

## ARTICLES

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### Board Composition, Committees, and Organizational Efficiency: The Case of Nonprofits

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*This article investigates the relationship between nonprofit board composition and organizational efficiency. Overall, we find a significant statistical association between the presence of major donors on the board and indicators of organizational efficiency. Although causality cannot be demonstrated, our findings are consistent with the Fama and Jensen (1983) conjecture that major donors monitor nonprofit organizations at least in part through their board membership. The multivariate analysis shows that the ratio of total expenses to program expenses is significantly and negatively associated with higher donor representation. Decomposing the total expense ratio into its two components, we find that different factors affect the administrative and fundraising expense ratios. The percentage of major donors on the finance committee, a key committee overseeing budgets and administrative expenses, is negatively related to the organization's administrative expenses ratio. The presence of major donors on other board committees is not significantly statistically associated with nonprofit efficiency.*

**Keywords:** *nonprofit governance; organizational efficiency; committees*

This study tests empirically the hypothesis that efficiency of the nonprofit organization is related to the existence and composition of its board of trustees and board committees.<sup>1</sup> Specifically, we concentrate our analysis on the role of major donors on boards and board committees in promoting organizational efficiency. Although a great deal of empirical work has been done trying to

link for-profit corporate governance with corporate performance, especially as it concerns the composition of the board of directors and, to a lesser extent, committee composition, much less empirical research has been done linking nonprofit governance with nonprofit performance. The recent review of the nonprofit literature by Stone, Bigelow, and Crittenden (1999) confirmed the paucity of nonprofit research regarding this linkage. More recently, Murray and Cutt (2000) stated that "There are four ways to check what actually occurs in the realm of nonprofit board evaluation of organizational performance: One is to look at research which has directly and specifically examined this topic. It will be seen that there is very little of this" (p. 196). This article attempts to fill the relative void by analyzing empirically a sample of U.S. nonprofit organizations that depend on donations for a significant portion of their funding.

The theoretical governance literature provides little guidance concerning the linkage between nonprofit governance and efficiency. One clear, testable hypothesis is the conjecture offered by Fama and Jensen (1983), who maintained that major donors are essential in monitoring the efficiency of nonprofit organizations. An important mechanism for monitoring the nonprofit organization is the board of trustees. In their view, major donors on nonprofit boards monitor the organization in ways that are parallel to large shareholders on for-profit boards.<sup>2</sup> The analysis of nonprofits by Hansmann (1980) bolstered this argument. Hansmann argued that the nonprofit form economizes on contracting costs with the purchaser (donor) especially when the purchaser of the good or service is not the recipient. By the same token, representation of major donors on the board in a monitoring capacity also helps to minimize contracting costs insofar as large donors on the board act as a credible signal to other donors that the goods or services supplied by the organization are of reasonable quality and that resources are not being squandered (or captured) by management. Monitoring on the part of large donors may be substantive and proactive or it may be passive. Just having large donors on the board may make the CEO more attentive to potential donor concerns such as the size of administrative budgets.

Although the Fama-Jensen (1983) conjecture is somewhat compelling, it also has its detractors. Williamson (1983), for one, contended that major donors may take their responsibilities fairly casually, having little monetary incentive, once the donations are given, to attend to dysfunctional managerial behavior. This is especially so if such behavior is unlikely to become public knowledge. Also, major donors can restrict the use of their funds to specific activities or the acquisition of specific fixed assets, reducing their personal incentive to monitor the organization's general activities.

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If the nonprofit organization is essentially a nexus of multiple constituencies, as has been suggested in the nonprofit literature (D'Aunno, 1992; Herman & Renz, 1997; Murray & Tassie, 1994), the definition of organizational efficiency is likely to differ among constituent types. As a consequence, there should be an association between those ratios that donors are likely to care about and donor board participation. Therefore, we measure organizational efficiency by three metrics: the ratio of administrative expenses to total expenses, the ratio of fundraising expenses to total expenses, and the ratio of program expenses to total expenses.<sup>3</sup> Efficiency ratios of these sorts are widely used by researchers (Callen, 1994; Posnett & Sandler, 1989; Tinkelman, 1996, 1998; Weisbrod & Dominguez, 1986), by nonprofit board committee members (Stout, 1997), by nonprofit rating agencies, and by the popular press as a measure of nonprofit efficiency even though some observers have questioned their appropriateness. For example, Letts, Ryan, and Grossman (1998) argued that undue emphasis on these ratios induces dysfunctional behavior in charities including underinvestment in the necessary organizational capacity to function effectively.

The conjecture that donors to nonprofits are likely to focus on specific ratios can also be rationalized from an *institutional theory* model, as discussed by D'Aunno (1992). Under this model, widely held beliefs and rules in the environment often influence organizational structure and behavior. Organizations such as nonprofits whose outputs or outcomes are especially difficult to measure face strong pressures to conform to expectations about how they should behave. Therefore, to the extent that the outside environment in which nonprofits operate perceives ratios such as the proportion of program expenses to be related to organizational efficiency, nonprofits are likely to adopt such ratios as meaningful performance metrics. The exaggerated response by business school deans to business periodical ratings is another case in point.

The next section briefly reviews the implications of the extant empirical literatures on the relationship between governance and organizational performance in both the for-profit and nonprofit sectors. Next, we describe the sample, then develop and test hypotheses relating nonprofit governance at the board level and nonprofit efficiency performance, then test similar hypotheses at the committee level.

