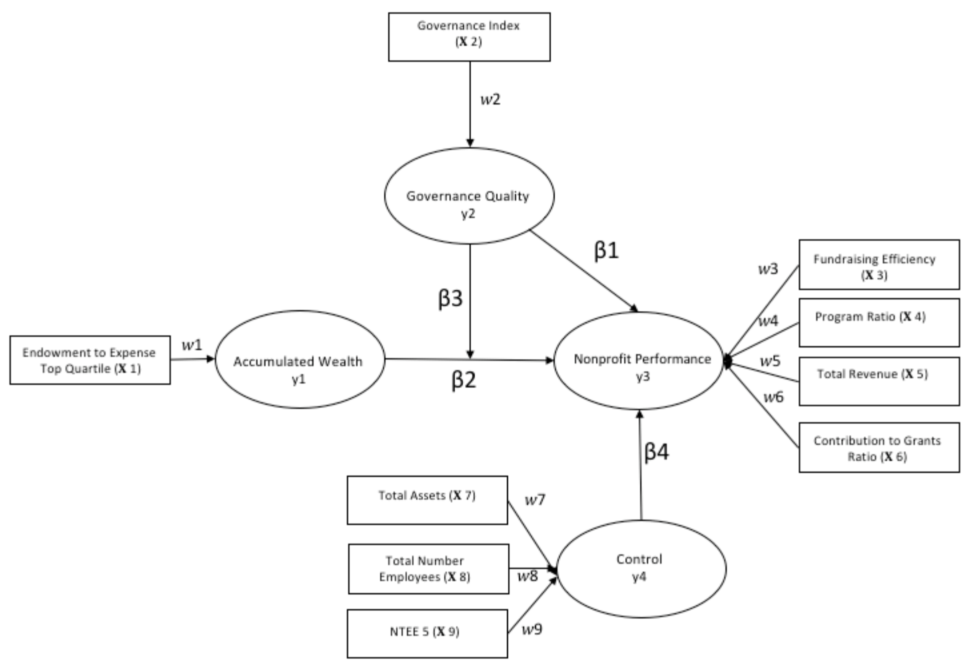


Figure 3: Research Study I – Structural Model

Governance Quality = Governance Quality + 0 (exogenous variable)
Accumulated Wealth = Accumulated Wealth + 0 (exogenous variable)
Control = Control + 0 (exogenous variable)

Nonprofit Performance = β1 Governance Quality + β2 Accumulated Wealth + β4 Control + β3 Governance Quality * Accumulated Wealth * Control + $\mathbf{z}1$

The formative latent variables are considered to be formed by the indicators following a multiple regression:

$$yg = \mathbf{X}\, g\, wg + \boldsymbol{\delta}g,\ \ E[\boldsymbol{\delta}g|\ \mathbf{X}\, g] = 0.$$

wg is estimated by the least squares algorithm in the software.

The model implemented in Smart PLS can be found in Figure D1 in Appendix D. Accumulated Wealth variables were lagged by one year to address endogeneity issues.

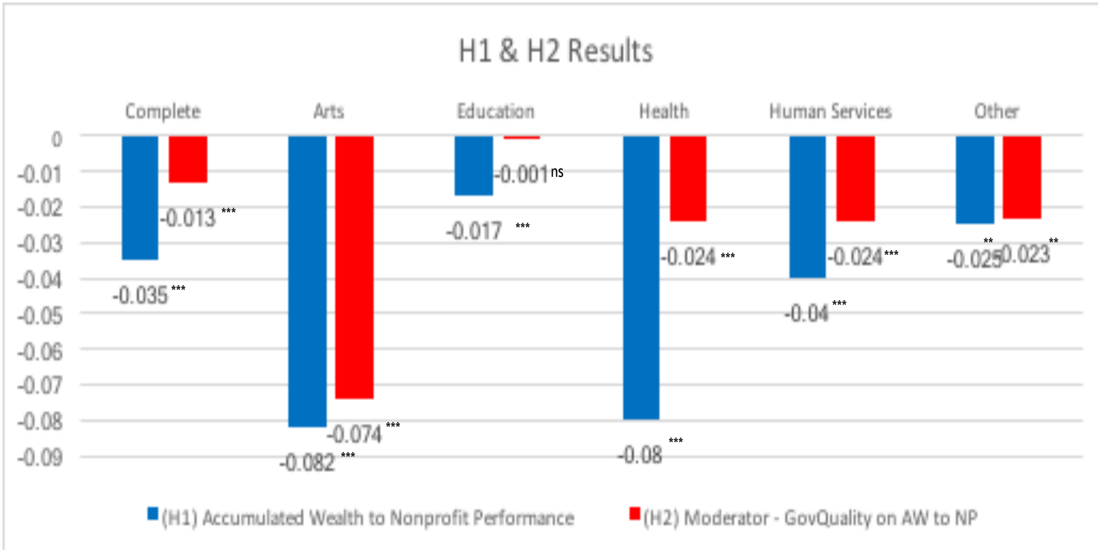
2.4 Results

In testing Hypothesis 1, governance quality was held constant and it was found that *b2* was negative, which indicates that the presence of accumulated wealth reduced nonprofit performance. In testing Hypothesis 2, as governance quality increases, *b2* becomes less negative, which suggests that strong corporate governance policies reduce the impact of accumulated wealth on nonprofit performance.

The results of the model can be found in Table 3 and are graphically represented in Figure 4.

Table 3: Results from PLS Model

Path Coefficients	H1	H2	Change	Percent Change	R^2
Complete Data Set	-0.035 ***	-0.013 ***	0.022 ***	63%	0.523
Arts	-0.082 ***	-0.074 ***	0.008 ***	10%	0.752
Education	-0.017 ***	-0.001	0.016	94%	0.743
Health	-0.080 ***	-0.024 ***	0.056 ***	70%	0.571
Human Services	-0.040 ***	-0.024 ***	0.016 ***	40%	0.505
Other	-0.025 **	-0.023 **	0.002 ***	8%	0.543
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$					



** $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$*

Figure 4: Graphical results from PLS Model

For the complete data set, the results indicate that Accumulated Wealth (AW) is negatively associated with Nonprofit Performance (NP) with a coefficient of -0.035 ($p <$ 0.001), consistent with H1. Furthermore, the moderating effect of Governance Quality reduced the negative association of Accumulated Wealth on Nonprofit Performance from -0.035 to -0.013 ($p < 0.001$), consistent with H2. In the following paragraphs, I will break the results down by NTEE category.

For the Arts NTEE category, my results show that AW is negatively associated with NP with a coefficient of -0.082 ($p < 0.001$) consistent with H1. The moderating effect of Governance Quality reduced the negative association of AW on NP from -0.082 to -0.074 ($p < 0.001$) consistent with H2 for Arts nonprofits.

For the Education NTEE category, our results show AW is negatively associated with NP with a coefficient of -0.017 ($p < 0.001$) consistent with H1. The moderating effect of Governance Quality reduced the negative association of AW on NP from -0.017 to -0.0001 but was not significant inconsistent with H2 for Education nonprofits.

For the Health NTEE category, our results show AW is negatively associated with NP with a coefficient of -0.080 ($p < 0.001$) consistent with H1. The moderating effect of Governance Quality reduced the negative association of AW on NP from a -0.080 to a -.024 ($p<0.001$) consistent with H2 for Health nonprofits.

For the Human Services NTEE category, AW is negatively associated with NP with a coefficient of -0.040 ($p < 0.001$) consistent with H1. The moderating effect of Governance Quality reduced the negative association of AW on NP from -0.040 to -0.024 ($p<0.001$) consistent with H2 for Human Services nonprofits.

For the Other NTEE category, our results show AW is negatively associated with NP with a coefficient of -0.025 ($p < 0.01$) consistent with H1. The moderating effect of Governance Quality reduced the negative association of AW on NP from -0.025 to -0.023 ($p<0.01$) consistent with H2 for Other nonprofits.

In summary, a negative effect of Accumulated Wealth on Nonprofit Performance (H1) was found in all nonprofit types reviewed. Governance quality improves the negative relationship between Accumulated Wealth and Nonprofit Performance in the Arts, Health, Human Services, and Other nonprofits by an average of 63%.

2.5 Discussion

These results show how the presence of accumulated wealth in nonprofits, across different sectors, reduces the financial performance of these organizations and how strong corporate governance practices reduce this effect. The findings demonstrate that having a strong governing body, governing policies, compensation policies, accountability, and transparency all help to hold management accountable for making decisions that ensure more efficient and effective execution of nonprofit missions in Arts, Health, Human Services, and Other classified nonprofits.

Notably, however, the positive affect of corporate governance practices was not evident in Education nonprofits. This is likely due to the composition of assets present at Educational institutions. Table 4 outlines the ratio of unrestricted net assets to total net assets for each of the five major nonprofit types.

Table 4: Ratio of Unrestricted Net Assets to Total Net Assets

NTEE Classification	Unrestricted Net Assets to Total Net Assets
Arts	0.797
Education	0.758
Health	0.977
Human Services	0.940
Other	0.891

Educational organizations have the lowest ratio of unrestricted net assets to total net assets (0.758) across all five nonprofit types. This means that more of their wealth takes the form of restricted net assets that require management to use this wealth as dictated by the donor. In higher education, large gifts to endowments are often for capital improvements, named positions, and specific programs, as opposed to unrestricted gifts for ongoing operations.

