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EXECUTIVE COMPENSATION AND FIRM PERFORMANCE: EVIDENCE FROM THE UK CHARITIES

By

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Abstract

The past two decades have seen extensive research on governance structures of the firm, executive compensation and performance. However, most of these studies are in the context of profit-making organisations with relatively very little attention being given to this subject in respect of non-profit making organisations. This study examines the determinants of executive compensation and firm performance in charities. Specifically this study attempts to answer the following questions:

What are the main determinants of CEO compensation in the UK Charities? What performance measures do the UK Charities use? What are the factors that influence performance in the UK charities?

Using both quantitative and qualitative methodologies, the study reports a number of interesting findings. Regarding the executive compensation, the study finds that organisational size, CEOs qualification and CEO’s tenure have a positive bearing on executive pay. However, the results suggest that the sector of the organisation and CEO duality have no impact while and CEO experience had significantly negative relations with CEO pay. Turning to the performance measures, it was found that five performance measures categories are used by the UK charities, namely, financial, the customer; the internal business process, benchmarking and learning and innovation. To get deep insights into performance, the study examined the managers’ opinions on the factors influencing performance. However, CEO pay and the sector of operations have a statistically negative influence on performance. The results indicated that four factors, namely, board size, board independence, CEO pay and sector of operations, have statistically significant influences on the overall performance of the UK charities. The also results suggest that board size and board independence have positive and significant influence on performance. In terms of individual performance measures, the size of the board has a positive and significant influence in respect to financial, customer, internal business and overall performance. The results also indicate that board independence has an influence on financial performance,
internal business, benchmarking and overall performance. On the contrary, benchmarking has a positive, but not significant, relationship with CEO pay. This relationship is not surprising, as it supports the social comparison and equity theory. The results also show that the gender of the CEO appears to have a positive, but not significant, impact on the CEO’s performance, with the exception of innovation and learning.
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I also gratefully acknowledge the support I received from the academics and managers of various charities who took time out of their busy schedules to provide comments during the pre-testing of my questionnaire, interview questions and data collection.

Please note that chapters 4 and 6 have been presented at British Accounting and Finance Association and British Academy of Management conferences in 2010 respectively, with chapters 4 and 6 submitted to Journals for consideration for publication. Chapter 4 is being revised for resubmission after the first round review.

Finally, I give all the glory to God the almighty in the name of Jesus, who enabled me to successfully complete my studies.

Luke 1 verse 37 “For with God all things are possible”.
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<td>Balanced Scorecard</td>
<td>BSC</td>
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<td>Chief Executive Officer</td>
<td>CEO</td>
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<td>Competing Values Approach</td>
<td>CVA</td>
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<tr>
<td>Department of Trade and Industry</td>
<td>DTI</td>
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<td>Electronic Initiatives Office</td>
<td>EIO</td>
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<td>Exempt Organisations</td>
<td>EO</td>
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<tr>
<td>Financial Reporting Standards</td>
<td>FRS</td>
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<td>Gross Domestic Product</td>
<td>GDP</td>
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<td>Initial public offering</td>
<td>IPOs</td>
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<tr>
<td>Internal Revenue Service</td>
<td>IRS</td>
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<tr>
<td>Multidimensional and Integrated Model</td>
<td>MIMNOE</td>
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<tr>
<td>Office for National Statistics</td>
<td>ONS</td>
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<td>Quality Standards Task Group</td>
<td>QSTG</td>
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<td>Return on Asserts</td>
<td>ROA</td>
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<tr>
<td>Return on Investment</td>
<td>ROI</td>
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<tr>
<td>Statistical Package for Social Sciences</td>
<td>SPSS</td>
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<td>Statement of Recommended Practice</td>
<td>SORP</td>
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<td>Summary Information Returns</td>
<td>SIR</td>
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<tr>
<td>United Kingdom</td>
<td>UK</td>
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<td>Variance Inflation Factor</td>
<td>VIF</td>
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Chapter 1

Introduction to the study

1.1 Introduction:

The size of the charity sector in the UK has increased rapidly over the past decade and now comprises a vast and growing segment of economic activity. There are over 180,000 charities registered with the Charity Commission of England and Wales as of June 2010, with an estimated annual turnover of £52.5 billion (Charity Commission, 2010). In Scotland, 23,806 charities are registered with the Office of the Scottish Charity Regulator (OSCR 2008) of which 355 of them are also registered with the Charity Commission and have an estimated annual income of £8 billion after the excluding those that are also registered with the Charity Commission. In Northern Ireland (NI), there are around 4,500 charities with an annual income of approximately £600 million (NI Council for Voluntary Action, 2005; Connolly and Dhanani, 2009). According to the UK National Council for Voluntary Organisations (2008) the sector now employs over 600,000 people, an increase of about 25% over the last decade (Hyndman and Connolly, 2010). Due to the manner of its contribution to the public good and its jurisdiction, the sector has formed active partnerships with government in the provision of a wide range of services. The sector’s growth in size and prominence has also led to increased visibility and public scrutiny by varying stakeholders including government oversight agencies, private donors and foundations, clients, the media and the public at large (Connolly and Hyndman, 2004). This has also been exacerbated by a series highly publicised financial scandals (Brody 2001; Home Office 2003;
Beattie et al. 2002 and Charity Commission 2004a) of which, the likes of Enron, Palmalat in Italy, Arthur Andersen, Global Crossing and WorldCom are only few of the latest examples. Partly as a result of this attention, the charitable sector has been subject to continued regulation, with government directives and voluntary codes focusing on the nature of executive pay and its disclosure. For example, two current legislations have recently been enforced in the UK include the Charities Act (England and Wales) which was enacted in 1997 and subsequently revised in 2000, 2005, 2006 and the latest one in 2011 which will take effect in March 2012 and the Charities and Trustee Investment (Scotland) Act. The other legislations before these included the Directors’ Remuneration Report Regulations (Department of Trade and Industry (“DTI”), 2002) and (“the Report Regulations”) which attempted to address these concerns by demanding that charitable companies increase the proportion of pay that is performance-related rather than fixed salary, and by increasing the level of disclosure of executive reward. However, despite the fact that many regulations have impact on remuneration practices, the way in which executive pay is set does not seem to address issues of ‘fairness’ and even more broadly, how this might influence the conduct of executive directors (Connolly and Hyndman, 2004). In particular, who and what determines the CEOs pay in charities remains largely unexplained (Akpeti, 2001).

At the same time, as the government has increasingly obligated the charities into providing public services, there has been increasing, and multiple pressures on nonprofit organisations to demonstrate excellence in performance (Cairns et al, 2005) as well as discharge accountability to their stakeholders to gain trust and
credibility from beneficiary and client groups (Connolly and Dhanani, 2009). As a result, there have been moves towards greater quality checks and performance measurement (Mordaunt and Cornforth, 2004). For example, the UK regulators have attempted to facilitate accountability by initiating the formal development of charity reporting practices through the publication of the original Statement of Recommended Practice (SORP) 2 Accounting by Charities (Accounting Standards Committee (ASC) 1988) which was influenced by the work of Bird and Morgan-Jones (1981) together with reports by the National Audit Office (1987) and Sir Philip Woodfield (Woodfield Report 1987) on the supervision and regulation of charities (Connolly and Dhanani, 2009). The revised SORP which was issued by the Charities Commission in 2000 was updated in 2005, to reflect new Financial Reporting Standards (FRS) (Beattie, Goodacre and Masocha, 2006).

Many researchers have highlighted the importance of measuring performance in nonprofit organisations. They suggest that it helps reassuring the stakeholders who often provide resources that donations are being utilised for the key charitable missions of these organisations and also helps bring greater financial flexibility and tighter function to these organisations (Bryson, 1995; Kearns, 1996; Letts, Ryan and Grossman, 1999; Pappas, 1995). It also helps “counter criticism for poor management and ineffectiveness” (Connolly and Hyndman, 2004:131). However, Connolly and Hyndman (2003) also argue that holding charities to account is problematic owing to the difficulty in identifying key performance measures. In fact, some scholars, (for example, Au, 1996; Kanter and Summers, 1987; Ostrander and Schervish, 1990) have indicated that the nature and characteristics
of these organisations and the fact that their objectives are based on social values tend to make conceptualisation of their effectiveness even more complex. Therefore, despite the debate on how to measure performance in nonprofit organisations, consensus on what is performance still eludes researchers.

In the similar vein, concerns also exist about the effectiveness of nonprofit boards. In the context of the UK, there have been a series of important reports and changes aimed at improving the self-regulation of firms at board level (see, Hampel, 1998; Cadbury, 1992; Greenbury, 1995). The most recent (Higgs, 2002) suggests a number of changes to strengthen the responsibility of non-executive directors in the interests of improved performance and accountability. It is apparent from the academic literature that governance is more critical in nonprofit organisations than for-profit firms. A research by Fama and Jensen (1983) highlights the lack of an active ownership market among nonprofit organisations and emphasise the function of internal governance practices among nonprofit organisations. Oster (1995) concurs by suggesting that the sophistication of the services provided by the distinctive nonprofit organisations and the lack of a clear metric like profitability as a performance measure also add to strain the governance abilities of the nonprofit board. For nonprofit organisations that have relations with government agencies, strong governance structures safeguards not only the status of the nonprofit organisations but also the interests of the public sector (Frumkin and Keating, 2001). However, just how effectively these boards are in terms of improving performance in nonprofit organisations remains a controversy, considering that previous research in this area have largely concentrated on only
financial measures of performances which do not seem to capture what these organisations are created for.

1.2 Research Aims and objectives

The purpose of this study is to examine the determinants of executive compensation and performance in charities. The study therefore explores the performance measures used by the U.K charities, the effects of the board composition, CEO duality and CEO pay on firm performance in the charities.

Specifically this research attempts to answer the following questions:

1. What are the main determinants of CEO compensation in the UK Charities?
2. What performance measures do the UK Charities use?
3. What are the factors that influence performance in the UK charities?

1.3 Definition and Scope of the Study

The term ‘nonprofit’ is misleading. There is no rule that says that nonprofit organisations may not make a profit (Frumkin and Keating, 2001). However, nonprofit organisations are constrained regarding what they do with the profit they make, and it is primarily this restriction that sets nonprofit organisations apart from their business counterparts. This unique characteristic is termed ‘the nondistribution constraint’ (Hansmann, 1980). This means that these organisations are lawfully forbidden from permitting anyone to have a lawful claim on the
residual proceeds. ‘The profits must either be reinvested in ways that directly promote the mission of the organisation or be distributed to individuals (e.g., through lower prices to service recipients) who do not control the organisation’ (White, 1995: 12).

A charitable organisation is type of a nonprofit organisation (NPO). According to charities Act (2006);

A charity, or charitable organisation, in England and Wales, is a particular type of voluntary organisation. A voluntary organisation is an organisation set up for charitable, social, philanthropic or other purposes. As a result, the voluntary organisation should use any profit or surplus only for the organisation's purposes, and it is not a part of any governing department, local authority or other statutory body. All charities are voluntary organisations, but not all voluntary organisations in England and Wales are charities.

This study will also focus on large charities with an income of over £1m. This is because the SORP committee of the Charity Commission, which is the regulatory body for charities in England and Wales, legally requires such large charities to comply with the SORP regulations and recommendations on accounting and financial reporting (NCVO, 2006). Hyndman and Connolly (2009) echo the same views and point out that, “Moreover, the requirements for large charities (charities with incomes in excess of £1 million per annum) relating to these aspects of reporting became even more extensive at the same time through the requirement to complete a Summary Information Returns (SIR)” (Hyndman and Connolly, 2009: 17). Furthermore, it is also mandatory for “larger charities to disclose information
regarding their governance arrangements and about policies and practices relating to their investments and reserves” (Charity Accounts and Reports 2000: 21)

1.4 Motivation for Study
For a variety of reasons outlined below, the UK charities provide a fascinating context in which to study executive compensation, performance and governance issues. First, charities play a pivotal role in the U.K. economy. Evidence from the *UK Labour Force Survey* (Office for National Statistics (ONS), 2004) indicates that the sector employed 2.2% of the overall paid workforce and that general charities contributed £7.2 billion to UK GDP in 2001/02. With a current turnover of over £52 billion, the contribution of charities to the UK economy cannot be overemphasised. Second, management pay in the nonprofit world has come under scrutiny as never before. New legislation requires nonprofit organisations to document how much they compensate their senior managers and requires that boards justify and outline the compensation determination process (Preston, 2002). However, despite pressure from regulators, the compensation packages have skyrocketed for several CEOs in the nonprofit sector (Schwinn and Wilhelm, 2003). This shows that the monitoring system is fraught with problems. Wages paid in 2003 to the senior CEOs of the nation’s leading nonprofit organisations increased by twice the inflation rate and the CEOs’ wages of the leading charities and foundations more than doubled from 1997 to 2002 receiving higher proportion increases compared to their counterparts in the business sector (Schwinn and Wilhelm, 2003). Besides, despite the rising trend and importance of charities, most studies on executive compensation tend to concentrate disproportionately on for-
profits firms. Moreover, most of the studies have concentrated mainly on US firms with relatively little attention on UK charitable organisations (see Twombly, 2002; Hallock, 2002).

Third, there is an increasing pressure on nonprofit organisations to demonstrate excellence in performance (Cairns, 2005). The UK nonprofit organisations have seen different government performance measures put in place such as quality checks and audits, named and shamed, and reforms in governance structures over the past decade (Blair, 1998; Schwinn and Wilhelm, 2003). Furthermore, the UK, regulators have continued to show commitment to improve the quality of charities’ accountability, by constantly reviewing and revising the charity Statement of Recommended Practice (SORP) which is currently in its fourth iteration (Hyndman and McMahon, 2009). For instance, the current revised SORP, 2005 also places more emphasis on the inclusion of the performance and governance requirements in the trustees’ annual report (Hyndman and McMahon, 2009 and Witfield, 2005).

Unlike, in for-profit organisations, the information on performance in nonprofit organisations is generally unavailable, expensive, theoretical, and not easily quantified (Weisbrod, 1988). Measures of performance and improvement that are usually common in the business world (profitability measures like Return on Assets (ROA), Return on Investment (ROI), profits, and share price) are essentially absent in nonprofit organisations. Finding appropriate performance metrics to satisfy stakeholders, as well as determining which performance
measures should be linked to the salary appears difficult (Handy and Katz, 1998; Steinberg, 1990). Consequently, nonprofit organisations boards frequently depend on more indirect and unsatisfactory measures of performance, such as an activity or process measures (Weisbrod, 1988). From the current literature it is evident that most studies have looked at only financial measures of performance neglecting the fundamental non financial measures that form the bedrock of the charity’s mission. It is against this backdrop that this study attempts to examine the determinants of executive compensation in charities, the performance measures that are used in the UK charities and the factors that influence performance in charities. Therefore, the gap in research regarding executive compensation and performance in UK charities provides a fertile ground for further research in this field. Thus, the aim of this study is to contribute and extend the existing body of literature to create better understanding on the two key issues, that is, executive compensation and performance in charities.

1.5 Structure of the Dissertation

This chapter has provided an overview of the background to the study, motivation of the study, the research aims and objectives and scope of the study. The next chapter (chapter two) contains a review of the relevant literature on governance and executive compensation relating to nonprofit organisations in general and charities in particular. Drawing from the extant literature, the chapter discusses the theoretical literature underpinning the executive compensation and governance which encompass agency theory, stewardship theory, resource dependency theory and stakeholder theory. This is followed by a review of literature in respect of
factors influencing executive compensation and challenges of executive compensation. We conclude the chapter with a review of performance and measures of performance in nonprofit organisations.

Chapter three outlines the methodology of the study. The chapter discusses the key research philosophy’s traditions and this study’s philosophical stance, research design, as well as data collection issues. Specifically under this section, we describe the sample selection procedure, the design of both interview and survey questionnaires. The response rate and sample characteristics are then reported. The final section discusses the reliability and validity issues of the study.

Chapter four investigates the determinants of executive compensation of the UK charities. Executive compensation has long attracted much attention from the media, financial economists, regulators, the investors and the public. However, as executive compensation continues to explode. The problem seems to be more pronounced in nonprofit organisations, due to the lack of an active ownership (Fama and Jensen, 1983). Although, there is still considerable disagreement about the extent and basis of such problems and how to deal with them (Bebchuk and Fried, 2004), most studies in this area have concentrated in for- profit organisations.

Chapter five focuses on measures performance used in the UK charities. The issue of what and how performance should be measured has been controversial in nonprofit organisations (see, Sowa et al 2004; Cameron, 1981, 1982; Connolly, Conlon, and Deutsch, 1980 and Etzioni, 1964; Pfeffer, 1982; Price, 1972). This
chapter examines what measures performance in the UK charities. The chapter provides a synthesis of what constitute performance in the UK charities and illuminate new avenues for scholars and practitioners to research this important topic.

The managers’ opinions on the factors that influence performance in the UK charities are examined in chapter six. Having identified the measures of performance in the UK charities, this chapter delves into the effects of board structure and executive pay on the performance identified in chapter five. Employing both financial and non financial measures of performance, an exploratory factor analysis is used to provide parsimonious set of distinct non-overlapping financial and non-financial performance measures. Factors influencing performance which encompasses board structure and executive pay are examined in the context of UK charities.

Chapter seven presents a summary of research background, methodology of the study and findings about determinants of executive compensation and firm performance in UK charities. The chapter also discusses the conclusions and recommendations. It gives the overall conclusion to the study by giving a comprehensive review of the entire research. An attempt has been made to answers to the research questions building up constructive arguments for each of the questions. The chapter finalises with a discussion on the study’s limitations and agenda for future research.
1.6 Summary

This chapter has established the context of the study, set out the aims and the scope of the research and described the importance of the study. The basic structure of the thesis has also been described here. It is evident from the above discussion that the study revolves around examining the determinants of executive compensation, what measures performance in charities, what factors affect performance in the UK charities.

The next chapter provides a detailed review of literature regarding executive compensation and performance in nonprofit organisations, charities in particular. Theoretical perspectives on executive compensation as well as different models of performance are also reviewed. This review of literature underpins chapters four to seven.
Chapter 2
Literature Review

2.1 Introduction
This chapter reviews the distinct strands of thoughts identified in the literature, to explain executive compensation and performance of charities. The chapter has four sections as follows: The first section reviews the theories of governance in general which encompasses agency theory, stewardship theory, resource dependency theory and stakeholder theory. The second section reviews the literature on executive compensation from the perspectives of psychological, social comparison and equity, human management standpoints and other determinants of executive pay. Identified and discussed are also the challenges of executive compensation in charities. Following that are measures of performance employed in charities and the factors that influence performance in charities.

2.2 Theoretical perspectives: Executive Compensation and Governance
This section explores the theories identified in the literature to explain executive compensation and governance. The section reviews and discusses the agency theory, stewardship theory, resource- dependency theory and the stakeholder theory.

2.2.1 The Agency theory and Executive compensation
Although the non-profit literature on Principal-Agent relations is extremely scarce, (Du Bois, et al., 2003) this study argues that the perspective can contribute
a lot in the understanding of the behaviour and internal organisation of nonprofit organisations. Agency theory looks at how an optimal contract is accomplished in circumstances in which principals (shareholders) delegate work to agents (top executives) in exchange for rewards (Jensen and Meckling, 1976). This theory concentrates on two problems connected with this agency condition: (a) goal conflicts between the principals and agents, and (b) differentiation in their feelings toward risks. Basically, two alternatives are available for principals (behaviour-based contract and outcome-based contract), and principals choose the lowest-cost option. When principals can monitor the agents’ activities easily at small cost, they prefer behaviour-based contract. In this case, rewards are paid like salary (Eisenhardt, 1988). In contrast, when principals cannot monitor the agents’ actions at minimum cost, they opt for an outcome-based contract, and rewards are paid as incentives designed to motivate behaviour that is related to the desired outcomes. Since the rewards differ with performance, they shift performance risk from principals to agents. The agents, who are alleged to be risk-averse, accept such agreements only when sufficient risk premiums are offered (Hansman, 1987).

The agency problem in nonprofit organisations is related to the relationship between the organisation and the donor, where the nonprofit organisation acts as the agent of the donor or principal This relation is sometimes described as the external Principal-Agent relation, in contrast with the internal Principal-Agent relation where the organisation is the principal and the manager is the agent (Hansmann, 1987). According to Shleifer and Vishny, 1997 contributors of NPO who provide money; donations and government subsidies and voluntary labour can
be seen as shareholders even though these actors do not have clearly defined residual claims. Essentially, they are owners who bear the risk associated to each business and managers act as decision-makers. Thus, a nonprofit organisation’s decision system has the same general features that a for-profit’s system, that means, the separation of decision management initiation and implementation- from residual risk bearing and then, from control ratification and monitoring of vital decisions.

The agency problem in this context refers to the difficulties donors have in ensuring that their resources are not expropriated or wasted on unappealing missions (Shleifer and Vishny, 1997). The clashes of interest between owners and managers presented in 1976 by Jensen and Meckling seemed to be quite clear; however, it is fairly atypical this relationship in a nonprofit organisation even though we have already defined the actual owners and managers and the possible divergence of interests. Fama and Jensen (1983a) argue that, for nonprofit organisations, the survival value of the decision system itself provides an assurance for donations to be effectively used and not easily expropriated. Researchers like Herzlinger (1996: 99) and Steinberg (1990:141) argue that Principal-Agent relations in nonprofit organisations are even more problematic than in for-profit firms. The performance of managers is hard to measure and the board of directors lack effective control mechanisms because of the lack of ownership incentives and complex, hard-to-define objective functions.
(Glaeser, 2001) also notes that even though the manager himself could be a volunteer, the agency problem springs from the separation of owners and decision-makers is persistent, because altruism, the concern for the welfare of others, does not make an individual a perfect agent who performs some service on behalf of the principal. This means that the agency problems cannot be solved by instilling greater altruism in people (Jensen and Meckling, 1994; Jensen, 1994). In fact, as trustees have no pecuniary incentive to monitor the effectiveness of managers, the administrators might be expected to have considerable discretionary power being able to divert resources for their own benefit (Ricketts, 1994). For instance, a series of financial scandals found in US nonprofit organisations has generated calls for more accountability and oversight (Frumkin and Keating 2001).

Core et al (1999) argue that firms facing greater agency problems is more likely to have higher-paid CEOs, suggestive of large managerial power and entrenchment. In order to keep agency problems at a minimum, Jobome (2006) suggest that organisations should adopt governance mechanisms which, curtail managerial power. These mechanisms include the adoption of various board committees, e.g. independent audit, nomination and remuneration committees (Cadbury Committee, 1992; and Combined Code, 2003), whose adoption should, therefore, exhibit a negative association with CEO pay. In addition, board design should aim to reduce board size; larger boards are viewed as prone to trustee ‘free-riding,’ hence potentially ineffective in exerting control over CEO decisions and pay structures. However, Jobome (2006) asserts that nonprofit do not have many of the
governance mechanisms that for-profit firms rely upon (e.g. prescriptive corporate
governance codes, shareholder pressure, takeover market, creditor pressure); yet
they keep management pay low relative to other sectors, contrary to the classic
agency exposition. Some studies suggest that ‘self-selection’ (Handy and Katz,
1998) or ‘sorting’ (Roomkin and Weisbrod, 1999) amongst nonprofit managers
may substitute for the absence of the typical checks and balances demanded by
shareholders in the for-profit context.

2.2.2 Stewardship Theory
The theoretical considerations of stewardship provide a point of view of
managerial motivation which is an alternative to agency theory (Donaldson 1990a,
1990b). Under this theory, the executive managers are “organisationally centred”
executives that identify closely with the organisation and thus derive satisfaction
from behaviours that promote the organisation. There is, therefore, no room for an
assumption regarding divergent preferences as there is in agency theory (Davis et
al., 1997). Davis et al. (1997) further delineate the characteristics which
distinguish stewardship from agency theory as being actors that foster trust, focus
on self-actualisation, serve the collective goal of the organisation, are intrinsically
motivated, and have a high value commitment and a long-term orientation (Oslon,
2005). As a result, a pay incentive will not necessarily stimulate managers to
perform better, suggesting an insignificant pay-performance link. In other words,
stewardship theory recognises intrinsic motivation and it predicts a weak
relationship between tenure and pay (Jobome, 2006).
Furthermore, stewardship theory recognises that performance variations can arise if the structural situation facilitates effective action. The issue is whether or not the organisational structure helps the executive to formulate and implement plans for high corporate performance. Argyris (1964) believes that the principal who endorses stewardship theory will empower the steward with the information, the tools and the authority to make good decisions for the organisation, contrary to the controls that are put in place through agency theory. In fact, Argyris (1964) suggests that putting control structures on stewards will significantly de-motivate the steward and be counterproductive for both the steward and for the organisation. Authors such as Donaldson (1990a, 1990b) and Barney (1990) support the stewardship view and suggest that if the CEO is given complete authority over the firm, performance is more likely to be enhanced, as decision making can be done in a timely manner.

2.2.3 Resource- dependency Theory and Executive Compensation

Resource dependency theory has implications for explaining the determinants of CEO pay in the nonprofit organisation (Wernerfelt, 1995; Barney, 1991; and Castanias and Helfat, 2001). Broadly speaking, the resource-based view highlights the need for there to be a fit between the external environment in which the organisation functions and its internal resources. For example, some variables that are potentially significant in explaining executive pay include the CEO’s level of experience or qualification, and strands of the resource-based view stress the role of such human capital (e.g. Castanias and Helfat, 2001). It is plausible, therefore, that given the so-called skills shortage in the nonprofit managerial market, CEO
pay could be driven by the need to attract the human capital required to achieve the objectives of the organisation and the resources available to do so. Using resource-based arguments, better qualified and experienced CEOs would be paid more, because they provide more human capital for the organisation, in which case qualifications and CEO’s age would exhibit positive relationships with pay (Jobome, 2006).

Resource dependency theory also suggests that the board functions as a resource for organisations (Pfeffer and Salancik, 1978). Hillman and Dalziel (2003) proposed an integrated perspective that acknowledges disadvantages in agency theory and that boards operate as resource catalysts for organisations by providing linkages to necessary resources. Hillman and Dalziel (2003) discussed the notion of board wealth, which includes human capital (expertise, experience, and reputation) and relational capital. Relational capital is networks and linkages to external constituencies. According to (Brown, 2004) resource dependency perspectives investigate, for instance, how board members provide connections to influential funders (private and public), bring technical competencies (i.e., financial or legal) to an organisation, and how the board provides strategic direction for the organisation. Therefore the board is not only performing monitoring and control functions but they are also adding value by bringing resources.
2.2.4 Human Resource Management Theory and Executive Compensation

The strategic management of human resources proposes that the conceptualisation and setting up of a suitable compensation package is essential for the establishment of a competitive benefit for human resources (Milkovich and Newman, 1996). CEOs, just like other paid staff in an organisation, can be motivated to achieve certain performance goals. For CEOs, their wages are not their incentives to perform well, but also by the prestigious value attached to their job and the fact that they hold the highest responsibilities (Roussel and Trepo, 1996; Gomez-Mejia, 1994). Therefore, the setting of CEO compensation must, consider four main, complementary goals namely; organisational performance, incentive to work, attraction and adherence of the best executives. The concept of total compensation should meet financial imperatives, sustain the motivation of executives and guarantee the stability of the organisation.

According to Zajac (1990), compensation techniques cannot be detached from those of choice and succession of management in organisations. The board of directors should make sure that they recruit a CEO who is skilled enough to improve the performance of the organisation, by achieving mission objectives in nonprofit firms. However, the major problem that nonprofit organisations confront is that radical for-profit businesses have managed to obtain a competitive advantage by attracting and employing often times with lucrative offers, outstanding and well-respected staff. Prestigious expertise is therefore more likely to favour business services corporations for the obvious reason that undercapitalised nonprofit organisations can rarely offer compensation comparable
to what large for-profit firms can pay (Goddeeris, 1988). If for-profit organisations continue to attract the best talent, nonprofit organisations are likely to be questioned as to whether they have knowledge and skills to compete at high levels. With time, if discrepancies between the sectors become excessively powerful, nonprofit organisations may face a real talent drain that will result in the sector its competitive advantage (Frumkin, 2001).

2.2.5 The stakeholder Theory

Although Freeman (1984) is widely recognised as the initiator of stakeholder theory; he acknowledges that many of the main ideas date back to the 1960s. The theory as such stems from the resource dependency theory. In short the theory describes different managerial behaviour in order to reach different goals in response to stakeholders that affect, or are affected by, the decisions taken by the company. How management should handle the relationships, is a question frequently debated within the theory. Max Clarkson one of the writers on this topic describes stakeholders as follows:

*Stakeholders are persons or groups that have, or claim, ownership, rights, or interests in a corporation and its activities, past, present, or future. Such claimed rights or interests are the result of transactions with or actions taken by, the corporation and may be legal or moral, individual or collective. Stakeholders with similar interests, claims, or rights can be classified as belonging to the same group: employees, shareholders, customers and so on* (Clarkson 1995: 106).
Clarkson's view remarkably shows that stakeholder interests in an organisation may be founded on ethical grounds as well as lawful ones. According to Freeman stakeholders, are "any group or individual who can influence or is influenced by the accomplishment of the organisation's objectives" (1984:46). In most business organisations, the stakeholders could comprise of shareholders, workers, clients, suppliers, creditors, competitors, government agencies, professional groups and the public. All these individuals or groups will have an impact on how the organisation function or may be affected by the organisation because they have the influence over the “resources and support, limit the firm's access to new markets or boycott the organisation's products" (Seeger, 1997:9). Therefore, Stakeholder theory is primarily a management instrument which contains methods for identifying and managing stakeholders.

An extensive amount of work was carried out to identify the virtual importance of diverse stakeholders (e.g. Mitchell et al, 1997). Mitchell et al (1999) contributed to the understanding of this concept and suggested that classes of stakeholders are created when stakeholders possess one or more of three relationships attribute namely power, legitimacy and urgency. When urgency is included as an attribute, it adds a vibrant constituent to the process whereby stakeholders achieve significance to the management. Mitchell et al (1999) combined the attributes generating a typology of stakeholders shown in figure 2.1 below.

According to Mitchell, et al (1999) Latent stakeholders only possess one of the three attributes and have low stakeholder salience.
However, if the present attribute is power, such stakeholder is called dormant stakeholder. Dormant stakeholder holds power but do not have either legitimacy or urgency. The power remains unused. Examples of a dormant stakeholder are laid off workers who could have hate towards their former employer and voice their opinions on radio or television (Mitchell, et al 1999).

Discretionary stakeholders have legitimacy only but lack the power to influence the firm and do not have any urgent claims. Demanding stakeholders have urgency
as their only attribute. They are Stakeholders without power and legitimacy, but with urgency towards the issue, and are referred to as “mosquitoes buzzing in the ears of managers” by Mitchell et al (1997: 108). Examples of demanding stakeholders could be a lonely protester outside the company’s headquarters. Expectant stakeholders have two attributes and their salience will be moderate. If the present attributes are power and legitimacy, they are called dominant stakeholders; but if the attributes are legitimacy and urgency these are called Dependent stakeholders. However, Dangerous stakeholders are the ones possessing power and urgency as attributes. Definitive stakeholders are the ones perceived by managers as having all the three attributes and their salience will be high. Cordery and Baskerville (2005) assert that, recipients of charitable services will never be in the definitive stakeholders because they do not have power to compel the trustees or management, or to impose their will. Therefore, Cordery and Baskerville (2005) posit that donors can move into the demanding category or into the powerful category if exercising adequate influence, whilst recipients remain in the discretionary or dependant categories. (Cordery and Baskerville 2005). Finally, all those who possess none of these attributes are classified into a residual ‘Nonstakeholder’ category. It has, however, been noted that, over time, the combination of stakeholders may change (Donaldson and Preston 1995). The typology is fundamental in identifying key stakeholders and determining the relative power of relevant stakeholders. It is, therefore, critical to understand the interests of main stakeholders in order to manoeuvre an organisation or a project with a minimum of conflict. Moreover, nonprofit sector is characterised to be multifaceted settings with numerous stakeholders that usually have manifold,
vague and diverging objectives. One of the key challenges facing the nonprofit sector manager is exactly how to handle the complexity (Box, 1999; Heeks, 2002; Layne and Lee, 2001; Boyne, 2002). Similarly, Anheier (2000) contend that this is complicated in the nonprofit sector because they have multiple bottom lines and diverse stakeholders linked with precise bottom lines and expecting their needs to be met. In a nonprofit organisation, stakeholders include workers, such as the CEO, managerial staff, administrative staff and professional staff. However, nonprofit are likely to have a huge group of volunteers who may significantly add to the employees (Lyons, Hocking, Hems and Salamon, 1999). The service users may usually require immeasurable services from the organisation, creating intense demands on the other stakeholders. Hudson (1999) highlights that these multiple stakeholders are even more confusing when the services are part funded by various agencies like grants or contracts from government, charitable groups, or donations from businesses or individuals, and by service users, through fees.

Frumkin and Keating (2001), however, divide the stakeholders in the nonprofit sector, into two main groups: those outside the organisation and those inside the organisation. Among external stakeholders, they say, it is possible to concentrate on three major groups: donors who provide resources to support the charity’s mission, clients benefit directly from the charity services and the community that benefit circuitously from the services.

*Donors have an interest in nonprofit performance, and accountability to ensure that charitable resources are not siphoned off for non-charitable purposes. Clients care about nonprofit performance and accountability*
because, in the absence of oversight, services may decline in quality or become too costly. Taxpayers and community members want performance and accountability because their tax burden may increase if exemptions are granted to ineffective organisations or by government grants funding programmes that are not productive for the community (Frumkin and Keating 2001 : 9-10).

Frumkin and Keating (2001) also talks of the “Inside nonprofit”. They posit that, two different groups have a stake in nonprofit organisations performance and accountability: the board and staff. According to Frumkin and Keating (2001), board members have legal responsibilities of care, loyalty, and agreement that require them to steward charitable resources conscientiously. Staffs, within the charitable sector often work for low earnings have a financial and intuitive stake in the effectiveness of their organisations. As nonprofit grow and change to meet new accountability standards, the main problem is that there are limited funds to attract and employ the much-needed, competent employees (Blacksell and Phillips, 1994). In organisations that traditionally depend on volunteers, the push to organise and professionalise may cause these nonprofit to hire paid workforce (Billis, 1989). The human resource challenge is heightened because nonprofit are forced to compete with their private counterparts for outcome contracts. Stakeholder theory has been utilised in a variety of settings to support strategy development and execution, but to the author’s knowledge, still the role of stakeholders and executive compensation has not received any attention yet. This study assumes that, need to attract and retain a talented CEO may largely determine executive compensation in nonprofit organisations. In addition, the
extensive array of stakeholders, who presumably support the nonprofit because of its charitable mission, combines with the difficulty of measuring organisational output in the nonprofit sector to create an opportunity for shirking on the part of nonprofit executives (Weisbrod 1989; Steinberg 1990).

