‘NON-CORPORATE’ CORPORATE GOVERNANCE

Much of the material written about the governance of organisations concerns ‘corporate’ governance, ie the governance of corporate limited and usually listed companies. There are very good reasons why this is an important area to study and understand as this is linked to the agency problem and the need for investors to trust and support the directors put in place as the ‘stewards’ of their investments.

The health of capitalist systems, the value of equities and the security of long-term shareholder value are all dependent on effective and robust systems of corporate governance and so it is right that these are at the centre of the Paper P1 *Study Guide* and in most of the textbooks on which the Paper P1 *Study Guide* draws. The Paper P1 *Study Guide* also covers governance in family and insider-dominated organisations (section A6b).

Governance issues also apply to a range of other organisational types, however. These types of organisation are important for different reasons to those for business organisations. In each case, an agency gap exists which governance systems can be used to address, but it is interesting to look at the nature of the principals in these agency relationships and how different types of organisations configure their governance arrangements.

In this article, I will consider two broad types of non-corporate organisation: public sector organisations and charitable/voluntary organisations. The purpose of this is to clarify and expand on the Paper P1 *Study Guide* section A1f.

Public sector organisations

Public sector organisations are those that are directly controlled by one or more parts of the state. In the usual composition of a state (executive/government, legislature, judiciary and secretariat/administration) public sector bodies are usually found implementing parts of executive (government) policy in the secretariat or administration. This does not mean that they are all parts of government departments, however (although they might be, such as some hospitals and schools). They can also be devolved government bodies such as local government authorities, nationalised companies (where the majority of shares are owned by the government), supranational bodies, or one of a number of ‘arms-length’ bodiessuch as non-governmental organisations (NGOs)

The size of the public sector varies in different countries. In some countries, many of the largest companies are state-controlled, for example. In others, business activity is largely private, but the state may control public services such as education and health.

In terms of strategic purpose, public sector organisations exist to implement one or more aspects of government policy. The control over a particular public service, utility or public good is seen as so important that it cannot be left to the profit motive and the demands for returns from private shareholders. Organisational objectives will, therefore, be determined by the political leaders of the country at that time in line with government policy. For a nationalised rail service, for example, some loss-making route services may be retained in order to support economic development in a particular region.

The way in which these organisations are regulated and controlled is different from most business organisations. The focus is likely to be on value for money rather than the achievement of profits, and the level of control from central or local government can be very high, giving rise to criticisms that public sector organisations are over-bureaucratic and unnecessarily costly. They are likely to have service delivery objectives underpinned by legislation.

Despite their contrasts with business organisations, public sector organisations also incorporate an agency relationship. Their management, sometimes comprising a mix of elected and executive officers, serve the interests of their principals but the principals, as discussed, are likely to seek objectives other than long run profit maximisation. In public sector organisations, the ultimate principal is the taxpayer and elector (in a democracy) in that it is he or she that pays for the service and the organisations exist for their benefit. Because taxpayers and electors are diverse and heterogeneous, different layers of public servants, elected and non-elected people seek to interpret taxpayers' best interests, a task that is sometimes fraught with difficulty.

A typical problem in the governance of public sector organisations is establishing strategic objectives and monitoring their achievement. The millions of taxpayers and electors in a given country are likely to want completely different things from public sector organisations. Some will want them to do much more while others, perhaps preferring lower rates of tax, will want them to do much less or perhaps not to exist at all. Interpreting these varying demands is affected by politics. It applies at all levels of state activity from the local, to the national to the supranational. It is normal in most countries to have a limited audit of public sector organisations to ensure the integrity and transparency of their financial transactions, but this does not always extend to an audit of its performance or 'fitness for purpose'.

In recent years, a number of national governments have privatised some of their state-owned organisations. This means that they attempt to gain an accurate market value for a state-owned enterprise and then sell newly issued shares in that company on the country's stock exchange. In doing this, the privatised organisation goes from state control to having to comply with company law and relevant listing rules. In liberalising their economies, many countries have undergone widespread privatisation programmes in recent years, creating large new companies in industries such as energy, water, transport and minerals, that were formerly state-owned. This change places the organisation in a potentially competitive market for the first time and changes the skills needed by executive directors to some extent. It is usually accompanied by a substantial internal culture change as the new company adjusts to its new strategic situation.

Charities and voluntary organisations

In many countries, there is a sizeable 'third' sector (the first two being business and the state). In some countries there are tens of thousands of charities and voluntary organisations that exist, usually, for a particular social, environmental, religious, humanitarian or similar benevolent purpose. In most countries, this benevolent purpose is recognised by the state in that they enjoy tax privileges and reduced reporting requirements.

In exchange for favourable regulatory treatment, however, a charity must demonstrate its benevolent purpose and apply for recognition by the country's charity commission or equivalent. It is not just regulatory authorities that a charity is accountable to, however. It also needs to raise funds to pursue its benevolent aims and so it needs donations. These usually come from individuals and organisations that share the charity's benevolent aims and ethical values.

This opens up an interesting accountability relationship: how do donors giving to charities know that their donations will be used for the intended purpose and not wasted, misdirected or embezzled? In some jurisdictions, regulation is very light and some charities have taken advantage of this by very partial disclosure and minimal financial reporting. This, in turn, has led to criticism and calls for more rigorous corporate governance regulation of charities in some countries. Some charities voluntarily provide full financial disclosures and this places increased pressure on others to do the same. There have been many reports, however, of recipients of charitable donations misusing funds, sometimes for self-enrichment. This is clearly a breach of the trust placed in the charities.

A common way to help to reduce the agency problem is to have a board of directors overseen by a committee of trustees (sometimes called governors). In this case, the board manages the charity and the trustees act as a control on the board to ensure that the board is delivering value to the donors and are acting towards the stated and agreed benevolent aims. This protects the goodwill of the donors and ensures the efficient delivery of charitable services. The trustees are typically people who share the values of the charity and act in a similar way to independent or non-executive directors in a public company. Some schools and universities are run along these lines, for example. The trustees also have the power to recruit and remove senior executives in the charity.

One of the recent developments in seeking to maximise the effectiveness of charities, and hence deliver value to donors and users of the charitable service, is to measure and then publish the contribution the charity makes. Using a social or environmental audit-type framework, including a regular and transparent report on how the charity is run and how it has delivered against its stated terms of reference and objectives can greatly aid accountability and increase the confidence and trust of all of the main stakeholders: service users, donors, regulators and trustees.

David Campbell is examiner for Paper P1

	Purpose	**Agents**	**Principals**	**Typical governance arrangements**
Public listed companies	Maximisation of long-term shareholder returns	Directors	Shareholders	Executive board monitored by non-executive directors and non-executive chairman.
Public sector	Implementation of government policy	Various layers of service and departmental managers. Sometimes elected representatives.	Ultimately, taxpayers and, in a democracy, voters (the two are often similar).	Complex political structures seeking to interpret the wishes of taxpayers and the best way to deliver services.
Charities and voluntary organisations	Achievement of benevolent purposes	Directors and service managers	Donors and other supporters provide the resources. Service users or consumers benefit from charities.	Ideally, an executive board accountable to independent trustees. Open to interpretation and abuse in some jurisdictions, however.