The effects of corporate governance quality were more pronounced in Health and Human Services, which also have the highest composition of unrestricted net assets to total net assets, 0.977 and 0.940 respectively. Health also had the highest average Governance Index value (4.57) among all nonprofits, indicating that they have more measures in place to ensure strong corporate governance quality. The high ratio of unrestricted to total net assets confirms that management has greater discretion over the investment of these assets for growing programs and services. When management has greater discretion over the investment of assets, the spotlight that comes from having accountability and transparency measures along with strong governance practices keeps these managers in check.

2.6 Conclusions and Directions for Future Research

This chapter investigates the nature of accumulated wealth in nonprofits and how corporate governance quality can improve the efficiency and effectiveness of the nonprofit. Having strong corporate governance quality in the Arts, Health, Human Services, and Other nonprofit sectors has a positive effect on the performance of the nonprofit. Past research has not looked at how nonprofit performance, as a function of efficiency and effectiveness measures, can be impacted when accumulated wealth is present. Past research has also not looked at how corporate governance practices can improve the overall efficiency of nonprofits through the lens of both free cash flow theory and the agency problem.

This study makes several contributions to theory and practice. It builds on the nonprofit literature which examines organizations with accumulated wealth (Core *et al.*, 2006; Calabrese 2011; Hughes 2013) by examining the presence of accumulated wealth in the context of multiple nonprofit performance measures versus only looking at philanthropic contributions. This study is consistent with previous findings on the impact of accumulated wealth on philanthropic contributions but extends this to measures of efficiency and effectiveness of fundraising and investment in programs. It is the first study to review the impact of accumulated wealth on nonprofits since the changes to IRS Form 990 disclosures in 2008. This study also builds on studies of nonprofit governance quality (Newton, 2015; Harris *et al.*, 2015) by examining the moderating effect of corporate governance on nonprofit performance when accumulated wealth is present. The use of Structural Equation Modeling through Partial Least Squares also sets this study apart from many that use regression models.

This model has important implications for practice. For the practitioner, this research can be used to help identify the characteristics of highly functioning boards and good governance practices that can keep them relevant and competitive in the philanthropic landscape. This research is particularly relevant now as many nonprofits move from a time of resource scarcity to resource abundance, driven by gifts or income that create significant endowment reserves for the organization.

There are several limitations to this study which offer multiple opportunities for future research. First, the use of a single governance index does not identify which aspects of corporate governance may have the biggest impact in the model. Breaking down the Governance Index model or extending the Harris *et al.* (2015) framework that looks at policies, audit, compensation, board, management, access, and minutes would be particularly valuable when translating this research for the practitioner. Secondly, this study only looks at the five major classifications of nonprofits versus the other classification groupings (NTEE 12 or NTEE 26), which would provide greater insight to management in these sectors and how negative performance can be mitigated when accumulated wealth is present. Qualitative inquiry into sample nonprofits would also provide additional context behind the decision making that leads to negative or improved performance.

CHAPTER 3 – HOW DIFFERENT DIMENSIONS OF CORPORATE GOVERNANCE AFFECT NONPROFIT PERFORMANCE WHEN ACCUMULATED WEALTH IS PRESENT

3.1 Introduction

In Chapter 2, I examined the impact of corporate governance quality on nonprofit performance in organizations with accumulated wealth. Accumulated wealth negatively impacts the financial performance of nonprofits in different sectors and strong corporate governance practices reduce this effect. Combining a strong governing body, governing policies, compensation policies, accountability, and transparency can help hold management accountable for more efficient and effective execution of a nonprofit's mission in Arts, Health, Human Services, and Other classified nonprofits.

However, Chapter 2 had several limitations and raised a variety of new questions in two areas. The first area is the measurement of corporate governance. Chapter 2 defined corporate governance as a single measure composed of sixteen different variables reported by a nonprofit on the IRS form 990 following Norton (2015). This measure demonstrated solid corporate governance practices but did not provide actionable insight into which variables had the greatest impact. Chapter 3 breaks the corporate governance measure down into four sub-indices following Newton (2015). They are governing body (i.e. board independence), governing policies (i.e. conflict of interest policy), compensation policies (for CEO and officers), and accountability / transparency (audit committee and audited financials).

The second area expanded upon is the categorization of nonprofits for analysis. Chapter 2 only examined the 5 major National Taxonomy of Exempt Entities (NTEE) categories of Arts, Education, Health, Human Services, and Other, which oversimplified the landscape of nonprofits. Chapter 3 looks at the NTEE 12 category classification which breaks the sample down into Arts, Education, Higher Education, Environment and Animals, Health, Hospitals, Human Services, International, Public/Societal Benefit, Religion Related, and Mutual/Membership.

In addition to extending the theoretical contribution of this research in the nonprofit space, the insights derived have practical implications for board and management in organizations with large unrestricted net assets relative to annual expense.

3.2 Conceptual Model & Hypothesis

Chapter 3 builds upon the framework and conceptual model developed in Chapter 2. The updated conceptual model expands the governance quality construct into four components, which categorize the ways governance measures are publicly reported by nonprofits on IRS Form 990's. These four categories are Governing Body, Governing Polices, Compensation Policies, and Accountability & Transparency. The changes are represented in Figure 5 below. Hypothesis 1 is tested again but the four new sub-indices are tested in Hypotheses 3a to 3b.

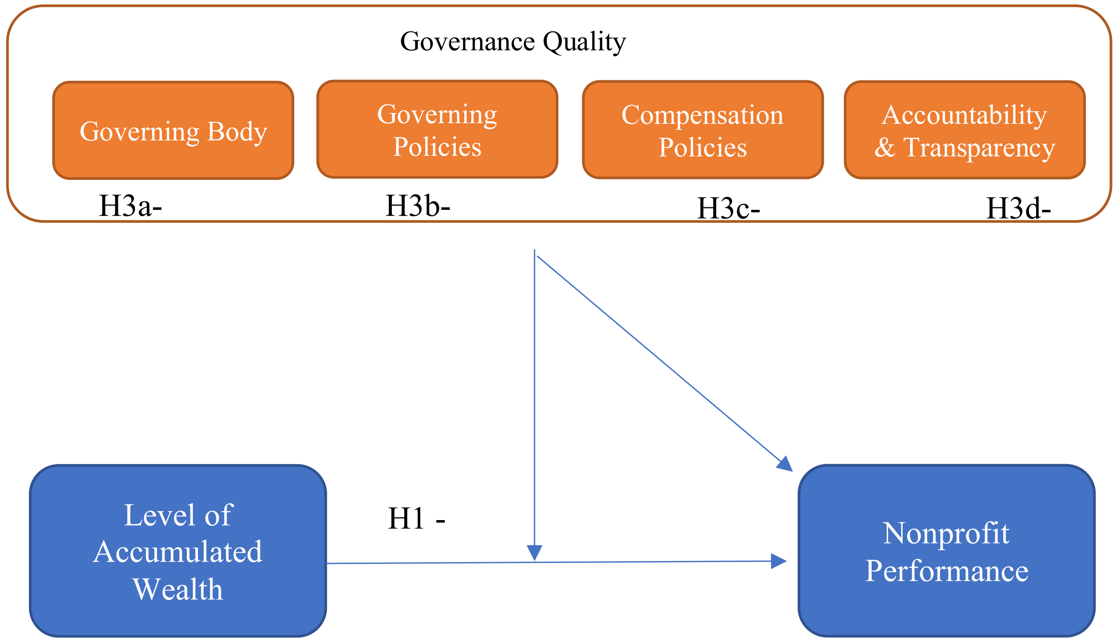


Figure 5: A Conceptual Model of Accumulated Wealth, Governance Quality, and Nonprofit Performance

Having a solid Governing Body is measured by items such as having an independent board of directors, having no business relationships between board members and the organization, delegation of control of management functions to an outside firm, having members who vote on board members, and by giving a copy of the IRS form 990 to the board before being filed. The independence of boards and impact on firm performance has been studied exhaustively in corporate finance but most studies have failed to identify a direct effect (Hermalin and Weisbach, 2003). Given the lack of owners in nonprofits vs. stockholders in for-profit corporations, independently monitoring management becomes more important when there are large amounts of unrestricted net assets that can be invested. For this test, a strong Governing Board is defined as having at least two-thirds of its members being independent, having no current or former officers engaged in direct business relationships, no outside management, members who can elect and approve decisions of the governing body, and providing a copy of the IRS form 990 to the board before being filed. Therefore, hypothesis 3a is:

Hypothesis 3a: When the governing body is strong, the relationship between accumulated wealth and nonprofit performance will be less negative.

Strong Governing Polices include having a conflict of interest policy, a whistleblower policy, a documentation retention policy, and policies restricting grants to officers. The impact of these polices, introduced and monitored since the Sarbanes-Oxley Act of 2002, has been explored in nonprofit research. Nezhina and Brudney (2012) found that one in four nonprofits attributed some benefits of better financial controls and reduced risk of accounting fraud to the adoption of provisions of the Sarbanes-Oxley Act, but at a cost of reallocating fees from program expense to administrative expense. For nonprofits with accumulated wealth, these costs would hurt less and help keep management in check. Therefore, hypothesis 3b is:

Hypothesis 3b: When good governing polices exist, the relationship between accumulated wealth and nonprofit performance will be less negative.

Best corporate governance practices for a nonprofit include having Compensation Policies for the CEO and other officers and policies for executive reimbursement and executive substantiation. Excess CEO compensation and the negative impact on firm performance has been established (Garner and Harrison, 2013). The reallocation of resources away from the nonprofit mission of the nonprofit is of particular concern when management has discretion over unrestricted net assets. Given the sizable impact that excess CEO compensation can have on donor perception (Kaden 2014) and firm performance (Harris *et al.,* 2015), it is expected that having established Compensation Policies will reduce negative firm performance when accumulated wealth is present. Therefore, hypothesis 3c is:

Hypothesis 3c: When compensation policies and executive reimbursement polices exist for the CEO and key officers, the relationship between accumulated wealth and nonprofit performance will be less negative.