2.2.6 The Psychological Perspective on CEO Compensation

Some researchers assert that the diverse aspects of the total compensation can also occur in line with numerous organisational goals of performance, internal and external equity, choice and retention of skilled executives (Gomez-Mejia and Balkin, 1992; Gomez-Mejia and Wiseman, 1997; Roussel and Trepo, 1996; Zajac and Westphal, 1995). The idea of total compensation should therefore, be linked to a variety of practices. In case of the nonprofit organisations, these would be (1) having a desirable package which can meet the CEO’s expectations and preference; (2) consider external equity and make the package competitive in relation to other firms (3) uncomplicated, comprehensible, fair and consistent so that it is acceptable with the other the workforce, the other stakeholders and the public (Akremi, Roussel and Trepo 2001). According to O’Reilly and Main, (2005) when thinking about governance and executive compensation, there is need to examine how CEOs might, intentionally or unintentionally, manipulate their boards. For instance, there is to consider the social, psychological mechanisms that might impede the board’s independence and thereby impinging on their ability to observe the CEO and align shareholder interests. O’Reilly and main, (2005) proposed two prevalent psychological processes that could diminish the board’s independence and these are; norms for reciprocity, and CEO social influence.
2.2.6.1 Norms for Reciprocity

Main, O’Reilly, and Wade (1995) viewed the board of directors as a social group subject to the norms of reciprocity. As a custom, reciprocity states that “when one party benefits another, an obligation is generated” (Gouldner, 1960:174). The anticipation is that when a person is helped they will feel obligated and it can generate a lot of valuable continuing exchanges. However, not reciprocating may provoke sanctions (e.g., Sethi and Somanathan, 2003; Fehr and Gaechter, 2000). Reciprocity is so pervasive and essential to human relations that it forms the foundation for some of psychological theories such as fairness and equity (Adams, 1963) and social exchange (Blau, 1994).

To demonstrate the power of reciprocity, Whatley et al (1999) highlighted that when people in an experiment received a small, unanticipated favour, they were consequently compelled to comply with a request despite knowing that the giver may not know they had reciprocated. Kunz and Woolcott (1976) had their experiment too in which they received a large number of responses from strangers they send Christmas cards. There is compelling evidence that servers can raise tips as way of reciprocating (Tidd and Lochard, 1978; Rind and Strohmetz, 2001). Similar confirmation is also apparent from studies of reciprocity in employment settings (see for example, Uhl-Bien and Maslyn, 2003). However, Dabos and Rousseau (2004) established that reciprocity in the work relations was positively associated with future performance but negatively related to turnover.
In a different experiment, Fehr, Kirchler, Weichbold and Gaechter (1998), investigated the effects of reciprocity on pay setting and found that, similar to Akerlof’s (1982) idea of employment as a gift exchange, reciprocity encourages earnings that are relentless above the competitive rate. In the context of corporate governance, there are clearly tangible advantages, both monetary and status-related, from being on a board. As much as the CEO can be regarded as to a certain extend responsible for aspects of their recruitment, for example, by being part of the nominating committee or paying generous fees, a board member can feel obliged to reciprocate (Westphal, 1998; Lorsch and MacIver, 1989).

However, on the positive side, reciprocity may strengthen the social relations that allow boards to serve as experts and advisors to the CEO, whereas, on the negative side, reciprocity may result in defensive and justifications behaviours for poor performance (Wade, Porac and Pollock, 1997; Porac, Wade and Pollock, 1999) and even the suppression of unwelcome news and misreporting of data (Abrahamson and Park, 1994; Bar-Gill and Bebchuk, 2002). By virtue of its pervasive nature, it seems that reciprocity will remain a factor in board-CEO relations. However, whether it yields positive or negative effects will depend significantly on the situation.

2.2.6.2 Social Influence

Evidence from earlier research indicates that CEOs have the ability to determine their own compensation levels sometimes. Main, O'Reilly and Wade (1995) in their study, confirmed that CEOs who had strong social influence over their
boards, were likely to earn considerably higher compensation than that forecasted by traditional economic theories. Other researchers have found similar effects for the impact of power and influence on executive compensation (e.g., Belliveau, O’Reilly and Wade, 1996; Finkelstein and Hambrick, 1989; Lambert, Larcker and Weigelt, 1993; Pollock, Fischer and Wade, 2002; Wade, O'Reilly and Chandratat, 1990). People are often attentive to those who are comparable, those of higher prominence, those with social capital, and those who seem to have expertise. Lorsch and MacIver (1989)’s study indicated that over 99 percent of the directors they surveyed acknowledged that the CEO had significant informal control over the board.

Early studies, (for example, Byrne, Clore and Worcel, 1966) indicated, that the same economic status was a foundation for increased appreciation and that attitudinal resemblance increased the level of salary subjects were prepared to pay others (Golightly, Huffman and Byrne, 1972). Concluding from these practices, O’Reilly, et al (1988), demonstrated that, after controlling for economic determinants of pay, CEOs whose compensation committee chair earned than the CEO, received more income. According to Westphal and Zajac (1995) existing board members favoured new appointments that were demographically more homogeneous, and also similarity improved the executive’s cash payment. Supported by the research that showed that demographic similarity may increase social impact, Main, O’Reilly and Wade (1995) and Tsui and O’Reilly (1989) reported that the level of CEO compensation was higher, as long as more similar board members were in age to the CEO.
2.2.7 The Perspective of Social Comparison and Equity

From the literature on executive compensation, some researchers note that CEO compensation strategies in nonprofit organisations are based on a process of social comparison (Beliveau, O’Reilly and Wade, 1996; O’Reilly, Main and Crystal, 1988). This may be because the economists believe that, in a perfectly competitive labour market, each worker is willing to work for wages no lower than he could obtain in alternative employment. The implication of the theory of social comparison to CEO pay emphasizes the significance of equity and organisational justice (Greenberg, 1990; Adams, 1965). Two view points, namely, internal equity and external equity can be used to address the management of equity regarding executive compensation. By using internal equity, the CEOs can benchmark their compensation to that of their subordinates within the organisation whereas with external equity the CEO compares their compensation to that of CEOs of their competitors. The other view which is internal coherence, lower-level employees tend to compare their pay to that of other workers in the organisation, including the compensation paid to CEOs (Cowherd and Levine, 1992). Individuals are not only concerned about the quantity of compensation (distributive justice), but also to the processes of calculating it, the information, the involvement and the negotiation of wage decisions (procedural justice). From the CEOs’ perspective, the idea of organisational fairness can enhance the strategies of total compensation for chief executives when it considers the elements of satisfaction and motivation with regard to salary. When CEOs compare internal wage differences with their subordinates they consider their responsibilities and constraints. They also benchmark their salary with that of CEOs of competing organisations. Boards of
directors and remuneration committees attempt to resolve the objectives of internal and external justice. The compensation must be competitive and desirable to motivate and retain the skilled CEOs. The purpose of internal equity is extremely complex because income differences must be adequately huge to take into account the responsibilities, capability and risks of CEOs, but not too hefty in order not to develop feelings of injustice amongst the other workers (Cowherd and Levine, 1992; Magnan et al, 2000; Gomez-Mejia and Wiseman, 1997).

In situations where CEOs enjoy pay differences that are not justified by their efforts or results, feelings of unfairness result from judgements. This can create an unacceptable social conflicts, dysfunction, and strikes and may even stimulate condemnation from stakeholders, the media and unions (Sanders, 1995; Gomez-Mejia, 1994). Given the significant implications, board members are expected to explain and rationalise their decisions concerning CEO compensation so that the stakeholders will perceive the decisions as impartial in terms of internal coherence and effectual in terms of creating the shareholders’ wealth in business firms. However, no doubt the same applies to nonprofit whose stakeholders might press to see the accomplishment of the organisational mission. CEO compensation strategies are therefore, basically depend on the management of perceptions and as a result, board members are more concerned about the message to convey than the actual effect or valuable use of a style or nature of compensation (Zajac and Westphal, 1995; Westphal and Zajac, 1994). The sense of balance between internal and external equity entails that compensation strategies must be deemed acceptable, attractive, lawful and realistic by the CEO and all the stakeholders.
Therefore, the board of directors must urge CEOs to improve performance as they also address their feelings of justice. According to Henninger (2000) and Gélinas (2001) compensation strategies are defined according to practices legitimised by the market, from an institutional perspective.

2.3 Legislation Issues in Charities

The extensive growth and increased importance of the charity sector coupled with the various frauds and other misdemeanours taking place within charities in recent years has led to the introduction of a variety of regulatory and legislative systems across the UK to help monitor and control the sector. Sinclair, Northcott and Hooper (2011) posit that accountability is critical for the charities sector as they help maintain the confidence and financial support of the public by reporting the charities activities. Furthermore, given the recurrent scandals that have plagued the charities, as well as allegations that creative accounting techniques are used to mislead funders, accountability has increasingly become a vital issue for charities (Khumawala & Gordon, 1997). While many within charities are against the imposition of accountability measures in charities (for example see Riddel 1999) arguing that given the altruistic nature of charities accountability is not necessary as charities are assumed to act reliably and with integrity (Connolly & Dhanani, 2009), advocates of accountability, ( see for example, Eisenberg, 2005 and Berger, 2009) condemn that idea. In fact Eisenberg says;

More and more, non-profit organizations self-righteously argue that because they provide good works, they need not be accountable to anybody – including the donors who support their work. Confidence has given way to cockiness (Eisenberg, 2005: 187).
Whereas Berger puts it concisely by saying:

*We must get past the notion of doing the „good work‟ with no accountability. We must get past the idea that nonprofits are too complex or unique to be measured. The non-profit sector must get its act together and make sure it is really helping provide meaningful change in communities and people’s lives. It is life or death for many of those we serve whether we are effective or not* (Berger, 2009:3).

Eisenberg (2008:1) further highlights that “inappropriate behaviour and excessive compensation are still a regrettable part of our [not for profit, including charities] world”. Moreover, appropriate accountability by charities helps them guard against any damaging media publicity that disheartens stakeholders (Berger, 2009).

### 2.3.1 Regulatory Bodies for UK Charities

In England and Wales, charities are regulated by a statutory organisation, the Charity Commission. It conducts general monitoring of charities and has powers set out by parliament in the Charities Acts to conduct statutory investigations. The latest Act is the Charities Act 2011, which repeals and replaces the Recreational Charities Act 1958, the Charities Act 1993 and many of the provisions of the Charities Act 2006. The other purpose of the Charity Commission is to guide the information content of, and financial accounting practices in, charity annual reports and reviews, which it accomplishes mainly through the Statement of Recommended Practice (SORP) for charities (Hyndman and McMahon, 2010 and Charity Commission, 2005). As already been highlighted, the SORP is partially influenced by the work of Bird and Morgan-Jones (1981), which highlighted remarkable issues in the charities’ annual reports and accounts. The research had
exposed that the sector was characterised by out-dated accounting practices, failure to apply the appropriate accounting standards as well as massive variability in accounting practices between charities (Hyndman and McMahon, 2010). However, some of the recommendations came from the *Private Action, Public Benefit* (Cabinet Office, 2002) report. Apart from the annual reports and accounts, charities also discharge accountability to their stakeholders through annual reviews and through disclosures on the Charities’ aims, objectives, activities, performance, and future plans (Connolly and Dhanani 2009). While the annual report which is mandatory is useful to large donors who have the ability to ‘understand and interpret not only the financial statements but also the financial performance and position of charities’, annual reviews are perceived as the more user-friendly documents that are suitable for other stakeholders ‘who may lack the necessary financial acumen to interpret detailed financial information’ (Connolly and Dhanani, 2009: 7).

Another piece of legislation has also recently come into force in the UK is the Charities and Trustee Investment (Scotland) Act. The Office of the Scottish Charity Regulator (OSCR), Scottish charities regulator, was established by the Scottish Parliament in 2003. Similarly, a Charity Commission for Northern Ireland was established in 2009 (Hyndman and McMahon, 2010). It is therefore evident that the government has reinforced its remit for the sector through legislation across all parts of the UK. Other examples of the regulatory initiatives include the establishment of the Guidestar UK website and The Strategy Unit (2002) which were established to promote and encourage charity accountability, the ImpACT Coalition and the introduction of Summary Information Returns (SIRs) which was
a response to the government’s review of the sector (Home Office 2003 and Connolly and Dhanani 2009). However, GuideStar UK monitors the accountability practice of charities with an annual turnover of more than £25 million. GuideStar is considered reliable because it sources its information from the charities’ annual reports (Sinclair, Northcott and Hooper, 2011).

### 2.3.2 Challenges of Accountability in Charities

Increased oversight and regulations have been hypothesised to be important drivers of higher administrative costs, therefore, to meet the complex regulatory and formal procedural requirements, charities may be forced to hire professional administrative expertise within both the board and staff (Gronbjerg 1993; Stone 1996; Saidel 1991; Perri and Kendall 1997), thus relying less on volunteers. Furthermore, the charity sector may end up being under increased to professionalise their operations and to introduce a degree of bureaucratisation which is likely to limit their flexibility, adaptability and autonomy (Frumkin, 2002). Besides, that administrative work and reporting procedures can be complex, tedious, and burdensome, as the charities are required to produce detailed monthly performance reports within fixed deadlines. Therefore, fulfilling all of these requirements may hinder the administrative staff from concentrating on the core organisational mission of providing services to the public (Tonkiss and Passey, 1999). Additionally, it can also cause severe managerial strain that can erode motivation and commitment (Bernstein (1999).
2.4 Empirical Determinants of Nonprofit Organisation Compensation

Evidence from extant literature shows remarkably little empirical research on the determinants of CEO pay for nonprofits. Frumkin and Keating (2001) believe that, since nonprofit organisations operate in noncompetitive environments and benefit from tax exemptions and donations, CEOs have the opportunity to receive unwarranted compensation, operate incompetently or divert funds from achieving their organisation’s mission to salaries. Those who believe that the nonprofit sector has become too professionalised and "corporate" cite excessive compensation as an example of how organisations are losing sight of their mission and their distinctiveness as nonprofit organisations (Mason, 1996). In such cases, nonprofit organisations perceived to be paying the CEOs highly are likely to erode donor confidence and cause increased public scepticism. Berger, (2010:1) explains why donor confidence can be eroded when he says, “Donors want to know that their charitable donations will go as far as possible to support the charity’s good works, rather than pad a CEO’s wallet”. However, the agency theory proposes that principals should offer agents incentives to motivate them to be effective and reduce self-seeking behavior (Jensen and Meckling, 1976; Fama, 1980). While it is appropriate for profit making organizations to offer incentives to the agents, for nonprofit organisations it brings another concern which Frumkin and Keating (2001) term the ‘violation of non-distribution constraint’. Unlike for profit organisations who can maximize profits and then pass them on to the shareholders, nonprofit organisations are legally prohibited from making distributions of its earnings to individuals who exercise control over it, for example, members, officers, directors, or trustees. Rather the net earnings, if any, should be ploughed
back into the system to support further production of services that form the basis of the organisation’s foundation (Hansmann, 1980). Therefore, paying incentives based on excess earning conflicts directly with the non-distribution requirement, since it means converting revenues and cost savings into higher earnings and benefits for employees instead of services for customers. As a result, the CEOs of nonprofit organisations are usually compensated lower than their counterparts in private sectors and government (Preston, 1989; Steinberg, 1990; Handy and Katz, 1998 and Ruhm and Borkosi, 2003).

Due to the non-distribution constraint, nonprofit organisations compensation strategies have traditionally been regarded as being based on the difficult-to-measure idea of advancement of the mission, rather than based on growth and revenues or earnings, although it is an improper approach for nonprofit organisations (Kertz, 1997; Frumkin and Andre-Clark, 1999). For this reason, nonprofit organisations have sought to avoid performance-related pay for their employees (Jobome, 2006). The challenge for nonprofit organisations is to frame and support an appropriate balance between regulations that effectively prevent abuses, yet maintaining the freedom that have traditionally been afforded to nonprofit organisations to carry out their duties without interference. In other words, there is a need to compensate executives in a way that will help in the selection and retention of talented executives, motivate performance yet retains the tax- exemption and stability of the organisation.
2.4.1 The Sector of the Organisation

The nonprofit sector, however, is not homogeneous. The sector includes a vast array of groups that provide different goods and services. Some nonprofits offer health and human services, while others provide education programmes. Moreover, the organisational practices and cultures of nonprofit vary significantly, which relates to Oster’s (1998) finding that organisational affiliation matters significantly in executive wage setting. Oster, (1998) used a 1995 Chronicle of Philanthropy Survey similar to the 2001 survey and finds that hospitals provide their executive directors the greatest compensation packages while social services provide the smallest. Twombly and Gantz (2001), using the complete sample, find that hospitals pay the highest salaries followed by the higher education. The third highest paying a set of organisations is health (excluding hospitals), but the median executive salary for these organisations is half of the median executive salary for higher education organisations and a third of the median executive salary for hospitals. Employee benefit plans are also most likely to hospitals and higher education. Religion related organisations paid the lowest executive director salaries but also were most likely to augment base pay with expense accounts. Even within sectors of the nonprofit universe, significant variation may also exist.

2.4.2 Organisational Size

Gomez-Mejia et al (1987) suggest that size of the organisation instead of efficiency is more influential on CEO compensation. In line with this, Andersen, (2002) developed a role-sizing framework for top jobs. It is thus believed that the complexity of the organisation also pays a crucial role, as well. Andersen (2002)’s
methodology relies on the principle that the size and complexity of the organisation influence the basic salary of a top job. Although the focus was on the profit making organisations, Eldenburg and Krishna, (2003); Frumkin, and Keating, (2001) and Hallock, (2000) provide compelling support for a significant and positive relationship between executive compensation and organisational size in nonprofit. Gray and Benson, (2003) also believe that size is a fundamental variable in investigating the determinants of CEO pay in nonprofits. These also support Agarwal (1981) who argued that size is a critical determinant of CEO pay because it signifies a proxy for organisational complexity. The management of complex organisations places considerable demands on the executive and call for more skillfulness and experience as compared to the management of smaller, simpler organisations. Large, complex organisations may require CEOs capable and skilled, which leads to higher salary (Hallock, 2002).

Frumkin (2002) also posits that, size or organisational scale may be more significant determinant of compensation in nonprofit than for-profit organisations, since inputs such as programme expenses and substantial assets are the most noticeable and quantifiable aspect of the organisation’s production process. Organisational size may also be a decisive factor in salary because governing boards frequently determine compensation by comparison against senior CEOs in nonprofit that are similar in size and from the same sector (Barbeito and Bowman, 1988).
Finally, Organisational size provides legitimacy (Meyer and Rowan, 1977; Scott, 1995; Zucker, 1988). Frumkin (2002) asserts that, “large organisations usually gain more exposure, have greater reputation, therefore, given the scope of their activities, they are considered more effective. Thus, it has been found out that, managers at these leading organisations can be highly compensated because they are categorically perceived as worthy and entitled to earn more. In short, the chief executive officer of a large and complex organisation will receive a higher basic salary than that of a smaller, less complex company, whether it is in a nonprofit or for-profit organisation.

2.4.3 The CEO’s Gender

Reports in the popular press show that senior female CEOs as well as other top positions of the nation’s nonprofit are normally paid less than males in comparable jobs-as high as a 50% gender discrepancy exists for CEOs (Lewin, 2001; Lipman, 2002). The pay difference is mostly among the large nonprofit (Lipman, 2002; Guidestar, 2004). A recent review of nonprofit compensation found the gender gap to persevere when compared to earlier surveys and that women earn considerably less than males in all employment categories. Although women were more likely to manage smaller organisations, even when controlling for organisation size, women earned less (GuideStar, 2004). This probably shows that executive gender may be a determinant of the executive’s compensation.
2.4.4 The CEO’s Characteristics

Preston (1989) argue that, many people choosing to work in the nonprofit sector engage in what he called “labour donations” and are willing to accept low pay than someone who works in the for-profit sector (for doing a similar job), because these individuals may, in effect, be donating labour to the organisation. In addition, they may be indicating to potential donors and others that they share the donors’ preferences for the activities of their organisation (for example, helping the needy) and are thus more likely to use a greater proportion of donors’ funds for service provision and not benefiting themselves (a means of dealing with information asymmetry problems). This ties in with the Hansmann’s (1980) signalling hypothesis in that, manager of nonprofit derives utility from the nonprofit’ service provision. In this case the CEO characteristics should not affect the setting of their compensation.

However, given the feature of lower wages in the charity sector (which there is evidence of); it may be difficult to recruit quality staff that are not in some way committed to a charity’s objectives. In addition, in the UK, anecdotal evidence suggests that some CEOs transfer from the private sector late in their career as a ‘contribution’ to society in areas where they are particularly interested. Apparently, Frumkim and Keating (2001) cite Young (1977) who notes that lower wages in charitable jobs act as a way of attracting only those CEOs who are willing to refrain from their need for profit. As Gomez-Mejia and Balkin (1992, p.169) note:
..... Executives are highly educated and possess many years of work experience in responsible jobs requiring much personal sacrifice. Few people have the ability, stamina, or willingness to pay the associated personal price in terms of stress, family life, loss of privacy, and minimal leisure time. So their higher pay may be seen as a return on this capital investment.

In terms of future expectations, rewarding competent executives with high pay can be as an inducement to retain them and also to maintain high standards of commitment, effort and performance (Pratt, 1996).

2.4.5 Donor Preferences

Twombly (2002) suggests that, donor preferences are among the other factors that determine executive compensation in nonprofits. He says, “The extent to which charitable givers support individual organisations, may have a significant impact on nonprofit wage setting”. The degree of donor involvement in the organisation may limit salaries if donors respond to increased salaries with a reduction in funding. Oster (1998) also finds that increased reliance on donations limits executive compensation; for every percentage point increase in reliance on private donations, average compensation falls by $1000. Hallock finds that donors seem to steer away from nonprofit hospitals that are competing with for-profit hospitals. In hospitals with increasing competitive pressures and compensation tightly linked to performance, donor contributions are reduced. The level of competition among nonprofit vying for donor support to a large extent influence the manner in which donor preferences influence the behaviour of nonprofit organisations. For example, if an organisation with few competitors ignores donor preferences, it will
loose fewer donations as compared to the one that has many competitors. Therefore, nonprofit that rely heavily on public contributions might be disinclined to pay high salaries to their executives.

2.4.6 Competitive Pressure

As noted by Twombly (2000), the economic prosperity in the United States has created a highly competitive labour market that cuts across the nonprofit and for-profit sectors, necessitating the use among nonprofit of innovative methods to attract and retain qualified leaders, while reducing the likelihood of donor concerns over excessive executive salaries. Those backing “comparable pay” argue that the success of nonprofit organisations relies on charitable managers specifically because of the complexity in evaluating a true bottom line in nonprofit. As a result of the service-oriented nature of the sector, the uncertainty of the finances and difficult-to-measure outcomes, nonprofit organisations must be prepared to spend uncompromisingly to attract and retain top human capital. Since the responsibilities of numerous nonprofits are increasingly becoming more challenging and demanding, there is need for personnel with strong management and leadership skills to ensure organisational growth (Letts, Ryan and Grossman, 1999).

There is, however, some evidence that alternative compensation methods are becoming prevalent in the nonprofit sector. In its study of compensation practices, the Applied Research and Development Institute International Inc. (1995) found that some nonprofit reduced their reliance on fixed salaries for top executives.
Others have found that pension contribution and health coverage are relatively high in the nonprofit sector (DuMond 1997).

2.4.7 The Media

The research on the media shows that reporters play an influential role in determining the public’s perceptions of issues and entities, effectively ‘setting the agenda’ for public discourse (McCombs and Shaw, 1972; Rogers, Dearing, and Bregman, 1993; Herman and Chomsky, 1988; Weaver et al, 1981). Consistent with this view, the attributions that journalists make regarding firms’ actions and outcomes can materially impact how firm managers and stakeholders perceive these actions. As a result, the journalists’ attributions may indirectly affect managers’ tendency to persist with existing actions or adopt new ones (Clapham and Schwenk, 1991; Staw, McKechnie, and Puffer, 1983; Wagner and Gooding, 1997). The quote below exemplifies journalists’ propensity to attribute a firm’s outcomes, including its performance, to the actions of its CEO.

*Welch has delivered extraordinary growth, increasing the market value of GE from just $12 billion in 1981 to about $280 billion today. No one, not Microsoft’s William H. Gates III or Intel’s Andrew S. Grove, not Walt Disney’s Michael D. Eisner or Berkshire Hathaway’s Warren E. Buffett, not even the late Coca-Cola chieftain Roberto C. Goizueta or the late Wal-Mart founder Sam Walton has created more shareholder value than Jack Welch* (Business Week, 1998).
In addition to explaining General Electric’s performance, this quote also highlights the manner in which journalists inform the public about the legitimacy and effectiveness of firms and their leaders (Baum and Powell, 1995; Lamertz and Baum, 1998; Pollock and Rindova, 2003) thus it is applicable to nonprofit organisations, as well. In the process of attributing a firm’s actions and performance to its CEOs, journalists create ‘celebrity CEOs’ (Hayward 2003). After creating such celebrity, journalists can then change stakeholders’ expectations about (a) the CEO and their behaviour (Kelley, 1972), and (b) how to respond to CEO actions (e.g., Bem, 1972; Festinger, 1957; McArthur, 1972). Therefore, recognising how attributions affect the behaviour and interactions of social observers with celebrity CEOs and above all, there is no doubt that this possibly can have effects on how the executive pay can be determined.

2.5 Corporate Governance in Nonprofit Organisations

The collapse of leading corporations such and Enron and WorldCom led Congress to enact the Sarbanes-Oxley Act in 2002 in the USA. This legislation seeks to protect shareholders by implementing regulations aimed at preventing accounting and corporate mismanagement and fraud. Recent scandals in the nonprofit sector, including problems of fraud and mismanagement (United Way, Red Cross) and the excessive compensation paid to trustees and managers, as revealed by the Boston Globe and, recently, the LA Times, it became clear that governance problems are not confined to for-profit corporations (Scott, 2004). The academic literature considers governance to be more valuable among nonprofit than the business sector. For instance, in their early work in finance by Fama and Jensen, (1983)
argue that the absence of an active ownership market among nonprofit accentuates the role of internal governance practices among nonprofit (Fama and Jensen 1983). Similarly, Oster (1995) posit that nonprofit organisations have complex products and services yet they lack simple performance measures like profitability. However, in the sectors that contract with government agencies, strong governance structures exist to safeguard not only the status of the nonprofit but also the welfare of the public sector. As Hevesi and Millstein, 2000 puts it, when the city of the governance practices inspects its nonprofit partners, the intention is to improve both the functions of those nonprofit and, as a consequence, improve the provision of public services.

2.5.1 The Board and Nonprofit Governance

Boards play a decisive role in the governance of nonprofit organisations. Boards do not only evidently make the essential choice of the CEO; they also play a significant role in policy, monetary decisions, and strategy formulation. Agency theory posits a conflicting connection between the board and the CEOs. It is the board’s responsibility to scrutinize the self-interested behaviour of executive (i.e., management) to ensure stockholder (the owners) interests. In principle, the theory suggests that, as one aligns board member interests with stockholders, they will be more vigilant in the monitoring tasks. Providing incentives to board members (e.g., stock ownership) and distancing board members from management (e.g., limit insiders) helps accomplish this. Insiders are typically those with significant ties to management such as former/current executives of the organisation (Fama and Jenson, 1983).
2.5.2 Agency Theory and the Board

According to Daily, Dalton and Cannella (2003), agency theory is by far the most utilised framework in the corporate governance literature when linking board effectiveness and organisational performance. Agency theory suggests that CEOs are self-serving, may have goals that diverge from those of the shareholders and, if not monitored, may engage in actions which are detrimental to shareholder wealth maximisation (Jensen and Meckling, 1976). Donaldson and Davis (1991) suggest that the use of a board of directors to monitor managerial actions on behalf of the shareholders can be useful in restraining such managerial “opportunism”. They argue that if the CEO serves as the chair of the board, the impartiality of the board may be compromised. Agency theory suggests that as you align the interests of the board with that of the stockholders, the board is more likely to be vigilant in its monitoring role. This may be achieved by providing incentives to board members (e.g., stock ownership) and by distancing board members from management (Fama and Jensen, 1983). However, the above discussion is in the context of for-profit organisations.

In the context of NPOs, a number of studies support the contention that board effectiveness improves organisational performance and thereby protects the interest of stakeholders. For example, Callen et al. (2003) found a positive relationship between the presence of major donors on the board and organisational performance. However, the applicability of agency theory to non-profit boards has been questioned because of the difficulty in identifying the owners of the organisation. Miller (2002) investigated the applicability of agency
theory to non-profit boards and found that the idea of a conflict-based relationship between the board and the executive management was at odds with the board members’ conceptualisation of their relationship with the management. Similarly, research on non-profit boards suggests that effective governance in NPOs tends to benefit from a trusting relationship between the board and the executive (Herman and Heimovics, 1991). Miller (2002) concluded that most board members in NPOs rely heavily on the chief executive and consider the chief executive as one of the most important assets in the organisation. Beyond the chief executive, many board members could not readily identify to whom they were accountable, sometimes merely suggesting it was only to themselves (Ostrower and Stone, 2001).

2.5.3 Resource-Based Theory and the Board

The resource-based view sees the firm as a portfolio of tangible and intangible assets and capabilities. Barney (1991; 2001) suggests that the unique resource endowments within a firm serve to explain the differences in firm’s performance because they allow firms to efficiently and effectively take advantage of opportunities or neutralise potential threats. Castanias and Helfat (2001) point out that one important aspect of a firm’s unique resources is the firm’s management, which helps to generate rent. In this light, resource-based theory views the board functions as a resource for organisations (Pfeffer and Salancik, 1978). Brown (2004) supports this argument by indicating that board members can augment the links between the organisation and influential funders (private and public), bring technical competencies (i.e., financial or legal) and provide strategic direction for
the organisation. Apart from performing monitoring and control functions, Chait, Holland, and Taylor (1991) recognise that the board’s role is to link the organisation to the community. This role suggests that the board can bring a sense of legitimacy to the organisation by maintaining and instituting relationships with key constituencies and key stakeholders. These relationships should bring financial resources by expanding contacts with donors and should bring public relations benefits by having the board function as boundary-spanners into the community (Adams and Perlmutter, 1995). In summary, the NPO’s board activities encompass the selection and firing of executives, monitoring, advising on plans and strategic direction, developing programmes, fundraising and financial analyses, making significant financial contributions, communicating with the public, and assessing its own performance (Klausner and Small, 2005). The above suggests that NPO boards act as a critical resource to enhance the efficiency within an organisation, and this paper attempts to elucidate how the board’s management resources influence the performance in such organisations.

2.5.4 Board Composition and Executive Compensation
The primary mechanism for addressing agency conflicts in nonprofit organisations is the Board of Directors (Brickley and Van Horn, 2004). Individual-board members, however, are not accountable to owners (as they do in for-profit organisations) and therefore they may or may not be committed to fulfilling the organisation’s mission. The prospect for personal gain can entice individuals to apply to serve on the board. As Bowen (1999: 82) notes: Various nonprofit organisations face challenges board members whose aims are to advance their own
agendas. In a competitive marketplace, poorly organised organisations do not survive eventually. Tax subsidies and donations can protect incompetent nonprofit organisations from competitive strains.

Fama and Jensen (1983a) argue that a nonprofit board will be effective managers or employees are not part of it. They assert that “nonprofit boards include few if any internal agents as voting members” to safeguard against managerial expropriation of organisational resources such as donations (Brickley et al (2004:5). According to one professional organisation, having the CEO serving as a voting member of the board can bring in a clash of interest (Board Source, 2002). By extension, if other private interest groups such as physicians on hospital boards or representatives of groups that receive charity on humanitarian association boards participate on the board it is likely that also agency conflict is also increased.

Corporate governance literature finds that CEOs have opportunities to line their compensation on the board. In the business world, however, shareholders and the risk of takeover can expel nonperformers on the board and in management (Bhagat, Shleifer and Vishny, 1990). In the nonprofit sector, some academics and professional associations have argued that, executives should not participate in voting as a member of their boards because there is an inherent risk of misuse of authority. A CEO who has voting powers on the board but not accountable to the shareholders could exert excessive influence to expropriate donations and other organisational resources (Frumkin and Keating, 2001). Moreover, critics argue
that, if a CEO in a nonprofit is a voting member of the board, the outsiders are likely to regard it as giving too much authority to its CEO, thereby making donors reluctant to give. To test these claims, Brickley, Van Horn and Wedig (2004) conducted complementary tests: “Do boards that include CEOs hold their executives to performance standards? Do donors withhold contributions from those boards, where a CEO is present? The difference in the level and rate of executive wage are “higher in organisations where the CEO and other officers are voting members of the board,” they reported executives receive estimated yearly raises that are 2.5 percentage points higher for each extra member of the managing team positioned on the board. They find that nonprofit CEOs are “far from overcompensated”; the mean salary is $200,000. In cases where an executive receives higher pay, Brickley, Van Horn and Wedig (2004) find his or her job performance tied to that pay. Brickley, Van Horn and Wedig (2004) also find that highly paid CEOs have had longer tenures. In addition, say the authors, if the CEO and other managers are voting members of the board, donations to the nonprofit increase rather than decrease.

From the strategic management of human resources perspective, the strategies of determining a suitable compensation structure are essential for the establishment of a competitive benefit for human resources (Milkovich and Newman, 1996). However, (Roussel and Trepo, 1996; Gomez-Mejia, 1994) note that, CEOs are not only enthused by their compensation only, but also by the prestigious worth attached to it, that of the manager holding the prestigious responsibilities. The strategies of setting CEO compensation must, therefore, consider the four key
corresponding objectives: organisational effectiveness, motivation to work, attraction and reliability of the skilled CEOs. The concept of total compensation should, thus, be financially viable, able preserve the motivation of the CEOs and guarantee the stability of the organisation.

2.6 The Challenges of Nonprofit Compensation

Just like for-profit organisations, nonprofit organisations are also businesses, though they are nonprofit businesses. This means they ought to have strong management practices, including reasonable personnel policies, adequately compensated staff members and a marketing / customer service orientation. Frumkin and Keating (2001) believe that, since nonprofit organisations operate in noncompetitive environments and benefit from tax exemptions and charitable donations, CEOs have the opportunity to be remunerated extremely, operate ineffectually or deflect resources from achieving their organisation’s mission. Thus, they cite excessive compensation and the violation non distribution constraint as the changes for threats to public trust. Salls (2004) suggests that, the demand for the sector to be transparent poses as the greatest existing challenge.

2.6.1 Excessive Compensation

Recently, excessive CEO pay has dominated the headlines for several nonprofit organisations. Those who believe that the nonprofit sector has become too professionalised and "corporate" cite excessive compensation as an example of how many organisations are losing sight of their mission and their distinctiveness
as nonprofit organisations (Mason, 1996). Because revelations of inordinately high compensation can erode donor confidence and cause increased public scepticism, board members should pay close attention to compensation decisions. The compensation of nonprofit executives usually lags far behind that of their counterparts in the private sector or government (Preston, 1989, Steinberg, 1990, Handy and Katz, 1998 and Ruhm and Borkosi, 2003). It is thus that many of those who opt for employment in the nonprofit sector engage in ‘labour donations,’ preferring altruistic and other non-pecuniary benefits to monetary rewards (Rose-Ackerman 1986, Preston 1989).

