

CORPORATE GOVERNANCE OF NON-PROFIT ORGANIZATIONS (CASE OF PUBLIC HOSPITALS IN ČR)

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Abstract

The main aim of this paper is to contribute to the development of the corporate governance (CG) of non-profit organizations. The methodology is based on the comparison of the main parameters of the CG of for-profit vs non-profit organizations. The main parameters were extracted from the basic literature sources describing the CG systems of for-profit organizations as well as their characteristics. The characteristics of the parameters for non-profit organizations were refined from the author's own research and the research of his students. The longitudinal research started in 2005 and continues up to now. Our statistical sample from 2016 is represented by almost two hundred public hospitals in the Czech Republic. They were analysed as representatives of non-profit organizations. Based on this statistical sample we can state that the characteristics of the parameters differ in for-profit and non-profit organizations. In some parameters, the characteristics differ distinctively and in others we can observe the tendency to convergence. The future tendencies are predicted and discussed.

Key words: corporate governance, public hospitals, characteristics, comparison with for-profit organizations

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Introduction

The corporate governance theory today is concentrated mostly on organizations established to generate profit. Non-profit organizations and their role in the national economy are highly important and very often underestimated; they create their own theoretical framework for the corporate governance and its application. The main aim of this paper is to contribute to the development of the theory of the corporate governance of non-profit organizations and to also show its practical consequences and future development.

1 Literature Review

Corporate governance authors in the last two decades were concentrated mostly on the corporate governance theory and the practice of for-profit organizations (Mallin, 2010; Monks & Minow, 2011; Aguilera & Crespi-Cladera, 2016). Now the situation is slowly changing.

The issues of corporate governance are no longer restricted to for-profit organizations. Governance of non-profit organizations has started to be addressed in the last decade (Aldashev, Marini & Verdier, 2015).

Rich bibliography of corporate governance topics of for-profit organizations allows to indicate the main characteristics or parameters of the corporate governance systems of for-profit organizations in the first step. Then, based on our research to collect corporate governance characteristics of real samples of non-profit organizations (in our sample public hospitals in the Czech Republic) and to do a comparison with the corporate governance characteristics of for-profit organizations in the second step.

The idea of this paper is based on a comparison of the main parameters of the corporate governance of profit and non-profit organizations, and so literature review of both sectors is inevitable. However, literature regarding for-profit organizations is vast and generally known, and therefore author reviews existing literature of non-profit organizations through data samples consisting of public hospitals, he also reviews hospital governance.

1.1 Non-profit organizations

One of the most fundamental distinctions between for-profit and non-profit sectors is the fact, that for the non-profit organization financial considerations, such as increasing shareholder value, form only one dimension of the mission statement (Dent, 2014). Non-profit organizations also cannot disburse profits that affect the very nature of non-profit organizations. Another important distinction may be the fact that non-profit organizations do not have real owners (Glaeser, 2003). Governance of non-profit organization differs, because the decision-making process is not only influenced by economic interests of shareholders, but by the interests of various stakeholders (Byers, 2014).

In for-profit organizations we can see a clear division of the roles of the principal as the owner on one side and the agent, hired manager on the other. Their roles are developing and according to Monks and Minow (2011) in the second half of the 20th century we could observe decreasing supervisory activity of the owners towards managers. Mostly from the

institutional investors (e.g. pension funds) or widely dispersed minority shareholders, their activity in the supervision of managers is unsatisfactory. According to Mallin (2010), the situation is slowly changing. Especially as the activity of institutional investors is increasing and their role is transforming from portfolio investors into strategic investors. They are more actively collaborating with company management in creating company vision, mission, aims, and strategy.

Facing the fact that most of the non-profit organizations have no owner, it is necessary to identify the objectives of the principals and agents and detect potential agency problems (Du Bois, 2009).

Board structure is another important difference between for-profit and non-profit organizations. Architecture of the boards is one of the main characteristics of governance systems all around the world. In for-profit organizations, we differentiate between two basic systems of organizational designs of boards: a one-tier structure with a board of directors and a two-tier structure with a management board and supervisory board (Hilb, 2004). Since a one-tier structure is the predominant system, a majority of research is focused on the responsibilities and roles of the board of directors. Boards of for-profit organizations generally consist of between 8 to 14 directors, while non-profit boards tend to be much larger because they need to represent the interests of many stakeholders (Zhu, Wang & Bart, 2014).