From a governance quality perspective, Accountability and Transparency is defined as having independently audited financial statements, an audit committee, and publication of tax forms on the nonprofit website. The Sarbanes-Oxley Act was again a driver for nonprofits in this area. An organization's principals can use accounting information and financial statements to monitor financial performance, with external auditors increasing the validity of the figures (Jergers, 2003). Garven, Beck and Parsons (2018) found that financial reporting quality increased after SOX even though the legislation does not apply to nonprofits. Atkins (2011) found that audits in government organizations make significant contributions to financial performance through internal control enhancements over the financial management practice. The audit function, audit committee oversight, and making that data available to the public are accountability and transparency measures which holds management accountable to their stakeholders. Therefore, hypothesis 3d is:

Hypothesis 3d: When the Accountability & Transparency practices exist, the relationship between accumulated wealth and nonprofit performance will be less negative.

Hypotheses 3a-3d are summarized in the Conceptual Model outlined in Figure 5 above.

3.3 Methodology

3.3.1 Constructs & Measures

The constructs of governance quality, accumulated wealth, and nonprofit performance were operationalized and measures identified for data analysis. The changes were made from the study presented in Chapter 2.

3.3.1.1 Governance Quality

Four sub-indices of the Newton (2015) "Governance Index" are used in this study in place of the single index used in Chapter 2. They are Governing Body, Governing Polices, Compensation Policies, and Accountability & Transparency. Figure B1 in Appendix B outlines the composition of each of these variables.

3.3.1.2 Accumulated Wealth

Calberese's (2012) Endowment to Expense Ratio is again used to determine the organizations with accumulated wealth in the top quartile of the dataset. The threshold ratio for the top quartile is an endowment with 2.67x expenses.

3.3.1.3 Nonprofit Performance

Total revenues from grants and contributions were removed in this study leaving just Program Ratio, Fundraising Expense Efficiency, and Total Revenue. This was changed to provide additional perspective into the expense side of this analysis as it relates to agency theory.

3.3.1.4 Control Variables

One control variable is changed from Chapter 2.

NTEE12 Industry Classifications - A set of 12 groups defined by the national Taxonomy of Exempt Entities (NTEE): Arts, Education, Higher Education, Environment and Animals, Health, Hospitals, Human Services, International, Public/Societal Benefit, Religion Related, and Mutual/Membership.

3.3.2 Data Collection

A dataset consisting of 71,354 Form 990 filings from 16,884 unique organizations from 2008-2012 was acquired from the National Center for Charitable Statistics (NCCS). The initial dataset comes from the Statistics of Income (SOI) files that contains all large charities plus a random sample of smaller nonprofits stratified and weighted by assets level. The industry composition of nonprofits represented is outlined in Table 5.

Table 5: Nonprofit industries in Sample

NTEE Classification	Sample	Percent of Sample
Arts	4,225	5.94%
Education	10,079	14.18%
Environment	1,867	2.63%
Health	10,343	14.55%
Higher Education	4,982	7.01%
Hospitals	12,458	17.53%
Human Services	17,360	24.42%
International	1,219	1.72%
Mutual Benefit	374	0.53%
Public Benefit	6,715	9.45%
Religion	1,454	2.05%

Descriptive Statistics for the variables in the full data set and in each of the major NTEE categories are included in Table 6 and indicator correlations examined for variables used in the model are included in Table 7. Note that only the Compensation Policy Index was highly correlated with the Governance Index variable (0.983) in the dataset. The Governing Body Index, Governing Policy Index, and Accountability and Transparency Index indicator correlations were all less than 0.5 indicating little overlap with the original Governance Index variable used.

Table 6: Descriptive Statistics										
	Gov Index Avg	GovIndex StdDev	GovBody Avg	GovBody StdDev	GovPol Avg	GovPol StDev	CompPol Avg	Comp Pol StdDev	Acct&Tran Avg	Acct&Tran StdDev
Arts	7.97	5.17	2.16	0.54	1.02	0.49	4.15	4.66	0.64	0.32
Education	7.42	4.89	2.09	0.62	1.00	0.48	3.69	4.42	0.64	0.30
Environment	7.21	4.79	2.22	0.50	1.01	0.49	3.33	4.28	0.66	0.34
Health	8.88	5.02	2.11	0.69	1.19	0.39	4.93	4.72	0.65	0.28
Higher Education	12.24	3.93	2.13	0.43	1.20	0.31	8.16	3.77	0.76	0.16
Hospitals	11.44	4.61	2.03	0.77	1.32	0.20	7.44	4.51	0.66	0.26
Human Services	6.95	4.51	2.19	0.60	1.03	0.48	3.09	4.06	0.63	0.30
International	9.20	5.00	2.14	0.61	1.08	0.46	5.26	4.42	0.72	0.32
Mutual Benefit	4.54	4.03	1.55	0.88	0.89	0.52	1.56	3.44	0.54	0.35
Public Benefit	7.56	4.91	2.11	0.65	1.08	0.46	3.72	4.41	0.66	0.35
Religion	4.76	3.96	1.85	0.81	0.77	0.54	1.72	3.29	0.43	0.37

Table 6: Continued

	Program Ratio Avg	Program Ratio StdDev	Fundraising Efficiency Avg	Fundraising Efficiency StDev	Total Revenue Avg (millions)	Total Revenue StdDev (millions)	# Employees Avg	# Employees StDev	Total Assets Average (millions)	Total Assets StdDev (millions)	AW Average	AW StdDev
Arts	0.76	0.17	0.06	0.08	19.85	80.62	203	571	90.10	278.07	3.08	1.14
Education	0.81	0.16	0.03	0.07	24.21	80.29	179	697	132.19	560.72	2.72	1.14
Environment	0.80	0.14	0.06	0.07	16.01	38.22	138	311	54.31	111.34	3.04	1.10
Health	0.81	0.18	0.03	0.09	77.34	813.36	355	1,178	99.37	538.24	2.48	1.16
Higher Education	0.82	0.10	0.02	0.02	191.62	503.31	2,412	4,423	613.36	2,585.99	2.65	0.77
Hospitals	0.83	0.14	0.00	0.00	258.48	600.72	2,008	3,796	351.87	923.02	2.05	0.79
Human Services	0.84	0.16	0.02	0.06	18.01	71.71	316	882	40.59	106.25	2.32	1.14
International	0.84	0.13	0.04	0.06	105.73	274.74	194	696	161.01	626.23	2.40	1.07
Mutual Benefit	0.86	0.26	0.01	0.07	25.55	61.16	28	108	209.36	635.65	2.12	1.29
Public Benefit	0.83	0.18	0.03	0.07	37.09	185.81	122	805	135.06	569.63	2.91	1.21
Religion	0.79	0.23	0.03	0.05	11.03	39.20	80	272	48.49	184.62	2.49	1.27

Table 7: Indicator Correlations

	# of Employees	Total Revenue (current year)	Total Assets (previous year)	Program Ratio	Fundraising Efficiency	Accumulated Wealth	Governance Index	Governing Body Index	Governing Policies Index	Accountability & Transparency Index
Total Revenue (current year)	0.688									
Total Assets (previous year)	0.621	0.551								
Program Ratio	0.066	0.055	0.039							
Fundraising Efficiency	-0.08	-0.053	-0.028	-0.368						
Accumulated Wealth	-0.07	-0.065	0.032	-0.137	0.238					
Governance Index	0.257	0.155	0.147	0.02	0.011	0.048				
Governing Body Index	-0.067	-0.059	-0.043	-0.011	0.079	0.121	0.2			
Governing Policies Index	0.138	0.088	0.075	0.029	0.024	0.077	0.511	0.163		
Compensation Policies Index	0.271	0.165	0.155	0.018	-0.006	0.017	0.983	0.051	0.412	
Accountability & Transparency Index	0.062	0.038	0.041	0.025	0.081	0.164	0.367	0.186	0.393	0.271

3.4 Data Analysis

The Structural Equation Modeling (Partial Least Squares) model for this study: *Nonprofit Performance = a + b (Accumulated Wealth) (Governance Quality Sub-Indices) + c (Governance Quality Sub-Indices)*. The structural model is represented in Figure 6.