However, Letts, Ryan, and Grossman (1999) state that, because the work of many nonprofit organisations is growing ever more complex and more demanding, there is need for personnel with strong management and leadership skills to ensure organisational growth. Thus, the increasing understanding of the need to attract and retain competent employees has added to the trepidation over how to design compensation strategies and programmes that are fair and reasonable. Hence, Axelrod (2001:91) (the president of National Centre for Nonprofit Boards), says,

*It is, of course, incumbent upon all board members and chief executives to avoid excesses. It is equally important that governing boards recognise that they must set a fair, adequate and competitive compensation level, or they will be difficult for them to attract and retain the leaders who can help America’s increasingly complex nonprofit organisations meet the growing demands they will face in coming years.*
2.6.2 Violation of the Non distribution

Frumkin and Keating (2001) highlight that another concern associated with nonprofit compensation is that management may divert excess earnings from providing future services. The agency theory advocates that principals should provide agents incentives to encourage achievement and decrease perquisite behavior (Jensen and Meckling 1979, Fama 1980). However, basing the incentives on excess earning conflicts with the non-distribution requirement, since revenues and cost savings get converted into higher wages and benefits for employees instead of being used for activities that directly benefit the clients. As a result of the non-distribution constraint, nonprofit organisations decisions on how to recompense CEOs have conventionally been based on the difficult-to-measure idea of achieving the mission, rather than based on growth and revenues or earnings, an approach regarded as unsuitable for nonprofit organisations (Kertz 1997, Frumkin and Andre-Clark 1999). The dilemma for nonprofit organisations is on designing compensation packages that can motivate the CEO to improve performance yet maintaining their tax-exemption status and focus on mission. For that reason, nonprofit organisations have sought to avoid performance-related pay for their employees.

However, Frumkin and Keating (2001) note that, recently restricted incentive compensation have been introduced in the nonprofit sector. Compensation consultants argue that pay-for-performance results in enhanced employee activity and retention, which converts into improved revenues and effectiveness (Barbeito and Bowman, 1998). This perspective supposes that nonprofit organisations
operate comparably to business corporations. In the business sector, owner can generate better performance by awarding incentives to risk-bearing CEOs, and incentives can be structured to capitalise on the principal’s effectiveness. In a nonprofit organisation, the agent is the CEO, but there is no lawful residual claimant to serve as principal (although, in some organisations, boards function as an effective substitute). Furthermore, the relevant goal is difficult to define and related programmatic outputs are difficult to observe and measure (Alchian and Demsetz 1972, Frech II and Ginsburg 1983). In such circumstances, it is not easy to define manager’s performance by linking pay with financial results (Frumkin and Keating 2001).

2.6.3 Scale and Complexity Limitations

According to Frumkin and Keating (2001), the extent of restrictions inbuilt in nonprofit organisations possess some concerns in nonprofit. The limited finances and human resources in these organisations limit their ability to organise complex, large scale programmes as quickly and easily as business corporations. Besides a few highly regarded national charities, nonprofit organisations are regularly inadequately financed and short-staffed. In fact, they often run on extremely limited resources and tight budgets trying to accomplish their mission. Furthermore, small nonprofit, which make up much of their organisational population, have limited experience to deal with complex information technology and administration issues, and skills needed if they are to handle caseloads and complex administrative requirements (Johnson and Rudney, 1997).


2.6.4 Availability of Capital

Simple under capitalisation can be significant for nonprofit organisations, given that some government contracts often require the client to be served first or some documented outcome to be achieved before releasing part of the service fee. Thus if a contractor only receives payment months after assisting a client, it means finding ways of covering the up-front costs of delivering services, as it waits for payment to arrive. This can put substantial capital demands on nonprofit organisations (Frumkin, 2002).

Frumkin (2002) notes that, while for-profit organisations have several tools at their disposal to raise capital, most nonprofit organisations do not have large revenue-generating operations to support substantial capital outlays, apart from being under capitalised by charitable supporters. To worsen their plight, if the management in nonprofit organisations could increase operating funds through other means like loans, watchdog groups might well criticise these charities and condemn them of taking too much risk which exposes their organisation to financial stress. For-profit organisations, if just starting, may approach venture capital investors and seek large amounts of funding and long-term commitment in exchange for stake in the firm. Once their business accomplishes a particular level of operation, it has a second chance to raise funds in the equity markets. Through initial public offering (IPOs) and routine stock offering, for-profit organisations can command resources on a substantial scale. With both venture and capital and equities, business sells
ownership stakes to outside parties. However, when they do not want to relinquish
ownership, they can raise funds through the bond market.

On the other hand, nonprofit organisations suffer a disadvantage in that they can
not sell ownership stakes. Furthermore, because they are ownerless organisations,
nonprofit organisations are not prepared to participate in equity markets. However,
they can, to a limited extent use bonds to fund significant capital projects. This has
only been confined to the major institutions like hospitals, universities and
museums. Bonds have not been a popular way of finance because of their high
transactions costs linked with assessing, underwriting and servicing them.
Moreover, since many underwriters do not only consider real estate in making
decisions, but dependable sources of funds as well, nonprofit organisations real
challenge in convincing the lender community that their multiple revenue streams
are reliable enough and their assets valuable enough to justify chief financial
commitments.

2.7 Assessing Nonprofit Performance
The demonstration of efficiency and effectiveness has recently become a critical
issue to nonprofit managers, funders, social entrepreneurs, regulators and
policymakers in nonprofit organisations. While improving nonprofit performance
is a fundamental goal, significant obstacles hinder progress toward this worthy
objective (Abramson, 2003). Additional resources would help nonprofit enhance
their performance, but nonprofit should also be able to achieve better results with
the resources they already have. Nonprofit leaders can take deliberate action to improve organisational performance. However, external factors that are hard for them to control may limit the progress they can make. The efficiency and effectiveness of nonprofit can be negatively affected by requirements imposed by government and private funders, for example. Moreover, as already been discussed, different stakeholders may have different expectations regarding nonprofit performance, making it difficult for nonprofits to satisfy any of the stakeholders. According to Bell-Rose (2002) the nonprofit does not enjoy the relatively straightforward market signal that the for-profit sector enjoys. Bell-Rose (2002) adds that, there are no accepted standards for capturing and detailing social values that are equivalent to the techniques used by for- profits in reporting profits and shareholder value.

2.7.1 The Importance of Measuring Performance

For any organisation, the most salient reason to measure performance is to improve effectiveness and to obtain information that will allow the organisation to drive its agenda forward. According to Hoff (2001:236)

_Self-assessment is about taking the pulse of your organisation—what is currently working well? What is not working well? What is hindering your progress? It should be designed to expose root causes of organisational problems or issues, so that appropriate and effective solutions can be implemented. Otherwise it may be used when doing something that has never been done before, thereby better informing you of the strengths you can apply to the effort and the deficiencies that might inhibit implementation of your new idea._
Bell-Rose (2002) asserts that, without method of assessing impact, organisations may not know if they are achieving their missions. Therefore, they may be missing prospects of improving their programmes. Some researchers emphasise that the goal of performance measurement as a tool for increasing efficiency (Hatry 1999; Behn 2003; Halachmi 2002). Flynn and Hodgkinson (2002) suggest that, in the increasingly competitive world in which nonprofit operate, there are new demands for impact analysis. Foundations want to know whether the programmes they fund are being effective. Private donors seek to know how donations serve targeted clients. Thus, assessing performance could enable donors to appreciate the achievements of different organisations and, therefore, make them shift their dollars to the best performers (Cunningham and Ricks, 2004). Therefore, the transparency and accountability by the assessment of performance might increase overall donor confidence in the sector and thus attract more financial support to boost the scale and capacity of their activities. Board members ask for detailed information on organisational activities and performance. Performance measurement has also become more prominent among government agencies. Over the past two decades and in particular under the conservative government, performance contracting quickly became the way local and national governments sought service delivery. This has led to new levels of both competition and collaboration among the three sectors which are; government, business and nonprofit although depending upon the approach of government (Weisbrod, 1997).
2.7.2 Challenges of measuring Performance in Nonprofit Organisations

Many nonprofit organisations are apprehensive about the issue of measuring performance. Herman and Renz (1999) and Forbes (1998) addressed the challenges of measuring nonprofit organisational performance in more detail. There are several significant limitations to measuring performance in nonprofit. Cameron and Whetten (1983) indicate that many of the difficulties with understanding effectiveness arise because it is a social construct, with unknowable boundaries. Some of the major barriers relating to performance in nonprofit result from the differences between businesses and nonprofit as explained below.

2.7.2.1 Different Missions

Businesses and nonprofit organisations have different missions. Businesses exist to create wealth for shareholders (Speckbacher, 2003). Therefore, the organisational mission and the measurement of performance can both be evidently expressed in fiscal terms (Moore, 2001). Consequently, if a business is making profit it is regarded as being successful in achieving the organisation’s mission because the generation of income or lack of it is directly associated with performance. On the contrary, nonprofit organisations revolve around wide-ranging and complex missions with diverse and complex components (Speckbacher, 2003). Taylor (2001) argues that nonprofits organisational performance is difficult to define and measure since it involves impact on individuals social aspects of life that are much more complex to measure in monetary terms. Since the accomplishment of the mission is hardly ever linked to the organisation’s ability to generate revenue, there are hardly any accepted performance measures in place.
The situation becomes complex because much nonprofit financial support comes from third parties who often have different agendas that may or may not be strongly linked to mission of the organisation, yet their support provides the financial backing for the organisation to function. While private sectors focus their attention on providing a service or product that directly boosts the organisation’s revenue, nonprofit usually no relationship between the mission they exist to accomplish and the financial support that enables them to exist. Nonprofits, then, have numerous bottom lines rather than one, and it further complicates the whole thing (Moore, 2000).

2.7.2.2 Responding to Environmental Pressures

It is also worthy noting that the market-driven business culture promotes and rewards organisations which adapt and change with the times. The organisations that change in response to changing markets achieve long term success. The bottom-line mission of an organisation is to create shareholder wealth, and it can be achieved using a number of activities. An organisation can change its activities radically without altering its mission (Moore, 2000). This contradicts the way nonprofit organisations operate. Nonprofit that change their activities in response to the external environment could be accused of “mission drift.” There is a risk that if they were to change their mission in response to changes in social conditions or donor enthusiasm, they would be accused of caring more for their survival than for their cause” (Moore, 2000: 192). While such a change for a for-profit organisation could lead to increased profits and praise for innovativeness, in nonprofit organisations, this could ruin the integrity of the whole organisation.
2.7.2.3 Client Satisfaction

Evaluating Customer satisfaction in nonprofits is another uphill task. In the private sector, clients have different choices and their choice of where to spend their money can rationalise their satisfaction or lack thereof. Whereas with nonprofits, customers have few or no options about where to look for a service, therefore, there is no market-like feedback method. To combat this, (Letts, et al, 1999; Lindenberg, 2001) suggest that nonprofits must deliberately put systems in place that give them feedback from their relatively immobilised service beneficiaries.

2.7.2.4 Funding Structure

The third party funding structure is also a serious threat to the measurement of performance in nonprofit sectors. For example, instead of concentrating on providing the services, nonprofits also are constantly occupied with efforts to sustain and develop financial sources, thereby making forecasting challenging (Wilensky and Hansen, 2001). Moreover, if they garner for foundation funding, nonprofits face numerous obstacles that act as barriers to nonprofit developing as high-performance organisations. Foundations exert a powerful force in shaping the nonprofit organisations. They do so because when they provide financial backing, they manipulate the directions and ideas related to research, assessment, and best practices that impact the nonprofit sector because those ideas are connected to the finances they give. Yet, “the big picture at foundations rarely includes concerns about organisational capacity and performance” (Letts, Ryan and Grossman 1999: 169-170). In fact, Letts, Ryan and Grossman (1999) believe that the grant-making
process enables many foundations to “undermine the ability of nonprofit to
develop the capacity for sustained high performance” (1999:170). The focus of
many foundations is usually on developing and testing new ideas and new
programmes, rather than investing to support broader capacity of the organisation
that can sustain such programmes.

Letts, Ryan, and Grossman (1999) show the variations in the venture capital
approach used in setting up business organisations and nonprofit organisations to
demonstrate the challenge facing a nonprofit organisation development. In for-
profit organisations, venture capitalists provide funding, a supportive environment
to convert potentially worthwhile proposals into a successful organisation and
liberty to discover the best methods for achieving it. However, foundations
funding nonprofit organisations, rarely offer this kind of support and flexibility.
According to (Letts, et al, 1999), Foundations deal with the risk of financing the
nonprofit organisations by “assuming an arm’s length oversight role that will
uncover poor management, rather than a partnering role that will actively develop
capable managers” (Letts, et al, 1999: 180). The result is that most of the time and
resources is spent in programme activity that yields a great list of activities as a
result, though the results themselves might not reflect the achievement of the
organisation’s goals. Foundations also customarily expect nonprofit to function
with extremely tight budgets and the nonprofit organisation that allocates much of
its budget directly to programme services and delivery and as little as possible for
administration and general organisational operation is considered effective. With
this mindset coming from donors, it is no wonder, several organisations put little
to no importance on internally building capacity and organisational vigour. Although an increasing number of foundations seem to be fascinated with capacity-building, nonprofit organisations are still expected devote the bulk of their resources on programme delivery. There is, however, a great expectation for nonprofit organisations to change the society in significant ways with little or no support. Whereas private sectors have the flexibility to create culture and capacity that support workers and organisational development so that they can successfully achieve their profit-driven missions, which as already been discussed, are easy to quantify and measure. The limited timelines for funding cycles given to foundation grant makers also hinders real capacity building (Letts, et al, 1999).

2.7.2.5 Human Resource Challenges
As far as the issue of human resources is concerned, nonprofit organisations encounter the challenges of recruiting and retaining a skilled workforce because their wages and compensation are less competitive than those of the business sector (McHargue, 2003; Letts, et al, 1999). Furthermore, non-profits seem to have no clearly defined goals and strategies which make it difficulty for employees to work towards clear goals. Therefore, Most of the nonprofit workers work without the rewards systems and achievement indicators like the workers in the for profit sector. Furthermore, in nonprofit organisations there is no time to celebrate their accomplishments. Therefore, these issues contribute to the discouragement of nonprofit employees (Letts, et al, 1999).
The over-reliance by nonprofit organisations on crucial volunteer staffing, also generates exclusive human resources problems, thereby making long-term forecasting, organisational structure and planning more difficult (Wilensky and Hansen, 2001). Additionally, since many nonprofit “value highly participatory worker customs and attract “just do it” individuals with their own definitions of accomplishment, organisations can end up with “too much information from too many people” (Kaplan, 2001:358) and this further complicates the already difficult task of clearly defining organisational strategy, a key element of successful performance.

2.7.2.6 Nonprofit Traditions

Academics and practitioners are embracing the fact that nonprofit need to focus more on performance and building stronger organisations. The challenge has been to find a model that truly works toward this end. However, despite attempts to adopt models from the public and business sectors and none of them has been entirely suitable, although some were better than others. Drucker (1989) points out that the nonprofit sector seem to divert their attention to exceptional management as they mature, although this may contradict with the original values of the sector. In fact, Drucker (1989 cited by Speckbacher, 2003:267) posit that, “Twenty years ago, management was a dirty word for those involved in nonprofit organisations”. However, now, more attention has shifted to nonprofit management, but on some level being “business-like” although contrary the values of the nonprofit sector. Dart, (2004: 303) mentions case studies “where the “business-like” alteration of
service delivery inconsistently reframed and reprioritised the specific nonprofit values of the programmes” Some of the organisations’ long valued principles were dropped in favour of others. As a result, although there is a need for performance measures, nonprofit organisations are afraid of losing their organisational values by embracing techniques from business sectors. Lindgren (2001) and Lindenberg (2001) also voiced the same apprehension about “goal displacement” when nonprofit organisations adapt performance measures from the business sector and apply it in their model. Lindgren (2001) and Lindenberg (2001) recognise that when strict performance measures are applied to nonprofit, it potentially creates a disconnection with the principles that inspire the sector. Lindenberg comments that if the nonprofit staff approach focus on impact and accountability to be successful, they may end up devoting “too much attention to market dynamics and private and public sector techniques will devastate their value-based organisational culture” (2001: 248). Undeniably, the need for high-quality management is vital in nonprofit organisations, but complex since it requires the measuring accomplishment of a social mission which is sophisticated when compared to meeting clear financial objectives. The goals of most nonprofits focus on satisfying what are often “vague and imprecise challenging human issues” (Wilensky and Hansen, 2001:224). Additionally, despite talks about the necessity for improvement of these issues, the pervading nonprofit culture there are individuals who are highly motivated and passionate about the cause they work for and therefore, cannot easily embrace techniques from other sectors without suspicion (Wilensky and Hansen, 2001; Moore, 2000).
Herman and Renz (1997) suggested that performance in nonprofit organisations is socially constructed and it is determined by who is asked. Thus, Bell-Rose (2002) states that there is no standard method to measure social value creation. Furthermore, considering that nonprofit participate in a variety of things like “environmental protection to heath care to disability, the arts and even economic development,” makes it exceedingly difficult. People are usually inclined to measure their achievements. For example, an organisation that has full classrooms, may report on the number of students being served, and may not even consider the number of students who got jobs (Bell-Rose 2002). Similarly, Ostrower and Stone (2006) contend that assessments of performance must move beyond relying solely on perceptions of executives. In general, concentrating on outcomes-indicators of authentic impact- will change the focus from the process to results, from how a programme functions to what it achieves. It is, therefore, increasingly vital for nonprofit to search for ways to stabilise mission, management, and performance, and it is imperative that nonprofit experts work together to address these challenges.

2.8 Ways of Measuring Nonprofit Performance

Charities are not driven by generating revenues like businesses, but they do have various socially-based objectives. Therefore, measurement of performance in these organisations should not only focus on financially related objective, but should also be based on the achievements of the charity in accomplishing its strategic goals and eventually its mission (Sayer, 2003). According to Trussel and Bitner (2001) a search to complement the financial measures with non financial measures
has gained significant momentum over the past decade. Weisbrod (1997) provides a perceptive overview of the need for carefully developed evaluations of the nonprofit sector as a whole, of obstacles in the process, and of proposed approaches. The focus of his inquiry is the extent to which the growth of the nonprofit sector over the past three decades is economically efficient and desirable. Weisbrod cautions that when attempting to measure sectoral outputs and outcomes. The danger, he argues, stems from the fact that nonprofit organisations are more likely than for-profit firms to provide outputs that are difficult to value and hence measure. A flawed attempt to measure performance in nonprofit organisations would yield a systematic underestimation of nonprofits’ social contributions.

Although several normative studies have attempted to operationalise effectiveness measures (AAA 1989, AICPA 1972, Elkin and Molitor 1984, Gambino and Reardon 1981, Lohmann 1980), no such measures have, as yet, been widely accepted (AAA 1989, Gronbjerg 1993). Herman and Renz, (1999) advance several theses about the effectiveness of nonprofit organisations. Regarding performance measurement, they argue that organisational effectiveness cannot be reducible to a single measure and that programme output indicators as measures of organisational effectiveness are limited and can be dangerous. Among other things, these authors recommend the development of conceptions and indicators of effectiveness that are appropriate for nonprofit organisations. This is because the lack of a set of accepted performance measures means that nonprofit organisations may follow a random walk as they compete to get resources to support their
missions. Flynn and Hodgkinson (2002) comment that, unless a useful methodology to describe and measure performance in the sector is developed, they will continue to function on philosophy about the increased value and their modern responsibilities and purposes. This shows that although the effort is demanding and complex, it is necessary, for the sector and its institutions to demonstrate their accomplishments and inherent worth in an era of greater accountability to the public.

2.8.1 Models of Performance Measurement in Nonprofit Organisations

The realisation that measuring performance in nonprofit organisations has such an indispensable role, in the UK public sector, the importance of measuring and reporting performance has strongly been articulated, and a number of guidance, much of it that could be read across to charities, is documented (Connolly and Hyndman, 2004). For example, charities in the UK must prepare annual reports and financial statements. The introduction to the 2000 Statement of Recommended Practice (SORP) highlights the importance of preparing the charity’s annual report and financial statements when it states that, “the purpose of preparing is to discharge the trustees’ duty of public accountability and stewardship” (Charity Commission, 2000). However, as much as financial disclosure and auditing have a place in nonprofit governance structure, researchers like Hyndman (1990); Parsons, (2003) and Falk (1992), advocate for other sorts of reporting that describe the non financial performance of the organisation which they believe to be far more valuable than its financial performance. Herzlinger (1996) echoes the same views and suggests that nonprofit organisations should disclose non financial
quantitative measures of the quantity and quality of services provided, although he does not offer guidance about how organisations should select such measures. There is a general consensus from previous studies that no single performance measure can capture what constitutes performance in nonprofit (Jobome 2006 and Sowa et al 2004), but there is need for a range of measures in order to cope with the multidimensional nature of public service (Stewart and Walsh, 1994). Apparently, researchers in the 1980s (Cameron, 1981, 1982; Connolly, Conlon, and Deutsch, 1980) advocated that the use of multidimensional approaches for measuring nonprofit effectiveness does not only reflect the role of the multiple constituencies of many nonprofit but helps users to access both the organisation’s ability to acquire resources (that is, fundraising). This has resulted in many scholars producing a number of models exploring organisational effectiveness in nonprofit organisations (Sowa et al 2004; Herman and Renz, 1999). Nevertheless, Cameron and Whetten, (1983: 7) posit that none of these many models can, however, ‘capture the total construct space or the total meaning of effectiveness’. Although there are many overlaps, there is none yet, that can claim to be a comprehensive set of criteria applicable to all voluntary organisations (Mistry, 2007).

2.8.1.1The Goal or Purposive-Rational Model

The goal or purposive-rational model by researchers, such as (Etzioni, 1964; Pfeffer, 1982; Price, 1972 assume that organisations exist to accomplish both formally specified and implicit goals. Therefore, the goal or purposive-rational model’s focus is on the internal organisational factors which focus on the extent to
which an organisation reaches its goals as the key criterion of effectiveness. However, some critics have questioned the effectiveness of this method. For example, Perrow (1996) noted that goals may be easily displaced and besides he questions whether ‘official’ or ‘operative’ goals are the ones by which an organisation should be judged. Similarly, Mistry (2007) argues that, some goal in some organisations may be practically impossible to measure but they may be desired outcomes nonetheless, for example, increased independence, self-esteem, awareness of development issues. As a result, the organisation’s ‘stated goals’ may give an incomplete or distorted picture of its outputs and outcomes (Mistry, 2007). On the other hand, some organisations may set goals and objectives at a level at which they have reasonable expectations of achievement (Gill, et al., 2005). However, Cameron (1980, 1981) thinks there is still a possibility that organisations may be judged ineffective even when they have met their goals, or indeed be adjudged effective despite failing to meet the goals.

2.8.1.2 The Systems Resource Model

‘The systems resource model’ developed by Seashore and Yuchtman (1967) concentrates on the external factors which focus on how the organisation relates to its environment. Seashore and Yuchtman (1967) cited in Sowa (2004: 713) define organisational effectiveness as “the ability to exploit its environment in the acquisition of scarce and valued resources to sustain its functioning”. In other words, an effective organisation is one that has the ability to successfully acquire needed resources from its external environment in order to strengthen its position.
and ensure its survival. However, Cameron (1980) notes the downside of this model and state that it can only be useful when there is a clear association between resources and the output of the organisation.

2.8.1.3 The Multiple Constituency Model / The Participant Satisfaction Model
Researchers like (Boschken, 1994; Connolly, Conlon and Deutsch, 1980; D’Aunno, 1992; Keeley, 1978; Miles, 1980, Zammuto, 1984) have utilised the multiple constituency model or the participant satisfaction model which was proposed as a viable alternative to goal and systems approaches (Connolly et al, 1980; Zammuto, 1984). The model views organisational effectiveness as the organisations' ability to satisfy the interests of one or more stakeholders linked with the organisation (Tsui, 1990). Herman and Renz (1997:187) consider the multiple constituency model to be a modification of the goal model, where ‘differing sets of stakeholders have (probably) different goals’; the greater the number of constituencies, the wider the ranges of interpretations of effectiveness. However, critics of this model have identified a number of problems when attempting to assess individual preferences and values. For example, people may find it difficult to report accurately their cognitive preferences and besides, the preferences may change radically over time and can even be unrelated or negatively related to one another and to judgements of organisational effectiveness (Cameron and Whetten, 1983 and Herman and Renz, 1999).
2.8.1.4 A Spatial Model of Organisational Effectiveness

Cameron (1978, 1981, and 1982) advocated for ‘the multidimensional approach’ in an endeavour to reconcile rational goal, the system resource, participant satisfaction and internal process models. Cameron (1981) argues that a unilateral view ignores the complexity of organisational effectiveness and that effectiveness models should capture multiple dimensions. The most meticulous and significant multidimensional approach is the Competing Values Approach (CVA) of Quinn and Rohrbaugh (1981; 1983). Quinn and Rohrbaugh (1981, 1983) developed a spatial model of organisational effectiveness that endeavours to recognise the competing principles that surround the evaluation of organisational effectiveness, principles such as internal versus external focus and the equilibrium between the process and results. Later, Quinn (1988) demonstrated that control-flexibility and internal-external are the two of the subordinate continua that can adequately describe the organisational effectiveness construct. However, when put together they can be envisaged as four quadrants namely; human relations, open systems, rational goal, and internal process. Quinn (1988) asserts that, each of the quadrants represents a model in itself. In the “Human Relations Model” involvement, discussion, and openness are regarded as ways of boosting confidence and achieve dedication. The “Internal Process Model” believes that stability, control, and continuity can be achieved through internal processes such as measurements, documentation, and information administration. However, from the “Open Systems Model” view, insight, novelty, and adaptation are regarded as ways of achieving external acknowledgment, support, acquisition, and development. Finally, the “Rational Goal Model” tries to find profit and efficiency through...
direction and purpose. Quinn and Rohbaugh (1983), Rohrbaugh (1983), and Quinn (1988) noted that organisations were likely to experience tension among organisational effectiveness attributes. For example, all organisations need to be stable, flexible adaptable, control, permit some degree of freedom and independence; a need for logical formal structures and non-rational relaxed relationships. They concluded that an organisation is deemed effective when its manager is able to strike the correct balance between these vital attributes, as mandatory to the organisation’s objectives and situation.

2.8.1.5 A Multidimensional and Integrated Model (MIMNOE)

Having looked at the above models, Sowa et al, (2004) considered the factors that should be assessed and how they interrelated. They ended up with a multidimensional and integrated model of nonprofit organisational effectiveness (MIMNOE) which they claim captures two prominent dimensions of organisational effectiveness that is, management effectiveness and programme effectiveness. According to Sowa et al, (2004), organisational effectiveness should not only constitute the mere outcomes of the programmes operated by the organisation or the services it provides, but should include the purpose of its management structures, how effective they are, and how effective they are on the most vital organisational resource, its employees. “An organisation that is well managed and operated but delivers poor programmes is not fully effective, just as an organisation that delivers well-run programmes but has an unhappy staff or poor overall organisational operations is not fully effective” (Sowa et al, 2004: 715). Similarly, (Hasenfeld, 1983) acknowledges that, management structures are
especially prominent in nonprofit organisations because employees have a crucial role in translating organisational inputs into outputs. Letts et al (1999) also argue that, if the management is effective, it improves programme performance, as it provides the basis for the sustainability, development, and expansion of programmes. Therefore, in this case, it is evident that organisational effectiveness should consist of a component that measures the effectiveness of the programme outcomes or the services an organisation provides while recognising the importance of effectiveness dimensions on management level.

2.8.1.6 The Balanced Scorecard

Originally conceived by Kaplan and Norton (1992, 1996a, 1996b), Balanced Scorecard (BSC) has played a pivotal role in the charitable sector as these organisations have struggled to measure their performance. Many nonprofit organisations have been inspired and taken ideas of performance measurement from the BSC. Moore (2003) asserts that, the BSC has encouraged for-profit managers to focus beyond their traditional dependence on the “financial bottom line.” It urged them not to concentrate on their past financial performance, but to also consider ways of sustaining that financial performance into the future. This has resulted in the development of a set of non-financial measures that help in tracking their achievement in executing the decided strategy. Thus, Trussel and Bitner (2001) say,

*We believe that the balanced scorecard is an ideal vehicle for establishing performance measures for the multiple constituencies of nonprofit
organisations. Further, the balanced scorecard establishes the link between organisational mission and the performance of individual constituencies.

They add that the balanced scorecard is strategic management, as well as a performance management, system.

The scorecard brings many of the seemingly diverse elements of an organisation’s agenda-program orientation, financial equilibrium, responsive services, revenue generation, environmental awareness, and the like into a single managerial report. Also, the scorecard forces administrators to consider all key performance indicators together. The balanced scorecard allows administrators to evaluate simultaneously the organisation from four important perspectives - the Financial Perspective, the Community Perspective, the Internal Process Perspective, and Innovation and Learning Perspective (Trussel and Bitner 2001: 5).

This is a multi-attribute system for conceptualising and measuring performance was designed originally for business organisations but later adapted for nonprofit organisations (Kaplan, 2001, Niven, 2003). Originally, the assumption is that the fundamental purpose of a business is long-run profit maximisation. The success criteria can be evaluated and grouped around four “perspectives” according to the “balanced scorecard of performance attributes”. These are 1) The Financial Perspective measuring different financial performance indicators of key interest to stakeholders; 2) The Customer Perspective which constitutes measures of customer satisfaction; 3) The Internal Business Perspective, measuring internal efficiency and quality; and 4) The Innovation and Learning Perspective attempting
to measure the organisation’s ability to adjust to changes required by a turbulent environment. In the nonprofit sector, however, their mission statement becomes the main goal to be achieved through these perspectives instead of the profit statement. “Customers” substitutes “clients” or “users” of the organisation’s services and the “financial perspective” becomes that of the donors or potential donors (Niven, 2003). The diagrammatic representation on figure 2.2 shows the adapted balanced scorecard suitable for the public and nonprofit sector.

**Fig 2.2: The Balanced Scorecard for the Public and Nonprofit Sectors**

![The Balanced Scorecard for the Public and Nonprofit Sectors](image)

(Adapted from Niven (2003: 2).

It aligns corporate activities with intended outcomes with the organisational mission. Speckbacher (2003) concludes that the Balanced Scorecard may be the most appropriate tool for effectiveness evaluation in nonprofit.
The implementation of the BSC has had both successes and challenges in the voluntary sectors (Wisniewski and Dickson, 2001; Radnor and Lovell, 2003; Martin et al, 2003; Niven, 2003). The key challenge has been the financial perspective which covers the main performance criteria in businesses; yet in the public sector doing well on the financial aspects is not the main mission of the organisation. In fact, Gambles (1999:24) asserts that ‘…in its usual form, the scorecard is clearly not suitable for the vast majority of the public sector’. Kaplan and Norton (2001:135) accept this criticism; saying that overarching mission should be placed at the top of their scorecard to reflect their long-term objectives. Kaplan and Norton (2001) also highlight that, the aim of the public sector scorecard was to have a generic version of the Balanced Scorecard for nonprofit organisations which reflect their values more directly, instead of adapting the architecture of the Balanced Scorecard each time the nonprofit organisations use it.

Another main difference is that several for-profit organisations do not involve stakeholders, as this does not suit the way they do business. However, in nonprofit organisations stakeholder involvement and input is much more crucial, because the organisation and the services exist to benefit of service users and other stakeholders. Moullin, (2002: 167) suggest that, users need to be involved in developing a service to meet their needs and also users and carers should be involved “in decisions about their own health and the care they give or receive” A number of measures of organisational effectiveness commonly used in nonprofit research studies bear some scrutiny as to whether they measure organisational effectiveness as correlates of board performance. Nobbie and Brudney (2003:575) identified the five most commonly used frameworks for measuring organisational
effectiveness as goal achievement, financial viability and resource acquisition, internal processes, CEO job satisfaction and CEO effectiveness.

2.9 Other ways of Measuring Performance

2.9.1 Benchmarking as a Performance Measure

The significance of benchmarking to the assessment of charitable organisations has recently gained momentum (Letts et al, 1999). However, the concept of benchmarking has varied meanings depending on the organisations using it. Despite the wide-ranging definitions, Camp (1989) notes that, the definitions can be put in two categories, that is, those that are limited only to the measuring and comparing, and those that focus also on implementation of change and the monitoring of results. For example, while Neely (2002) defines benchmarking as a system that compares the organisation’s processes and practices with those of similar organisations, Czarnecki (1999) describes benchmarking as an approach that can be utilised to assess performance and identify performance gaps, as well as bring inventive ideas into organisational processes, thereby improving the management of the organisation. In this context, the former definition is referring to the measurement process alone while the latter highlights the decision-making component (Camp 1989). In this study “benchmarking is simply about making comparisons with others and then learning the lessons that those comparisons throw up” (Murby, 2008:3)

From the extant literature several kinds of benchmarking processes are depicted. However, Camp (1995) makes a distinction between four kinds of benchmarking
which are internal, competitive, functional, and generic. Neely (2002) describes them as:

- **Internal Benchmarking**: comparing similar operations within one’s own organisation.
- **Competitive Benchmarking**: comparing with best practice of organisations in direct competition.
- **Functional Benchmarking**: comparing practices and methods with similar processes in the same function outside one’s industry.
- **Generic Process Benchmarking**: comparing one’s work processes with those organisations that have innovative, exemplar processes (Neely, 2002: 220).

Like any other approaches of measuring performance, benchmarking has got its challenges. Paton (2003) is among the few who have surveyed the challenges of benchmarking in assessing the nonprofit practices. In his findings, Paton (2003) found out that comparing performance with other organisations has been difficult overtime because there has been a tendency of changing measurement tools frequently, thus, making it hard to gather the same data over long periods. Furthermore, Neely (2002) highlights that the actual implementation of benchmarking depends on the network of connections created, the extent of mutual receptiveness of ideas, and the readiness to test these ideas in a new situation. Moreover, due to the uniqueness of nonprofit organisations, the practices that may bring success to one organisation might not work for the other (Paton, 2003). Also, Letts, Ryan and Grossman (1999) note that in order for improvements to take place, organisations need to invest in time and resources. This might probably be a
challenge to nonprofits that usually operate with limited resources. That probably explains why benchmarking is still not being utilised frequently, particularly, in the UK, despite the considerable enthusiasm (Paton, 2003). However, despite the challenges, the benefits of benchmarking cannot be overemphasised, and it could be a valuable mechanism for performance improvement in charities.

2.9.2 Financial Viability and Resource Acquisition.

Bradshaw et al (1992:233) used ‘percentage change (growth) in the annual budget’ and ‘size of any deficit incurred’ over the past three years to gauge organisational effectiveness. They found “no significant relationship between the ability to obtain budget increases and the ability to avoid deficits; that common vision is negatively associated with budget growth”; that certain negative board characteristics are associated with massive budget deficits; and that “boards that engage in more strategic planning have smaller deficits” (Bradshaw et al, 1992:242-3). Nobby and Brudney (2003) used annual ‘revenue to expenditure ratios’ (a measure of surplus or deficit) to examine whether adoption of the policy governance model or practices recommended by the National Centre for Nonprofit Boards would improve their performance on these ratios over a five-year period. There were no significant differences between the first and second time periods. This suggests that board performance has no significant impact on this measure of organisational effectiveness. Ritchie and Kolodinsky (2003) identified 16 potential financial performance measurement ratios in 4 categories (fiscal performance, fundraising efficiency, public support and investment performance and concentration) that might be reasonably accessible as organisational effectiveness measures in
university fundraising foundations. They found that fiscal efficiency, public support and fiscal performance could be gauged by two measures in each category. While their analysis pertained more specifically to fundraising operations, they reinforce Gill’s (2005) perspective as a former agency CEO (practitioner) that the ratios noted below are the most decisive measures for assessing financial performance.