An inseparable part of the governance structure are committees responsible for particular areas within the board of directors. A financial responsibility and transparency is no longer an issue for only for-profit organizations. The United States Sarbanes-Oxley Act from 2002 applies also to non-profits which are obligated to set up an audit committee out of independent members of the board. However, even in 2004 out of the 128 largest U.S. non-profit organizations, 10 of them did not have an audit committee and 36 percent of non-profits had an audit committee that was not completely independent (Vermeer et al., 2006).

On the other hand, it is important to point out that the organizations of both sectors also share similar difficulties. According to Glaeser non-profit organizations have governance problems that resemble the problems in for-profit firms, but are often far more extreme (Glaeser, 2003).

1.2 Hospital governance

Due to the fact that our data sample consists of public hospitals, literature namely focused on non-profit hospitals was reviewed as well. Within the governance of non-profit organizations,

the healthcare sector faces very specific challenges. According to Eeckloo et al. (2007) the term hospital governance refers to the complex of checks and balanced that determine how decisions are made within the top structures of hospitals.

Eeckloo et al. (2004) analyse whether and to what extent governance models existing in the corporate world can be implemented in the hospital governance. According to the authors corporate governance can provide a potential frame of reference, nevertheless the unique social aspects of hospitals, including a large diversity of stakeholders and the lack of clear business objectives, have to be taken into account.

Preker et al. (2007) elaborate the theory of agency in the health-care sector. The principal-agent relationship is easily identified in corporate world, while in the health care sector there are several principal-agent relationships on various levels. *“This relationship exists between government and health funds; private owners and health funds (the private insurance company); private owners and private hospitals; government and public hospitals; health funds and hospitals; health funds and general practitioners; hospitals and hospitals-based doctors; patients and health funds; patients and hospitals; patients and general practitioners; and patients and hospital-based doctors.”* (Preker et al., 2007: 167). It is a rather unique characteristic of the health-care sector that various parties constitute several agency relationships and the change in one pair of relationships will affect others. This characteristic is a consequence of the non-existing owner in public hospitals as was explained above. The emphasis has therefore shifted to the large diversity of stakeholders (tax payers, patients, GPs, government authorities, health insurers, etc.) (Eeckloo et al., 2007).

The board of directors as a governing body plays a significant role in the overall performance of the hospital. Therefore, the relationship between the characteristics of the board and hospital performance is analysed similarly to the empirical research existing in the for-profit sector. For instance, Jha and Epstein (2009) survey board chairs of 1,000 U.S. hospitals to examine the potential influence of a hospitals' board on quality of care. Findings show that fewer than half (44 percent) of the boards rated quality of care as one of their two top priorities, and those engaged boards are more likely to be associated with better performance.

2 Data sample and Methodology

The adopted methodology is a comparative analysis which is based on a comparison of for-profit and non-profit organizations. The main parameters for the comparison were extracted

from literature sources, describing the corporate governance system of for-profit organizations (e.g. Mallin 2010, Monks, Minow 2011) and from our own research for non-profit organizations. The following parameters are specified for the comparison:

- characteristics of ownership structure
- ways of collecting capital resources
- organization aims and strategy
- board structure and composition

From the main aim of this paper we can derive the following two hypotheses:

H1: The characteristics of the parameters of the defined CG system differ in for-profit and non-profit organization.

H2: The development of the characteristics of the parameters of both systems tends to convergence.

For the second step of our methodology it was necessary to elaborate the analysis of our statistical sample. The characteristics of the parameters for non-profit organizations were refined from our own research, the analysis of 182 public hospitals in the Czech Republic as the representatives of the non-profit organization. This sample represents almost all the non-profit hospitals in the country, and the data was collected in 2016 with the assistance of doctoral and master degree students. Main sources were hospitals' annual reports, verified by interviews of top managers from selected hospitals. The results of our analysis are depicted in Tab. 1-4.

Tab. 1: Ownership structure

Characteristics of ownership	No. of units	Percentage
Ministry of Healthcare	51	28%
Region	87	48%
City, Municipality	27	15%
Church	11	6%
Ministry of Defence and Justice	4	2%
Other legal persons	2	1%

Source: Own research

Tab. 2: Capital Resources

Characteristics of Capital Resources	No. of units	Percentage
Founding organizations	160	88%
Sponsorship	9	5%
Charity	7	4%
Bank loans	5	3%

Source: Own research

Tab. 3: Aims and Strategy

Hospital aims and strategies	No. of units	Percentage
Shareholders access (Stewardship theory)	84	46%
Shareholders access (Agency theory)	7	4%
Stakeholders access	91	50%

Source: Own research

Tab. 4: Board structure

Board structure and composition	No. of units	Percentage
One-tier without committees	0	0%
One-tier with committees	0	0%
Two-tier without committees	4	2%
Two-tier with committees	0	0%
Board of trustees without committees	142	78%
Board of trustees with committees	36	20%

Source: Own research

3 Findings and Discussion

Our findings are concentrated in the following comparative analysis of different parameters.