3.4.1 Structural Model

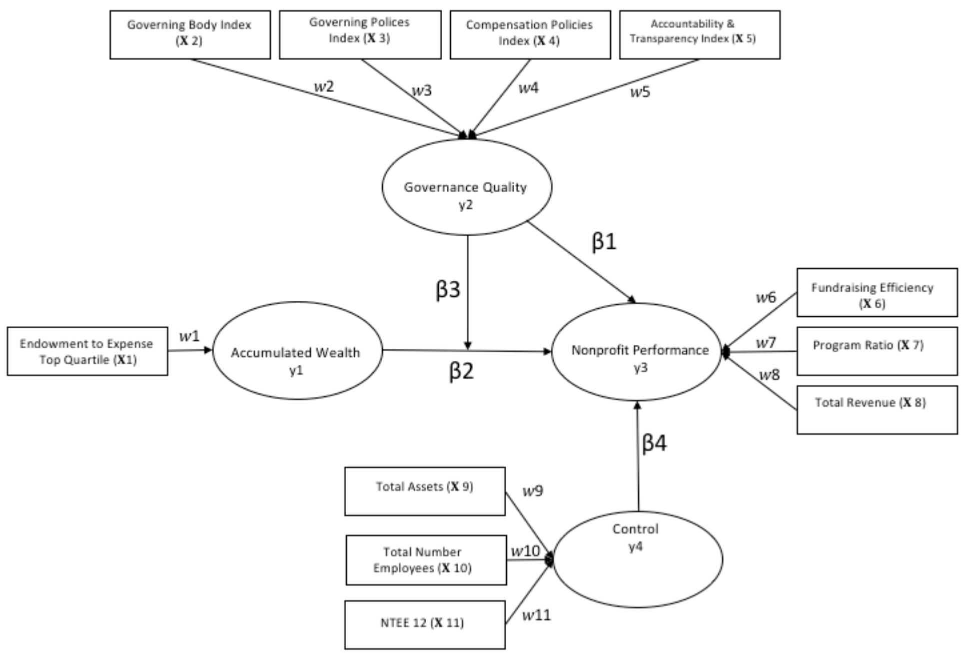


Figure 6: Research Study II – Structural Model

Governance Quality = Governance Quality + 0 (exogenous variable)
Accumulated Wealth = Accumulated Wealth + 0 (exogenous variable)
Control = Control + 0 (exogenous variable)
Nonprofit Performance = β1Governance Quality + β2Accumulated Wealth + β4 Control + β3 Governance Quality * Accumulated Wealth * Control + $\mathbf{z}1$

The formative latent variables are formed by the indicators from a multiple regression:

$$yg = \mathbf{X}\, g\, wg + \boldsymbol{\delta}g, \quad E[\boldsymbol{\delta}g |\, \mathbf{X}\, g] = 0.$$

where wg is estimated by the least squares algorithm in the software.

In testing of Hypotheses 3a to 3d, as governance quality increases, I expect that the effect on *b2* will be less negative, which would indicate that strong corporate governance policies would reduce the impact of accumulated wealth on nonprofit performance. Figure E1 in Appendix E shows the model as constructed in SmartPLS.

The endogeneity issues with the Accumulated Wealth variables were addressed in one additional way for this study. The standard deviation of the Governance Index was reviewed for each organization over the five years of data. In 74% of the organizations, the Governance Index was within one standard deviation of the previous years reported Governance Index. This reinforces that the presence of Accumulated Wealth is a driver for the changes observed in Nonprofit Performance and not changes in the Governance Index.

To observe the impact of the four Governance Index sub-indices on the model, the SEM-PLS model was run four times on the same data set as described in Tennenhaus *et al.* (2005). During each run, the Governance Index measure was replaced with the sub-indices of Governing Body, Governing Policies, Compensation Policies, and Accountability & Transparency. Results outlining the path coefficients, the unmoderated effect of accumulated wealth on nonprofit performance, the moderated effect of governance quality on accumulated wealth to nonprofit performance, the change, and the R^2 of the model are outlined in Tables 8 through 12. Table 13 and Figure 7 summarize the index results.

3.5 Results

Table 8: Results from Complete PLS Model					
Path Coefficients	**H1**	**H2**	**Change**	**Percent Change**	**R^2**
Complete Data Set	-0.058***	-0.048***	0.010***	17%	0.504
Arts	-0.106***	-0.095***	0.011***	10%	0.832
Education	-0.078***	-0.037***	0.041***	53%	0.506
Environment	-0.190***	-0.184***	0.006***	3%	0.727
Health	-0.063***	-0.060***	0.003***	5%	0.449
Higher Education	-0.069***	-0.053***	0.016***	23%	0.840
Hospitals	-0.040***	-0.013***	0.027***	68%	0.920
Human Services	-0.068***	-0.062***	0.006***	9%	0.647
International	-0.209***	-0.151***	0.058***	28%	0.670
Mutual Benefit	-0.002	0.039	0.041	2050%	0.446
Public Benefit	0.012	-0.012	-0.024	-200%	0.753
Religion	-0.058***	-0.054***	0.004***	7%	0.380
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$					

Table 9: Results of Governing Body PLS Model					
Path Coefficients	**H1**	**H3a Governing Body**	**Change**	**Percent Change**	**R^2**
Complete Data Set	-0.048***	0.011***	0.059***	123%	0.502
Arts	-0.091***	0	0.091	100%	0.822
Education	-0.063***	0.030***	0.093***	148%	0.505
Environment	-0.148***	-0.029***	0.119***	80%	0.699
Health	-0.057***	0.0180***	0.075***	132%	0.444
Higher Education	-0.055***	0.04***	0.095***	173%	0.841
Hospitals	-0.040***	0.007	0.047	118%	0.919
Human Services	-0.063***	0.008	0.071	113%	0.641
International	-0.192	-0.042***	0.150***	78%	0.641
Mutual Benefit	-0.001	-0.008	-0.007	-700%	0.456
Public Benefit	0.018***	0.009	-0.009	-50%	0.753
Religion	-0.032***	-0.004	0.028	88%	0.360
*$p < 0.05$; **$p < 0.01$; ***$p < 0.001$					

Table 10: Results of Governing Policies PLS Model

Path Coefficients	H1	H3b Governing Policies	Change	Percent Change	R^2
Complete Data Set	-0.052***	-0.019***	0.033***	63%	0.502
Arts	-0.099***	-0.053***	0.046***	46%	0.825
Education	-0.074***	-0.017***	0.057***	77%	0.505
Environment	-0.175***	-0.101***	0.074***	42%	0.710
Health	-0.057***	-0.017***	0.040***	70%	0.444
Higher Education	-0.070***	-0.009	0.061	87%	0.835
Hospitals	-0.041***	-0.005***	0.036***	88%	0.919
Human Services	-0.063***	-0.027***	0.036***	57%	0.643
International	-0.206***	-0.112***	0.094***	46%	0.659
Mutual Benefit	-0.012	-0.036	-0.024	-200%	0.456
Public Benefit	0.013	-0.002	-0.015	-115%	0.753
Religion	-0.042***	-0.013	0.029	69%	0.362

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

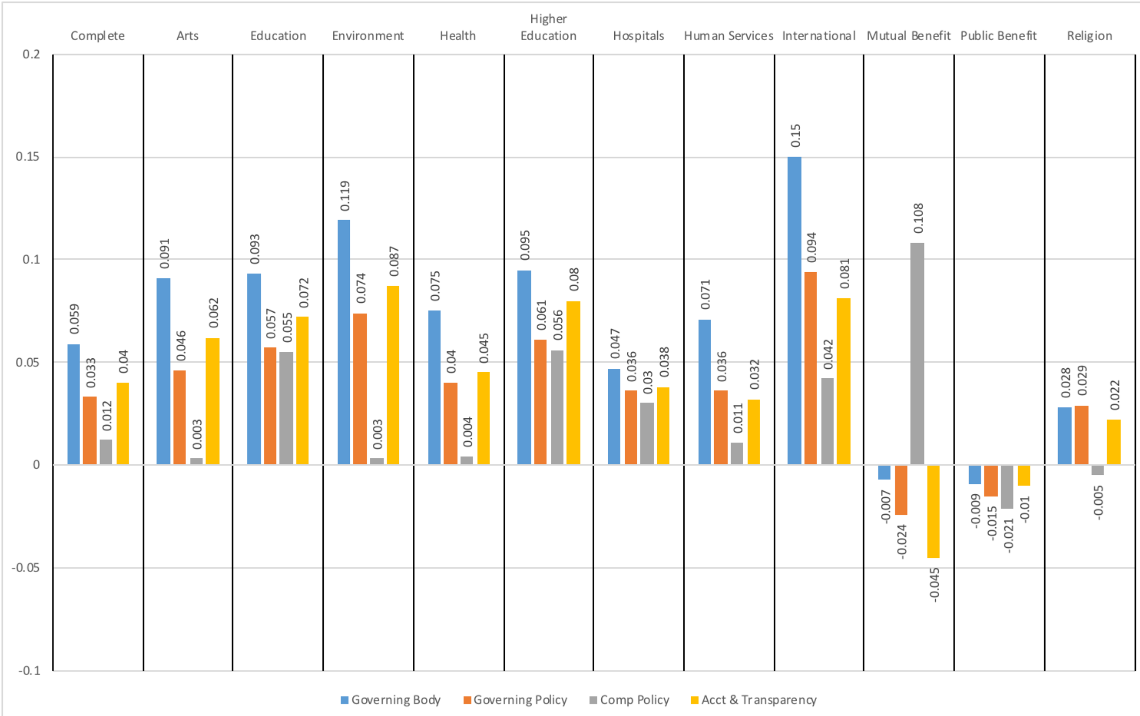
Table 11: Results of Compensation Policies PLS Model

Path Coefficients	H1	H3c Compensation Policies	Change	Percent Change	R^2
Complete Data Set	-0.057***	-0.045***	0.012***	21%	0.504
Arts	-0.111***	-0.108***	0.003***	3%	0.833
Education	-0.077***	-0.022 **	0.055 **	71%	0.505
Environment	-0.187***	-0.184***	0.003***	2%	0.727
Health	-0.063***	-0.059***	0.004***	6%	0.449
Higher Education	-0.071***	-0.015***	0.056***	79%	0.835
Hospitals	-0.040***	-0.010***	0.030***	75%	0.920
Human Services	-0.068***	-0.057***	0.011***	16%	0.647
International	-0.200***	-0.158***	0.042***	21%	0.667
Mutual Benefit	0.018	0.126	0.108	600%	0.464
Public Benefit	0.014	-0.007	-0.021	-150%	0.753
Religion	-0.043***	-0.048	-0.005	-12%	0.372