Gill (2005) suggests three measures of financial performance should be readily available for any nonprofit: 1) the ratio of administrative expenses to overall expenditures; 2) the annual surplus or deficit as a percentage of annual expenditures; and, 3) the cumulative surplus or deficit as a percentage of the annual budget. Most sectors have some accepted standard for the proportion of total expenses consumed by administrative overheads. These typically range from 7 to 20 percent in service delivery agencies. For example, Revenue Canada guidelines for charities assert that no more than 20 percent of receipted fundraising revenues should be allocated to fundraising costs. Comparisons to other agencies and to past performance would provide some indication of relative efficiency.

Whether planned and manageable, a deficit seems as weighty as the actual level of a deficit, provided that there is a longer-term strategy to recover from such a deficit. The ratio of cumulative deficit to the annual operating budget may be a better indicator of this. Some agencies, in Gill’s experience, purposely generate deficits to ‘expand their funding envelope’, sometimes with the tacit blessing of funders, governments in particular. The ‘manageability’ of a deficit depends on the credit limitations on the agency and the prospects for recovery of deficit funded
expenditures. The adequacy of resources is pretty much a subjective judgment, except in nonprofit that may have a statutory mandate with an uncontrollable demand (e.g. hospitals and child welfare agencies). In such cases, annual deficits may be more a matter of funding inadequacy than organisational ineffectiveness per se. Growth in the budget may be a dubious measure of organisational effectiveness in times of funding constraints imposed from external sources. In fact, some of the most effective organisations studied by Gill (2001) were those that had sufficient resilience to adapt to such funding constraints and to reposition their mandate and operations as leaner, more viable and efficient organisations, less reliant on core government funding.

2.9.3 CEO Job Satisfaction.

According to Nobbie and Brudney (2002) CEO Job satisfaction may be viewed as a criterion of either board or organisational effectiveness. In fact, CEO Job satisfaction may be a correlate of boards that are either clear in their expectations of management or simply ‘allow managers to manage’. The earlier may be interpreted as an evaluation of board proficiency, while the latter may suggest renunciation of accountability for direction and oversight.” (Gill, et. al 2005)

2.9.4 CEO Effectiveness

Nobbie and Brudney (2003:585) hypothesized (based on the Carver contention that CEO and organisational performance were one and the same… a contention, not without detractors) that the high-board effectiveness in implementing policy governance behaviours would correlate with high ratings of the CEO by board
chairs. They asked board chairs to rate CEOs “in terms of their ability to work toward the goals of the organisation without violating the organisation’s policies”. While the correlations were in the right direction, they were not statistically significant. This measure was perhaps not sufficiently robust or multidimensional and suffered from the sole-source influence.

2.9.5 Charities Rating Services

As noted in Murray (2001), numerous assessment methods have been developed to help donors and the public judge on the performance of a variety of charities. Some of them report on public accessibility of audit reports, different aspects of a charity’s finances, how fund raising is conducted and policies for its board of directors like conflict of interest policies. However, the problem is that, as these rating services attempt to compare organisations built around wide ranging and dissimilar missions, the standards do not consider outcomes. The assumption is that organisations are likely to be effective in attaining their goals if they meet their process standard despite the lack of published research that supports these assumptions (Murray, 2001). As already been alluded to, those to be affected by an assessment system must be involved in developing it, otherwise it will not succeed (Mark et al, 2000, Cutt and Murray, 2000, Sonnichsen, 2000).

It seems nonprofit organisations still have a colossal challenge before they find a suitable an evaluation system that can reveal complete picture of how effective the organisation is. Although some see no point in trying, the fact that organisations continue to make decisions based on untested suppositions and idiosyncratic
perceptions of performance should justify the need to continue with the search. However, it is valuable to note that a main drawback of most performance measurement frameworks, such as the Performance Prism and the Balanced Scorecard, is inadequate emphasis on management of risk. Similarly Pickford (2001: 34) states that ‘if risk is to be controlled, it must first be measured’. In other words, all organisations should take the risk into account in determining strategy; otherwise it will be difficult to evaluate how they affect their objectives.

2.10 Pay for Performance in Nonprofit
As mentioned earlier, one of the problems of studying nonprofit organisations is their myriad of different potential missions. As already been alluded to, pay-for-performance in the nonprofit organisations is a critical issue due to the lack of consensus how to measure performance and risk of violating the non-distribution constraints. With profit firms, the goal of true measure of performance is increasing shareholder value, which many authors (for example, Jensen and Murphy 1990) measure with firm market value (firm size). The literature on CEO pay and firm performance provides several measures to test the top manager’s performance, among which are stock returns and change in market worth or size of the firm. Since nonprofit are not owned by shareholders, there is no stock price or value of the nonprofit in the normal sense. Thus, Lazear 1995) posits that “…designing incentive compensation plans in for-profit firms is difficult, but it may even be more difficult to measure the performance of CEOs in nonprofit because these organisations are likely to be striving to create something much different from returns to shareholders. A classic example of how difficult it is to
measure performance for managers in the nonprofit sector is the case of a manager of a nursing home (Weisbrod and Schlesinger 1986). A manager could be paid based on the profits he or she accrues but this gives him or her incentives to provide lower-quality care to the residents.

As a result, Zingheim, Schuster, and Thomsen (2005) note that nonprofit organisations such as charities, social welfare organisations, hospitals, and nursing homes have been slower to embrace the need to more closely align the rewards of the senior executive team with the organisation’s performance than for-profit organisations. They posit that, the main concerns of the nonprofit are usually the visibility and potential adverse publicity regarding excessive compensation packages paid to their executives. However, Zingheim, Schuster, and Thomsen (2005) have highlighted that, apart from aligning executive performance and maintaining a positive public image.

Many studies have examined the linkage between the executive compensation levels and company financial performance drawing on the agency theory. Some have found a connection between executive pay and profitability (Agarwal, 1981), though many other studies have concluded that firm performance is not a key driver of CEO compensation (Benston, 1985; Deckop, 1987; Jensen and Murphy, 1990; Kerr and Bettis, 1987; Murphy 1985; Redling, 1981). However, according to Preston (1989) the pay for performance link seems strongest for nonprofit operating in highly competitive markets. In a study on hospitals, Hallock et al
(2000a) find that, as competition in the health care market increases, executives’ compensation is more tightly tied to profitability. Oster (1998) documents a positive relationship between compensation and size of organisation that varies by industry, and the relationship is strongest for foundations and hospitals organisations that most closely compete with for-profit institutions for employees. Although Oster’s (1998) work is tremendously informative, it is, however, based on limited samples and is only cross-sectional (Hallock 2002) and did not consider changes within organisations using organisation-specific effects.

Hallock (2002) further had some investigations to find out if there might be other measures of performance. He points out that another potential choice is the ratio of expenses spent on programme services, a measure that most nonprofits seem to concentrate. Frumkin and Keating (2002) state that, in the nonprofit total programme expenses include costs of the programme but exclude administrative and fundraising expenses. In a cross sectional study, (Hallock 2002) finds that, the higher pay is associated with high levels of expenses going to programme services. This is consistent with the findings of Frumkin and Keating (2002) who find that, a CEO’s total remuneration rose by $0.25 and $0.07, for every thousand dollars of fixed assets or programme expenses, respectively. Frumkin and Keating thus, believe that the way the organisation uses its resources is another criterion of assessing managerial performance. For the reason, since a culture of service governs the nonprofit sector, a few organisations accept the wasting of resources. “Frugality is a virtue in nonprofit,” (Frumkin and Keating 2002: 22). Cost cutting in nonprofit is often an organisational requisite, especially when resources are
scarce or when the services to be provided to the clients are exceptionally critical. Some nonprofit managers believe they maximise their ability to implement their mission if they reduce administrative expenses. Even donors and nonprofits regulators interpret low ratios of administrative to total expenses as assign that a nonprofit is operating effectively and focused on its mission.

Both Oster and Hallock find that characteristics of the organisation may affect salaries. As already been indicated, Oster (1998) finds that increased reliance on donations limits executive compensation while Hallock (2002) finds that donors seem to steer away from nonprofit hospitals that are competing with for-profit hospitals. In hospitals with increasing competitive pressures and compensation tightly linked to performance, donor contributions are lower. Hallock (2002) also notes that, while success in fundraising may be a valuable metric by which to evaluate managers of nonprofit, another possible measure of performance could be a combination of government grants and direct and indirect support from the public. In his investigations, he finds that the higher the fundraising, the higher the pay of the manager. Frumkin and Keating (2002) echo the same sentiments when they highlight that the ability to raise a large amount of money is also often regarded as a sign that the organisation is successful. The common sense is that donors reward organisations that are doing excellent job and penalise those that are not by withholding donations. Thus, Frumkin and Keating contend that, fundraising results provide an easily measured metric as a proxy of mission accomplishment as it can be followed year to year. Therefore, executive
compensation determined by the CEO’s performance, successful fundraising thus becomes a critical factor of any verdict about managerial success or failure.

Frumkin and Keating (2002) note that, the availability of surplus funds, and the amount of monitoring directed towards the organisation also determines compensation in nonprofit organisations. Unrestricted funds within the organisations provide nonprofit boards with the flexibility of using “free cash” for nonessential and non-budget stuff, like increased wages and benefits for the management. Nonprofit organisations get the funds from at least 3 restricted sources. First, they may be engaged in trading and earn revenues that are not monitored by funders. Nonprofit that receive large amounts of earned income from charging of fees or trading usually have the flexibility on where they can allocate resources than charities that only rely on donations or other funding sources. Users and clients usually not concerned about the underlying financial practices of the nonprofit organisation and they rarely evaluate or scrutinise financial statements. Their focus is usually on convenience and cost of the services offered. If the paying clients are satisfied and if the fee income generates surpluses, it will result in nonprofit having substantial judgment in making operating and compensation decision.

Second, nonprofit may have levels of liquidity that allow them some flexibility in spending (Frumkin and Keating 2002). Nonprofit often receive unanticipated funds in the form of unrestricted donations. These donations are usually small and come from a wide range of supporters. Contrary to restricted grants, these
donations are not scrutinised. These unpredicted finances regularly kept in the form of liquid assets and can be utilised to rationalise pay rises. Finally, some organisations may have endowments and they use interest from these funds to finance the general budget or some restricted functions. Endowment decrease pressure on the management to increase funding through annual appeals and reduce the monitoring and oversight that can be triggered by new donations. Thus, organisations with endowments have flexible cash available in comparison to organisations operating without the cushion and protection that endowment provide. Frumkin and Keating (2002) thus posit that, although distributing “excess earnings” legally infringes the non-distribution constraint, therefore paying the CEOs free cash flows can be regarded as breaking “the spirit” of contact.

2.10.1 Why Reward Executive Performance?

According to Zingheim, Schuster, and Thomsen (2005) many organisations claim to “pay for performance.” However, where tenure determines compensation instead of performance; organisations that reward for performance always outperform those that reward for service only. Zingheim, Schuster, and Thomsen (2005) view the logic for creating a high-performance culture as powerful. Thus, they have highlighted the reasons for paying for performance, in addition to complying with intermediate sanctions as to; reinforce the organisation’s mission, vision, and goals, align the executive’s success with the organisation’s success, enable the organisation to attract and retain executive talent, provide a vehicle to discuss the organisation’s goals and progress in achieving goals (Zingheim, Schuster, and Thomsen 2005: 2). Behn (2003) and others suggest that public sector
managers measure performance because it assists them address explicit administrative concerns, among them to evaluate and improve. Webb and Blandin (2005) cite Prendergast’s (1999) seminal work on incentives and compensation, which considers how pay-for-performance schemes affect employee behaviour, and whether organisational outcomes improve with such schemes. Prendergast reports that pay for performance does not seem to improve organisational performance unless the organisation has the capability to assess output or prove that work effort affects output. She also finds that multitasking in complex jobs may cause CEOs to focus on activities that are directly rewarded (Holmstrom and Milgrom, 1990, Baker, 1992). This may cause misalignment between the individual’s and the organisation’s goals.

2.11 Summary
From the review of the extant literature, it is clear that past empirical efforts in respect of executive pay, governance and performance have been concentrated on for-profit organisations with relatively little attention being given to nonprofit organisations. This raises a question whether existing theories on governance are equally applicable to charities. For example, do existing governance variables influence the executive compensation in charities and if so what are they? The second issue emanating from the review of the literature is: what measures performance and how do we operationalise performance? This is against the backdrop that, researchers such as (Sowa et al, 2004; Rainey and Steinbauer, 1999; Goodman et al., 1977) have point measuring performance in charities is controversial because of multiple stakeholders. Moreover, performance in
nonprofit organisations are becoming important given the government, philanthropic funders, clients and the public demand that these organisations demonstrate effectiveness. There is therefore a need to shed more lights on how the UK charities measure performance and provide a synthesis on what constitute performance.

Apart from the difficulty of measuring performance, the literature gives little indication whether governance and board structure variables used in for-profit organisations are applicable to non profit organisations. Yet in the UK, there have been progressive moves towards greater quality checks and performance measurement (Mordaunt, Cornforth and Otto, 2004). The UK regulators have sought to improve the quality of charity reporting through successive revisions of the charity Statement of Recommendation Practice (SORP). For instance, the current revised SORP, 2005 places more emphasis on governance, accountability and performance. This raises an important issue regarding the effects of the nonprofit boards on organisational performance. According to Andrés-Alonso, Cruz, Romero- Merino (2006), no convincing answers have emerged so far, and our understanding of board effects on performance is fairly scant. In the context of nonprofit organisations, the lack of such link and the paucity of research in respect of board characteristics, composition and their effects have been identified as a gap that needs to be filled to enhance our understanding of governance and nonprofit organisational performance.
It is important to point out that this chapter underpins chapters 4, 5, 6 and 7 of this dissertation.
Chapter 3
Methodology

3.1 Introduction:

The focus of this study embraces four research questions. First, what are the main determinants of CEO compensation in the UK Charities? Second, what performance measures are used in the UK Charities? Third, what are the factors that influence performance in UK charities? However, to successfully achieve the objectives of this study, it necessary to decide suitable research approach, and to collect appropriate set of data and to follow proper analytical procedures. This chapter addresses the issues concerning the methodological choices, taking into account the research problem and the goals of this study which are detailed in chapter one. The chapter also presents a discussion on research philosophy including a debate around the various philosophical perspectives and a statement on the research paradigm stance adopted in this study. Next, the chapter outlines the research design with a particular emphasis on the measurement approach, followed by a description of the process of data collection, and also focussing on sample choices and characteristics on which the quantitative component of this investigation is based. The chapter finalises with an explanation of the quantitative aspect of the study detailing decisions regarding the implementation of the interviews.
3.2 Research Paradigms and Methodology:

According to Collis and Hussey (2003) every educational research is inevitably underpinned by a choice of a research paradigm stance, with implications on both the approach to the research process and the ways in which the data is collected and analysed. Creed et al (2004) describe paradigm as

*...a term used to refer to a set or cluster of commonly-held beliefs or values within the research or scientific community about a field of study. The beliefs are seen as shaping or dictating how scientists and researcher should proceed in carrying out research in their field.* (Creed, et al 2004:10)

In other words, choice of the research paradigm dictates the approach to the research process and the methods of collecting and analysing the data. Easterby-Smith et al (1991) provide three reasons to explain the relevance of philosophical paradigms within research,

1. accurately defining a philosophical position helps the researcher to clarify the design and the overall configuration of his/her research.

2. knowledge of philosophy enables the researcher to ascertain approaches which would be most appropriate within a particular research study, and

3. considering such issues can potentially aid a researcher in creating a new and/or adapting an existing research design, according to the constrains of different subject knowledge structures.

Easterby-Smith et al, (1991), also highlights that there are two basic philosophies of research that exist, namely, positivism and phenomenology. Positivism views reality as external and objective, with the role of research cast as making reliable
and valid observations of this reality in order to test fundamental laws hypothesised from existing theory (Easterby-Smith et al. 1991). Whereas, in contrast, “Phenomenology is associated with humanistic research using qualitative methodologies, that is, approaches that place special emphasis on the individual’s views and personal experiences” (Descombe 2003:97). Its credentials as an alternative to positivism are further reinforced by the fact that phenomenological research generally deals with people’s perceptions or meanings; attitudes and beliefs; feelings and emotions. Thus, Descombe (2003: 96), comments, “In direct contrast to positivism, phenomenology is seen as an approach that emphasises:

- subjectivity (rather than objectivity);
- description (more than analysis);
- interpretation (more than measurement);

Easterby-Smith et al (1991) outline the key elements of these two polar extremes. This is depicted in the Table 3.1.
<table>
<thead>
<tr>
<th>Basic beliefs</th>
<th>Positive paradigm</th>
<th>Phenomenological paradigm</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The world is external and objective</td>
<td>The world is socially constructed and subjective</td>
</tr>
<tr>
<td></td>
<td>Observer is independent</td>
<td>Observer is part of what is observed</td>
</tr>
<tr>
<td></td>
<td>Science is value free</td>
<td>Science is driven by human interests</td>
</tr>
<tr>
<td>Researcher should</td>
<td>Focus on facts</td>
<td>Focus on meaning</td>
</tr>
<tr>
<td></td>
<td>Look for causality and fundamental law</td>
<td>Try to understand what is happening</td>
</tr>
<tr>
<td></td>
<td>Reduce phenomena to simplest elements</td>
<td>Look at the totality of each situation</td>
</tr>
<tr>
<td></td>
<td>Formulate a hypothesis and test them</td>
<td>Develop ideas through induction from data</td>
</tr>
<tr>
<td>Preferred methods</td>
<td>Operationalising concepts so they can be measured</td>
<td>Using multiple methods to establish different views of phenomena</td>
</tr>
<tr>
<td>include:</td>
<td>Taking large samples</td>
<td>Small samples investigated in-depth or over time</td>
</tr>
</tbody>
</table>

Adapted from Easterby- Smith et al., 1991

From the above summary, it is essential to note that each theoretical perspective is independently prohibitive and by focusing on one particular category, research is restricted within that band. This may not be the case as the research subject area may call for a combination of perspectives, thus skimming the advantages of all the approaches into a specific research design. A number of authors like Easterby-
Smith et al, (1991), Alvesson and Wilmott, (1996), highlight the point when they posit that the transition from one perspective to the other is gradual promoter of any one position because it may attempt to incorporate insights from other perspectives into research design. Many studies have combined positivist and phenomenological approaches to management research. In support of combined approaches, Grey and French, (1996) describe the need for ‘dialectic pluralism’ and that they should no longer be the ‘pretence of indisputable and unproblematic techniques’. Steier, (1991) sees the need for ‘methodological pluralism’ that will avoid a ‘one right way’ syndrome from either tradition. Therefore, while distinct positivist and phenomenological approaches exist they do not necessarily have to be viewed as mutually exclusive. This thesis is no exception. Both positivist and phenomenological philosophies underpin this piece of research.

3.3 Choice of Methodology

Closely allied to the two philosophical paradigms is the choice between quantitative and qualitative research methodologies (Creswell, 1994). Quantitative research allows the researcher to familiarise oneself with the problem or concept to be studied, and then generate hypotheses to be tested (Golafshani, 2003). “Concepts, variables and hypotheses are chosen before the study begins and remain fixed throughout the study,” (Creswell, 1994:7). According to Bogdan and Biklen, (1998), the emphasis in this paradigm is, (1) based on facts and causes of behaviour (2) the information can be quantified and summarised, (3) the mathematical procedure is the custom for scrutinising the numeric data and (4) the ultimate result is expressed in numerical terminologies (Charles, 1995). As
Descombe (2003) puts it, quantitative methods inherently measure phenomena so that they can be transformed into numbers and “once the phenomena have been quantified, they lend themselves to analysis through statistical procedures – procedures which are very powerful but utterly dependent on receiving numerical data as the input,” (Descombe, 2003:232). Therefore, the researcher attempted to draw up the boundaries of phenomena into quantifiable or common groupings that can be useful to all of the subjects or wide and comparable situations (Winter, 2000). As a result, the researcher's techniques include “the use of standardised measures so that the varying perspectives and experiences of people can be fit into a limited number of predetermined response categories to which number are assigned” (Patton, 2001:14).

On the other hand, the qualitative researcher does not attempt to manipulate the phenomenon of interest but employs a naturalistic approach that seeks to comprehend phenomena in context-specific situations, thereby allowing the "phenomenon of interest unfold naturally" (Patton, 2001: 39). Strauss and Corbin (1990:17) thus, describe qualitative research, as "any kind of research that produces findings not arrived at by means of statistical procedures or other means of quantification". Contrary to quantitative researchers who try to find underlying determination, prediction, and generality of results, qualitative researchers instead, look for clarification, understanding, and extrapolation to related circumstances (Hoepfl, 1997) and also depends on “transforming information from observations, reports and recordings into data in the form of the written word, not numbers” (Descombe, 2003:232). While Descombe (2003) says, quantitative data can be
analysed easily because of the statistical procedures, Burgess (1982) argues that qualitative methodology provides the researcher with an opportunity to probe a small number of samples in-depth to uncover new clues, open up new dimensions of a problem, and secure vivid, accurate and inclusive accounts that are based on personal experience.

As a result, methods like interviews and observations dominate in the naturalist paradigm and complementary in the positive paradigm, where survey is prominent (Golafshani, 2003). Table 3.2 below compares these two research techniques,

### Table 3.2 – Qualitative versus Quantitative Research

<table>
<thead>
<tr>
<th></th>
<th>Qualitative Research</th>
<th>Quantitative Research</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Objective</strong></td>
<td>To obtain a qualitative understanding of underlying reasons and motivations</td>
<td>To quantify the data and generalise the results from the sample to the population of interest</td>
</tr>
<tr>
<td><strong>Sample</strong></td>
<td>Small number of non-representative cases</td>
<td>Large number of representative cases</td>
</tr>
<tr>
<td><strong>Data collection</strong></td>
<td>Unstructured</td>
<td>Structured</td>
</tr>
<tr>
<td><strong>Data analysis</strong></td>
<td>Non-statistical</td>
<td>Statistical</td>
</tr>
<tr>
<td><strong>Outcome</strong></td>
<td>Develop an initial understanding</td>
<td>Recommend a final course of action</td>
</tr>
</tbody>
</table>

**Note: Adapted from Malhotra, 1993.**

Descombe (2003) also gives the following distinctions between qualitative and quantitative research methods.

- Qualitative research tends to be associated with description while quantitative research is associated with analysis.
Qualitative research tends to be associated with small scale studies and quantitative is associated with large-scale studies.

Qualitative research tends to be associated with a holistic perspective studies and quantitative research is associated with specific focus

Qualitative research tends to be associated with researcher involvement and quantitative research is associated with research detachment.

Qualitative research tends to be associated with an emergent research design and quantitative is associated with a predetermined research design.

Aspects of executive compensation and performance in charities have been investigated previously using the quantitative methodology. For example, researchers such as Jobome (2006), Brickley and Horn (2002) and Hallock (2002), have employed the quantitative survey methods in the positivist tradition. The emphasis on quantitative methodology within the executive compensation and performance in non-profit organisations literature is predictable given the characteristics of the methodology. Large samples surveys allow the researcher to establish the relationship between the number of independent variables and to generalise the results (Creswell, 1994).

Morgan and Smircich (1980) observed that the appropriateness of the research approach to be adopted depends on the aims and the nature of the social phenomena to be explored. In this thesis, both qualitative and quantitative
methods are engaged. According to Patton, (1990) qualitative and quantitative approaches are complementary strategies for research, and not mutual exclusive. This research study opted for a combination of research techniques for numerous reasons. Many researches (see, for example, Maggars-Rapport 2000, Coll and Chapman 2000 and Hammersley et al 2003) suggest that combing qualitative and quantitative research (triangulating) tend to produce more valid and reliable results. In other words, triangulating permits the researcher to detect varying perspectives and gain a more holistic picture. Secondly, the multi-methods approach offers either collaborative findings or opportunity for question by comparing the data derived from the differing methods.

3.4 Primary Data Collecting

Primary data collection constituted the main purpose of the field study. The following sections discuss the research design and the sample choice the procedures for collecting the primary data. However, secondary data like financial statements were also collected from charities reports on the websites of the organisations involved.

3.4.1 Chosen Research Design

According to Churchill, (1987) a research design is,

‘simply the framework or plan for a study used as a guide in collecting and analysing data. It is the blue print that is followed in completing a study’.

Sproull (1988) supports this statement by describing research design as,
‘a plan for conducting research which usually includes specification of the elements to be examined and procedures to be used’.

There are various types of research design. The five principal research strategies employed in social science research are, experiments, surveys, archival analysis, histories and case studies. According Yin, (1989; 1994) three criteria must be followed when choosing an appropriate research design, namely,

1. The type of research question posed.
2. The extent of control an investigator has over actual behavioural events.
3. The extent of focus on modern in contrast to past events.

According to Muijs (2004) the most popular (quantitative) research design in social sciences is survey research. Angus and Katona (1953:16) posit that, "It is this capacity for wide application and broad coverage which gives the survey technique its great usefulness...” Survey research designs are concerned with description, explanation and exploration. Survey research methods can be grouped into two classifications, cross-sectional and longitudinal. In cross-sectional surveys, data is collected from a sample drawn from big population at that particular time. Longitudinal surveys collect data at different points in time; changes in descriptions and explanations are reported. Primary longitudinal designs are trend studies, cohort studies and panel studies. Survey research designs can appear in various forms. These are; ‘self- completion’ questionnaires (postal or web-based and email forms), and interviews (telephone or face-to-face) Descombe (2003). Both methods have advantages. Interviews are generally characterised with more reliability of information, high response rates and more flexible as their strengths. Glastonbury and MacKean (1991:228) say, "Interviewing offers the
flexibility to react to the respondent's situation, probe for more detail, seek more reflective replies and ask questions which are complex or personally intrusive”. However, interviews have weaknesses which include being relatively expensive, potentially susceptible to the interviewer’s bias and taking a longer time. Descombe (2003) posits that mail questionnaires lessen prejudice. There is standardized question presentation and no middle-man bias. The researcher's own views will not manipulate the respondent to respond to questions in a particular way. There are no verbal or visual hints to influence the respondent. Gilbert (1993) also highlights that questionnaires are less invasive than telephone or face-to-face surveys. The respondent chooses when to complete the questionnaire. Mail questionnaires can also cover a wide geographical area; can provide an anonymous setting for threatening and embarrassing topics. However, response rate can be low and also nonresponse bias. Mail questionnaires require limited length and complexity of questions, and there is little control over who actually completes the questionnaire (Barabba, 1990 and Kervin, 1992).

Survey design and interviews were the options considered for this research. Data was gathered via a cross-sectional survey using the web-based and the email questionnaire as well as semi structured interview techniques on a sample of large UK charities. The combination of approaches makes it possible to triangulate, thereby taking advantage of the strengths of each method to compensate the weaknesses of other methods. Mathison (1988: 13) elaborates this by saying:

*Triangulation has raised an important methodological issue in naturalistic and qualitative approaches to evaluation [in order to] control*
This also contributes to improve both reliability and validity of findings (Deshpande 1983; Lodorfos and Boateng, 2006). The same view is highlighted by Golafshani, (2003) who posits that triangulation is fundamentally an approach for improving the validity and reliability of research or assessment of results. This is significant based on the assumption that any bias inherent in a method is neutralised when used in conjunction with other methods (Boateng, 2000). Also, the utilisation of a multi-method approach enables the research activities to reach a level of authority. As such data was collected in two phases, that is, qualitative and quantitative phases as detailed below. An effort was made to collect data from charities with an annual turnover of £1million and over. This is because such charities are legally required to comply with the SORP regulations and recommendations on accounting and financial reporting by the SORP committee of the Charity Commission, which is the regulatory body for charities in England and Wales (NCVO, 2006). Due to the selection criteria, the results are more generalisable to large charities.

3.5 Questionnaire Design

According to Descombe (2003), questionnaires are at their most productive when used with large of numbers in many locations. This research was concerned with charities across the UK, therefore, so much dispersed and making use of questionnaire appropriate for this study. The design of the questionnaire is heavily
influenced by the recommendations of Dillman (1978) and Oppenheim (1992) who both have presented comprehensive reviews of the literature on questionnaire design. Therefore, the layout consisted of a series of sections each relating to a particular aspect of the study. While designing the questionnaire due importance was given to:

- Wording of the questionnaire
- Content and purpose of the questionnaire
- Appropriateness of the questions to the research aim and objectives
- Appearance of the questionnaire

The questions generated were based on the aims of the study and from the literature review.

3.5.1 Web-based questionnaire

For the purpose of this study, web-based questionnaire was preferred over postal paper questionnaire. Dillman (2000) describes a web-based questionnaire as a compilation of data using a self-administered electronic series of questions on the web. The major advantage of web-based is that it is relatively cheap. "There is no other method of collecting survey data that offers so much potential for so little cost as Web surveys" Zanutto, (2001:7). Zanutto, (2001: 7-8) describes some of the benefits of web surveys as:

- a quicker response rate; easier to send reminders to participants; easier to process data, since responses could be downloaded to a spreadsheet, data analysis package, or a database; dynamic error checking capability; option of putting questions in random order; the ability to make complex skip
pattern questions easier to follow; the inclusion of pop-up instructions for selected questions; and, the use of drop-down boxes”.

Also, Dillman (2000) posits more advantages when he says;

*With Web-based surveys, the manager has control over the physical appearance and can create attractive and inviting forms. Web-based surveys can include radio buttons and drop-down lists that permit only one choice for the response. Check boxes allow multiple answers. Text boxes can be one line with a limited number of characters, or they may permit unlimited text entry (Dillman, 2000:352).*

These are possibilities that cannot be included in paper surveys. However, Web-based surveys are not without problems. The browsers and different monitors may present the questionnaires differently causing respondents to receive the different visual stimulus. Respondents may lack computer expertise which can cause mistakes or non-response (Zanutto 2001). Sampling of email addresses is difficult as there are no directories and finally, the choice not to respond is likely to be prompt (Dillman 2000). However, in this study, the email addresses of the CEOs were obtained from The Charity commission website, which is the registrar of charities in England and Wales and contains the data on the personal characteristics of chief executives.

The questions incorporated in the questionnaire are two types: questions of a factual nature and attitudinal questions designed to measure the attitudes, perception and opinions of the respondents. An issue in trying to capture the attitudes of the respondents is the level of scale measurement to apply. Among the
scaling techniques used in the surveys, the semantic differential scale and the Likert are the most widely used techniques. Holmes (1974) points out that 5-point scale are generally most effective and easier to comprehend from the respondent point of view because by using only two or three options it means measuring only direction rather than strength of opinion too. Johns (2010:6) echoes the same view when he says;

*One simple way of illustrating the problems with long scales is that labelling the response options becomes extremely difficult. Typically, for seven-point scales, options labelled ‘slightly agree/disagree’ are introduced either side of the neutral point. Much beyond that, though, the shades of agreement become as hard for survey designers to express as they are for respondents to distinguish.*

Taking into considerations such factors as the type of information needed and the characteristics of the respondents, using a Likert like 5 – point scale was chosen for the study. A copy of the study’s questionnaire is provided in Appendix 1.

**3.5.2 Sample Choice and Characteristics**

The research population of interest was obtained from two online sources. The first one is CharitiesDirect.com, which is the essential online for the UK charity information service for professionals working within UK charities, UK charity advisors and the general public. The website contains a list of all registered UK charities in alphabetic order as well as 500 top UK charities in order. The Charity commission website which is established by law as the watchdog and registrar of charities in England and Wales was also utilised. The data on the personal characteristics of chief executives were obtained mainly from this website.
The sample chosen represents a cross representative selection of UK charities as they were drawn from different sub sectors. The sub sectors included Health, Education, Overseas aid, Social services, Arts and culture, Media. It is however; worthy noting that charities registered with the charity commission excludes exempt charities such as certain museums and universities (Kreander et al 2006). However, these particular charities have also been omitted in this study.

The characteristics of the sample are shown in Table 3.3. The size of the organisation is classified according to the number of employees with small constituting 57 percent and medium/large being around 42 percent.

<table>
<thead>
<tr>
<th>Size of organisation</th>
<th>Frequency</th>
<th>Percent</th>
<th>CEO's qualifications</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small: &lt; 250 employees</td>
<td>60</td>
<td>57.1</td>
<td>Up to degree level</td>
<td>56</td>
<td>53.3</td>
</tr>
<tr>
<td>Medium/Large &gt; 250 employees</td>
<td>45</td>
<td>42.9</td>
<td>Higher degree</td>
<td>34</td>
<td>32.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Professional qualification</td>
<td>15</td>
<td>4.3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sector of the organisation</th>
<th>Frequency</th>
<th>Percent</th>
<th>CEO's tenure in the organisation</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>16</td>
<td>15.2</td>
<td>1-5 years</td>
<td>29</td>
<td>27.6</td>
</tr>
<tr>
<td>Art &amp; Culture</td>
<td>19</td>
<td>18.1</td>
<td>6-10 years</td>
<td>32</td>
<td>30.5</td>
</tr>
<tr>
<td>Social services &amp; relief</td>
<td>21</td>
<td>20</td>
<td>over 10 years</td>
<td>44</td>
<td>41.9</td>
</tr>
<tr>
<td>Education</td>
<td>21</td>
<td>20</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Religious</td>
<td>12</td>
<td>11.4</td>
<td>CEO’s age</td>
<td>27</td>
<td>25.8</td>
</tr>
<tr>
<td>Others</td>
<td>16</td>
<td>15.2</td>
<td>25-44</td>
<td>37</td>
<td>35.2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>45-54</td>
<td>41</td>
<td>39.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>55 &amp; over</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Total                        | 105       | 100     | Total                           | 105       | 100     |

Notes: Others stand for organisations offering more than one service
The sample distribution based on industry classifications is as follows: the most frequent sector of operation education, social services and relief (20% each). This followed by art and culture 18 percent with health and other sectors forming 15 percent each. Regarding the CEO characteristics, CEOs with Bachelor degree form over half of the sample, higher degree (32%) and professional qualification (4%). In terms of the age group of the CEOs, over 55 years constitutes about 39%; 45 - 54 (35%) and 25-44 (25%). Regarding the tenure, CEOs with tenure over 10 years constitutes about 41%; 6-10 (30%) with 1-5 years (27%).

Survey samples may be classified into two types: probability and non-probability samples (purposive samples). A probability sample is where all members of the population have an equal chance of being chosen. It is only when this specification is not met, and the selection process involves personal judgement that the sample then becomes classified as a non-probability sample (Descombe 2003). Thus, non-probability sampling has been used for this survey because an attempt was made to choose from the large UK companies with turnover of £1m and over. Such companies are likely to have compensation policies and follow recommendations laid down by Charity commission.