3.1 Ownership structure

Based on literature sources (for-profit organizations) and statistical results from non-profit hospitals (Table 1), we can draw the two following conclusions. In for-profit organizations, the most common situation is when the so-called majority owner(s) is the decisive factor for strategic decision-making. There are two variants of the majority owner; either he/she is

closely connected with the bank or institutional investor and thus top management is heavily influenced by external owners, or the shareholders (owners) are broadly dispersed and all of the power is concentrated in the hands of the chief executive officers or managing director together with the whole board of directors. State ownership is rare, and is concentrated in a few monopoly companies (e.g. railway, post, sometimes strategic energy) and their incidental losses are covered by a governmental budget.

In the case of non-profit organizations, i.e. the hospitals in our sample, in almost all cases, the owner is identical with the founder.

In some non-profit organizations, the definition of a ‘real owner’ is often very difficult; the owner is vague or simply does not exist. In these cases, a ‘real owner’ is substituted by a so-called Administrative Owner, who is represented by special bodies (Board of Trustees, Board of Governors). Some examples are faculty hospitals, hospitals founded by churches or foundations.

3.2 Capital Resources

Similarly as in previous characteristics our conclusions are based on literature sources and statistical data from Table 2. There are two main ways that for-profit organizations acquire the necessary investment capital: either through a capital market (IPO) when an active and liquid capital market exists or through bank credits, when capital market is relatively passive (Mallin, 2010).

Non-profit organizations do not rely on the capital market and the accumulation of capital by the IPO. The usual method of obtaining initial investment capital is through founding organizations, sponsorship and charity, and rarely through bank loans.

3.3 Organization aims and strategy

In non-profit organizations, our findings come to the conclusion that the situation is substantially different from for-profit organizations (Tab. 3). Here, generating profit is not the priority goal but there is usually a set of goals, mostly social and partly economic, but as a rule, difficult to quantify.

Due to the unclear characteristics of the owner in non-profit organizations, diversified and sometimes hardly specified aims result. Economic aims are of secondary importance (e.g. the aim of public hospital is the highest quality of care for all patients).

Non-profit organizations prefer the implementation of the stewardship theory instead of the agency theory. The stewardship theory is not based on the theory of “economic man”

but on psychology and sociology. It comes from the idea that a manager does not follow his individual aims but is fully identified with the aims of the institution, and thus follows primarily its goals. Managerial benefit, in case he follows the company's goals, is higher than following his own individual goals. Implementation of the stewardship theory leads logically towards lower agency costs, because the supervision of the managers by the owner is not so intense. On the other side, however, there is a danger of the managers abusing power.

In the governance of non-profit organizations, as backed up by the empirical results from our survey, we can state that the agency costs are relatively low compared to those in for-profit organizations, and the supervising role is underestimated. The typical consequence of lower costs could be defalcation. Our findings have not found any attempts to do it in Czech hospitals. A possible explanation of the absence of fraudulent behaviour of the top managers (contrary to the other sectors of a transition economy) is the stewardship theory, implemented broadly in non-profit organizations. The same situation with lower agency costs exists with the problem of incomplete contracting, where the ratio of unpredictable situations is much higher. The reason is that non-profit organizations operate in a less stable environment with more complicated relationships and often unpredictable behaviour of political bodies on a governmental level.

The characteristics of the so-called administrative owner influence the original theory of agency costs. The roles of both partners, the principal and the agent, are not so clearly defined and their roles are often overlapping. Motivation of managers is sometimes difficult because the organization's goals are difficult to quantify; instead of one clear goal, as in for-profit organizations (profit), there is usually set of different goals. Lack of quantitative criteria leads to underestimation of the control of managers. The consequences are lower agency costs on one side, but the danger of unclear financial transactions and defalcation on the other.

Implementation of the stakeholder theory, in which the main aim is to satisfy the expectations of all stakeholders such as customers, suppliers, employees, creditors, central and municipal governments, local communities, social groups including shareholders – contrary to stakeholders theory concentrated on increasing the wealth of only shareholders (Mallin, 2010) – is more often in non-profit than for-profit organizations. The shareholder theory is, from its substance, close to the goals of for-profit organizations. Non-profit organizations prefer the stakeholder theory. The main reason for this application is the broad diversity of strategic goals, fulfilling the expectations of different participants.