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Table 12: Results of Accountability & Transparency PLS Model					
Path Coefficients	**H1**	**H3d Accountability /Transparency**	**Change**	**Percent Change**	**R^2**
Complete Data Set	-0.051***	-0.011***	0.04***	78%	0.502
Arts	-0.102***	-0.040***	0.062***	61%	0.824
Education	-0.071***	0.001	0.072	101%	0.504
Environment	-0.196***	-0.109***	0.087***	44%	0.714
Health	-0.056***	-0.011	0.045	80%	0.444
Higher Education	-0.068***	0.012	0.080	118%	0.835
Hospitals	-0.040***	-0.002	0.038	95%	0.919
Human Services	-0.066***	-0.034***	0.032***	48%	0.642
International	-0.212***	-0.131***	0.081***	38%	0.664
Mutual Benefit	-0.012	-0.057***	-0.045***	-375%	0.455
Public Benefit	0.005	-0.005	-0.010	-200%	0.754
Religion	-0.07***	-0.048***	0.022***	31%	0.377
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$					

Table 13: Summary of Changes in Governance Sub-Indices					
Path Coefficients	**Governance Index H2**	**Governing Body H3a**	**Governing Policies H3b**	**Compensation Policies H3c**	**Accountability & Transparency H3d**
Complete Data Set	0.010***	0.059***	0.033***	0.012***	0.040***
Arts	0.011***	0.091	0.046***	0.003***	0.062***
Education	0.041***	0.093***	0.057***	0.055***	0.072
Environment	0.006***	0.119***	0.074***	0.003***	0.087***
Health	0.003***	0.075***	0.040***	0.004***	0.045
Higher Education	0.016***	0.095***	0.061	0.056***	0.080
Hospitals	0.027***	0.047	0.036***	0.030***	0.038
Human Services	0.006***	0.071	0.036***	0.011***	0.032***
International	0.058***	0.150***	0.094***	0.042***	0.081***
Mutual Benefit	0.041***	-0.007	-0.024	0.108	-0.045***
Public Benefit	-0.024***	-0.009	-0.015	-0.021	-0.010
Religion	0.004***	0.028	0.029	-0.005	0.022***
Average Percent Increase in Nonprofit Performance	*22%*	*122%*	*61%*	*33%*	*50%*
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$					



Path coefficients

Figure 7: Graphical results from PLS Model

In summary, a negative effect of accumulated wealth on nonprofit performance (H1) was found in Arts, Education, Environment, Health, Higher Education, Hospitals, Human Services, International and Religious nonprofits. Having a strong Governing Body (H3a) was found to improve the negative relationship between accumulated wealth and nonprofit performance in Education, Environment, Health, Higher Education, and International nonprofits by an average of 122%. Having established Governing Policies (H3b) was found to improve the negative relationship between accumulated wealth and nonprofit performance in Arts, Education, Environment, Health, Hospitals, Human Services, and International nonprofits by an average of 61%. Compensation Policies (H3c) were found to improve the negative relationship between accumulated wealth and nonprofit performance in Arts, Education, Environment, Health, Higher Education, Hospitals, Human Services, and International nonprofits by an average of 33%.

Accountability and Transparency measures (H3d) were found to improve the negative relationship between accumulated wealth and nonprofit performance in Arts, Environment, Human Services, International, and Religion nonprofits by an average of 50%

3.6 Discussion

Consistent with Chapter 2's findings, these results confirm the negative effect between accumulated wealth and nonprofit performance (H1) across the narrower categorization of nonprofits. The evaluation of the four governance sub-indices (H3a-H3b) provides new insights for analysis.

To provide context to the discussion, Table 14 outlines the ratio of unrestricted net assets to total net assets for each of the twelve major nonprofit types.

Table 14: Ratio of Unrestricted Net Assets to Total Net Assets

NTEE Classification	Unrestricted Net Assets to Total Net Assets
Arts	0.797
Higher Education	0.708
Education	0.786
Hospitals	0.985
Environment	0.818
Health	0.967
Human Services	0.940
International	0.914
Mutual Benefit	0.941
Public Benefit	0.900
Religion	0.925

The nonprofit performance construct was also refined in this study. Total revenues from donor contributions and grants were removed leaving the construct focused on the expense measures of program ratio and fundraising efficiency. This further differentiates this study from previous research that focused on the effect of accumulated wealth on donor sensitive revenues.

Higher Education organizations have the lowest ratio of unrestricted net assets to total net assets (.708) across all twelve nonprofit types. This means that most of their wealth takes the form of restricted net assets which require management to use this wealth as dictated by the donor. In higher education, large gifts to endowments are often for capital improvements, named positions, and specific programs versus unrestricted gifts for ongoing operations. Higher Education also had the highest average Governance Index value (12.24) among all nonprofits which means they have more measures in place to ensure strong corporate governance quality. This confirms that management has greater discretion over the investment of these assets for growing programs and services. In these situations, board monitoring through accountability and transparency measures along with strong governance practices keeps these managers in check.

The Governing Body index (i.e. independent board of directors, having no business relationships between board members and the organization, delegation of control of management functions to an outside firm, having members who vote on board members, and by giving a copy of the IRS form 990) resulted in the largest average increases in nonprofit performance when accumulated wealth was present (122%). This is true in the Complete, Education, Environment, Health, Higher Education, and International data sets. Given that Education, Health, and Higher Education nonprofits are most closely aligned with for-profit operations given their size and scope, it is consistent, in part, with Fama and Jensen's (1983) finding that board independence is one way to ensure that principal and agents align. It follows that in addition to board independence, keeping control of management functions also ensures the best outcome for the nonprofit because it eliminates the introduction of an external principal – agent relationship between management and a vendor. Having members vote on board members also brings the principal-agent relationship full circle by aligning the members' interests to the board who in turn, monitors management. Understanding how transparency with the Form 990 impacts this relationship is a direction for further research.

The Governing Policies index (i.e. having a conflict of interest policy, a whistleblower policy, a documentation retention policy, and policies restricting grants to officers) also resulted in increases in nonprofit performance when accumulated wealth was present, by an average of 61%. This is evident in Arts, Education, Environment, Health, Hospitals, Human Services, and International. These policies are useful as monitoring mechanisms by multiple principals in these organizations. It gives both the board and benefactors to the organization confidence that common governance oversights are supported by strong policies that hold the chief executive and staff accountable.

The Accountability and Transparency policies index (i.e. having independently audited financial statements, an audit committee, and publication of tax forms on the nonprofit website) resulted in an average improvement of 50% in performance. This is evident in the Arts, Environment, Human Services, and International categories, as well as in the Complete dataset. These four nonprofit categories have business models in which revenues traditionally come from donors or government entities and not from fee-for-service activities such as tuition higher education or insurance in hospitals. Although

Higher Education had the highest Accountability and Transparency index (0.759), it did not have a significant impact on nonprofit performance.

Compensation Policies were important in Education, Higher Education, and International but the effect was more muted in Arts, Environment, Health, and Human Services nonprofits. The average in increase in performance was only 33%. Higher Education had the highest Compensation index (8.16), which may be because of the rich data available for Compensation analysis for higher education administrators made available by trade associations and unions. This type of data is not as readily available in nonprofit spaces such as the Arts and leaves boards and compensation committees to pay for expensive salary surveys or scour the Internet for comparable data. Compensation policies broad impact across the range of nonprofits is consistent with the use of compensation by principals to ensure the alignment of an agent's actions. Specifically, having compensation tied to goals that move the organization mission forward coupled with strong measurement is the best way to improve this relationship (Newton 2015).

There was no evidence that good governance has any impact on nonprofit performance when accumulated wealth is present in Public Benefit nonprofits. Since Public Benefit organizations are chartered by state governments for specific purposes such as retirement funds insurers, etc., there is not much context under which the unique business models of these organizations can be evaluated.

Similarly, good governance practices at Mutual Benefit nonprofits had minimal impact with the exception of accountability and transparency which decreased performance by an average of -375%. This is likely impacted by the relatively small sample size (n=374). Since Mutual Benefit companies are organizations such as credit unions, associations, or utilities but are allowed to operate in a generally non-transparent way, it seems appropriate that some external measures of accountability and transparency would have a positive impact.

Religion nonprofits also benefited from accountability and transparency measures when accumulated wealth was present, increasing performance by an average of 31%. Religious organizations are not unique in their nonprofit business models, however, the way agency theory would play out given the very personal and intrinsic motivation that drives benefactors to contribute and the hierarchy of different religions make this a unique case which presents an opportunity for future research.

In the case of Public Benefit, Mutual Benefit, and Religious nonprofits, there may be some additional reasons why agency does not seem to work in those settings. For Religious and Mutual Benefit nonprofits, an optimistic reading would be that there are no agency issues because the beneficiaries are the owners and so performance maximization is completely aligned with their interests. A more cynical reading would be that the governance structure is completely captured by the CEO and management team such that the pastor or the head of a Mutual Benefit nonprofit are not in any meaningful way beholden to the members. However, in a serious crisis, publicity increases the spotlight on the organization to the point that transparency is assured. This is arguably also the case with Public Benefit nonprofits. In short, the principal-agent problem is alive and well in all three types, but the principals have no power, so agents run amok, constrained only by publicity.

In principle, Mutual Benefit members and Religious congregations could and should have better governance power over the principals, which suggests reform of the structure of these organizations and boards should be considered.