3.5.3 Pilot Study

A pilot study was undertaken to pre-test the mail questionnaire. Firstly, the questionnaire was subjected to critical review by 4 UK academics and 3 managers of large charities. Some useful feedback was given on some aspects of the questionnaire. Common comments included the length of the questionnaire,
several statements being used to ask about the same thing, difficulty of some questions and clarity of some words. Revisions were made in light of the various suggestions made by these academics and managers. The survey was then pre-tested with 8 organisations. The organisations were representative of the population being subjected to the survey. The rationale for the pre-test was to evaluate the clarity and reaction to the use of electronic survey. None of the contacted organisations cited problems with screen configurations, though, later, in the actual survey four respondents had such problems. Only minor changes such as grammatical and typing errors were required to the questionnaire after this stage.

3.5.4 Mail-out procedures

The questionnaire was prepared using the ‘create survey wizard’ from free online survey. The respondents were invited by email to the survey site. On the email was the cover letter on which a URL or web address was embedded for respondents to click. In order to improve the response rate, Solomon, (2001) recommendations were considered. Solomon (2001) stated that personalised email cover letters, reminders by email, prenotification of the purpose of the study, uncomplicated formats, and explicit design proved to increase response rates for Web-based surveys. The deliberate effort was made to personalise the cover letter, simpler formats and plain designs were employed and follow up reminders were made by email as a way of trying to maximise the response rate.
3.5.5 Covering letter

On the covering letter, sufficient background information about the research was provided. The purpose of the research and how the information will be used was explained. The covering letter had The Nottingham University logo to indicate the auspices under which the research was undertaken. The contents of the letter also included the importance attached to the opinion of the respondent and a suggested deadline for returning the questionnaire. Finally, an expression of thanks, to the respondents, for the time taken to complete the questionnaire was made. In exchange for their participation in the survey and to provide inspiration and accurate responses, the participants were guaranteed of anonymity and a summation of the report findings. (See appendix 2 and 3 for the cover letter and reminder cover letter samples).

3.5.6 Anonymity/Confidentiality

For confidentiality purposes, the respondents were assured that they and their organisations were not going to be identified in any way at any stage of the analysis, nor in the publication of the results. Thus, instead of using company names, codes were to be used. A promise of anonymity and strict confidentiality was assured at the beginning of the questionnaires, and also stressed in the covering letter to signify the importance the researcher attached to the issue of anonymity and confidentiality of the respondents. The purpose of such assurance was to encourage participation, provide motivation and candid responses. Furthermore, anonymity and confidentiality of participants are essential to ethical research practice in social research (Crow and Wiles, 2008).
3.5.7 Instructions to the respondents

According to Bryman (1989), “mistakes that occur can invalidate a whole questionnaire, so it is worth being meticulously careful in giving instructions on how to do these answers”. A considerable effort was therefore, made to give specific instructions for each question. For instance, where the style of the questionnaire varies, the respondents were instructed to put a tick in the appropriate box, circle the relevant number or delete as appropriate.

3.5.8 Response rate

A breakdown of response rate and reasons for non-response are shown in table 3.4 below. Dillman et al. (2001) acknowledges that since 1990 response rates have been on decline for all types of surveys. This has been proven in this survey. It is apparent from table 3.4 that 105 charities completed usable questionnaires representing a response rate of only 21%. The most common reasons highlighted for non-completion were that; some charities had purely voluntary trustees and no paid staff and some cited their company policy of not participating in surveys.
Table: 3.4
Response Rate and Reasons for non-participation

<table>
<thead>
<tr>
<th>Description</th>
<th>No. of Charities</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charities contacted</td>
<td>500</td>
<td>100</td>
</tr>
<tr>
<td>Total usable replies</td>
<td>105</td>
<td>21</td>
</tr>
<tr>
<td>Charities replies but unable or unwilling to participate</td>
<td>245</td>
<td>49</td>
</tr>
<tr>
<td>Reasons for non participation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of time</td>
<td>26</td>
<td>5.2</td>
</tr>
<tr>
<td>Policy not to answer Questionnaires</td>
<td>18</td>
<td>3.6</td>
</tr>
<tr>
<td>Provided websites and suggested accounts could be checked there</td>
<td>12</td>
<td>2.4</td>
</tr>
<tr>
<td>Unable to view data</td>
<td>4</td>
<td>0.8</td>
</tr>
<tr>
<td>Not resourced to deal with such requests</td>
<td>24</td>
<td>4.8</td>
</tr>
<tr>
<td>Undisclosed reasons</td>
<td>161</td>
<td>32.2</td>
</tr>
<tr>
<td>No replies</td>
<td>150</td>
<td>30</td>
</tr>
</tbody>
</table>

3.5.9 Non-response Bias

From 10\textsuperscript{th} of November to 25\textsuperscript{th} of January 2008 questionnaires and cover letters were mailed to 500 charities. By the end of May, a total of 63 usable completed questionnaires were returned. To enhance the response rate further, reminders were sent to the charities that had not responded from the 3\textsuperscript{rd} of June to the 27\textsuperscript{th} July 2008. All non-respondents were identified because of the use of special coding system on the questionnaire. This helped avoid unnecessary mailing to those who had already responded. A total of 42 usable completed questionnaires were returned, as a result. Because of the differences between the first leg of response and the second leg of response, a test was conducted to test for response bias. The procedure used by Armstrong and Overton (1977) was used to test the
response bias in this study. This procedure tests the non-response bias by implementing a t-test comparing early and late response rate along a number of key descriptive variables. The results of the sample t-test the null hypothesis that there is no difference between early respondent and late respondents along the variables: sector of the charity, number of employees and the size of the board are shown on table 3.6. The t-statistics with the associated probabilities gave no grounds for rejecting the null hypothesis. Thus, the results indicate no evidence of non-response bias between the early and late respondents along the chosen dimensions.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Early Respondent</th>
<th>Late Respondent</th>
<th>t-value</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sector of the firm</td>
<td>1.57</td>
<td>1.75</td>
<td>0.38</td>
<td>0.93</td>
</tr>
<tr>
<td>Number of employees</td>
<td>0.50</td>
<td>0.50</td>
<td>0.47</td>
<td>0.69</td>
</tr>
<tr>
<td>Size of the board</td>
<td>1.08</td>
<td>0.91</td>
<td>0.40</td>
<td>0.79</td>
</tr>
</tbody>
</table>

3.6 Validity and Reliability of the Instrument

When doing a research, researchers need to evaluate and verify that their studies are feasible. Schwab (1980) asserts that validity and reliability of the instruments are the two fundamental concepts that influence the overall acceptability of the research outcome. This is consistent with Patton (2001)’s views that, any researcher should be concerned about two factors namely, validity and reliability when designing a study, scrutinising the results and evaluating the quality of the research. This corresponds to the question that “How can an inquirer persuade his
or her audiences that the research findings of an inquiry are worth paying attention to?” (Lincoln and Guba, 1985:290). In quantitative research credibility relies on instrument construction whereas in qualitative research, “the researcher is the instrument” (Patton, 2001:14). Joppe (2000:1) defines reliability as:

...The extent to which results are consistent over time and an accurate representation of the total population under study is referred to as reliability and if the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable.

In other words, this citation embodies the notion of replicability or repeatability of results or observations Golafshani, (2003:598) cites Kirk and Miller (1986: 41-42) who recognised three types of reliability stated in quantitative research, which correspond to: “(1) the degree to which a measurement, given repeatedly, remains the same (2) the stability of a measurement over time; and (3) the similarity of measurements within a given time period”. Joppe (2000:1) provides the following explanation of what validity is:

Validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are. In other words, does the research instrument allow you to hit "the bull’s eye" of your research object? Researchers generally determine the validity by asking a series of questions, and will often look for the answers in the research of others.

Similarly, (Zikmund, 2003) simply defines validity as the ability of a scale or measuring instrument to measure what it is intended to measure. Content or face validity is the most common variant concept of validity, although
there are some like criterion and construct validity (Uddin and Boateng, 2007). The evaluation of content validity characteristically involves a prearranged review of the survey’s content to ensure that it consists of everything it should and excludes anything it does not (Boateng, 2000). Wainer and Braun (1998) describe the validity as “construct validity”. The construct is the preliminary idea, concept, query or supposition that determines the type of data is to be gathered and how to gather it (Golafshani, 2003). While the definition of reliability is concerned about whether the outcome is replicable, validity looks at the accuracy of the measurement and also, if they are measuring what they are anticipated to measure.

Fried (2005) posits that reliability can be measured by test-retest method, split-half method and the Cronbach’s alpha method. This study focuses on the “internal consistency”, which refers to whether participants are responding to the different items of a questionnaire in a consistent manner in a single trial. The most sophisticated and widely applied index of internal consistency is “Cronbach’s alpha”. This examines the average inter-item correlation of the items in a questionnaire (Cortina, 1993). If all items are measuring the same thing (without any error) alpha will be equal to one. Otherwise, if there is no shared variance in the items, then these are supposed to reflect only “error” resulting in alpha being equal to zero (Hinton, 2004). The reporting and correct interpretation of Cronbach’s alpha is essential for judging the internal consistency of the developed
outcome measures. Lack of reliability is a serious drawback of an outcome measure as it indicates errors in measurements (Powell, 1999).

The reliability for the constructs used in the questionnaire of the study used was tested, and the Cronbach’s alpha values were well above the suggested threshold. Field (2005) has stated that a value of 0.70 to .080 is acceptable. However, Kline (1999) has indicated that in some situations a value lower than 0.70 is acceptable. Nunnally (1978) and Robinson et al. (1991) suggest that the alpha value of 0.60 as a threshold. The Cronbach’s alpha for the constructs are reported in each of the relevant chapters as well as appendix 5.

In order to assess content validity, an extensive literature review has been done to develop the items in the questionnaire. Furthermore, to give the final shape to the data collection instrument, the questionnaire instrument was piloted in two stages, which involved consultation with academics from related and unrelated fields and also with top management of UK charities. Furthermore, as already been eluded to, a triangulation of both survey questionnaire and interviews to collect data were utilised to enhance the validity and reliability of data (Descombe, 2003 and Cohen et al, 2005).

3.7 The Qualitative Phase of the Investigation

The literature review has raised concerns about performance measures that have so far been employed by nonprofit organisations researchers, for example, Frumkim and Keating, (2001); Brickely and Van Horn, (2002) and Hallock, (2002). Having considered the uniqueness of each charity, performance measures used in these
organisations may not be fully captured using quantitative standardised questionnaires or surveys but qualitative approach. As Lodorfos and Boateng (2006) put it, a qualitative method is preferred when an in-depth understanding is desired. The qualitative aspect has been employed to generate further facts, opinions, and insights (Yin, 1984), and get a more comprehensive picture of participants’ experiences of the performance measures that are used in charities. In short, the general goal of the qualitative phase of this research is to gain a better understanding of performance measures used in charities.

3.7.1 Interview Technique

Frey and Oishi (1995:01) define an interview technique as "a purposeful conversation in which one person asks prepared questions (interviewer) and another answers them (respondent)". This is a way of gathering information on a particular subject or a topic to be investigated. Interviews can be either structured (closed interview style), semi structured or unstructured (open interview style). Nichols (1991:131) defines Open-ended or unstructured interviews as "an informal interview, not structured by a standard list of questions. Fieldworkers are free to deal with the topics of interest in any order and to phrase their questions as they think best."

In this case, a broad range of questions are asked in any order in accordance to how the interview proceeds (Breakwell, Hammond and Fife-Schaw 1995). Wimmer and Dominick (1997) posit that open-ended questions grant the interviewer, if necessary, the opportunity to probe deeper into the original responses of the respondent to obtain a more comprehensive response to the
question. The quality of the data therefore, depends entirely on the interviewer who must evaluate how much probing is necessary. Nichols (1991) defines Closed or structured interviews however, as a social survey where a series of likely responses to each question is known beforehand because possible answers are frequently listed on the form and the interviewer merely indicates the suitable answer in each case. The method is standardised and interviewees can choose from a list of prearranged answers. Therefore, there is a lack of flexibility, due to the predetermined question order and that there are also uniform (Wimmer and Dominick 1997). Although this has advantages in that the information is easily comparable and quantifiable, there is “little room for unanticipated discoveries” due to the lack of flexibility in this approach” (Breakwell, Hammond and Fife-Schaw 1995:231). Furthermore, sometimes people may feel that the designated answers do not fit with their responses.

The semi structured interview is one of the most regularly used qualitative methods. Borgatti (1998) describes an interview as an instrumental tool to get to the root of the issue, through expanding questions and get more information. The interviewer has a script that contains a set of questions to guide the interaction (Almeida et al, 1999). Although the original script of the interview ensures the consistency of subject across the whole sample, the difference is caused by the probing that is done by the interviewer as a result of responses given by the interviewee (Honey 1987). For the purpose of this study, the semi-structured interviews were chosen as the appropriate means of data collection. Just like other
methods in a research, interviews have both advantages and disadvantages. Table 3.7 summarises some of the advantages and disadvantages.

**Table 3.6**

Advantages and Disadvantages of Interviews

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>• It is easier for questioning to be guided points can be clarified more easily when necessary than in mailed questionnaire.</td>
<td>• It is an extremely time-consuming method: it requires more time to collect and analyse data.</td>
</tr>
<tr>
<td>• Respondents can qualify and clarify responses</td>
<td>• Training is sometimes necessary in order curtail to possible biases in the interview:</td>
</tr>
<tr>
<td>• Interviewees may also provide incredibly detailed responses in an effort to figure out the intention of the survey.</td>
<td>• The technique relies on the respondent's willingness to give accurate and complete responses.</td>
</tr>
</tbody>
</table>

Adapted from Frey and Oishi 1995; Breakwell, Hammond and Fife-Schaw, 1995; Wimmer and Dominick 1997.

**3.7.2 Interview Questions Design**

Dilman (1978) presented a comprehensive review of literature on questionnaire design and this influenced the design of the questions for the interview for this study. The interview questions created were based on the aims of the study and literature review and were about what measures performance in the UK charities.
Since Lincoln and Guba, (1985); Shah and Corley, (2006) regard the protection of informants’ confidentiality as one of the elements needed to ensure the trustworthiness of qualitative research, the interviewees were assured of confidentiality.

3.7.3 Pre-testing Interview Questions

The pre-testing of the interview questions was conducted two phases. The first phase involved comments from two UK leading academics that are experts in executive compensations and performance in nonprofit organisations. The reason of the pre-test was to obtain feedback on aspects such as the content of the questions, the clarity of the questions, length of questions, questions, relevance and irrelevance of questions and whether any key issues have been overlooked (Webb, 2000 and Remenyi, Williams, Money and Swarts 1998). The suggestions from the academics were given due attention and the questions were revised and changed accordingly before being subjected to the second phase of pre-testing.

The second phase of the pre-test involved 3 charities. The researcher conducted the pre-test through personal interviews with respondents from these charities. The feedback was however, positive feedback and there were remarkably few comments, such as the clarity of the questions, which were taken into consideration in the construction of the final version of the interview script.

3.7.4 Interview Procedure

According to Kvale, (1996) and Kvortnik, (2003) it is necessary to establish rapport with the interviewee before the interview by giving them information
about the interviewer, the purpose of the interview, and the relevance of his/her participation in the study. Consequently, the researcher introduced herself and explained the purpose and the importance of the study before the actual interview. Some easy and non-controversial questions (for example, in which sector of industry is your charity involved? what are the main activities of your charity?) were included as opening questions following Churchill (1999) and Malhotra (2004) recommendations and potentially sensitive and controversial questions, (e.g. What measures performance in the organisation?), were placed later as Rubin and Rubin (1995) suggest that, that is when the interviewer will have built an atmosphere of empathy and trust with the respondent. The length of interviews varied from 45 minutes to 60 minutes. The participants, particularly from face to face interviews did not agree that the interviews be recorded by digital recorder. This was however, not surprising since Kvortnik, (2003) and Vieira, (2005) suggest that interviewees sometimes experience some discomfort and, in some cases, risks in participating in the research. The semi-structured interview technique (Minichiello et al., 1995) was used. An interview script involving the same open-ended questions was employed for all interviews. The researcher took notes and included all the details discussed and any corresponding views expressed by the interviewees and impressions of the researcher without delay.

3.7.5 Sample Characteristics and Response

The data for this study were collected via semi structured interviews with senior managers from large UK charities. Between September and November 2007, 14 open and semi-structured interviews – 85.7 percent telephone and 14.3 percent
face to face, with senior managers who were key decision makers of charities. An evaluation of the job titles of the respondents showed that: 41 percent of the respondents were CEOs; 43 percent were finance managers; and 16 percent were event managers. It is likely that these respondents are involved in strategic decision making in their respective Charities. Secondary data like financial statements were also collected from charities reports on their websites and previous research in the subject area.

The characteristics of the sample are shown in Table 3.7. The size of the organisation is classified according to the number of employees with medium/large constituting 57 percent and the small being around 42 percent. The sample distribution based on industry classifications is as follows: the most frequent sector of operation Art and culture (28%). This is followed by Health and Religious sectors with around (21 percent each) and Social services & relief and Education sectors form 14 percent each.
Table 3.7: Characteristics of the Sample for Interviews

<table>
<thead>
<tr>
<th>Charity</th>
<th>Colour</th>
<th>Sector</th>
<th>Size of organisation</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>CH 1</td>
<td>Blue</td>
<td>Religious</td>
<td></td>
<td>CH 1</td>
<td>1</td>
</tr>
<tr>
<td>CH 2</td>
<td>Red</td>
<td>Health</td>
<td>Small: &lt; 250 employees</td>
<td>6</td>
<td>42.9</td>
</tr>
<tr>
<td>CH 3</td>
<td>Blue</td>
<td>Religious</td>
<td>Medium/Large &gt; 250 employees</td>
<td>8</td>
<td>57.1</td>
</tr>
<tr>
<td>CH 4</td>
<td>Green</td>
<td>Art &amp; culture</td>
<td></td>
<td>CH 4</td>
<td>1</td>
</tr>
<tr>
<td>CH 5</td>
<td>Orange</td>
<td>Education</td>
<td></td>
<td>CH 5</td>
<td>1</td>
</tr>
<tr>
<td>CH 6</td>
<td>Blue</td>
<td>Religious</td>
<td></td>
<td>CH 6</td>
<td>1</td>
</tr>
<tr>
<td>CH 7</td>
<td>Green</td>
<td>Art &amp; culture</td>
<td>Health</td>
<td>3</td>
<td>21.4</td>
</tr>
<tr>
<td>CH 8</td>
<td>Red</td>
<td>Health</td>
<td>Art &amp; Culture</td>
<td>4</td>
<td>28.6</td>
</tr>
<tr>
<td>CH 9</td>
<td>Yellow</td>
<td>Social services &amp; relief</td>
<td>Social services &amp; relief</td>
<td>2</td>
<td>14.3</td>
</tr>
<tr>
<td>CH 10</td>
<td>Orange</td>
<td>Education</td>
<td>Education</td>
<td>2</td>
<td>14.3</td>
</tr>
<tr>
<td>CH 11</td>
<td>Red</td>
<td>Health</td>
<td>Religious</td>
<td>3</td>
<td>21.4</td>
</tr>
<tr>
<td>CH 12</td>
<td>Yellow</td>
<td>Social services &amp; relief</td>
<td>Total</td>
<td>14</td>
<td>100</td>
</tr>
<tr>
<td>CH 13</td>
<td>Green</td>
<td>Art &amp; culture</td>
<td></td>
<td>CH 13</td>
<td>1</td>
</tr>
<tr>
<td>CH 14</td>
<td>Green</td>
<td>Art &amp; culture</td>
<td></td>
<td>CH 14</td>
<td>1</td>
</tr>
</tbody>
</table>

Notes: For reasons of confidentiality, the charities and the interviewees are coded so as to guarantee anonymity of the participants involved. CH stands for Charity and colour codes are for the sector of the charity.

3.8 Data Analysis

The study consists of several but related analysis as well as a discussion of the results and their implications. Several analytical techniques are used. As already mentioned, the independent t-test was used to test the non response bias of the responses collected from the survey and Cronbach’s alpha has been used to assess the reliability of the measurement of the scale used in the questionnaire. Descriptive statistical tools were also used to describe the general characteristics of sampled charities. The study also conducted factor analysis using varimax rotation to find out a parsimonious set of distinct, financial and non-financial
performance measures utilised in charities. The Statistical Package for Social Sciences (SPSS) for Windows (version 17) was utilised to analyse data, and is reported in Chapters four to seven. Details of hypotheses development together with detailed descriptions of each analytical component used to support those hypotheses are contained in appropriate chapters.

3.9 Summary

This chapter has discussed the research paradigm stance. This was followed by the outline of the research design, the preparation of the survey as well as the interviews, and the pre-testing of the questionnaire. The chapter also discussed issues related to procedures of data collection, sampling issues, decisions regarding the distribution of the questionnaires, the presentation of the sample characteristics, validity and reliability of the data and finalised with data analysis procedures. Secondary data like financial statements were also collected from charities reports on the websites of the organisations involved. Primary data collection, which constitutes the main purpose of the field of the study, was gathered via a cross-sectional survey using a questionnaire and semi structured interviews with senior managers from large UK charities. A listing of these charities was obtained from two online sources, CharitiesDirect.com and Charity commission website which are established by law as the regulator and registrar of charities in England and Wales. From the survey, 105 usable questionnaires were received after one reminder, representing a response rate of 21%. 14 charities participated in the interviews. As the questions were strategic in nature, upper level managers who were key decision makers of charities were targeted.
Therefore, the data from both questionnaire and interviews represent the perceptions of managers in charities. The study has used appropriate statistical tests to find out the levels of significance of results.

After discussing and justifying the methodological choices for this research, the next chapter examines the determinants of executive compensation in UK charities.
Chapter 4

Determinants of Executive Compensation: An Examination of the UK Charities

4.1 Introduction

The issue of executive compensation has produced a vast amount of literature in the past three decades. The interests stem from the recognition that the compensation of executives is a key motivation factor which in turn influences, to a large degree, the overall direction of the organisation (Finkelstein and Hambrick, 1989 and Hoskisson, Hitt, Turk, and Tyler, 1989). However, what is striking about the research on executive compensation is the disproportionate concentration on for-profit organisations compared to nonprofit making organisations (see Gomez-Mejia and Balkin, 1992; Sanders, 2001; Benson and Hornsby, 2002; Vafeas, 2003; Caranikas-Walker et al, 2008). Given the massive differences between the nature, purpose, financial structure and ownership of profit and nonprofit organisations, one would expect an equal devotion of empirical efforts to nonprofit organisations. In fact, Mason (1996) argues that, nonprofit often operate in non-competitive environments, benefit from tax exemption and charitable contributions, therefore; paying managers high levels of pay that rival those in business for profits would be highly controversial. It would not only undermine public trust but may lead to the tendency for funds to be diverted to pay compensations at the expenses of fulfilling their organisations’ missions (Frumkin and Keating, 2001).
Another salient point is that, high levels of compensation defeat the basis of the formation of these organisations. For example, researchers such as Hansmann, (1980); and Jobome (2006) assert that, any attempt to increase pay levels in these organisations should consider the specific organisational and motivational issues which have been the bedrock and other pertinent characteristics such as altruism associated with managers working for such organisations. On the other hand, it may be argued that given the difficulty in attracting the right calibre personnel to nonprofit making organisations, these organisations must be prepared to spend uncompromisingly to attract and retain top capable and skilled human resources (Pappas, 1995; Drucker, 1992). This debate is against the backdrop that, who and what determines the CEOs pay in charities remains largely unexplained (Akpeti, 2001). Researchers such as Gray and Benson, 2003; and Brickley et al, 2004 support the above assertion by pointing out that empirical studies focusing on executive pay determinants in US nonprofit have only recently emerged. Jobome (2006) re-echoes similar views and points out that the evidence on executive pay and performance in the UK nonprofit organisations is scarce. This study attempts to extend the few prior studies on the determinants of executive pay in the UK charities. We pursue this goal by submitting the key constructs previously identified in the literature to a rigorous test via a survey of the opinions of CEOs of the UK large charities instead of just using secondary, thereby providing a strong conceptualisation of executive compensation in nonprofit organisations.
4.2 Hypotheses Development

4.2.1 The Sector of the Organisation

Research evidence on executive compensation suggests that executive pay levels vary by industry. For example, Joskow, Rose, and Shepard (1993) show that CEOs in regulated industries earn less than those in unregulated industries. This is consistent with Hallock’s findings that salaries are highest in medical research, general and rehabilitative health industries, and lowest in religious and housing and shelter industries. Oster (1998); Twombly and Gantz (2001) find that hospitals give their executive directors the highest compensation packages followed by the higher education while social services give the smallest. This is because nonprofit hospitals and health related institutions particularly in the USA engage in relatively substantial competition for employees with for-profit institutions, while social service and religious organisations do not (Preston, 1989). However, in the UK; there seem to be no such direct competition between UK business firms and the charities; therefore, Oster (1998); Twombly and Gantz (2001)’s findings may not be directly applicable to the UK charities. In the UK, Jobome, (2006) found that charities operating in the health sector paid their CEOs more and he attributed it to the fact that these organisations are relatively more able to generate resources for their causes due to their direct relevance to public health and also that their organisations’ work tends to be heavily supported by legacies (Framjee, 2004). This renders support to the resource-based explanation.
In the stewardship construct however, the manager will make decisions in the best interest of the organisation, putting collectivist options above self-servicing options. Davis, Schoorman and Donaldson, (1997) argue that, senior executives act as stewards for the organisation and in the best interests of the principals. If this is the case, then an organisational sector should have no significant effect on CEO pay as managers have a commitment to organisational goals. It is therefore, expected that CEO pay would not be driven by the sector. In the light of the above, this study hypothesises that:

**Hypothesis 1: Executive compensation will not be influenced by sector of the organisation.**

4.2.2 Organisational Size

Economic theory also provides a rationale for the pay-for-size association. Roberts (1959) argued that individuals get paid according to their marginal productivity (their impact on the organisation’s total output). Even a small percentage gain, in an extremely large organisation, would justify a substantial pay differential for the top executives. Since executives’ impact increases with the size of the organisation, one would expect to find the high correlations between compensation and size reported in the literature.

Researchers such as Meyer and Rowan, (1977); Scott, (1995); Zucker, (1988) support this line of reasoning and suggest that organisational size provides legitimacy for high executive pay. Frumkin (2002) also suggests that, large organisations typically can acquire more exposure, have higher reputation, and are
regarded as more effective because of the scale of their activities. As a result, managers can and do receive large compensation packages in larger firms because they are generally judged as worthy and entitled to earn more. While a number of studies has rendered support for the positive relation between organisation size and CEO pay, (see Eldenburg and Krishna, 2003; Finkelstein and Hambrick, 1989; Chalmers et al, 2006; Magnan et al, 1995; Kuskiut, 1989; Deckop, 1988: Jones, Kato 1996), studies such as Boyd, (1994); Lambert et al (1991) have rendered support for the weak relation between CEO compensation and firm size measured by sales. However, it should be pointed out these studies were in the context of for-profit organisations. The only study in the UK that has examined the size and pay association is that of Jobome (2006). Given the conflicting views in respect of size-pay association, further studies appear warranted. The study, therefore, hypothesises that:

**Hypothesis 2: Organisational size will positively impact on executive compensation in the UK charities.**

### 4.3 CEO’s Characteristics and Executive Pay

Prior studies have suggested the relationship between executive compensation and CEO characteristics (see O’Neill, 1997; Frey 1997; Jegen, 2001 and Jobome, 2006). These studies use three broad theoretical perspectives, namely, human capital theory, the stewardship view and resources based view to explain the link between executive compensation and CEO characteristics. We explore below these theoretical perspectives and their links with CEO pay.
4.3.1 Human Capital Theory

The human capital of the executive may have a significant effect on the levels of compensation. It is thus argued that, better educated and more experienced executives perform better and consequently it leads their organisations to high performance levels. However, highly qualified CEOs may demand a premium in the labour market because they have more employment opportunities elsewhere (Gray and Benson, 2003). Human capital theory suggests that CEOs have a crucial task in the achievement of the organisation by improving performance, growth, prosperity and market positioning. Therefore, CEO pay should be designed to acknowledge the individual contribution of a CEO as a wealth creator, for the loyalty to the organisation, and the demands of the job, as well as the relative worth in the labour market (O’Neill, 1997; O’Neill and Lob, 1999). In this context, CEOs reward package should reflect the need to attract and retain these key decision-makers, (O’Neill, 1990; Henderson, 1995; Hill, et al 1994).

4.3.2 Stewardship View

The stewardship theory perceives the executive manager to be far from being an opportunistic shirker, but the one who in essence wants to perform a worthwhile job, to be a trustworthy steward of the company resources. Davis et al (1997) delineate characteristics which distinguish the stewardship theory from agency; these include among other things, trust, actors with a focus on self-actualisation, serving the collective goal of the organisation (no conflict of interest assumed), intrinsically motivated, and having high-value commitment and a long-term orientation (Oslo, 2005). The stewardship view recognises intrinsic motivation
and argues that nonprofit managers tend to have a high level of altruism and that increasing pay levels in the nonprofit sector could lead to monetary incentives crowding out altruism and attracting the wrong managers. For example, Third Sector, (2003) argues that the charity chief executives should be motivated by their cause and be prepared to be paid little or nothing at all. In practical terms, this might mean keeping the sector’s managerial pay low (relative to public). This line of reasoning is consistent with Frey and Jegen (2001); Jegers and Lapsley (2003) who both caution about the effects of transference of the business sector practices to this sector and the possibility of monetary incentives crowding out intrinsic motivation in order to attract the right manager (Hansmann, 1980). Simply put, stewardship theory recognises intrinsic motivation and it predicts a weak relationship between tenure and pay (Jobome, 2006). Thus, the adoption of constraining devices such as corporate governance codes and agency-prescribed small boards should have no significant effect on CEO pay. Therefore, neither financial performance nor governance restraints should be related to CEO pay in this stewardship model (Jobome 2006).

### 4.3.3 Resources Based View

The resource based view highlights that the growth in the sector’s role has led to greater expectation for high quality professional service and competition for skilled workers. There is therefore, a need for the sector to adopt its monetary incentives and compensation (Jobome 2006). In fact, (Third Sector, 2004) cites the level of pay as the biggest issue behind staff turnover, and this may partly explain why 75% of charities experience difficulties in filling some vacancies. This should
be regarded as a critical matter, mainly in a progressively ever changing environment characterised by globalisation, competition and intricacy (O’Neill and Clarke, 1990). Against this backdrop, the study argues that charities should set high monetary incentives for executives. Using resource-based arguments, better qualified and experienced CEOs would be paid more, because they provide better human resource for the organisation, in which case CEO qualifications, experience and age would exhibit positive relationships with pay. In the light of the above discussions, the study hypothesises that:

Hypothesis 3: There is a positive relationship between CEO’s qualifications and pay.

Hypothesis 4: There is a positive relationship between CEO’s experience and pay.

Hypothesis 5: There is a positive relationship between CEO’s tenure and pay.

4.4 CEO Duality and Executive Pay

CEO duality, the practice of one person serving as both the CEO and chairperson of the board of directors, has been the subject of debate and numerous studies for the last two decades (e.g. Dalton et al, 1998; Lorsch and MacIver, 1989; Millstein, 1992; Pound, 1992; Pi and Timme, 1993; Brickley, et al, 1997). Managerial power theorists and advocates of board reforms believe that the dual position of the CEO will result in them having considerable informal stature and heightened formal authority over the board (Harrison et al, 1988; Rechner and Dalton, 1991; Crystal, 1991 and Vance, 1983), thereby limiting their ability to monitor setting of the CEO’s pay. Consequently, studies (for example, Cyert, Kang and Kumar, 2002;
Core, Holthausen and Larcker, 1999) found that CEO pay is 20–40 percent higher if the CEO is the chairman of the board. Apparently, the above evidence indicates that managerial power affects pay arrangements in the way predicted by the managerial power approach, thereby supporting the agency view. As a result, in the UK, this has prompted several reports aiming to correct this corporate governance problem. The recent (2003) version of the Code combines the Cadbury and Greenbury reports on corporate governance, the Turnbull Report on Internal Control (revised and republished as the Turnbull Guidance in 2005), the Smith Guidance on Audit Committees and elements of the Higgs Report which have helped focus attention on the importance of corporate governance issues. Their recommendations included adopting a clear division of responsibilities between the chairman, who is in charge of the board, and CEO of an organisation, whose main concern should be running the business. Thus, it implies that these two roles cannot be fulfilled by the same person (The Combined Code 2003). Core et al (1999) suggest that firms facing greater agency problems are more likely to have higher-paid CEOs, indicative of large managerial power and entrenchment. Therefore, organisations that adopt governance mechanisms which curtail managerial power and agency problems should also pay their CEOs less.

On the contrary, a conflicting theoretical perspective regarding the benefits and costs of CEO duality supports the stewardship theory, and seem to suggest that CEO duality provides an integrated strategic leadership at the top of the firm, which helps ensure the presence of strong leadership (Boyd, 1995). In addition, it might also be both a structural and psychological empowerment of the CEO,
which encourages the CEO to better serve the firm and its shareholders (e.g., Davis et al, 1997). As far as charities are concerned, Jobome (2006) noted that they do not have many of the governance mechanisms that for-profit firms rely upon (e.g. prescriptive corporate governance codes, shareholder pressure, takeover market, creditor pressure). Nevertheless, they keep management pay low relative to other sectors, contrary to the classic agency treatise, because CEOs in charities do not seem to take advantage of their position, but they behave altruistically and are intrinsically motivated. Given the altruism and intrinsic motivation nature of the sector (Jobome 2006 and Frey 1997), this study therefore, hypothesises that:

Hypothesis 6: There is no relationship between CEO’s duality and executive pay.

4.5 Data Analysis

To examine the hypothesised relationship, correlation coefficients were computed first, and we further employed multiple regression analysis to test the hypotheses discussed above.

4.6 Dependent Variable CEOPAY

The dependent variable the CEOPAY was operationalised as the log of the base salaries only (over a 12 month period). The measures of CEO pay widely used in the literature include total remuneration, salary only, salary plus benefits, and bonuses. This study uses total CEO remuneration (base salary), mainly because, unlike in the U.S., pay components such as benefits and bonuses are not publicly reported separately. Base salary represents a fixed element of total compensation, while bonuses are determined by some performance measures (Gomez-Mejia,
Moreover, bonuses are a small fraction of charities CEO remuneration in the UK.

4.7 Measurement of Independent Variables

An explanation of each independent variable is given below.

4.7.1 Organisational Characteristics

The variables used to measure organisational characteristics are: the size of the organisation (SIZE) and the sector in which the organisation operates or the nature of the organisation (SECTOR).