3.4 Board structure

There are two basic systems of the organizational design of boards: a one-tier structure with a board of directors and a two-tier structure with a management board and supervisory board. For increasing the efficiency of their activities, both systems create special committees, assisting the boards. Their main task is to prepare data for the board meetings and elaborate the decision-making versions and their analysis. The board members then make the final decision. The typical committees are committees for audit, nomination, remuneration, risk, financial, executive committees. To increase the supervisory role of the boards, for-profit organizations nominate, as board members, independent members and representatives of the employees.

In non-profit organizations, we can find versatile structures, as well as other bodies, that usually do not exist in the for-profit sector, for example, a board of trustees or governors. There are still missing committees for audit, remuneration, and risk management. The independent members of the boards are absent; in addition, the representatives of employees in boards and supervisory functions are often underestimated.

The main difference between for-profit and non-profit organizations is the existence of the board of trustees or governors, which in many non-profit organizations substitutes the real owner and acts as an administrative owner. In some hospitals, we observed only a supervisory board and management. Only in the hospitals with the legal form of joint-stock companies have we found classical two-tier structures with a management board and a supervisory board.

We can observe the other differences between for-profit and non-profit organizations in the board structure: an unclear system of the compensation and remuneration of board members, the absence of quantitative indicators of the task for managers and board members, and a remunerations policy based on fulfilment of these indications (base salary, bonuses, and benefits).

3.5 Comparison of for-profit and non-profit organizations

The main results of the analyses of the differences of the characteristics in the parameters of the corporate governance in for-profit and non-profit organizations are depicted on table 5.

Tab. 5: Characteristics of CG by parameters

Organization	Parameters			
	Ownership structure	Capital resources	Organization aims and strategy	Board structure
For-profit	Major and minor owners, owner is clearly defined	Markets Banks	Higher agency cost, internal planning, profit growth Shareholders theory still dominant	One or two-tier structure, committees, long-term manager motivation (share options)
Non-profit	Administrative owner, owner is unclear	Charity, sponsors, bank lends	Unclear separation of competencies, implementation of stewardship theory, owners role diminished Lower agency cost Predominant stakeholders theory	Nonstandard structures, incomplete boards, boards of trustees or governors, committees not existing, low long-term managers motivation

Source: Own research

Conclusion

In accordance with the main aim of our paper “to contribute to the development of the theory of the CG of non-profit organizations as well as show its practical consequences” we tried to specify the main characteristics of the CG parameters in for-profit and non-profit organizations and indicate the similarities and differences in both systems.

The analysis of our sample of 182 public hospitals in the Czech Republic allowed the verification of both of our hypothesis.

Hypothesis H1 “The characteristics of the parameters of the defined CG system differ in for-profit and non-profit organizations” was verified and confirmed practically in all parameters. In parameters, e.g. “capital resources”, “ownership structure”, “organization aims and strategy”, and “board structure”, some characteristics differ distinctly. There are some similarities too. For instance “the role of stakeholders” is important for for-profit as well as

for non-profit organizations.

Hypothesis H2 “The development of the characteristics of the parameters of both systems tends to convergence” was confirmed only partly, namely in the following parameters: “ownership structure”, tending to higher privatization, and “organization aims and strategy” with the tendency of increasing role of different stakeholders.

On the other side, we indicated high diversity without any tendency to convergence, mostly in parameter “board structure”.

Based on our research, we may formulate the following tendencies for the future development of CG in non-profit organizations. Ownership structure will change in the way that the number of privately owned companies will increase. This tendency we can observe not only in the Czech Republic, but almost in all countries. With regard to capital resources, we cannot expect any radical change in the financing of non-profit organizations. The current tendency to rely on charity and sponsors will be more and more important.

In organization aims and strategy, an increasingly controlling role of administrative owners is expected to prevent abuse of managerial positions for self-interests and moral hazards. In the stakeholder theory, we expect the continuation of the implementation of stakeholder views and an increasing tendency of the institutions toward corporate social responsibility and activities tending to the fulfilment of the idea that an institution acts as a “good citizen”.

The results of our comparative analysis correlate with the conclusions of other literature sources (Hopt and Hippel, 2010) that in the CG of for-profit and non-profit organizations we can observe the development of two relatively independent systems in harmony with the principal factors influencing them substantially. These factors are macro policy, economic and social policy, culture, and public opinion. Our analysis, however, also revealed certain elements of convergence in for-profit and non-profit sectors that can indicate higher convergence in the future.

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