The four corporate governance indices we measured (governing body, governing policies, compensation policies, and accountability and transparency) can be tied back to agency theory and stakeholder theory. Agency theory is largely based on monitoring through the alignment of compensation policies between owners and agents along with monitoring through other governance policies (Jensen & Meckling, 1976). Stakeholder theory looks at the salience of different stakeholders and uses the degree of independence of these groups as a barometer for measuring the salience of the stakeholder much like the governing body index that is used in this research looks at independence (Fama & Jensen, 1983). Transparency and information flow is also critical between the multiple stakeholders in these environments (Wellens & Jegers, 2014). Analyzing the results by grouping the compensation and governance policy indices under agency theory and governing body and accountability/transparency indices to stakeholder theory provide additional insights. The results are outlined in Table 15.

Table 15: Breakdown of Governance Sub-indices by Theory				
	Agency Theory		Stakeholder Theory	
NTEE Category	Governance Policies	Compensation Policies	Governing Body	Accountability & Transparency
Arts	0.046***	0.003***	0.091	0.062***
Education	0.057***	0.055 **	0.093***	0.072
Environment	0.074***	0.003***	0.119***	0.087***
Health	0.040***	0.004***	0.075***	0.045
Higher Education	0.061	0.056***	0.095***	0.080
Hospitals	0.036***	0.030***	0.047	0.038
Human Services	0.036***	0.011***	0.071	0.032***
International	0.094***	0.042***	0.150***	0.081***
Mutual Benefit	-0.024	0.108	-0.007	-0.045***
Public Benefit	-0.015	-0.021	-0.009	-0.010
Religion	0.029	-0.005	0.028	0.022***
* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$				

Elements of agency theory and stakeholder theory are complementary in organizations with business models which are most analogous to their for-profit counterparts. Organizations such as higher education, education, hospitals, and international nonprofits all have complex business models which rely on significant fee-for-service revenues (tuition, health care payments, government aid, etc.) and less on donor driven revenue. These environments benefit the most from robust governance across the board and are also industries that are highly regulated by other outside agencies.

Conversely, arts nonprofits have very diverse revenue streams and are largely supported by donor-sensitive revenues. Accountability and transparency measures in arts nonprofits have the largest effect which speaks to the more active involvement of multiple stakeholders in the governance of the organization. Arts nonprofits also benefit from the compensation and governance policies associated with agency theory, but the effect is smaller.

The results in Health and Human Services nonprofits tend to support agency theory measures and, in this study, performance is not impacted by the independence of the board or accountability and transparency measures as identified in stakeholder theory.

CHAPTER 4 - CONCLUSION

In summary, with more money comes a greater need for monitoring given the opportunities for malfeasance by decision makers. This dissertation explores how this problem manifests itself in 501 (c) (3) nonprofits and looked at the corporate governance mechanisms which mitigate this effect.

The initial research study established that having strong corporate governance quality in the Arts, Health, Human Services, and Other nonprofit sectors had a positive effect on the financial performance of the nonprofit when accumulated wealth was present. Performance increased, on average, by 44% in these sectors. It established the framework for a more detailed analysis which followed in the second research study.

The second research study further explored four key elements of corporate governance (governing body, governing policies, compensation policies, and accountability and transparency) that serve as monitoring devices for various stakeholders. Performance measures were also focused more on expenses and efficiency measures versus donor sensitive revenues. A total of thirteen categories of nonprofits were evaluated. When accumulated wealth was present, at least one of the elements of corporate governance played a moderating role in improving the financial performance of Arts, Education, Environment, Health, Higher Education, Hospitals, Human Services, International, and Religious organizations. Performance increased by approximately 22% in these categories.

4.1 Research Contribution

In summary, these chapters examine the accumulated wealth of nonprofits and the effect of governance quality on nonprofit performance. This research contributes to the stream of literature which looks at agency theory, in particular the role of the nonprofit board of directors and governance practices, to nonprofit performance in nonprofits with accumulated wealth/large endowments. Through the lens of agency theory and more specifically the monitoring functions of the multiple principals in nonprofits (boards and benefactors), it offers new insights into how the implementation of the governing body, governing policies, compensation policies, and accountability and transparency measures can serve as monitoring agents for these various stakeholders. The implementation of these policies ensure that chief executives and management teams make decisions that are in the best interest of the beneficiaries of the nonprofits mission-based services. This study provides empirical evidence that supports the complementary nature of agency theory and stakeholder theory in higher education, education, hospitals, and international nonprofits. It identifies the importance of measures such as accountability and transparency when the nonprofit relies heavily on donor sensitive revenues and when multiple stakeholders exist.

In mutual benefit, public benefit, and religious nonprofits, the findings suggest that the principal-agency problem is alive and well, but the principals have no power, so agents run amok, constrained only by publicity.

Furthermore, this is the first study to review the impact of accumulated wealth in nonprofits since the changes to IRS Form 990 disclosures in 2008, and the first to look at the effects of governance quality in organizations with accumulated wealth across the twelve major NTEE disciplines. For the practitioner, this research can be used to identify the monitoring mechanisms that should be implemented by boards to ensure their governance practices can keep them relevant and competitive in the philanthropic landscape. Nonprofit practitioners have the opportunity to increase performance measures up to 122% by focusing on improving governance quality. This research is particularly relevant now as many nonprofits move from a time of resource scarcity to resource abundance, driven by gifts or income that creates significant endowment reserves for the organization.

4.2 Limitations

There are several limitations that I look forward to overcoming in future work. The impact of accumulated wealth on performance relative to the timing of changes to corporate governance is an area that could be more fully explored, perhaps using a smaller sample of organizations in specific nonprofit sectors. The profitability of nonprofits and the accumulation of wealth can rise and fall based on a variety of factors including reputation, changes in government funding, disasters, grants, and changing donor behaviors. The impact of making changes in corporate governance practices may also have varying degrees of impact over different time periods.

Another limitation is that the study uses the IRS Form 990's for financial performance data for all the different nonprofit segments. As identified numerous times in these chapters, nonprofit business models can be different within and between categories. Although generally accepted measures were selected in this research, more meaningful insights may be gleamed by looking at measures more narrowly among nonprofits within an even more specific category. External regulatory requirements across industries should also be reviewed alongside the different business models.

Finally, the sample contains all large nonprofits but only a weighted sampling of the smaller nonprofits. While it captures the landscape from a revenue perspective, looking more thoroughly at the smaller nonprofits within categories may provide additional insights that may be different from the way corporate governance monitoring mechanisms work in larger organizations.

4.3 Directions for Future Research

This research defined accumulated wealth as the ratio of endowment to expense (Calabrese, 2011) and looked at only those in the top quartile of the dataset. This provided insight into the effects of large amounts of accumulated wealth (2.67x) but does not evaluate if there is a threshold that boards should monitor. Future research could plot accumulated wealth data out and identify potential thresholds where the impact of governance quality on nonprofit performance may change.

Additionally, Chapters 2 and 3 look at nonprofit performance through the lens of efficiency. Additional research could look at this construct through the lens of revenue or profit by NTEE category given the different ways in which nonprofits operate.

As described in the limitation section, further research on smaller samples within specific nonprofit categories may also provide detailed insights by more fully exploring the measures that are most applicable and variances that may exists between large and smaller nonprofits.

The literature would likewise benefit from further research on the complementary nature of agency theory and stakeholder theory in nonprofits. Further analysis of underlying business models and a look at the salience of the multiple stakeholders in nonprofit groups may be a step towards further understanding how these theories apply to nonprofit organizations. Additionally, extending existing research on overinvestment and underinvestment related to agency theory and debt could be applicable in nonprofits.

Finally, a case study involving a specific industry would be an excellent way to extend this theory to practice. For example, approximately thirty public media stations received over $1.9 billion dollars in 2017 (Janssen 2017), arriving as unrestricted net assets. Understanding the organizations prior to their arrival, the sums' impact, and how these organizations changed since would provide fresh insights and provide a framework for conducting additional studies.

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APPENDIX A – NONPROFIT PERFORMANCE MODELS

<table>
<tr><th rowspan="19">Effectiveness</th><th>Main Dimensions</th><th>Sub-Dimensions</th><th>Indicators</th><th rowspan="19">Benchmark</th></tr>
<tr><td rowspan="2">Board Effectiveness</td><td>Board governance</td><td>Board structure (homogeneity – experience)</td></tr>
<tr><td>Accountability</td><td>Corporate governance</td></tr>
<tr><td rowspan="4">Managerial Effectiveness</td><td>Achieving goals</td><td>Mission success</td></tr>
<tr><td>Organizational flexibility</td><td>Ability to adapt to changes</td></tr>
<tr><td>Strategy</td><td>Strategic plans</td></tr>
<tr><td>Professionalism</td><td>Paid staff – Organizational learning - Procedures</td></tr>
<tr><td rowspan="4">Resource Effectiveness</td><td>Tangible resources</td><td>Tangible resource acquisition (Fundraising)</td></tr>
<tr><td>Intangible resources</td><td>Intangible resource acquisition (Volunteers)</td></tr>
<tr><td>Capacity</td><td>Cost effectiveness – Unit cost and efficiency</td></tr>
<tr><td>Human resources management</td><td>Job satisfaction – Turnover</td></tr>
<tr><td rowspan="2">Financial Effectiveness</td><td>Financial performance</td><td>Financial ratios (budget / income/expense tables)</td></tr>
<tr><td>Financial health</td><td>External financial audits – internal financial health</td></tr>
<tr><td rowspan="2">Environmental Effectiveness</td><td>Technical environment</td><td>Technology – IT systems and their suitability to the environment</td></tr>
<tr><td>Social environment</td><td>Legitimacy – Public relations – Reputation (popularity)</td></tr>
<tr><td rowspan="3">Program Effectiveness</td><td>Successful programs and projects</td><td>Program delivery</td></tr>
<tr><td>Service quality</td><td>Client or customer satisfaction</td></tr>
<tr><td>Outcomes</td><td>Stakeholder satisfaction</td></tr>
</table>