4.7.2 SIZE (Size of the Firm)

In this study, the number of employees denotes the size of the organisation. A simple rationale behind this is that, previous executive pay literature measures firm size by such variables as market value, book value of assets, and number of employees (Murphy, 1985; Finkelstein and Hambrick, 1989; Kostiuk, 1990; Lambert, Larker, and Weigelt 1991). In this study, size was classified according to the international accounting standards, which states that organisations with up to 250 employees are small organisations and those with over 250 employees, are therefore, classified as large in this study.
Table 4.1

Size of Organisation

<table>
<thead>
<tr>
<th>SIZE</th>
<th>Code</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small organisation: up to 250 employees</td>
<td>0</td>
<td>60</td>
<td>57.1</td>
</tr>
<tr>
<td>Large organisation: more than 250 employees</td>
<td>1</td>
<td>45</td>
<td>42.9</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>105</td>
<td>100</td>
</tr>
</tbody>
</table>

4.7.3 SECTOR (Sector of the Firm)

The SECTOR value has been coded ordinally as follows: Health (1), Art and culture (2), Social services and relief (includes overseas aid) (3), Education (4), Religious (5) and Others denote the following charities: media, museum, sports & recreation and environmental charities (6).

Table 4.2

Sector of the Organisation

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>Code</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>1</td>
<td>16</td>
<td>15.2</td>
</tr>
<tr>
<td>Art &amp; Culture</td>
<td>2</td>
<td>19</td>
<td>18.1</td>
</tr>
<tr>
<td>Social services &amp; relief</td>
<td>3</td>
<td>21</td>
<td>20</td>
</tr>
<tr>
<td>Education</td>
<td>4</td>
<td>21</td>
<td>20</td>
</tr>
<tr>
<td>Religious</td>
<td>5</td>
<td>12</td>
<td>11.4</td>
</tr>
<tr>
<td>Others</td>
<td>6</td>
<td>16</td>
<td>15.2</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>105</td>
<td>100</td>
</tr>
</tbody>
</table>
4.7.4 CEO Characteristics

The proxies comprise the educational qualification of the CEOs (QUAL), their overall experience (EXP) – which is proxies for, the age of the executive and (TENURE) – how long the CEO has been in post as chief executive in that organisation.

4.7.5 QUAL (CEO Qualifications)

The QUAL value has been coded ordinally as follows: Up to degree level (1), Masters/PhD degree (2) and Professional qualification (3) as shown on the table below.

<table>
<thead>
<tr>
<th>QUAL</th>
<th>Code</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to degree level</td>
<td>1</td>
<td>56</td>
<td>53.3</td>
</tr>
<tr>
<td>Masters/PhD degree</td>
<td>2</td>
<td>34</td>
<td>32.4</td>
</tr>
<tr>
<td>Professional qualification</td>
<td>3</td>
<td>15</td>
<td>4.3</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>105</td>
<td>100</td>
</tr>
</tbody>
</table>

4.7.6 TENURE (CEO’s Tenure)

The TENURE value has been coded ordinally as follows: 0 to 5 years (1), 6 to 10 years (2) and Over 10 years (3) as shown on the table 4.5.
### Table 4.4

**CEO’s Tenure in the Organisation**

<table>
<thead>
<tr>
<th>TENURE (in years)</th>
<th>Code</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-5</td>
<td>1</td>
<td>29</td>
<td>27.6</td>
</tr>
<tr>
<td>6-10</td>
<td>2</td>
<td>32</td>
<td>30.5</td>
</tr>
<tr>
<td>Over 10</td>
<td>3</td>
<td>44</td>
<td>41.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>105</td>
<td>100</td>
</tr>
</tbody>
</table>

4.7.7 EXP (CEO’s age)

Experience is proxied by the age of the participating CEOs, and it is recorded within the ranges shown in Table 4.6. Old age does not necessarily mean longer experience as CEO, but it might have some impact on greater human capital accumulation (Jobome, 2006). It is apparent that almost 80% of CEOs who participated are 45 years and over, which might be explained by the fact that CEOs generally need more experience.

### Table 4.5

**CEO’s Experience**

<table>
<thead>
<tr>
<th>AGE</th>
<th>Code</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>25-44</td>
<td>1</td>
<td>27</td>
<td>25.8</td>
</tr>
<tr>
<td>45-54</td>
<td>2</td>
<td>37</td>
<td>35.2</td>
</tr>
<tr>
<td>55 &amp; over</td>
<td>3</td>
<td>41</td>
<td>39.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td>105</td>
<td>100</td>
</tr>
</tbody>
</table>

4.7.8 DUAL (CEO duality)

Based on prior literature, (e.g. Boyd, 1995; Conyon and Peck, 1998; Core et al, 1999; Brick et al, 2006). CEO duality was coded as a dummy variable. A CEO
who also served as the chairperson of the board was coded as 1; otherwise coded as 0.

<table>
<thead>
<tr>
<th>SIZE</th>
<th>Code</th>
<th>Frequency</th>
<th>Percent %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO also chair</td>
<td>1</td>
<td>40</td>
<td>38.1</td>
</tr>
<tr>
<td>Otherwise</td>
<td>0</td>
<td>65</td>
<td>61.9</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>105</td>
<td>100</td>
</tr>
</tbody>
</table>

The discussion of the dependent and independent variables suggest the following model. The model provides an inclusive indication of the determinants of CEO compensation, which includes CEO characteristics (CEO qualification, experience and tenure) and Firm characteristics (Sector and size of the firm) and CEO duality as depicted by the following equation:

\[
\text{CEOPAY} = \alpha + \beta_1 \text{SIZE} + \beta_1 \text{SECTOR} + \beta_2 \text{QUAL} + \beta_3 \text{TENURE} + \beta_4 \text{EXP} + \beta_5 \text{DUAL} + \epsilon
\]

4.8 Results and Discussion

Table 4.7 reports correlation of the independent variables and the dependent variable in this study. Bivariate relationships shown in the Table indicate a correlation of the following independent variables namely, size; CEO tenure, CEO qualification, and CEO’s pay. However, no significant correlation appears in respect of the sector; CEO duality; CEO tenure and CEO pay.
The study conducted multiple regression to predict the determinants of executive compensation. Table 4.8 shows that the $F$-value was significant ($p < 0.01$) and that the regression explained 45% of the determinants of executive compensation. The Table indicates support for the following independent variables: size ($p<0.01$); CEO qualifications ($p< 0.01$) and CEO tenure ($p<0.05$) rendering support for hypothesis 2; 3 and 5. From the examination of Table 4.9, we can conclude that size has a strong, positive impact on executive pay providing a support for previous work, (for example, Rosen, 1982; Agarwal 1981; and Frumkin and Keating 2001) which suggests the size of their organisation determines executive compensation. To further analyse the magnitude of size effect compared with other independent variables, the study found that size has the largest effect on executive pay. This finding supports the study by Werner, Katz and Gomez-Mejia (2000) concluded size accounts for about 40 percent in the variation of executive pay.
### Table 4.8

**Multiple Regression Results**

<table>
<thead>
<tr>
<th>Variables</th>
<th>Beta</th>
<th>t- value</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>-1.025</td>
<td></td>
</tr>
<tr>
<td><strong>Organisational characteristics</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sector of the organisation</td>
<td>.038</td>
<td>.496</td>
</tr>
<tr>
<td>Size of organisation</td>
<td>.394</td>
<td>4.056***</td>
</tr>
<tr>
<td><strong>CEO characteristics</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO experience</td>
<td>.024</td>
<td>.313</td>
</tr>
<tr>
<td>CEO qualifications</td>
<td>.282</td>
<td>2.933***</td>
</tr>
<tr>
<td>CEO Tenure</td>
<td>.175</td>
<td>2.363**</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>.119</td>
<td>1.317</td>
</tr>
<tr>
<td>R Square</td>
<td>0.485</td>
<td></td>
</tr>
<tr>
<td>Adjusted Square</td>
<td>0.453</td>
<td></td>
</tr>
<tr>
<td>F-value</td>
<td>15.369***</td>
<td></td>
</tr>
<tr>
<td>Number of cases</td>
<td>105</td>
<td></td>
</tr>
</tbody>
</table>

Notes: Beta denotes Standardised regression coefficient of the variable in the model. Significance Level: ****, ***, * means significant at p< 0.01, p< 0.05; and p< 0.1 levels respectively.

The finding that organisation size impacts on executive pay appears not surprising in that firm size is perceived as a proxy for organisational complexity (Agarwal, 1981) and management of complex organisations places greater demands on the executive by virtue of the scope of its activities compared with smaller and simpler organisations. Hence executives may be rewarded for taking up difficult and complex jobs (Hallock, 2002). The results indicated that the sector of operation had no impact on executive pay, thereby supporting the first hypothesis.

The result also suggests positive and significant relationship between the CEO qualification and CEO’s pay (p<0.01) and renders support to hypothesis 3. This finding is consistent with extant research, which acknowledged that, better
educated CEOs lead to better organisational performance. This result supports the human capital theory argument, which views increased wage variation as a function of better education in that highly qualified and trained executives tend to perform well leading to higher organisation performance (Barkema and Gomez-Mejia, 1998 and Leonard, 1990). The results also show that tenure of the CEO has a positive significant impact on CEO pay (p<0.05). Jobome (2006) also found similar results and the positive effect seem to be credible in a resource-based interpretation where tenure is regarded as increasing CEO proficiency on the job.

The finding that CEO’s experience (proxied by CEO’s age) has no significant impact on CEOs pay appears surprising in that it was expected that experience should be positively associated with CEO pay, however; this appears not to be the case. However, the results support the stewardship view that the compensation of altruistic managers should not be determined by their experience (Jobome, 2006). In sum, the three human capital measures used in this study, namely, qualification, tenure and experience appear to indicate no clear and unequivocal relationship between human capital and executive compensation in the UK charities.

The findings also indicated that there was no relationship between duality and executive pay, rendering support to hypothesis 6. However, the result regarding CEO duality is not surprising and it renders support to the fundamental premise of stewardship theory, which maintains that CEOs in charities are good stewards of the organisations who are altruistic and trustworthy and can therefore, be trusted not to indulge in pay excesses (Jobome 2006).
4.9 Summary and Conclusion

There has been substantial research on the determinants of CEO compensation in the context of profit-making organisations, yet relatively very little research exists on this subject on not-for profit making organisations. This study makes a contribution in this direction, by examining the determinants of CEO pay in the UK charities, which have witnessed a substantial growth since the assumption of power by the labour government over a decade ago. The findings suggest that three factors play a significant role in determining executive compensation in the UK charities. They are size of the organisation, the qualifications and tenure of the CEO. A fundamental conclusion emanating from this study indicates that organisation size accounts for single most crucial determinant for CEO pay in the UK charities compared with variables such as qualification, experience, tenure and CEOs duality. The results may be explained by the fact that organisation size represents complexity which involves a more demanding tasks, and management of such difficult tasks to achieve overall goals of the organisation. This requires people with the right education and training to meet the challenging tasks. An alternative explanation as to why size is the most decisive factor is the prestige associated with running of large organisations. The implication of this result is self evident indicating that size is a single decisive factor influencing CEO pay for the UK charities. Another conclusion to be drawn from this study is that human capital variables, such as CEO qualifications and tenure have a positive and significant influence on the executive compensation, CEO experience appears to have no significant influence of executive pay. Another conclusion from this study is the
insignificance of the sector of the charity to executive pay. Although the findings are at variance with the conclusions drawn by Oster (1998); Twombly and Gantz (2001) and Jobome (2006) that sectoral affiliation and operating in a health sector has a positive impact on executive pay, they support the altruistic nature of the sector (Frey, 1997). However, this study suggests that a better understanding of the relationship between the sector of firms and executive pay of charities may be required.

The results also indicated that CEO duality had no significant impact on executive pay. A fundamental conclusion emanating from this study indicates that dual leadership structures are not significantly associated with executive pay in charities; all of which are consistent with a pattern of the intrinsic motivation of charities managers.

The next chapter examines the performance measures used in the UK charities.
Chapter 5

Measures of Performance used in the UK charities

5.1 Introduction

The subject of organisational performance is a decisive yet elusive one because of the dilemma of how to measure performance. Different parties can assign different meanings to performance, and meanings can vary from customer to customer and from citizen to citizen (Stewart and Walsh, 1994). Researchers such as Oster, (1998); Speckbacher, (2003) and Hallock, (2002) argue that it is because nonprofit organisations are built around wide-ranging and complex missions with varied and diverse constituents. Belle-Rose (2002) encapsulates the above into the following statement:

*When one considers that nonprofit organisations activities involved in everything from the environmental protection, health issues, education, arts and economic development, it is easy to understand the difficulty. There are no universal bottom lines* (Bell-Rose, 2002: 273).

It is well documented in the extant literature that it is difficult to define and operationalise what performance is (see Stewart and Walsh, 1994; Boateng and Glaister, 2002). “The dilemma of performance management in the public domain therefore, is to secure effective performance when the meaning to be given to it can never be perfectly defined, and the criteria by which judgement can never be finally established” (Stewart and Walsh, 1994:45). Despite the problems associated with measuring performance, Likierman, (1993) pointed out that
performance measures allow the charitable sector to justify its existence. To Connolly and Hyndman, (2004), “Unless performance measures are in place it is difficult for the charitable sector as a whole or for individual charities in particular to counter criticism for poor management and ineffectiveness”. Measuring performance in charitable sectors is very important to the stakeholders who often provide resources for such organisations to function, without demanding the payment of cash dividends, compared to profit making organisations. Despite the importance of performance measures in charities sector, the Strategy Unit report (2002) points out that there has been inadequate attention all over the charitable and non-for-profit sector on measuring and improving performance. Against this backdrop, it is necessary to examine measures of performance and provide an all-inclusive picture of the key components of measures of performance in charities. This chapter attempts to examine measures of performance used in the UK charities using both interviews and survey approaches. The main research question of this study is:

What measures performance in the UK charities?

The next and final section of this chapter discusses the analytical techniques and the findings.

5.2 Data Analysis

To address the above research question both interview and the survey were carried out to obtain in-depth information regarding what measures performance in the UK charities. For the qualitative data from the interviews, the responses were classified, summarised and organised into sets of meaningful categories. The
researcher analysed the responses from 14 respondents and coded the responses. A coding system applied to each response was based on a scale of 1–3, e.g. 1 = Significant; 2 = Moderate and 3 = not significant (see table 5.3). For example, some key phrases, such as “very influential”, “very important”, “a significant measure”, “definitely”, “substantial” were categorised as evidence of rating their perceptions as “significance”, while respondents’ comments such as, “to some extent”, “should be”, “in some cases”, “play certain roles” are grouped as “moderate”. However, phrases like, “not really”, “we do not use that” or “it is not applicable” were grouped as “not significant”. Table 5.1 shows the frequency of performance measures used in the UK charities.

**Table 5.1**
Frequency of Performance Measures used in UK charities

<table>
<thead>
<tr>
<th>Performance Measure</th>
<th>Significant No</th>
<th>Significant Percentage</th>
<th>Moderate No percentage</th>
<th>Not Significant No</th>
<th>Not Significant Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue growth</td>
<td>(4)</td>
<td>28.6%</td>
<td>(5)</td>
<td>35.7%</td>
<td>(5)</td>
</tr>
<tr>
<td>Programme Spending</td>
<td>(12)</td>
<td>85.7%</td>
<td>(0)</td>
<td>0%</td>
<td>(2)</td>
</tr>
<tr>
<td>High level of fundraising</td>
<td>(8)</td>
<td>57.1%</td>
<td>(2)</td>
<td>14.3%</td>
<td>(4)</td>
</tr>
<tr>
<td>Adequate working capital</td>
<td>(6)</td>
<td>42.9%</td>
<td>(6)</td>
<td>42.9%</td>
<td>(2)</td>
</tr>
<tr>
<td>Quality of Product/Service</td>
<td>(9)</td>
<td>64.3%</td>
<td>(3)</td>
<td>21.4%</td>
<td>(2)</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>(7)</td>
<td>50%</td>
<td>(5)</td>
<td>35.7%</td>
<td>(2)</td>
</tr>
<tr>
<td>Community involvement</td>
<td>(2)</td>
<td>14.3%</td>
<td>(5)</td>
<td>35.7%</td>
<td>(7)</td>
</tr>
<tr>
<td>Efficiency</td>
<td>(7)</td>
<td>50%</td>
<td>(4)</td>
<td>28.6%</td>
<td>(3)</td>
</tr>
<tr>
<td>Employee Satisfaction rates</td>
<td>(4)</td>
<td>28.6%</td>
<td>(6)</td>
<td>42.9%</td>
<td>(4)</td>
</tr>
<tr>
<td>Donor Sustainability</td>
<td>(6)</td>
<td>42.9%</td>
<td>(5)</td>
<td>35.7%</td>
<td>(3)</td>
</tr>
<tr>
<td>Competitors’ performance</td>
<td>(7)</td>
<td>50%</td>
<td>(5)</td>
<td>35.7%</td>
<td>(2)</td>
</tr>
</tbody>
</table>
The interview results indicate that an overwhelming majority, that is (12) about 86% of the respondents regard ‘programme spending’ as the most important performance measure. This is followed by ‘Quality of service’ with (9) over 64%; ‘fundraising’ 8 (57.1%) while (7) 50% of the participants suggest that ‘efficiency’ and ‘customer satisfaction’ and ‘competitors’ performance’ are also key performance measures, (6), about 43% of the respondents used ‘donor sustainability’ and ‘adequate working capital’ as important performance measures and (4) 28.6% used ‘employee satisfaction rates’ and ‘revenue growth’ as performance measures. Only (2) 14.3% used ‘community involvement’ as a criterion to measure performance.

For the survey, the respondents were questioned about their opinions on different performance measures used by charities in the UK. Respondents assessed 23 performance measures perceived to be crucial to performance objectives of the charitable organisations on a 5 point Likert-type scale (1 = “not at all important”; 5 = “very important”). Cronbach’s Alpha for each of the factors ranged from 0.928 to 0.933 which is well above the threshold of 0.70 suggested by Hair et al, 1998. (Please see Appendix 5). The performance measures used by the UK charities were tested by considering differences in means of the relative importance of the measures. Given the fairly large sample size, it was reasonable to assume that the sample is from a normal distribution and therefore Friedman two-way Anova test was therefore implemented.

Table 5.2 shows the rank order of factors used to measure performance in the UK charities, based on a mean measure of the importance of 23 factors. Scores are
significantly different on the Friedman two-way Anova test ($p < 0.001$). For the 23 performance measures, the median value of 3 is exceeded by 15 criteria being the most important ones. However, it is important to point out all the measures were statistically significant ($p<0.01$).

**Table 5.2: Relative Importance of Performance Measures in UK Charities**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Performance Measures</th>
<th>Mean</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Programme spending</td>
<td>4.95</td>
<td>0.50</td>
</tr>
<tr>
<td>2</td>
<td>Quality of product/service</td>
<td>3.90</td>
<td>0.83</td>
</tr>
<tr>
<td>3</td>
<td>Customer satisfaction</td>
<td>3.80</td>
<td>1.01</td>
</tr>
<tr>
<td>≥4</td>
<td>High level of fundraising</td>
<td>3.70</td>
<td>0.90</td>
</tr>
<tr>
<td>≥4</td>
<td>Accountability</td>
<td>3.70</td>
<td>0.94</td>
</tr>
<tr>
<td>6</td>
<td>Output</td>
<td>3.59</td>
<td>0.94</td>
</tr>
<tr>
<td>7</td>
<td>Efficiency</td>
<td>3.54</td>
<td>0.94</td>
</tr>
<tr>
<td>8</td>
<td>Competitors’ performance</td>
<td>3.51</td>
<td>0.96</td>
</tr>
<tr>
<td>9</td>
<td>Board involvement</td>
<td>3.46</td>
<td>0.92</td>
</tr>
<tr>
<td>10</td>
<td>Revenue growth</td>
<td>3.43</td>
<td>0.98</td>
</tr>
<tr>
<td>11</td>
<td>Diversification of revenue sources</td>
<td>3.39</td>
<td>0.81</td>
</tr>
<tr>
<td>12</td>
<td>Donor sustainability</td>
<td>3.33</td>
<td>1.01</td>
</tr>
<tr>
<td>13</td>
<td>Percentage of earned income</td>
<td>3.18</td>
<td>0.83</td>
</tr>
<tr>
<td>14</td>
<td>Adequate working capital</td>
<td>3.13</td>
<td>0.90</td>
</tr>
<tr>
<td>15</td>
<td>Employee satisfaction</td>
<td>3.01</td>
<td>0.90</td>
</tr>
<tr>
<td>16</td>
<td>Investments performance</td>
<td>2.98</td>
<td>0.89</td>
</tr>
<tr>
<td>17</td>
<td>Employee turnover rates</td>
<td>2.97</td>
<td>0.90</td>
</tr>
<tr>
<td>18</td>
<td>Improve skills (number of people trained)</td>
<td>2.95</td>
<td>0.95</td>
</tr>
<tr>
<td>19</td>
<td>Community involvement</td>
<td>2.87</td>
<td>1.01</td>
</tr>
<tr>
<td>20</td>
<td>Job Creation</td>
<td>2.78</td>
<td>0.92</td>
</tr>
<tr>
<td>21</td>
<td>Technology competency ratings</td>
<td>2.58</td>
<td>0.97</td>
</tr>
<tr>
<td>22</td>
<td>Percentage of board members as donors</td>
<td>2.32</td>
<td>1.00</td>
</tr>
<tr>
<td>23</td>
<td>Board meeting attendance</td>
<td>2.30</td>
<td>0.92</td>
</tr>
</tbody>
</table>

Notes: $N=105$;
The mean is the average on a scale of 1 (=‘not important at all’) to 5 (=‘very important’).
SD = Standard Deviation
Scores are significantly different on the Friedman two-way Anova test ($p < 0.001$).

The highest ranked performance measures are: programme spending (4.95), quality of product/service (3.90), customer satisfaction (3.80), high level of fundraising (3.70), accountability (3.70), Output (3.59), efficiency (3.54), competitors’ performance (3.51), board involvement (3.46), revenue growth
(3.43), diversification of revenue sources (3.39), donor sustainability (3.33), percentage income earned (3.18), adequate working capital (3.13) and employee satisfaction (3.01). It is clear from the Table that, most of the performance measures found from the survey correlated with the interview results confirming the measures are important for measuring performance in the UK charities. The findings in Tables largely conform to most important measures of performance identified in the literature. All the measures were perceived to be significant in measuring performance in the UK charities. The measures include both internal and external measures; financial and non-financial measures.

5.3 Discussion of Results
It is also apparent from the table that the three highest ranked performance measures which are programme spending, quality of product/service, customer satisfaction, high level of fundraising, accountability, Output and efficiency are concerned with the effective provision of services which are directly linked to the main purpose and objectives of the charity. It is therefore, not surprising that the performance measures that are ranked high are mainly concerned about the sector’s contribution to the social well-being of its beneficiary and client groups.

The results suggest that programme spending and quality of product/service are ranked as important performance measures in charities using both survey and interview approaches. The finding suggests that the charity is spending its resources on activities directly linked to the achievement of the organisational mission, thus making it a credible performance measure. Other researchers, for
example, Baber et al, (2002); Gold, (1993); Hardman, (1993); Schuman, (1993); Smith; (1993) also pointed out that the ratio of programme expense to income (or the percentage of programme expense to total expenditure) is a performance measure used in charities. The above was also emphasised by the interviewees. Asked why programme spending is regarded as a significant performance measure one participant said, “Of course it is, by spending on activities that help achieve the mission of the organisation; we clearly demonstrate our commitment to the cause of this organisation. Therefore, we have trust from the external agencies that our other decisions are not self-seeking”. Sargeant’s (1999) observation that as competition for funds has heightened among charities, donors regard organisations which spend a large proportion of their donations on the fundamental programmes are considered as better performers. The interviewees from a religious charity concur and pointed out that, “We by all means try to ensure that we spend a large chunk of donations from our donors to the main cause of our mission, and by so doing we assure them we are being faithful stewards of the money they give”. Glaser’s (1994 p.178) confirms these findings in his study and reports that the variable “adequate amount spent per programme” was cited as the second most vital factor in a decision to donate.

Another valuable measure of performance used by the UK charities is quality of service. Most charities shared and recognised this view as key to their success in attracting and keeping both customers and donors. In explaining the relevance of quality of service as a performance measure, one interviewee said,
There is now a tendency by most of the public organisations to measure performance by outputs, which is the amount of ‘activities,’ for instance, number of people served or a pupil attendance at school. While these just tell us something has happened, they do not show whether it successfully achieved its intended goal, or whether the clients had a satisfactory experience.

This is consistent with the views by Belle-Rose (2002) who cautions that, where the measure for performance is outputs, nonprofit managers may be tempted to target clients they can reach easily and with the lowest individual cost instead of the neediest clients with the highest cost per individual. Although the former strategy may prove to be profitable, the latter may produce high social returns. The extant literature also provides some support for quality of service as a significant performance measure in the UK charities. For example, The U.K.’s Quality Standards Task Group (QSTG) has seen the adoption and implementation of quality systems by the voluntary sector as a better way of demonstrating to stakeholders their organisational effectiveness and the standard of their services (Cairns, et al 2005; Barclay and Abdy, 2001; Johnson et al, 1998). As a result, in most of the UK, the voluntary and community sector adopted the quality system as a result of increasing pressure from funders and governmental purchasers of services. However, for other nonprofit organisations, it was a proactive action taken in anticipation of future pressure and to maintain integrity and authenticity as well as to demonstrate how accountable they are to a diversity of stakeholders. (Cairns et al, 2005). However, despite the perceived benefits of quality of service as a measure, it is not surprising that still some charities are finding it challenging
to implement the idea. For instance, one respondent commented, “Well, measuring quality is not as easy as it sounds. The problem is different aspects of quality matter to different people at different times, so to reconcile that is no easy task. Our main concern is to develop reasonable measures that approximate what we are trying to achieve”.

The results also suggest that customer satisfaction is among top ranked measures of performance. This finding is consistent with the observation made by Chrisman, Hoy, and Robinson (1987); Chrisman and Katrishen (1994) who pointed out that customer satisfaction is a primary indication of organisational effectiveness. Most of the respondents highlight the importance of knowing the needs and expectations of the customers, because meeting them, would not only lead to more satisfied customers, but, essentially, resulted in the provision of services more efficiently and effectively.

Another intriguing finding is the level of fund raising. About 60 percent of the respondents views high level of fundraising as a key performance measure used by UK charities. This finding appears consistent with the views of (Frumkin and Keating 2001); they suggest that, as a proxy for mission fulfilment, fundraising results provide a simple measurement metric that is straightforward to follow yearly. The ability to raise huge funds is also often regarded as an indication of the effectiveness of the organisation. Most interviewees agree that raising vast amounts of funds give them the flexibility to spend on the programmes required to fulfil their mission. It is, however, worth noting that some interviewees who
suggest that fundraising is not a significant performance measure at all but for
decidedly different reasons. One participant gave the following response:

*We have a stable funding base already, and we do not rely on the funds we
raise to survive. We therefore, do not measure our performance by how
much fund we raise, but the issue rather, is on how we spend the funds that
we have by the end of the each year.*

Yet another respondent said: “As much as we use the funds we raise to achieve
our goals, we, however, do not regard fundraising as a measure of effectiveness,
but rather as a means achieve effectiveness”.

The study finds efficiency as an important measure of performance. In this study,
the term ‘efficiency’ was not used as a ratio of outputs to inputs, but as a
perception of smoothly, coordinated working practices and effectively organised
processes (Mistry, 2007). Most interviewees suggest that being efficient means;
short waiting time by clients, swift response to letters and queries, staff’s proper
preparation and communication skills as well as the regularity of feedback after
receiving services. Another director said their clients made reference to the same
internal processes, when describing how the quality of service delivery and these
elements fed into the fostering of a sterling reputation, which enhanced satisfaction
on the part of the recipient. Another interviewee said;

*We used to get lots of complains from our customers for lack of efficiency.
The reason was we were short of staff due to limited financial resources.
Now that we know how much that means to our clients, and we strive to
raise more funds as well as getting volunteers to fill in the gaps, so we can*
cut our clients’ waiting times. So we measure how well we are doing by the efficiency of our staff.

It is also apparent from table 5.2 that competitors’ performance (benchmarking) is also a relevant performance measure in charities. Gamble, (2008) defines benchmarking as a way of ‘comparing performance and practice to learn and improve’. It was not surprising that 50 percent of interviewees agreed that they used benchmarking as a measure of performance. This is consistent with Gamble, (2008)’s survey findings of UK charities, which reported that, the use of benchmarking as a performance measure within the sector is still minimal, after only a quarter of his survey respondents asserted that they were using it for performance improvement. In this study, some of the directors interviewed highlighted they benchmark themselves with similar organisations in areas like personnel staffing, retention, composition of the employees including diversity issues, appraisal and salary strategy, governance processes, to mention a few, some of which have also been highlighted by Gamble, (2008). One CEO commented that benchmarking is increasingly becoming a critical performance measure as it helped the organisations to have the reassurance about what they are doing well, as well as helping in determining course of action and in setting pragmatic goals, and gaining insights into ethical practice.

It is hardly surprising that most interviews chose donor as a crucial measure of performance in the UK charities. According to Krishnan, Yetman and Yetman (2006) donors have an implicit contract with nonprofit organisations in that donors provide funding in exchange for better services for recipients. Accounting
information can assist donors monitor and evaluate whether the nonprofit organisations is using their contributions efficiently and effectively to achieve the organisational mission. Therefore, if a charity can sustain its donors, it indicates that the donors’ approval of use of their donations. Given the fact that Sargeant and Jay, (2004) observe that due to economic recession, giving in nonprofit organisations has decreased, yet competition has increased, and donor audiences and expectations have changed. Therefore, organisations need to work extremely hard to solicit and maintain the levels of support. This study assumes that charities will do their utmost to continue to appeal to their donors.

The few charities that cited that they used revenue growth as performance measures explained that they did other trading activities within their organisations to raise funds, instead of wholly relying on fundraising and donations. Therefore, revenue growth was tremendously vital to them. Also, community involvement was not used by many as a performance measure. However, those who used it stated that they relied more on volunteers, therefore, the more they got people from the community to volunteer the more they got the assurance that their services were appealing to the community. It is, however, worth noting that exceedingly few studies have previous used these as measures of performance.

In sum, as expected, the results indicated that charities in the UK use both financial and non financial measures of performance thereby supporting views by researchers like Jobome 2006; Cameron, 1981, 1982; Connolly, Conlon, and Deutsch, 1980; Stewart and Walsh, 1994 and Sowa et al 2004). They advocated
that a range of measures is most suited in nonprofit organisations to cope with the multidimensional nature of public service. It was, however, surprising that ‘learning innovation’ one of the measures depicted on the BSC was not popularly used as a measure of performance. All the interviewed charities did not consider the aspects of learning and innovation as pertinent performance measures.

The performance measures used by the UK integrates both financial and non-financial measures as encapsulated in management models such as balanced scorecard (BSC) developed by Kaplan and Norton (1992, 1993, 1996a, 1996b). This study classified the performance measures using all the four components of the balanced scorecard thereby confirming that BSC who was originally developed for profit-making organisations are also applicable for non-profit making organisations. In addition, benchmarking was found to be an important performance for charities in the UK. The finding that BSC constitutes an important performance measure is significant in that BSC provides a more holistic approach to organisational performance. It thus extends the usual essence of performance measurement in finance and accounting literature beyond financial performance, thereby providing a combination of financial and non-financial measures that subject administration and employees operations on accomplishing the organisation’s mission and values. Benchmarking is regarded pivotal particularly in nonprofit organisations because researchers (e.g. Beliveau, O’Reilly and Wade, 1996; O’Reilly, Main and Crystal, 1988) purport that performance strategies in nonprofit organisations are based on a process of social comparison or
benchmarking against rival firms. It also supports the social comparison and equity theory.

The results in respect of performance measures are therefore summarised as follows in the framework below. Overall, the measures include internal and external, financial and non-financial measures.

**Figure 5.1 Framework for Performance Measurement in charities**

- **Customer Perspective**
  - Quality of Product/Service
  - Customer Satisfaction
  - Accountability
  - Community involvement
  - Job Creation
  - % of board members as donors

- **The internal Business**
  - Efficiency
  - Employee Satisfaction rates
  - Output
  - Donor Sustainability
  - Board involvement
  - Board meeting attendance
  - Employee turnover rates

- **Firm Performance (Organisational Mission)**

- **Financial Perspective**
  - Revenue growth
  - Percentage of earned income
  - Program spending
  - High level of fundraising
  - Adequate working capital

- **Innovation & Learning**
  - Technology competency ratings
  - Improve skills (number of people trained)

- **Benchmarking**
  - Competitors’ performance
  - Investments performance
5.4 Summary and Conclusions

As the measurement of performance continues to plague empirical work in nonprofit organisations, this study has sought to shed light on the performance measures used by the UK charities. Furthermore, this study also extends the quantitative studies that have attempted to provide an in-depth knowledge on performance measures in the UK charities by the use of interviews. The findings suggest that four of the five performance measures categories used in this study which are, financial performance indicators, the measures of customer satisfaction; the internal business and benchmarking are widely used in UK charities. However, Learning and innovation is also valuable measure of performance in the UK charities. The conclusion emanating from the study is that, although benchmarking does not appear on the BSC, the results have shown that it is a significant performance measure in charities. Another important conclusion emanating from this study indicates that the performance measures directly linked to charity's main purpose or objectives such as programme activities, efficiency, customer satisfaction quality of service and fundraising ranked in the top. It is, however, apparent that most organisations seem to be conscious of how stakeholders are likely to judge performance in their organisation, and this influences them to a certain extent to choose their performance measures to suit the stakeholders’ expectations (sometimes unknowingly).

The implication here is that, the financial measures of performance that have traditionally dominated previous study need to be complemented with non financial measures, when it comes to measuring performance in nonprofit
organisations. It is also evident that the same performance measures cannot be
generalised across the charities because of their wide ranging and complex
missions with varied and diverse constituents (Oster, 1998; Speckbacher, 2003;
Hallock, 2002). Although the approach taken in this study has not provided
decisive answers to this issue, it has illuminated new avenues for academics and
practitioners to investigate this crucial and enduring subject.

The next examines the managers’ perception on the impact of board structure and
governance on performance measures identified in this chapter.
Chapter 6

Managers’ perception on the Factors Influencing Performance in the UK Charities

6.1 Introduction:

The connection between governance structure of a firm, executive compensation and performance has been extensively studied over the past two decades. However, the bulk of these studies are in the context of profit making firms with relatively little attention being given to the nonprofit sector and charities (Bensen and Hornsby, 2002; Gomez-Mejia and Balkan, 1992; Unite, Sullivan, Brookman, Majadillas and Taningco, 2008). The disproportionate concentration of studies on profit making firms stems from the fact that agency problem appears to be more severe for these firms due to the economic relationship between executive pay and performance, ownership structure and the goal of maximising the wealth of shareholders as reflected in share prices (Jensen and Murphy, 1990; Unite et al, 2008). For example, Jensen and Murphy (1990) pointed out that, with profit making firms, the goal of true measure of performance is increasing shareholder value i.e. measuring firm market value of the firm.

By contrast, Voluntary sector or charities are built around wide ranging and complex missions with varied and diverse constituents (Oster, 1998; Speckbacher, 2003; Hallock, 2002). As a result, it is argued that organisational performance of nonprofit making organisations is not reducible to a single performance measure (Herman and Renz, 1999; Jobome, 2006). Frumkin and Keating (2001) echo
similar views and put forward the three main reasons why performance measurement in nonprofit organisations may be difficult.