Figure A1: Integrated nonprofit effectiveness measurement model (Taysir & Taysir, 2012)

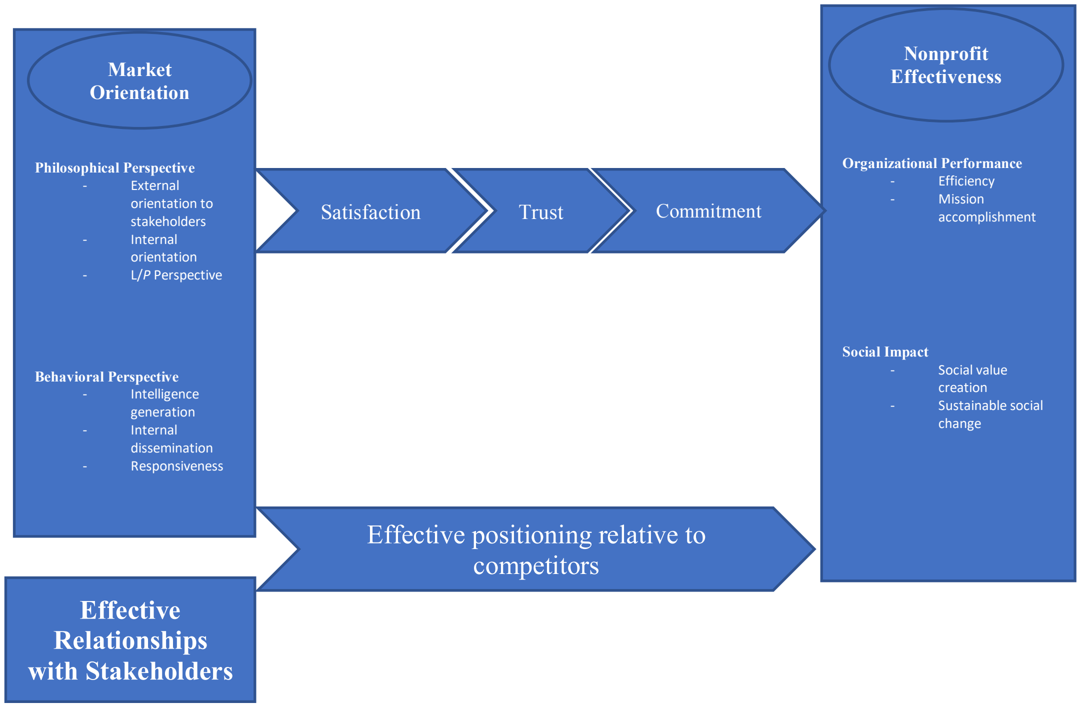

Figure A2: A marketing based framework for evaluating nonprofit effectiveness (Rey Garcia *et al.*, 2012)

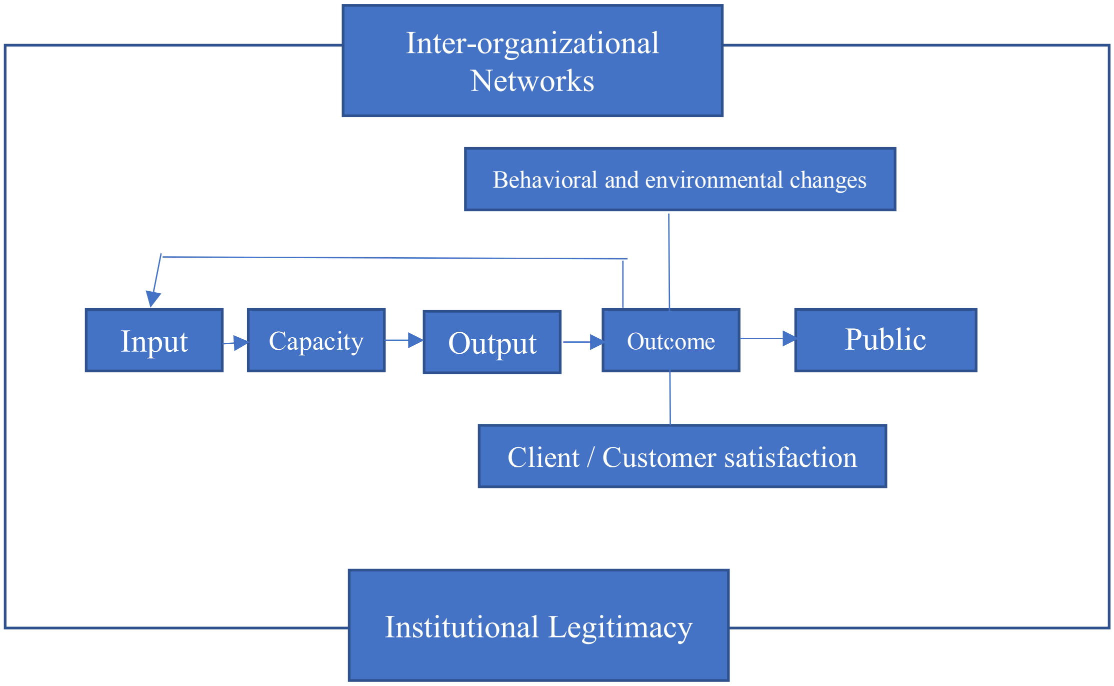

Figure A3: Nonprofits' performance (Lee & Nowell, 2015)

APPENDIX B – GOVERNANCE FACTORS - HARRIS

Harris *et al.* (2015) identified seven different good governance factors which were composed of twenty-one underlying measures pulled from the Form 990. In this research, they evaluated these factors in relation to the effects on philanthropic giving.

- *Policies*
  - Policies is comprised of the existence of a written conflict of interest policy, whistleblower policy, and document destruction policy. *The Principles for Good Governance and Ethical Practice* (2015) identify these as good governance practice for legal compliance and public disclosure. Each policy encourages behavior by key individuals and employees which fosters an environment where activities benefit the interest of the nonprofit.
- *Audit*
  - Audit is comprised of whether the organization's financial statements were reviewed or audited by an independent accountant and whether there is the presence of an audit committee which oversees the financial reporting process. *The Principles for Good Governance and Ethical Practice* (2015) identify these as good governance practice for strong financial oversight. The IRS (2008) encourages a charity with substantial assets or revenue to consider obtaining an audit by an independent auditor and to have an independent audit committee to select the auditor and oversee the process.

- *Compensation*
  - Compensation is comprised of whether specific criteria are used to determine the compensation of the CEO and of other key employees. These can include review by a compensation committee, an independent committee, compensation surveys, written employment contract, or review of other form 990's. Having these policies in place can reduce agency problems where managers enrich themselves at the expense of the nonprofits stakeholders.
- *Board*
  - Board is comprised of both board size and the ratio of independent board members to all board members. Boards of directors have ultimate responsibility for the effective functioning of an organization. The IRS (2008) notes that an active and engaged board is important to the success of the charity and compliance with regulatory requirements. *The Principles for Good Governance and Ethical Practice* (2015) recommends that at least two-thirds of its board members should be independent as a measure of effective governance.
- *Management*
  - Management is comprised of factors related to potential managerial weaknesses in the organization. These include the absence of related parties, outsourcing of key managerial duties, and the ability of key individuals to be reached at the organization's address, and the reviewing whether any significant changes were made to organizational documents.

The IRS (2008) identifies the potential conflict of having overlapping business and personal relationships. Outsourcing managerial responsibilities increases the potential of agency problems because it is more difficult to ensure that work is being performed accurately.

- *Access*
    - Access is comprised of factors related to the transparency the organization which include whether the tax forms are available on their own website along with the contact information for the person responsible for the organizations records. *The Principles for Good Governance and Ethical Practice* (2015) recommends that a nonprofit make both its financial information and information on the board and staff widely available.
- *Minutes*
    - Minutes is comprised of factors related to having documentation of meetings of the board and authorized committees of the board. The IRS (2008) encourages boards and committees to keep minutes of meetings.

Here are the specific Form 990 governance measures by Harris *et al.* (2015)

Table B1: Governance Factors (Harris et al., 2015)

Measure	Description	Form 990 Reference	Coding
board_size	Number of voting members in the governing body	Part VI Section A Question 1a	Continuous variable
independence	Percentage of independent voting members to total board members	Part VI Section A Question 1b	Continuous variable
no_relations	Family/business relationship between key personnel	Part VI Section A Question 2	=1 for no =0 for yes
no_outsource	Management function delegated to an outside entity	Part VI Section A Question 3	=1 for no =0 for yes
no_doc_changes	Significant organizational document changes	Part VI Section A Question 4	=1 for no =0 for yes
no_asset_diversion	Material diversion of assets	Part VI Section A Question 5	=1 for no =0 for yes
doc_gov	Documentation of governing body meetings	Part VI Section A Question 8a	=1 for yes =0 for no
doc_comm	Documentation of authorized committees meetings	Part VI Section A Question 8b	=1 for yes =0 for no
review_990	Governing body review of Form 990 pre-filing	Part VI Section A Question 10	=1 for yes =0 for no
no_unreachable	Key organization personnel reachable at org address	Part VI Section A Question 11	=1 for no =0 for yes
conflict	Organization has a written conflict of interest policy	Part VI Section B Question 12a	=1 for yes =0 for no
officers_conflicts	Key organization personnel disclose conflicts of interest	Part VI Section B Question 12b	=1 for yes =0 for no
enforce_conflict	Compliance enforcement of conflict of interest policy	Part VI Section B Question 12c	=1 for yes =0 for no
whistleblower	Organization has written whistleblower policy	Part VI Section B Question 13	=1 for yes =0 for no
destruction	Organization has written document retention and destruction policy	Part VI Section B Question 14	=1 for yes =0 for no
ceo_salary	Top executive compensation approved	Part VI Section B Question 15a	=1 for yes =0 for no
officer_salary	Other key personnel compensation approved	Part VI Section B Question 15b	=1 for yes =0 for no
own_web	Applicable forms disclosed on own website	Part VI Section C Question 18a	=1 for yes =0 for no
contact_info	Contact information for person with organization records is available	Part VI Section C Question 20	=1 for yes =0 for no
review_or_audit	Organization's financial statements were either reviewed or audited by an independent accountant	Part IX Questions 2a and 2b	=1 for yes =0 for no
audit_committee	Organization has an audit committee	Part IX Question 2c	=1 for yes =0 for no

APPENDIX C – GOVERNANCE FACTORS - NEWTON

Table C1: Governance Index Sub-Indices Adapted from Newton (2015)

Governance Index	Description	Coding	Weights
Governing Body			
Board Independence	Is at least two-thirds of the organization's board of directors is independent? [VI.A.1b/V1.A.1a]	=1 if Yes =0 if No	.500
Inside Business Relationship	Did any person who is a current or former officer, director, trustee, or key employee have a direct business relationship with the organization [IV.28a], have a family member who has a direct or indirect business relationship with the organization [IV.28b], or serve as an officer, director, trustee, key employee, partner, or member of an entity doing business with the organization [IV.28c]?	=1 if No =0 if Yes	.433
Outside Management	Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors or trustees, or key employees to a management company or other person? [VI.A.3]	=1 if Yes =0 if No	.266
Stockholders	Does the organization have members or stockholders [VI.A.6] who may elect one or more members of the governing body [VI.A.7a] and approve the decisions of the governing body [VI.A.7b]?	=1 if Yes =0 if No	.378
Form 990 to Board	Was a copy of the Form 990 provided to the organization's governing body before it was filed? [VI.A.10]	=1 if Yes =0 if No	.396
Governing Policies			
Conflict of Interest Policy	Does the organization have a written conflict of interest policy [VI.B.12a] that is regularly and consistently monitored and enforced [VI.B.12c], and that requires officers, directors or trustees, and key employees to disclose annually interests that could give rise to conflicts [VI.B.12b]?	=1 if Yes =0 if No	.404
Whistleblower Policy	Does the organization have a written whistleblower policy? [VI.B.13]	=1 if Yes =0 if No	.442
Document Retention Policy	Does the organization have a written document retention and destruction policy? [VI.B.14]	=1 if Yes =0 if No	.429
Grant to Officer	Did the organization provide a grant or other assistance to an officer, director, trustee, key employee, or substantial contributor, or to a person related to such an individual? [IV.27]	=1 if No =0 if Yes	.244
Compensation Policies			
CEO Compensation Policy	Indicate the number of ways that the organization uses to establish the compensation of the organization's CEO/Executive Director [Schedule J, I.3]. Note: The six possibilities listed are a compensation committee, independent compensation consultant, Form 990 of other organizations, written employment contract, compensation survey or study, and approval by the board or compensation committee.	Continuous Variable	.315
Non-CEO Compensation Policy	Did the process for determining compensation of the non-CEO officers or key employees of the organization include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision? [VI.B.15b]	=1 if Yes =0 if No	.480
Executive Reimbursement Policy	If the organization provided fringe benefits to any person listed in the Schedule of Compensation to Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees [Schedule J, I.1a], did the organization follow a written policy regarding payment or reimbursement or provision of all of the associated expenses [Schedule J, I.1b]?	=1 if Yes =0 if No	.346
Executive Substantiation Policy	If the organization provided fringe benefits to any person listed in the Schedule of Compensation to Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees [Schedule J, I.1a], did the organization require substantiation prior to reimbursing or allowing associated expenses [Schedule J, I.2]?	=1 if Yes =0 if No	.273
Accountability & Transparency			
Tax Forms on Website	Does the organization make its Form 1023 (or 1024 if applicable), 990, and 990-T available for public inspection on its own website? [VI.C.18]	=1 if Yes =0 if No	.236
Audited Financial Statements	Were the organization's financial statements compiled, reviewed, or audited by an independent accountant? [XI.2a-b] (If audited, the audit must not be a Circular A-133 audit [i.e., "No" to XI.3a])	= 1 if Audited =.50 if Reviewed or Compiled =0 if No	.409
Audit Committee	If the organization's financial statements are compiled, reviewed, or audited by an independent accountant [XI.2a-b], does the organization have a committee that assumes responsibility for oversight of the audit, review, or compilation of its financial statements and selection of an independent accountant [XI.2c]?	=1 if Yes =0 if No	.299

APPENDIX D – SMART PLS MODEL – CHAPTER 2

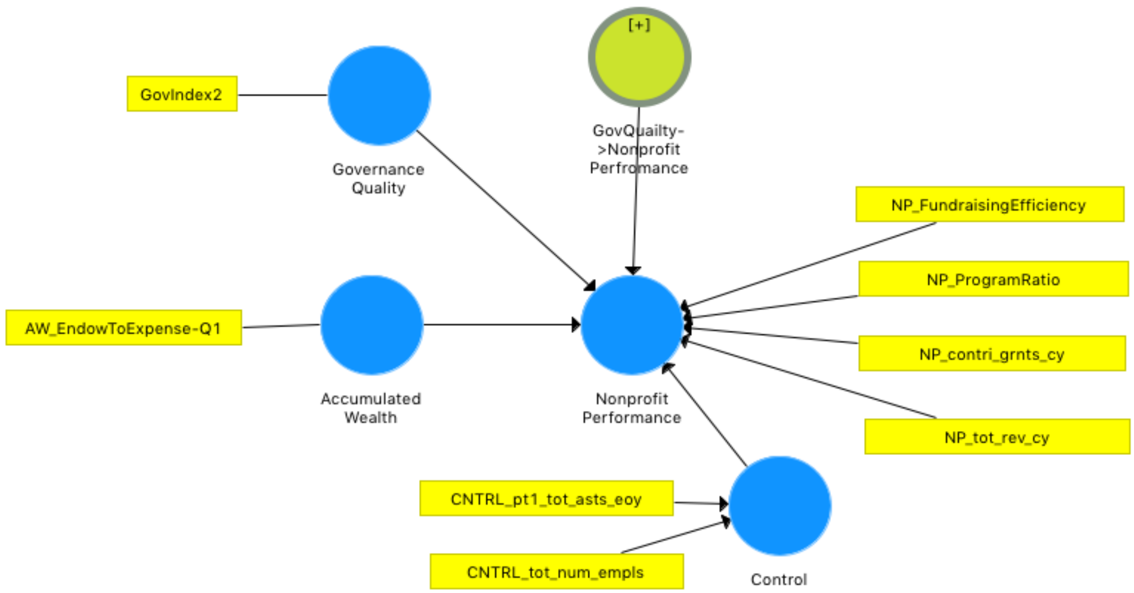

Figure D1: Smart PLS Model – Chapter 2

APPENDIX E – SMART PLS MODEL – CHAPTER 3

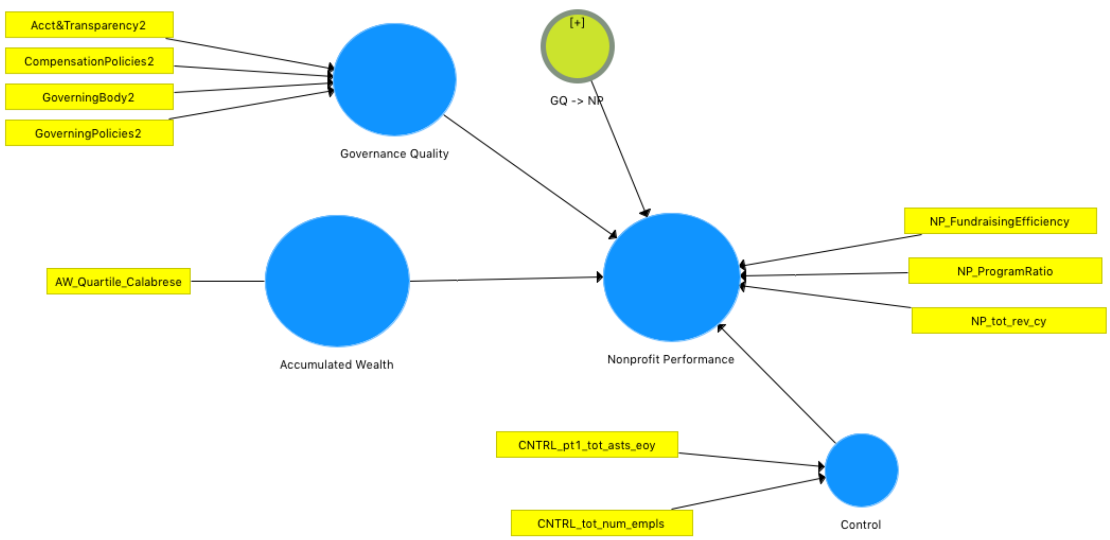

Figure E1: Smart PLS Model – Chapter 3