“First, there is no owner with an equity stake in nonprofit within the organisation demanding or requiring measurement. Second, there are no bottom lines of profitability or easily quantifiable outcomes that can be used as a benchmark, only the far more ambiguous notion of mission accomplishment. Third, the diffuse nature of ownership and stake holding in the nonprofit sector raises the additional problem of building an accountability system that is consistent and meaningful across the sector (Frumkin and Keating 2001:9).

Yet prior studies in respect of performance of nonprofit organisations (See Frumkin and Keating, 2001 and 2004; Hallock, 2002; Brickley and Van Horn, 2002) have used only financial measures to analyse performance although these organisations may be striving to create something much different from returns to shareholders. For example, Weisbrod and Schlesinger (1986) suggested that the use of profit-based performance measures as opposed to the quality of care, to measure the performance of a manager of a nursing home may be an incentive to provide lower quality of care to the residents. This raises a question of how performance is measured in charitable organisations.

Another important motivation for this study is that prior studies have shown that well-performing boards usually coincide with well-performing organisations (Herman and Renz, 2000). However, while the link between board effectiveness and corporate performance has been explained through agency theory and resource-
based theory, their applicability to charities remains unclear (Coombes et al., 2011). Ostrower and Stone (2006) point out that the lack of studies linking board characteristics with the performance of non-profit organisations has been identified as a research gap that needs to be filled. To understand the role of non-profit boards and their link to performance, the study utilises three theoretical perspectives, namely, agency, stewardship and resource-based theories, to examine the relationship between the board’s characteristics and the organisation’s performance for a group of UK charities.

The researcher in this study believes that a more promising line of measuring performance in nonprofit making organisations should include the use both financial and non-financial measures of performance. The performance measure which integrate both financial and non-financial measures is encapsulated in management models such as balanced scorecard (BSC) developed by Kaplan and Norton (1992, 1996). This study departs from previous studies by using balance scorecard to assess the performance of the UK charities. This is significant in that BSC provides a more holistic approach to organisational performance, and thus, extends the conventional focus of performance measurement in finance and accounting literature beyond financial performance. It therefore, provides a blend of financial and non financial measures that focus management and staff activity on achieving the organisation’s mission and values.

A number of researchers such as Niven, 2003; Trussel and Bitner, 2001 have suggested that BSC can be used for nonprofit organisations because it explicitly
captures non financial performance measures. The BSC views organisational performance from four perspectives which encompasses i) financial - measuring various financial performance indicators of primary interest to shareholders; ii) the customer - comprising measures of customer satisfaction; iii) the internal business process which measures internal efficiency and quality; and iv) the learning and growth which attempts to measure the organisation’s capability to acclimatise to changes required by a turbulent environment. This study uses all the four components of the balanced scorecard. The study extends the performance measures by adding benchmarking which is an important performance metric for charities. This study asks the opinions of Charities’ managers whether board characteristics and CEO pay impact the performance of the UK charities.

The rest of the chapter is structured along the following lines. The next section presents hypotheses of the study. Following that is the findings of the study. The last section provides a summary of the conclusion of the study.

6.2 Hypotheses Development:

6.2.1 Board Size and Organisational Performance:
A number of studies have suggested that large boards are better for corporate performance because they bring into the organisation a range of expertise to help make better decisions, and make it harder for a powerful CEO to dominate (Kyereboah-Coleman and Nicholas Biekpe, 2005; Haleblian and Finkelstein 1993). The view is consistent with the resource dependency theory which suggests that companies are better off with large boards in that large board membership are
likely to provide the firm with greater expertise and access to resources (Zahra & Pearce, 1989). The positive impact of board size on performance has a support from researchers such as Mak and Li, 2001; Adams and Mehran, 2005. A meta-analysis based on 131 studies by Dalton and Dalton (2005) reported that large boards have significant correlation with higher firm performance. On the other hand, researchers such as Jensen, 1993; and Lipton and Lorsch 1992) suggest that large boards are difficult, costly to co-ordinate and in some cases may inflict managerial conflicts thereby exerting negative effect on performance. Lipton and Lorch (1992) further argue that, agency problems may increase, when boards have several members, as some directors may follow along as free-riders and hence poor performance. For example, Yermack, (1996) found small boards to be more effective in large US corporations. Mak and Yuanto, 2003; Sanda et al, 2003 obtained similar findings indicating that, firm performance is positively related with small, as opposed to large boards. Jensen (1993: 865) points out that, “When boards get beyond seven or eight people they are less likely to function effectively and are easier for the CEO to control” and rendering support for small board-performance relationship. These findings are in the context of profit making organisation.

In the context of NPOs, DeFond, Haan and Hu, 2000, and Fich, 2005, argue that size may not be important when it comes to performance but rather that it is the expertise of the board members that matters. In a recent study, Andres-Alonso et al. (2010) find no direct relationship between board size and a foundation’s efficiency. This study argues that NPO’s boards perform complex sets of activities
aside from the monitoring role due to the diverse nature of the stakeholders associated with these organisations. Large boards are beneficial because they bring in resources through networking, fundraising and providing expertise for decision making. However, large boards may lead to co-ordination problems because of the lack of resources in NPOs. Despite these arguments, there is no conclusive evidence regarding how board size influences an organisation’s efficiency (Andres-Alonso et al., 2010). On the balance, the study expects that the size of the board exerts a positive influence on an NPOs performance. The study therefore hypothesises the following:

H1: The board size is positively related to the performance of the UK charities

6.2.2 Board Independents and Organisational Performance:

Duchin, Matsusaka and Ozbas (2010) suggest that an increase in the number of outsiders on the board is viewed with scepticism. It has been acknowledged, at least theoretically, that the effectiveness of outside directors is limited by their inferior information regarding company activities as compared to corporate insiders. In addition, the contention that outside directors cannot effectively monitor and control agency problems has been central to corporate finance research for decades (Fama and Jensen, 1983; Jensen, 1993). Another important argument put forward by the critics of outside directors is that outside directors may “owe their position to management” and thus may not be as independent as assumed (Hart, 1995). For example, according to the Higgs Report (2003), a high level of informality surrounds the process of appointing outside directors.
According to the report, almost half of the non-executive directors surveyed for the report were recruited to their role through personal contacts or friendships; only 4% had a formal interview, and only 1% obtained the job through answering an advertisement. Among the studies which investigated the relationship between the proportion of outside directors on the corporate board and firm performance, Yermack (1996) reports a significant negative correlation between the proportion of independent directors and the contemporaneous Tobin's q. Forsberg (1989) found no relationship between the proportion of outside directors and various performance measures. However, Pearce and Zahra, 1992, and Millstein and MacAvoy, 1998, document a positive correlation between the proportion of outside directors and the firm’s financial performance. Dalton, Daily, Ellstrand, and Johnson (1998) cover the area well in their meta-analysis study, which included 159 studies covering 40,160 companies over more than 40 years. They concluded that empirical work in this area does not provide consistent guidance on the relationship between company performance and board independence. Despite the empirical controversy surrounding the relationship between board composition and performance, no study has explicitly investigated the relationship in the context of UK charities, and most studies have concentrated on for-profit organisations. Following the arguments advanced for profit making organisations, the study hypothesises the following:

**H2:** Board independence is positively related to the organisation’s overall performance.
6.2.3 Gender and Organisational Performance:

There has been an increasing focus on the gender as board members of firms during the past decade. It is argued that board diversity is potentially positively related to firm performance (Smith et al 2006). This view is consistent with Higgs (2003) in the UK in which it is argued that diversity could improve board effectiveness and recommends that firms should appoint more female professional as directors to their boards. While men continue to occupy most seats on the corporate board (Catalyst, 1998), researchers propose numerous reasons for including women on an organisation’s board of directors. For example, as advocated by the resource dependency theory, increased variety of board members may bring a greater wealth of expertise, knowledge and information for the board to use in their operations to represent shareholders’ interests and improving firm performance (Burgess and Tharenou, 2002; Hillman, Canella and Harris, 2002). Catalyst (2004) and Adler (2001) find positive correlations between ‘female-friendly’ US Fortune 500 firms and the performance of these firms. Carter et al (2003) also find a significantly positive effect of the proportion of women and minorities on boards of directors and organisational worth after controlling for a number of other factors which may influence organisational worth.

On the other hand, a number of researchers such as Kochan et al (2003) find no positive association between gender diversity in management and organisational performance for US corporations. Specifically, Bradshaw, Murray and Wolpin (1992) investigated the increased percentage of women on the board and found no association between women on the board and performance. Henrekson (2000)
found that women on the board seem to underperform in the study of firm performance of Swedish firms. Siciliano (1996) also found a negative association between a higher percentage of women on the board and the level of donations received by the organisation, but the ability of the organisation to fulfil the organisation mission was enhanced by equal representation of both sexes on the board. The findings from previous researches seem to provide no conclusive support for the major contentions of the resource dependency theory (Zahra and Pearce, 1989; Dalton, Daily, Crete, and Roengpitya, 2003).

The above mixed results are in the context of profit-making organisations, but considering that this study focuses on charities, gender diversity should have no significant impact on performance, given altruistic ethos of nonprofit organisations, which is consistent with the stewardship view. Therefore, the study hypothesises the following:

\[ H3: \text{There is no relationship between the gender of directors on the board and the performance of the UK charities.} \]

### 6.2.4 CEO Duality and Organisational Performance:

The relationship between CEO duality and firm performance has been widely researched, primarily in for-profit organisations, but the empirical results have been mixed (Rechner and Dalton, 1991; Rhoades et al., 2001; Kang and Zardkoohi, 2005; Chaganti, Mahajan, and Sharma, 1985). At one end of the spectrum, it is argued that CEO duality leads to the concentration of power in the hands of one person; thereby rendering the board’s monitoring role ineffective
(Mallette and Fowler, 1992). The argument that duality restricts board independence and diminishes the possibility that the board can properly implement its oversight and governance roles has been supported by a number of authors such as Fizel and Louie, 1990, and Dobnynski, 1991. This argument is consistent with agency theory because duality promotes CEO entrenchment by reducing board monitoring and effectiveness. Fama and Jensen (1983) reinforce this point and assert that duality is an indication that decision management and control have not been separated, making it difficult for insecure directors to be honest when evaluating firm performance. This lack of honesty, in turn, leads to long-term organisational drift (Carver, 1990).

On the other hand, researchers such as Stoeberl and Sherony, 1985, and Anderson and Anthony, 1986, argue that duality leads to superior firm performance as it allows precise leadership for the purposes of strategy formulation and implementation, which should result in better organisational performance. Finkelstein and D’Aveni (1994) point out that that duality removes any internal and external ambiguity regarding responsibility for the firm’s processes and outcomes. The study therefore hypothesised the following:

\[ H_4: \text{CEO duality is positively related to the performance of the UK charities.} \]

### 6.2.5 CEO Pay and Performance:

To implement strategic human resources management and create a competitive advantage for human resources, it is necessary to conceptualise and implement an appropriate compensation system (Milkovich and Newman, 1996). CEOs, just like any other salaried personnel in a firm, can be motivated to accomplish specific
performance objectives through the use of compensation systems (Gomez-Mejia, 1994; Roussel and Trepo, 1996). If compensation in non-profit organisations is perceived to be low, high-level expertise is more likely to move to a for-profit firm for the obvious reason that undercapitalised NPOs can rarely offer a salary comparable to what large for-profit corporations can pay (Goddeeris, 1988). As a result this may have negative implications for performance.

On the other hand, Mason (1996) argues that NPOs often operate in non-competitive environments, benefitting from tax exemption and charitable contributions; it would be highly controversial if they were able to pay managers salaries that rival those in for-profit businesses. It would not only undermine public trust but could also lead to a tendency to divert funds to pay compensation at the expense of fulfilling the organisations’ mission (Frumkin and Keating, 2001). High levels of compensation defeat the principles upon which these organisations are based. For example, researchers such as Hansmann (1980) and Jobome (2006) contend that before any attempt to increase pay levels in these organisations, the specific organisational and motivational issues which have been the bedrock of the organisation and other important characteristics, such as altruism, that are associated with the managers working for such organisations must be considered. For the above reasons, the study expects that CEOs working for charities are likely to be motivated by altruism. The following is therefore hypothesised:

**H5: CEO pay is negatively related to the performance of the UK charities**
6.3 Data Analysis:

To examine the hypothesised relationship, correlation coefficients were computed first, and then multiple regression analysis was further employed to assess the relationship between board characteristics, executive compensation and firm performance.

6.4 Dependable Variables:

Table 6.1 shows how the dependent variables were measured. The dependent variables are composed of 23 performance measures identified as important to the performance objectives of charities. An attempt was made to produce a parsimonious set of distinct, non-overlapping financial and non-financial performance measures by means of exploratory factor analysis. The analysis yielded the following five factors: The Financial Perspective, measuring various financial performance indicators; The Customer Perspective, comprising measures of customer/user satisfaction; The Internal Business, which measures internal efficiency and quality; The Innovation and Learning Perspective, which attempts to measure the organisation’s ability to adapt to changes required by a changing environment and Benchmarking, which is the process of comparing the organisation’s operations and performances to those of similar organisations (Trussel and Bitner, 2001). Overall, the factors explained 71.6 percent of the performance measures. In terms of the overall performance measure, the study used a composite index (an arithmetic average score) consistent with the measures used by Boateng and Glaister, 2002. Cronbach’s Alpha for each of the factors
ranged from 0.928 to 0.933, which is well above the threshold of 0.70 suggested by Hair et al., 1998. Five fundamental factors resulted from the factor analysis and are summarised in Table 6.1.

**Table 6.1**

**Factor Analysis on performance measures**

<table>
<thead>
<tr>
<th>Factors</th>
<th>Factor Loads</th>
<th>Eigen values</th>
<th>% of Variance Explained</th>
<th>Cumulative %</th>
<th>Cronbach’s Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Financial Perspective</td>
<td></td>
<td>8.313</td>
<td>36.143</td>
<td>36.143</td>
<td>0.931</td>
</tr>
<tr>
<td>Revenue growth</td>
<td>0.82</td>
<td></td>
<td></td>
<td></td>
<td>0.934</td>
</tr>
<tr>
<td>Percentage of earned income</td>
<td>0.72</td>
<td></td>
<td></td>
<td></td>
<td>0.932</td>
</tr>
<tr>
<td>Diversification of revenue sources</td>
<td>0.62</td>
<td></td>
<td></td>
<td></td>
<td>0.932</td>
</tr>
<tr>
<td>Cost efficiencies</td>
<td>0.53</td>
<td></td>
<td></td>
<td></td>
<td>0.932</td>
</tr>
<tr>
<td>High level of fundraising</td>
<td>0.84</td>
<td></td>
<td></td>
<td></td>
<td>0.933</td>
</tr>
<tr>
<td>Adequate working capital</td>
<td>0.88</td>
<td></td>
<td></td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>2. Customer Perspective</td>
<td>3.431</td>
<td>14.917</td>
<td>51.059</td>
<td></td>
<td>0.928</td>
</tr>
<tr>
<td>Quality of Product/Service</td>
<td>0.90</td>
<td></td>
<td></td>
<td></td>
<td>0.932</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>0.70</td>
<td></td>
<td></td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>Accountability</td>
<td>0.81</td>
<td></td>
<td></td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>Community involvement</td>
<td>0.55</td>
<td></td>
<td></td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>Percentage of board members as donors</td>
<td>0.75</td>
<td></td>
<td></td>
<td></td>
<td>0.932</td>
</tr>
<tr>
<td>3. The internal Business</td>
<td>2.570</td>
<td>11.174</td>
<td>62.233</td>
<td></td>
<td>0.928</td>
</tr>
<tr>
<td>Employee Satisfaction rates</td>
<td>0.57</td>
<td></td>
<td></td>
<td></td>
<td>0.928</td>
</tr>
<tr>
<td>Output</td>
<td>0.82</td>
<td></td>
<td></td>
<td></td>
<td>0.929</td>
</tr>
<tr>
<td>Donor Sustainability</td>
<td>0.83</td>
<td></td>
<td></td>
<td></td>
<td>0.931</td>
</tr>
<tr>
<td>Board involvement</td>
<td>0.76</td>
<td></td>
<td></td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>Board meeting attendance</td>
<td>0.67</td>
<td></td>
<td></td>
<td></td>
<td>0.931</td>
</tr>
<tr>
<td>Labour turnover rates</td>
<td>0.62</td>
<td></td>
<td></td>
<td></td>
<td>0.929</td>
</tr>
<tr>
<td>4. Innovation &amp; Learning</td>
<td>1.143</td>
<td>4.970</td>
<td>67.203</td>
<td></td>
<td>0.929</td>
</tr>
<tr>
<td>Technology competency ratings</td>
<td>0.82</td>
<td></td>
<td></td>
<td></td>
<td>0.931</td>
</tr>
<tr>
<td>Improve skills (number of people trained)</td>
<td>0.56</td>
<td></td>
<td></td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>5. Benchmarking</td>
<td>1.030</td>
<td>4.479</td>
<td>71.682</td>
<td></td>
<td>0.930</td>
</tr>
<tr>
<td>Competitors’ performance</td>
<td>0.64</td>
<td></td>
<td></td>
<td></td>
<td>0.931</td>
</tr>
<tr>
<td>Competitors’ Investments performance</td>
<td>0.68</td>
<td></td>
<td></td>
<td></td>
<td>0.932</td>
</tr>
</tbody>
</table>

Principal components factor analysis with varimax rotation.
K-M-O Measure of Sampling Adequacy = 0.830
Bartlett Test of Sphericity = 1692.300 (p <0.01).
The manner in which the independent variables are measured is shown in Table 6.2.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size (SIZBD)</td>
<td>We measured board size by the number of directors on the board of trustees. Small board (1-8 members). Big board (over 8 members (Jensen, 1993; Lipton and Lorsch, 1992)</td>
</tr>
<tr>
<td>Board Independence(BINDR)</td>
<td>Represented by the percentage of outside directors (non-officers of the charity)</td>
</tr>
<tr>
<td>Gender</td>
<td>Female = 1, Male =2</td>
</tr>
<tr>
<td>CEO’s Duality (DUALITY)</td>
<td>A dummy variable to indicate whether CEO is also the board chairman = 0; otherwise =1 (Lomsch and MacIver, 1989; Fizel and Louie, 1990)</td>
</tr>
<tr>
<td>CEO PAY</td>
<td>CEO’s annual base salary only over 12 months.</td>
</tr>
<tr>
<td>Size of Charity</td>
<td>Number of employees; Up to 250 = Small; Above 250 = Large.</td>
</tr>
<tr>
<td>SECTOR</td>
<td>Measured according to the proportion of sectoral distribution: 1=Health; 2= Social services &amp; relief; 3= Education; 4= Religious charities; 5=Art &amp; Culture; 6= Others</td>
</tr>
</tbody>
</table>

**Table: 6.2**

Measurement of Independent Variables

6.5 Control variables:

The study controls for the size and the sector of the organisations, as prior literature suggest size and sectors have a positive influence on the firm’s performance (see Frumkin, 2002; Finkelstein and Hambrick, 1996).
6.6 Results and Discussion:

Table 6.3 shows a summary of the means and standard deviations as well as the correlation matrix for the independent and the dependent variables. Correlations between the variables are low with the exception of CEO duality, which produced the highest at 0.574. As a check, we carried out variance inflation factor tests. All of the condition indices are below 10, indicating that there are no serious problems with multicollinearity (Hair et.al., 1998). Bivariate relationships shown in Table 6.3 indicate support for the following independent variables: board size (p< 0.01); board independence (p< 0.05); and sector (p<0.05). However, CEO pay is negatively correlated at p< 0.01.
## Table 6.3:

Summary Statistics and Pearson Correlation Matrix of Dependent and Independent Variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>MEAN</th>
<th>SD</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
<th>F</th>
<th>G</th>
<th>H</th>
<th>I</th>
<th>J</th>
<th>K</th>
<th>L</th>
<th>M</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. SIZBD</td>
<td>.7429</td>
<td>.43916</td>
<td>1000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. GENDER</td>
<td>1.4381</td>
<td>.49853</td>
<td>-.227**</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C. CEOPAY</td>
<td>.5238</td>
<td>.50138</td>
<td>.289***</td>
<td>-.162*</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D. DUALITY</td>
<td>3.1619</td>
<td>1.41506</td>
<td>.222**</td>
<td>-.129</td>
<td>.574***</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E. BINDR</td>
<td>2.9238</td>
<td>1.19049</td>
<td>.164*</td>
<td>-.057</td>
<td>.113</td>
<td>.184*</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F. SECTOR</td>
<td>5.6000</td>
<td>3.3729</td>
<td>.138</td>
<td>.031</td>
<td>-.061</td>
<td>-.033</td>
<td>.131</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>G. SIZE</td>
<td>.4286</td>
<td>.4725</td>
<td>.377***</td>
<td>.260***</td>
<td>.404**</td>
<td>.515**</td>
<td>.121</td>
<td>.092</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>H. FINANCE</td>
<td>3.3810</td>
<td>.71377</td>
<td>.223**</td>
<td>.049</td>
<td>-.282**</td>
<td>-.084</td>
<td>.268**</td>
<td>-.003</td>
<td>-.203***</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I. CUSTOMER</td>
<td>3.3071</td>
<td>.69964</td>
<td>.158</td>
<td>.003</td>
<td>-.158</td>
<td>-.104</td>
<td>.080</td>
<td>.058</td>
<td>-.043</td>
<td>-.161***</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>J. INTBUS</td>
<td>3.4254</td>
<td>.69721</td>
<td>.235**</td>
<td>.030</td>
<td>-.189*</td>
<td>.0130</td>
<td>-.145</td>
<td>.182*</td>
<td>.074</td>
<td>-.096**</td>
<td>.451***</td>
<td>1.000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>K. LEARN</td>
<td>2.7667</td>
<td>.83513</td>
<td>.202**</td>
<td>-.226**</td>
<td>.0188</td>
<td>.145</td>
<td>.122</td>
<td>.185</td>
<td>.028</td>
<td>.058</td>
<td>.116</td>
<td>.494***</td>
<td>1.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>L. BENMK</td>
<td>2.9952</td>
<td>.71217</td>
<td>.104</td>
<td>.074***</td>
<td>.195***</td>
<td>.173*</td>
<td>.227**</td>
<td>.175*</td>
<td>.169*</td>
<td>.227***</td>
<td>.461***</td>
<td>.456***</td>
<td>.447***</td>
<td>1.000</td>
<td></td>
</tr>
<tr>
<td>M.OVERALL</td>
<td>4.898</td>
<td>.26121</td>
<td>.121***</td>
<td>.215</td>
<td>.028***</td>
<td>.059</td>
<td>.147**</td>
<td>.185**</td>
<td>-.376</td>
<td>-.489***</td>
<td>.401***</td>
<td>.512***</td>
<td>.154***</td>
<td>.238**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

Notes: No. of cases: 105

"***", "**", "*" means significant at 0.01, 0.05 and 0.1 levels respectively.
### Table: 6.4

**Regression results: Managers’ perceptions on Factors Influencing Performance**

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
<th>Model 4</th>
<th>Model 5</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>2.755 (9.508***)</td>
<td>3.142 (13.747***)</td>
<td>2.969 (9.215***)</td>
<td>2.639 (6.827***)</td>
<td>1.950 (5.850***)</td>
<td>2.975 (10.877)***</td>
</tr>
<tr>
<td>SIZBD</td>
<td>0.365 (3.763***)</td>
<td>0.214 (2.110***)</td>
<td>0.311 (3.094***)</td>
<td>0.157 (1.499)</td>
<td>0.009 (0.085)</td>
<td>0.411 (4.261)***</td>
</tr>
<tr>
<td>BINDR</td>
<td>0.286 (3.217***)</td>
<td>0.077 (0.783)</td>
<td>0.182 (1.910*)</td>
<td>0.145 (1.486)</td>
<td>0.234 (2.411**)</td>
<td>0.267 (3.016)**</td>
</tr>
<tr>
<td>GENDER</td>
<td>0.062 (0.576)</td>
<td>-</td>
<td>0.061 (0.636)</td>
<td>0.201 (2.022**)</td>
<td>0.121 (1.228)</td>
<td>0.065 (0.720)</td>
</tr>
<tr>
<td>DUALITY</td>
<td>0.037 (0.341)</td>
<td>0.052 (0.436)</td>
<td>0.110 (0.966)</td>
<td>0.097 (0.864)</td>
<td>0.050 (0.421)</td>
<td>0.055 (0.534)</td>
</tr>
<tr>
<td>CEOPAY</td>
<td>-0.306 (-2.549***)</td>
<td>-0.199 (-1.661*)</td>
<td>-0.227 (1.961**)</td>
<td>-0.049 (-0.344)</td>
<td>0.148 (1.436*)</td>
<td>-0.279 (-2.268)***</td>
</tr>
<tr>
<td>Control</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SIZE</td>
<td>-0.147 (-1.211-)</td>
<td>0.073 (0.509)</td>
<td>-</td>
<td>-0.121 (-1.019)</td>
<td>0.025 (0.175)</td>
<td>-0.109 (-0.878)</td>
</tr>
<tr>
<td>SECTOR</td>
<td>0.089 (-0.994)</td>
<td>-</td>
<td>-0.012 (-0.423)</td>
<td>-</td>
<td>0.148 (1.513)</td>
<td>-0.161 (-1.830)*</td>
</tr>
<tr>
<td>F-statistic</td>
<td>5.874***</td>
<td>2.281*</td>
<td>3.256***</td>
<td>2.409**</td>
<td>2.714***</td>
<td>9.054***</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.265</td>
<td>0.087</td>
<td>0.166</td>
<td>0.108</td>
<td>0.143</td>
<td>0.385</td>
</tr>
<tr>
<td>Adjusted $R^2$</td>
<td>0.220</td>
<td>0.050</td>
<td>0.115</td>
<td>0.073</td>
<td>0.101</td>
<td>0.348</td>
</tr>
</tbody>
</table>

Notes: N=105

Notes: Beta denotes the standardised regression coefficient of the variable in the model; t-values are in Parenthesis; Significance Level: **** p< 0.01; **p< 0.05; and *p< 0.1 levels respectively

Multiple regressions were conducted to examine the relationship between the board characteristics, CEO pay and performance of charities. Table 6.4 shows that the $F$-values for all of the performance measures in the models were highly significant. The regression procedure suggests that four factors, namely, board size, board independence, CEO pay and sector of operations, have statistically significant influences on the overall performance of the UK charities. These factors explained approximately 34% of variations in overall performance. The
results suggest that board size and board independence have positive and significant influence on performance. However, CEO pay and the sector of operations have a statistically negative influence on performance. The results support hypotheses 1, 2, and 4. In terms of individual performance measures, the size of the board has a positive and significant influence in respect to financial, customer, internal business and overall performance. The result that board size improves financial performance is consistent with the conclusion drawn by Dalton and Dalton, 2005, and Dalton et al., 1998, that larger boards are associated with improved financial performance. In addition, this study finds that board size is associated with customer satisfaction and internal business, suggesting that larger boards bring in the management resources necessary to improve networking, public communication, and the expertise to manage the broad set of complex responsibilities charities face. The results, therefore, are consistent with the resource-based theory which sees board management as a unique resource that explains the differences in organisational performance (Barney 1991; Barney et al., 2001).

The results also indicate that board independence has an influence on financial performance, internal business, benchmarking and overall performance. The results may be explained by the fact that the board of directors perform a service task and are expected to bring different types of resources to the firm (Daily and Dalton, 1994; Pfeffer and Salancik, 1978). Among the services provided by the board are external legitimacy and networking (Minichilli, Zattoni and Zona, 2009). In the context of charitable organisations, outside directors may be important for networking and external legitimacy because they bring in new capabilities, broader
professional profiles and other skills needed to facilitate better decision making regarding the firms’ activities; all of these qualities have positive effects on performance and thereby rendering support for resource-based theory. However, the result opposes the view because outside trustees serve voluntarily and without compensation, outsiders may lack the specific knowledge, time and effort needed for such a role. This difference may be due to the perception that serving in a charity is a service to the community or for public good, and therefore managers are motivated by these ideals. Moreover, the nature of the UK charities, such as schools and hospitals, may also explain the results. For example, outsiders serving on the board of trustees for a school may be an alumni or have children that attended that school; that connection, in itself, provides motivation to put in time and effort to improve performance. The positive association between board independence and internal business suggests that outside directors play an important monitoring role, thereby rendering support for the applicability of agency theory to NPOs. The positive relationship between CEO duality and the performance measures in the model (although not significant) is consistent with the fundamental premise of stewardship theory, which suggests that the CEO in an NPO is highly altruistic and, if empowered, is more likely to produce better performance for the firm. The results for the relationship between CEO pay and performance suggest that CEO pay has a negative and significant influence on all of the performance measures in the model (with the exception of benchmarking), which is consistent with the prediction of Hypothesis 4. On the contrary, benchmarking has a positive, but not significant, relationship with CEO pay. This relationship is not surprising, as it supports the social comparison and equity
theory. It also is consistent with the conclusion drawn by O’Reilly, Main and Crystal, 1988, who indicate that CEO compensation strategies in non-profit organisations are based on a process of social comparison or benchmarking against inside employees and rival firms. The results suggest that managers working for charities, while motivated by the nature of services and altruism, would also like their performance to be benchmarked and rewarded accordingly. The results also show that the gender of the CEO appears to have a positive, but not significant, impact on the CEO’s performance (with the exception of innovation and learning), thereby rendering support to hypotheses 3. The results are surprising, given the vast amount of literature which indicates that female directors bring distinctive and valuable resources to board’s that enhance decision-making (see Brammer, Millington and Pavelin, 2009).

6.7 **Summary and Conclusion:**

The goal of this chapter was to examine the influences of board characteristics on the performance of the UK charities. The results indicate that that board size and board independence have a positive and significant influence on performance. However, CEO pay and the sector of operation have a negative and statistically influence on performance. On the theoretical front, this study elucidates the complexity of governance and performance issues in charitable organisations. The results appear to support the stewardship perspective, relative to agency theory, in explaining the CEO pay and duality influences on performance. In the case of board size and outside directors, this study reinforces the value of resource-based theory. Since 1997, the UK government has increased its commitment to fund and
develop the capacity of charities to accomplish their missions and play their rightful role in UK communities, but resource constraints remain a key issue facing charities in a dynamic and changing environment. This study has highlighted boards as a key management resource which can make a difference in the performance of UK charities. The results therefore support the contention made by Coombes et al., 2011, that resource-based theory can be generalised beyond the for-profit context. The results also indicated that the CEO’s gender appears to have no significant influence on overall performance.

An important conclusion of this study indicates that business-type corporate governance mechanisms are not significantly associated with performance in charities, thereby supporting the belief that charities managers are intrinsically motivated and altruistic. The implication is that policy makers in these organisations should use approaches that explicitly recognise the altruistic and stewardship ethos of the voluntary sector in their hiring decisions. Managerial recruitment and retention issues should focus more on intrinsic incentives to attract managers with a significant level of altruistic motivation. Another interesting conclusion from this study is the positive but insignificant relationship of CEO duality to performance, which is consistent with the stewardship view’s predictions. This finding is surprising because it contradicts the widespread perception, according to agency theory, that CEO duality leads to negative performance. This study therefore suggests that a better understanding of the relationship between firms with a dual CEO leadership structure and the performance of charities is required.
Another interesting conclusion from this study derives from the negative relationship between executive pay and performance. This negative relationship confirms the notion that the CEOs of charities should not be paid on the basis of performance, as are their counterparts in for-profit organisations. The implication here is that high levels of compensation defeat the mission upon which these organisations are founded. Indeed, most of the CEOs in charities may want to engage in “labour donations”, and therefore, pay may not be their main motivation. Consistent with the views of Jegers and Lapsley (2003), the study cautions against the blanket transference of business sector practices to the charitable sector and note the possibility that monetary incentives can crowd out intrinsic motivation when attempting in order to attract the right kind of manager.

Despite the contribution of this study in elucidating the complex and unexplored phenomenon of board structure, executive pay and performance issues in charities, further studies appear warranted. Future study should use both case studies and surveys to probe deeper into the effects of board structure on performance along similar lines to those used in this study.

The final chapter presents a summary of the research findings and discusses the implications of the results regarding executive compensation and performance in the UK charities.
7.1 Introduction
This chapter presents a summary of the research findings and discusses the implications of the results regarding executive compensation and performance in the UK charities. This chapter is organised into eight sections. The next section summarises background and objectives of the study. Section three provides a brief description of the methodology used in the study. Section four presents a summary of the main findings. Section five and six presents implications and contribution of the study respectively. Section seven describes the main limitations of the study. The study concludes with an outline of potential future research in section eight.

7.2 Background and Objectives of the Study:
During the past decade, the voluntary, third sector has experienced enormous growth, which has seen it employing 600,000 people an increase of about 25% over the last decade (Hyndman and Connolly, 2010) and contributing an estimated annual turnover of £52.5 billion (Charity Commission, 2010). However, this growth, together with well publicised scandals has led to increased visibility and public scrutiny by diverse stakeholders including government oversight agencies, private donors and foundations, clients, the media and the public at large (Connolly and Hyndman, 2004) and has heightened concerns about the accountability of charities (Kreander et al, 2006). Of particular concern are issues like the nature of executive pay and its disclosure, increased and multiple
pressures to demonstrate excellence in performance and calls to improve the self-regulation of charities at board level (through, for example, non-executive directors, an audit committee, and a separation of chairman and Chief Executive Officer). As a result, there have been a string of significant reports and reforms and a constant review of the charity Statement of Recommended Practice (SORP) in the UK aimed at addressing these concerns as well as improving the effectiveness and accountability in the sector (Cadbury, 1992; Greenbury, 1995; Hampel, 1998 Higgs, 2002 and SORP 2005). However, despite the fact that many regulations executive compensation in charities continues to be on the rise for many chief executives in the nonprofit sector (Schwinn and Wilhelm, 2003) proving that the monitoring system is fraught with problems. Even the issue of measuring performance has remained an issue as the search for appropriate performance metrics to satisfy stakeholders is still some way off, due to the multi-dimensional nature of sector (Oster, 1998; Speckbacher, 2003; Hallock, 2002). Furthermore, from the current literature it is apparent that most studies, (for example, Hallock, 2002; Jobome, 2006 and Frumkin and Keating, 2001) have looked at only financial measures of performance neglecting the prominent non-financial measures that form the bedrock of the charities’ mission. The recent (2003) version of the Code combines the Cadbury and Greenbury reports on corporate governance, also recommended that there be a clear division of responsibilities between the chairman, who is in charge of the board, and CEO of an organisation, whose main concern should be running the business. However, regardless of the growing concern of CEOs possessing excessive power and authority in both firm management and governance control (Henry et al., 2005),
and the recommendation of the combined code (2003), some firms still persist with this combined leadership structure in their corporate governance arrangements (Finkelstein and Mooney, 2003). The continuing prevalence of CEO duality leadership structure, coupled with lack of empirical investigations in charities points to the need for further study to help improve our understanding of the corporate implications of this corporate leadership structure. Therefore, the gap in research regarding executive compensation, governance and performance in UK charities has laid the stone for further research in this field. The purpose of the study was to examine: a) the main determinants of CEO compensation in the UK Charities b) the performance measures used in the UK Charities c) the effects of board composition and the executive compensation on performance in UK charities.

8.3 Summary of Research Methodology:

The methodology for this study is based on a multi-method approach, combining both the qualitative and quantitative approaches. While in the qualitative phase of the study a combination of literature with semi structured interviews were employed, as detailed in the previous chapter, the quantitative phase consisted of a mail survey to top managers of charities. A listing of the charities which served to provide sample frame was obtained from two online sources, CharitiesDirect.com and Charity commission website which are established by law as the regulator and registrar of charities in England and Wales. The survey was based on 500 large UK charities, and 105 usable responses were received, representing a response rate of 21%. For the survey, data were gathered via a cross- sectional survey using the
web-based and the email questionnaire. The design of the questionnaire is heavily influenced by the recommendations of Dillman (1978) and Oppenheim (1992). Consistent with their advice, the layout consisted of a series of sections each relating to a particular aspect of the study. Pre-testing was conducted in two phases to enhance the validity and reliability of the data. Firstly, the questionnaire was subjected to critical review by 4 UK academics and 3 managers of charities. Revisions were made in light of the various suggestions made by these academics and managers. The survey was then pre-tested with 8 organisations, and due attention was given to the suggestions received from those who participated in this phase. In order to improve the response rate, Solomon (2001) recommendations were considered. These included personalising the cover letter with the university logo to indicate the auspices under which the research was undertaken, simpler formats and uncomplicated designs, guarantee of confidentiality and anonymity and follow up reminders were made. A considerable effort was made to give specific instructions for each question according to Bryman (1989)’s suggestions that, it is worth being meticulously careful in giving instructions on how to do the answers as mistakes that occur can invalidate a whole questionnaire. Potential non-response bias was checked by implementing the procedure used by Armstrong and Overton (1977). This procedure tests the non-response bias by implementing a t-test comparing early and late response rate along a number of key descriptive variables. This was to test the null hypothesis, and that there was no difference between early and late responses along a number of chosen descriptive variables such as the sector of the charity, number of employees (used as a proxy for the size of the organisation) and the size of the board.
For the qualitative phase, 14 charities participated in the interviews. The non-probability sampling was used to choose the participants because an attempt was made to choose from the large UK charities with turnover of £1m and over which had not participated in the survey. The interview questions generated were based on the aims of the study. Pre-testing was also conducted in two phases. The questions were first subjected to critical review by 2 UK academics and then 3 managers of charities after being revised. Since Lincoln and Guba, (1985); Shah and Corley, (2006) regard the protection of informants’ confidentiality as one of the elements needed to ensure the trustworthiness of qualitative research, the interviewees were assured of anonymity. Following Churchill (1999) and Malhotra (2004) recommendations, some easy and non controversial questions were included as opening questions and potentially sensitive and controversial questions were placed late. The length of interviews varied from 45 minutes to 60 minutes.

The semi-structured interview technique (Minichiello et al., 1995) was used. An interview script involving the same open-ended questions was employed for all interviews.

Several analytical techniques have been used in the analysis of the data. Cronbach’s alpha was used to assess the reliability of the measurement of the scale used in the questionnaire. Descriptive statistical tools were also used to describe the general characteristics of sampled charities. The study also conducted factor analysis using varimax rotation to find out a parsimonious set of distinct, financial and non-financial performance measures utilised in charities. Data analysis was
conducted using the Statistical Package for Social Sciences (SPSS) for Windows (version 17), and as reported in detail in Chapters four to seven.

7.4 Summary of Main Findings:

This section provides the summary of the main findings of this study in light of the proposed research objectives. The developed hypotheses have been analysed using a variety of approaches.

7.4.1 Determinants of Executive compensation: An Examination of the UK Charities

The main goal of this part of the study was to examine the determinants of executive pay in the UK charities. The findings suggest that size has a strong, positive impact on executive pay providing a support for previous work, (for example, Rosen, 1982; Agarwal 1981; and Frumkin and Keating 2001) which suggests CEOs are paid according to the size of their organisation. The result also suggests positive and significant relationship between the CEO qualification and CEO’s pay and renders support to hypothesis 3. This finding is consistent with previous research, which documented that better educated CEOs lead to better organisational performance. This result supports the human capital theory argument, which, views increased wage variation as a function of better education in that highly qualified and trained executives tend to perform well leading to higher organisation performance (Barkema and Gomez-Mejia, 1998 and Leonard, 1990).
The results also indicate that the tenure of the CEO has a positive significant impact on CEO thereby supporting the resource-based interpretation which asserts that tenure increases the CEO’s proficiency on the job. Similar results were also reported by Jobome (2006). According to this study, CEOs age (proxied as CEOs experience) has a negative and significant impact on CEOs, although it was expected that experience should be positively associated with CEO pay. However, the findings support the stewardship view that the compensation of altruistic managers should not be determined by their tenure-based power or experience (Jobome, 2006). Therefore, the three human capital measures used in this study, namely, qualification, tenure and experience appear to show no clear and unequivocal relationship between human capital and executive compensation in the UK charities. There was no relationship between duality and executive pay, rendering support to the stewardship view, which regards CEOs in charities as good stewards of the organisations who are altruistic and dependable and can therefore, be trusted not to pay themselves excessively (Jobome 2006).

7.4.2 Measures of Performance used in the UK Charities
This phase of the study sought to examine performance measures used in UK charities. In all 23 individual performance measures were identified and programme spending and quality of product/service were ranked as most important performance measures in charities. The other performance measures ranked at the top were customer satisfaction, level of fundraising, efficiency and competitor’s performance. This study classified the performance measures into five categories, of which four of them are derived from Kaplan and Norton (1992)’s performance
measure model, “the balanced scorecard”, and the fifth one ‘benchmarking’ which came from the literature, proved to be valuable. The findings suggest that four of the five performance measures categories used in this study which are, financial - measuring various financial performance indicators, the customer - comprising measures of customer satisfaction; the internal business process which measures internal efficiency and quality; and benchmarking which is comparing performance and practice with those of other firms were widely used in UK charities. However, Learning and innovation is also valuable measure of performance in the UK charities. It is clear from the results that, although benchmarking does not appear on the BSC, it is a critical performance criterion in charities. The findings reinforce views by researchers like (Jobome 2006; Cameron, 1981, 1982; Connolly, Conlon, and Deutsch, 1980; Stewart and Walsh, 1994 and Sowa et al 2004) thereby pointing to the difficulties of applying only financial performance measures to nonprofit organisations with their distinctive cultures, diffuse power structures, different values, multiple stakeholders, and multiple goals. The results provide a further justification for the appropriateness of including both financial and non-financial measures to measure performance in charities as adopted in this study.

7.4.3: Managers’ Perception of the Factors Influencing Performance in the UK Charities

This part of the study examined the impact of firm performance in UK charities. The performance measures are composed of 23 factors, identified from the previous chapter. Due to potential for conceptual and statistical overlap among the
23 performance measures, an attempt was made to produce a parsimonious set of distinct, non-overlapping financial and non-financial performance measures by means of exploratory factor analysis. The analysis yield five factors, namely, The Financial Perspective, The Customer Perspective, The Internal Business, Innovation and Learning Perspective and Benchmarking. Overall the factors explained 71.6 percent of performance measures. In terms of the overall performance measure, the study used a composite index (an arithmetic average score) consistent with the measures used by Sim and Ali, 1998; Boateng and Glaister, 2002.

The findings suggest that four factors, namely, board size, board independence, CEO pay and sector of operations, have statistically significant influences on the overall performance of the UK charities. The results also show that board size and board independence have positive and significant influence on performance. However, CEO pay and the sector of operations have a statistically negative influence on performance. When considering individual performance measures, the size of the board has a positive and significant influence in respect to financial, customer, internal business and overall performance. In addition, this study finds that board size is associated with customer satisfaction and internal business, suggesting that larger boards bring in the management resources necessary to improve networking, public communication, and the expertise to manage the broad set of complex responsibilities charities face. The results also indicate that board independence has an influence on financial performance, internal business, benchmarking and overall performance. This may
be due the fact that the board of directors bring different types of resources to the firm (Daily and Dalton, 1994; Pfeffer and Salancik, 1978) and also provide services such as external legitimacy and networking to the organisation (Minichilli, Zattoni and Zona, 2009). This renders support for resource-based theory.

The positive association between board independence and internal business seem to render support for the applicability of agency theory to NPOs by suggesting that outside directors play an important monitoring role. The results also indicate a positive relationship between CEO duality and the performance measures in the model (although not significant) which is consistent with the fundamental premise of stewardship theory, which suggests that the CEO in an NPO is highly altruistic and, if empowered, is more likely to produce better performance for the firm. The results for the relationship between CEO pay and performance suggest that CEO pay has a negative and significant influence on all of the performance measures in the model (with the exception of benchmarking), which is consistent with the prediction of Hypothesis 4. On the contrary, benchmarking has a positive, but not significant, relationship with CEO pay. The results are consistent with the conclusion drawn by O’Reilly, Main and Crystal, 1988, who indicate that CEO compensation strategies in non-profit organisations are based on a process of social comparison or benchmarking against inside employees and rival firms. The gender of the CEO appears to have a positive, but not significant, impact on the CEO’s performance (with the exception of innovation and learning), thereby rendering support to hypotheses 3. The results are surprising, as they are at variance with views in the literature that female directors bring distinctive and
valuable resources to board’s that enhance decision-making (see Brammer, Millington and Pavelin, 2009).

7.5 Contribution of the Study:
The main focus of this study was to examine the determinants of executive compensation, governance and performance in charities. Executive compensation is a topic that has produced a huge amount of academic literature in past decades. The importance of the topic cannot be overemphasised, especially given the widespread public perception of executive compensation as excessive, unfair, and difficult to explain. However, there has been a disproportionate concentration on for-profit organisations compared to non-profit making organisations, charities in particular. Furthermore, most studies seem to have focussed on executive pay determinants in US nonprofits as compared to the UK. Given the vast differences between the nature, purpose, financial structure and ownership type of profit and non-profits organisations, it would be fair to expect that equal empirical efforts are devoted to nonprofit organisations to test applicability of existing theories in the context of non-profit organisations. The issue of performance measurement in nonprofit organisations has recently gained impetus, but still continues to be shrouded with controversy, as researchers have failed to come to an agreement on the criteria by which performance should be measured and operationalised. The widespread controversy regarding performance measures in charities as well as the scarcity of research in this area made the findings of this study immensely valuable.
First, this study contributes to the ongoing literature on executive compensation in nonprofit organisations by eliciting the opinions of CEOs of the UK large charities via a survey instead of just relying on secondary data like the previous studies, (for example, Frumkin and Keating, 2001; Hallock, 2002 and Jobome, 2006). While very few of previous studies done in this area have looked at nonprofit organisations in general, this study makes a contribution in this direction by examining the determinants of CEO pay in the UK charities which have witnessed a substantial growth since the assumption of power by the labour government over a decade ago.

Second, as the issue of the measurement of performance continue to plague empirical work in nonprofit organisations, this study sought to establish the performance measures that are being used by charities. It extends the quantitative studies that have attempted to shed light on performance measures issues in charities by the use of interviews. In terms of theoretical contributions, this study proposes a stronger conceptualisation of performance measures, by combining survey and qualitative empirical evidence with literature in order to identify the performance measures used in charities from top level managers who make key decisions in large charities, thereby narrowing the gap in the literature. It is therefore, perceived that the incorporated qualitative aspect in this study has played a decisive role in strengthening the quality of this study’s contributions for both theory and practice. From the findings, it was apparent that the performance measures directly linked to charity's main purpose or objectives such as programme activities, efficiency, customer satisfaction quality of service and
fundraising are widely used. However, other measures which contribute to the overall efficiency of the NPO are also important. This study makes a contribution in this direction by incorporating financial and nonfinancial measures of performance, to reveal the comprehensive picture of what measures performance in the UK charities. Previous researchers normally used one or two financial measures of performance. This study serves an important reminder for researchers attempting to measure performance with one or two variables that charities have multiple objectives and therefore measuring performance with one or two measures could be misleading at best.

Third, by eliciting the opinions of CEOs on the effects of board characteristics and executive pay on performance, it is also perceived that this investigation has extended the knowledge on the performance measures in charities in that, it has expanded the empirical research on charities by submitting its key constructs previously identified in the literature to a rigorous, quantitative test and has also integrated qualitative evidence, thereby providing a strong conceptualisation of performance measures in charities. This study departs from previous studies by using both financial and nonfinancial measures of performance in charities it reveals the comprehensive picture of performance measurement in charities. The study uses the BSC in addition to benchmarking to assess the relationship between board structure and performance in UK charities. The new multidimensional model of performance measures, which combines the balanced score card and benchmarking, to the author’s knowledge has not been used in previous studies. Therefore, this study also contributes to the models of performance, for example,
by suggesting benchmarking as an additional performance measure of the balanced scorecard.

Fourth, another significant contribution of this study is to exploring other theoretical approaches that can be useful in explaining executive compensation, particularly in charities. Previous studies on executive compensation seem to have concentrated on the economic perspective, which is fundamentally based on agency theory (Jensen & Meckling, 1976). It views compensation as a way of control that is used to align the interests of shareholders with those of the executives. However, not only does the theory fail to give explanations to other non-economic questions, it seems to be inapplicable to charities, since they do not have shareholders but numerous stakeholders. Therefore, this study adopts stewardship/stakeholder; executive power, equity and social comparison approaches with the view that, a combination of several theories would be more capable for embracing all the complexities of CEO compensation (Baron and Cook, 1992; Lambert, Larcker and Weigelt, 1993) particularly in charities. Furthermore, to date, numerous empirical investigations have been performed to examine the effects of CEO duality on firm performance (Dalton et al., 1998; Mallette and Fowler, 1992), but there has been extremely little academic research on the impact of duality on executive pay particularly for the UK charities. This study also contributes to filling this gap.
7.6 Implications of the Study:

This research suggests several implications for policy makers and managers, as well. The findings of this research indicate that organisation size accounts for single most influential determinant for CEO pay in the UK charities. This indicates that organisation size represents complexity which involves a more demanding tasks and management of such difficult tasks to achieve overall goals of the organisation. This requires people with the right education and training to meet the challenging tasks. The resource based view highlights that the growth in the sector’s role has led to greater expectation for high quality professional service and competition for skilled workers. The level of pay is cited as the biggest issue behind staff turnover, and this may partly explain why 75% of charities experience difficulties in filling some vacancies (Third Sector, 2004). The implication of this result is that, policy makers should not overlook the fact that charities, due to the ‘violation of non-distribution constraint’ are legally prohibited from making distributions of their earnings to individuals who exercise control over it, like CEOs. Furthermore, they are also prohibited from paying their managers equity-based incentive compensation that could also be used to alleviate agency problems (Frumkin and Keating, 2001). As a result, the charities CEOs’ compensation packages are always lagging behind those of their for profits counterparts. However, since charities engage in relatively substantial competition for employees with for-profit institutions, there is a need to structure compensation policies and programmes that will enable them to attract and retain the human capital needed to achieve the goals of organisations, in line with the resource based
theory (Hillman and Dalziel 2003). However, these have to be fair and competitive, without crowding out altruism and yet maintaining public trust.

Another implication of the analysis bears on the enduring performance measurement predicament that confronts so many nonprofit organisations. The results in this study indicate that the performance measures directly linked to charity's main purpose or objectives such as programme activities, efficiency, customer satisfaction quality of service and fundraising were rated at the top and are also widely used in charities. The implication here is that, the financial measures of performance that have traditionally dominated previous study need to be complemented with non-financial measures, when it comes to measuring performance in charities. Adherence to social purposes does not, however, necessarily generate financial returns that are readily apparent, so assessments of nonprofit performance must continue to consider attitudes and perceptions of multiple constituents (Brown, 2005). It is also evident that the same performance measures cannot be generalised across the charities because of their wide ranging and complex missions with varied and diverse constituents (Oster, 1998; Speckbacher, 2003; Hallock, 2002). Therefore, the implication is that, policy makers should consider the performance measures that can best suit each charity’s mission and objectives.

Analysis was conducted to determine the extent to which board characteristics accounted for performance according to the managers’ opinions. The results seem to support the premises of the stewardship perspective to the detriment of agency
theory, which is a clear indication that business-type corporate governance mechanisms are not significantly associated with performance in charities; all of which are consistent with a pattern of intrinsic motivation and support the altruistic nature of charities managers. The implication, therefore, is that, the policy makers in these organisations should employ approaches that explicitly recognise the altruistic and stewardship ethos of the voluntary sector. Therefore, the managerial recruitment and retention issues should focus relatively more on intrinsic incentives, in order to attract mainly managers with a significant level of altruistic motivation. Different theoretical perspectives (agency theory, resource dependency theory, stewardship/stakeholder; executive power, equity and social comparison) provided the framework to consider how CEO duality might affect executive pay in this study. Agency theory, which posits the CEO as an adversary of stakeholder interests, is the most widely used theoretical model to explain corporate governance, but its applicability to nonprofits has been questioned. This study suggested that agency theory is only limited to economic perspective, but fail to give explanations to other non-economic issues like organisational and motivational issues which have been the bedrock of charities and other pertinent characteristics such as altruism associated with managers working for such organisations. It was therefore not surprising that the findings suggest a positive link between CEO duality and firm performance, rendering support to the stewardship premise that CEOs in NPOs are motivated by the cause of the organisation. Furthermore the findings for the relationship between CEO pay and performance also suggest a negative and significant influence on all of the performance measures in the model (with the exception of benchmarking), thus,
support the stewardship premise that, CEOs in charities do not seem to take advantage of their position, but they behave altruistically and are intrinsically motivated. The managerial and policy implications are that CEO-chair positions should not be split as recommended in the combined code (2003) and Donaldson and Davis (1991). Also, since the evidence indicates that CEO compensation strategies in non-profit organisations are based on a process of social comparison or benchmarking against inside employees and rival firms, charities should strive to create proper network connections with similar organisations, so they can also use benchmarking as a valuable mechanism for performance improvement as well.

7.7 Limitations of the study:

Like any other research, there are limitations to this study. The focus of this study has been primarily on understanding the performance measures used by the U.K charities, the factors that affect firm performance in the charities. The study addresses research questions and hypotheses which are based upon empirical and theoretical studies undertaken by others and not usually relating to charities. The main criticism for this study may be that, while there is much emphasis on empirical and exploratory research, there has been little in the area of theory development. However, although the aims of this study did not include theory development, future research in this field may benefit from the development of theory.
One other limitation of this study is the possible omission of how government funding of charities can affect executive compensation in charities. Charities who receive government funding are expected to comply with a myriad of rules and regulations that accompany government support (Frumkin, 2002; Oliver, 1999). The regulatory codes include financial management and accounting requirements, maintenance of minimum quality standards, promotion of basic programme objectives, and adherence to certain national policy goals to ensure uniformity in the delivery of services (Krashinsky 1990). I am of the view that, the adherence of the above may lead to excessive bureaucracy and therefore may be detrimental to performance.

Finally, the study focuses exclusively on large UK charities and therefore generalisations may not be applicable to other charities beyond this group.

7.8 Areas of Future Research:
Charities represent a rich and relatively unexplored opportunity for better understanding the complex phenomenon of executive pay, governance and performance. Though some effort has been made to ameliorate the problems in this study, there are still several areas which merit further investigations. From the extant literature; it was clear that CEO pay-setting is not a straightforward economics issue because the process involves the social psychology of group behaviour (O’Reilly and Main, 2007) as well as motivational factors, particularly in charities were monetary rewards are accused of crowding out altruism, thus leading to attracting the wrong kind of manager (Jobome 2006). There is,
therefore, need for future researchers to examine the effects of reciprocity and social influence on CEO pay determination as well as identifying other determinant variables that explicitly recognise the altruistic and stewardship ethos of the sector. Also, future research will benefit from looking at whether government funding of charities has effects on executive pay setting and performance. A major contribution of this study has been to provide new empirical evidence of performance measures used in UK charities, as well as extending the knowledge on the performance measures in charities by incorporating financial and non-financial measures of performance. However, more research is needed to validate the findings in this study and to provide a more comprehensive picture, possibly by identifying and testing additional measures of performance in the charities which could lead to improvement on the current multidimensional models of performance. The methodology used in this study was based on cross-sectional surveys and case studies. While the approach was appropriate for this initial study, it only provided only a snapshot view of the issues examined. As already been highlighted, it is also evident that the same performance measures cannot be generalised across the charities because of their wide ranging and complex missions with varied and diverse constituents (Oster, 1998; Speckbacher, 2003; Hallock, 2002). In future, longitudinal research could explore the factors influencing the adoption of particular performance measures by different charity sectors and their effects on accomplishing the organisational mission. Furthermore, while this study has looked at the relationship between board characteristics and performance, exploring the processes and dynamics of the pay-setting relationship between managers, their boards (Jobome 2006) might provide
another rich area for further research. Finally, given the fact that this study concentrated on large charities, yet the majority of charities are smaller than the ones studied in this research, future research on small charities might be useful.
Appendix 1

Survey Questionnaire

Executive Compensation and Firm Performance: An Examination of UK Charities.

Thank you very much for taking the time to complete this questionnaire. As indicated in the letter, your responses are completely confidential

Background Information

1. Name of your organisation…………………………………………........................................

2. Main activities ………………………………………………………………………………………

3. Sector of charity? (Please tick as appropriate) ………………………

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<th>Main Focus</th>
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<td></td>
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<tr>
<td>(d) Media</td>
<td></td>
</tr>
<tr>
<td>(e) Sports and recreational charities</td>
<td></td>
</tr>
<tr>
<td>(f) Education</td>
<td></td>
</tr>
<tr>
<td>(g) Religious charities</td>
<td></td>
</tr>
<tr>
<td>(h) Environmental charities</td>
<td></td>
</tr>
<tr>
<td>(i) Museums</td>
<td></td>
</tr>
<tr>
<td>(j) Aid overseas</td>
<td></td>
</tr>
</tbody>
</table>

4. Number of employees……………………………………………………………………………………

5. What is the size of the board? (please tick as appropriate)

6. (a) 0-5 [    ] (b) 6-10 [    ] (c) 11-15[  ] (d) 16-20 [  ]
    (e) Over 20 [  ]
7. Is the CEO also the chair of the board? (Please tick as appropriate)
   (a) Yes [ ]                (b) No [ ]

8. Does your organisation receive government’s grants? (please tick as appropriate)
   (a) Yes [ ]                (b) No [ ]

9. Does your organisation do any trading activities to make Profits? (Please tick as appropriate)
   (a) Yes [ ]                (b) No [ ]

**Personal information**

10. Gender of the CEO. (Please tick as appropriate)  
    (a) Male [ ]                (b) Female [ ]

11. Age of CEO (Please tick as appropriate)
    (a) Under 25 [ ]            (b) 25-34 [ ]  
    (c) 35-44 [ ]              (d) 45-54 [ ]
    (e) 55-64 [ ]             (f) 65 and over [ ]

12. How long have the CEO been working for company?
    (a) 0-5 years [ ]          (b) 6-10 years [ ]  
    (c) 11-15 years [ ]       (d) 16-20 years [ ]
    (e) Over 20 years [ ]

**Techniques used as compensation packages**

13. Which of these techniques do you use to compensate the CEO? (Tick all appropriate answers)
    (a) Annual salary/ Base salary [ ]             (b) Bonus on turnover growth [ ]
    (c) As a proportion of funds raised [ ]
    (d) Other (Please specify) .................................................................

14. As far as you are concerned how effective are the following compensation packages in your organisation?
<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Annual/Base salary</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Bonus on turnover growth</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Bonus on turnover growth</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Other (Please specify)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

**KEY**

A - Not effective at all   B- Less effective   C – Neutral   D – Effective   E – Very effective

15. What is your annual compensation in total? (Please tick as appropriate)

a) Under £50 000   [ ]

b) £50 000 to >100 000 [ ]

(c) £100 000 to >250 000   [ ]

d) £250 000 to >500 000   [ ]

e) £500 000 to £1m   [ ]

(f) over £1m   [ ]
Factors influencing Executive Compensation

16. How influential are the following factors in determining your executive compensation? (Please circle as appropriate)

<table>
<thead>
<tr>
<th>Factor</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Size of the Company</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(b) Nature &amp; complexity of the company</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(c) Competitor’s packages</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(d) Difficulty &amp; demands of the job</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(f) Donors’ preferences</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(g) Government grants</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(h) Manager length of education &amp; training</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(i) Manager’s level of experience</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(j) CEO length of employment with the company</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(k) Perception of outsiders/ media</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(l) Level of independence of compensation committee</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(m) Managerial reputation at the time of employment</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(o) Government legislation/ code of practice</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(p) Operational costs</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(q) CEO performance</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(r) Organisational growth</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>(s) Quality of Service</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

KEY
A - Not influential at all      B - Less influential   C – Neutral   D – Influential
E – Very influential

Performance Measures

17. Which of the following factors does your Organisation use to measure performance? (Tick all appropriate answers)

Financial performance
(a) Revenue growth           [ ]        (b) percentage of earned income  [ ]
(c) Diversification of revenue sources     [ ]    (d) Programme spending        [ ]
(e) Investment performance    [ ]        (f) High level of fundraising    [ ]
(g) Donor Sustainability  [  ]  (h) Adequate working capital  [  ]
(i). Other (Please specify) …………………………………………………………………………

**Program Effectiveness**

(a) Quality of Product/Service  [  ]  (b) Customer Satisfaction  [  ]  (c) Efficiency  [  ]
(d) Employee Satisfaction rates  [  ]  (e) Board involvement  [  ]  (f) Output  [  ]
(g) Accountability  [  ]  (h) Community involvement  [  ]  (i) Job Creation  [  ]
(j) Competitors’ performance  [  ]
(j) Other (Please specify)………………………………………………………………………………

**Management Effectiveness**

(a) Board meeting attendance  [  ]  (b) Employee turnover rates  [  ]
(c) Percentage of board members as donors  [  ]  (d) Technology competency ratings  [  ]
(e) Improve skills (number of people trained)  [  ]
(f) Other (Please specify)………………………………………………………………………………
18. In your opinion how important are the following performance measures?

<table>
<thead>
<tr>
<th>(a) Financial Measures</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue growth</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Percent of earned income</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Diversification of revenue sources</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Programme spending</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Investment performance</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>High level of fundraising</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Donor Sustainability</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Adequate working capital</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(b) Programme Effectiveness</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of Product/Service</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Efficiency</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Employee Satisfaction rates</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Board involvement</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Output</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Accountability</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Community involvement</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Job Creation</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Competitors’ performance</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

© Management Effectiveness

<table>
<thead>
<tr>
<th>(i) Board meeting attendance</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee turnover rates</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Percentage of board members as donors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Technology competency ratings</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Improve skills (number of people trained)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

**KEY**

A - Not influential at all  
B - Less influential  
C – Neutral  
D – Influential  
E – Very influential
Board composition and Firm Performance

19. In your opinion how influential are the following factors on performance in charities? (Please circle as appropriate)

<table>
<thead>
<tr>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
<th>E</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) The size of the board size</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(i) Small board (0 to 8 members)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(ii) Big board (over 8 members)</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(b) Ratio of inside directors to outside directors in the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(i) More inside directors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(ii) More outside directors</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(c) Gender ratio of directors in the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(i) More female directors on the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(j) More male directors on the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(d) Managerial Power</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(i) CEO as the chair of the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(ii) CEO not the chair of the board</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(iii) When CEO elects the board members</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(e) Board Governance Committees</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(i) Audit committee</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(ii) Nomination committees</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>(iii) Remuneration committees</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
</tbody>
</table>

**KEY**

A - Not influential at all  B- Less influential  C – Neutral  D – Influential  
E – Very influential

**Company Details:**

If you or your company would like to receive a copy or a summary of the research findings please give your details below or enclose your business card:

Your name: ...................................................................................................
Job title of Respondent: ..............................................................................
Address: ........................................................................................................
......................................................................................................................
Telephone Number: ......................................................................................
Once again thanks for taking time to complete this questionnaire

For further inquires, please contact:
Girlie Ndoro on lixgn1@nottingham.ac.uk or Dr Agyenim BOATENG on agyenim.boateng@nottingham.edu.cn
Appendix 2

Specimen Cover Letter

Date: 10 November 2007

The Chief Executive Officer
Mrs Rebecca Wood
Alzheimer’s Research Trust
The Stables
Station Road
Great Shelford, Cambridge
CB22 5LR

Subject: Request for your kind participation in a survey on Executive Compensation and performance: An examination of UK Charities.

Dear Mrs Wood,

We are undertaking a research on executive compensation and performance using evidence from the UK charities. Your charity has been chosen to be part of the sample. We therefore kindly request you to complete the attached questionnaire to help in this research. We wish to stress that the replies to the questions will be treated in strictest confidence. Neither you nor your organisation will be identified at any stage of our analysis, nor in the publication of the results.

We have a number of aims in carrying out this research, but we are particularly interested to find out the determinants of executive compensation and performance in the UK charities. Despite systematic research regards to this issue, executive
compensation still continues to generate controversy among academics and practitioners. Furthermore, the issue of the measurement of performance continue to plague empirical work in charities, therefore this study intent to establish the performance measures that can help charities to be accountable of the good work they are doing and counter criticism for poor management and ineffectiveness. It is therefore anticipated that the findings will be useful, not only to academics interested in this area but also help to find better methods of aligning executive compensation to stakeholders’ interests and also help charities to a certain extent to choose suitable performance measures that will suit their missions of their organisations and thereby assuring donors, governmental funders, and business sponsors, they have the organisational capacity to deliver services effectively. Again we will stress that the results will be presented in highly aggregated form and no other person or organisation will be able to identify your responses.

Although the questionnaire will occupy a short period of your time, your answers will be enormously valuable to this project. When the analysis is completed we will be pleased to send you a summary of the findings. We would be grateful if you respond by the 30/11/ 2007.

Thank you for your time and co-operation.

Yours sincerely,

Girlie Ndoro, (PhD student) Nottingham University and Professor A. Boateng Senior Lecturer and Supervisor.
Appendix 3

Specimen Reminder Letter

Date: 3 June, 2008

The Chief Executive Officer
Mrs Rebecca Wood
Alzheimer’s Research Trust
The Stables
Station Road
Great Shelford, Cambridge
CB22 5LR

Subject: Request for your kind participation in a survey on Executive Compensation and Firm Performance: An Examination of UK Charities.

Dear Mrs Wood,

You may recall that I recently send you a questionnaire concerning research that I am undertaking on the determinants of executive compensation and performance in the UK charities. Despite systematic research regards to this issue, executive compensation still continues to generate controversy among academics and practitioners. Furthermore, the issue of the measurement of performance continue to plague empirical work in charities, therefore this study intent to establish the performance measures that can help charities to be accountable of the good work
they are doing and counter criticism for poor management and ineffectiveness. This study aims to feel that gap with your valuable contribution.

I appreciate how busy you may be at the moment. However, your views on this subject are of great importance to this study, and for that reason I would like to request you yet again to complete the questionnaire at your earliest convenience. Once more, I will stress that your responses will be treated in the strictest confidence and no other person or organisation will be able to identify your responses.

I have attached herewith, another copy of questionnaire for your convenience. When the analysis is completed we will be pleased to send you a summary of the findings. Please your details in the questionnaire if you wish to receive a copy.

Thank you in advance for your time and co-operation in this research.

Yours sincerely,

Girlie Ndoro, (PhD student) Nottingham University and Professor A. Boateng
Senior Lecturer and Supervisor.
Appendix 4

Interview Questions

Executive Compensation and Firm Performance: An Examination of UK Charities.

The questionnaire for the interviews is divided into three main parts as follows:

(1) The first part is concerned with the company’s background.

(2) The second part of the questionnaire has questions about the CEO compensation.

(3) The last part deals with questions relating to performance.

Background Information

1. Which sector of industry is your organisation involved in?

2. What are the main activities of your company?

3. What is the approximate number of employees within your organisation?

4. What is the annual turnover of your organisation?

5. (a) Age of the CEO, (b) Level of education (c) gender (d) How long has the CEO worked for the company?
CEO Remuneration

6. Do you have a guide in respect of how CEO is paid in your organisation?

7. Please can you give me the main provisions contained in the guide (Also if you have the code in written form, I would be glad to have a copy for further analysis)

8. Who determines the CEO’s compensation?
   (If the answer is the - board)
   
   (a) What is the size of the board?
   (b) How many of the board members are paid?

9. In your opinion what are the determinants of CEO compensation in the UK Charities?

10. Which ones do you regard to be the most influential in order? (please rank them) (To suggest the rest if they omit some)

11. In your opinion how influential are the following board composition factors in determining performance in your organisation?
12. In your opinion, is there any relationship between the Executive Compensation and Charitable donations in nonprofit organisations?

13. If so, how?

14. Does the level of government grants to charities influence how Chief Executives are compensated?

15. If yes, please indicate how?
16. Between which ranges does your CEO receive annually as total compensation?

Performance Measures

17. Which factors does your organisation use to measure performance?

18. From these performance measures which ones do you consider to be influential in determining executive compensation in UK charities?

19. In your opinion do you think there are any relationship between pay and performance in the UK charities? Why?
Appendix 5

Reliability Analysis for the UK Charities Performance Measures

<table>
<thead>
<tr>
<th>Variable</th>
<th>Cronbach’s Alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue growth</td>
<td>0.916</td>
</tr>
<tr>
<td>Percentage of earned income</td>
<td>0.914</td>
</tr>
<tr>
<td>Diversification of revenue sources</td>
<td>0.914</td>
</tr>
<tr>
<td>Cost efficiencies</td>
<td>0.913</td>
</tr>
<tr>
<td>Investments performance</td>
<td>0.913</td>
</tr>
<tr>
<td>High level of fundraising</td>
<td>0.914</td>
</tr>
<tr>
<td>Donor Sustainability</td>
<td>0.912</td>
</tr>
<tr>
<td>Adequate working capital</td>
<td>0.911</td>
</tr>
<tr>
<td>Quality of Product/Service</td>
<td>0.912</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>0.910</td>
</tr>
<tr>
<td>Efficiency</td>
<td>0.912</td>
</tr>
<tr>
<td>Employee Satisfaction rates</td>
<td>0.907</td>
</tr>
<tr>
<td>Board involvement</td>
<td>0.910</td>
</tr>
<tr>
<td>Output</td>
<td>0.908</td>
</tr>
<tr>
<td>Accountability</td>
<td>0.910</td>
</tr>
<tr>
<td>Community involvement</td>
<td>0.910</td>
</tr>
<tr>
<td>Job Creation</td>
<td>0.912</td>
</tr>
<tr>
<td>Competitors’ performance</td>
<td>0.912</td>
</tr>
<tr>
<td>Board meeting attendance</td>
<td>0.912</td>
</tr>
<tr>
<td>Employee turnover rates</td>
<td>0.910</td>
</tr>
<tr>
<td>Percentage of board members as donors</td>
<td>0.915</td>
</tr>
<tr>
<td>Technology competency ratings</td>
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<tr>
<td>Improve skills (number of people trained)</td>
<td>0.911</td>
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Number of items = 23
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