## PREVIOUS EMPIRICAL STUDIES

### The For-Profit Literature on Boards and Board Committees

A relatively large number of studies has examined the relationship between board composition and overall for-profit firm performance. *Board composition* in this literature is usually defined as the percentage of outside (or inside) directors on the board; *firm performance* is measured typically by accounting

variables, such as return on assets, return on equity, variations on Tobin's Q ratio, net earnings, and growth in sales.

Overall, these studies have yielded contradictory results. Baysinger and Butler (1985) found some evidence that companies perform better if their boards have more outsiders. MacAvoy, Cantor, Dana, and Peck (1983), Hermalin and Weisbach (1991), and Bhagat and Black (1999) obtained little to no evidence that the proportion of outsiders (or insiders) on the board is related to stock market performance or accounting measures of profitability. In contrast, Molinari, Morlock, Alexander, and Lyles (1993); Klein (1998); and Agrawal and Knoeber (1996) found a negative relationship between firm performance and the percent of outsiders on the board. In a different vein, Yermack (1996) maintained that smaller corporate boards are actually more efficient than larger boards due to an inverse relationship between board size and firm value.

Klein (1998) examined the relation between firm performance and board committee composition. She found a positive relationship between the percentage of inside directors on board committees dealing with long-term strategic investment decisions and various accounting and market measures of firm performance. She also reported more positive stock market reactions around proxy mailing dates for firms whose boards propose to increase the percentage of insiders on these committees than for firms whose boards propose to decrease this percentage. Klein (1998) found no significant cross-sectional relationships between the percentage of outside directors on board monitoring committees (e.g., audit and compensation) and firm performance, although she found some weak evidence that markets react positively to increases in the percentage of outside directors on board compensation committees.

#### The Nonprofit Literature on Boards

There are numerous management and practitioner-oriented prescriptive papers and books on how nonprofit boards should operate. The empirical literature dealing with the actual impact of nonprofit boards is far more limited, exploratory, and diffuse. By *limited* and *exploratory*, we mean such studies as Plambeck (1985), who looked at the board effectiveness of four large metropolitan United Way organizations; or Widmer (1993), who investigated the roles played by 13 nonprofit boards' members.

Bradshaw, Murray, and Wolpin (1992) pointed out that this literature falls into two major categories: (a) empirical studies using subjective performance measures, such as self-reported ratings by organizational members (e.g., Miller, Weiss, & MacLeod, 1988; Young, Beekun, & Ginn, 1992); and (2) empirical studies using more objective measures of performance. The latter, in turn, fall into three subcategories: measures of board performance in obtaining resources, measures of board performance in organizational goal attainment (effectiveness), and measures of board performance in transforming inputs

into outputs (efficiency). Empirical studies with objective measures of performance are relatively few, as we shall now see.

Some of the early studies supported the view of the management literature concerning the importance of the external environment on nonprofit board performance. Price (1963), examining the board of the Oregon Fish and Game Commission, found that board members tend to serve as a buffer between staff and the public at a time when the legitimacy of the organization is being questioned rather than as an effective monitor of internal administration. Zald (1967) showed that boards of Chicago YMCAs are more likely to spend time raising funds than involving themselves with programs or attending meetings because fundraising is considered more crucial for the organizations' existence. Pfeffer (1973) discovered that hospital boards dependent on local communities for support tend to coopt local well-known community leaders to raise funds. In contrast, hospitals dependent on religious groups or the federal government for support have boards that are involved to a greater extent in administrative activities. For a different sample of hospital boards, Pfeffer and Salancik (1978) found that fundraising is a more important function for boards of (private and nonprofit) hospitals characterized as dependent on private donations. By comparison, hospitals (public and profit seeking) characterized as dependent on federal funds are more concerned with the internal administration of the organization. Provan's study (1980) of 46 nonprofit human service agencies concluded that their boards are more useful in protecting the agencies' resources during crises than in raising funds.

A few studies tried to relate nonprofit governance directly to organizational performance. Siciliano (1990) found that the proportion of businesspeople on YMCA boards is either unrelated to, or negatively related to, organizational performance. She also found a positive relationship between board involvement in formal planning and a measure of social performance. Bradshaw et al. (1992) studied a cross section of Canadian nonprofits. They found that board effectiveness, as measured by avoiding deficits and overseeing three years of budget growth, is related primarily to strategic planning variables and, albeit to a much lesser extent, to variables proxying for common vision, conflict avoidance, and board formalization. It is interesting that they found board effectiveness to be unrelated to board size and the number of committees. Callen and Falk (1993) related the efficiency of 73 Canadian *specific health focus* charities to the composition of the board of trustees in terms of its members' status as *insiders* or *outsiders*. Measuring efficiency by data envelopment analysis, they found no significant relationship between efficiency and board composition. Green and Griesinger (1996) studied 16 nonprofit organizations and correlated their qualitative effectiveness measure, based on ratings by the authors, practitioner-experts, and a government funding source, with data on the board's effectiveness obtained from CEOs and board members. They found that effectiveness is correlated with the extent of board activity in various board responsibilities, especially strategic planning, board development, resource development, financial management, and conflict

resolution. Herman and Renz (1997) investigated the criteria that various stakeholders use to judge nonprofit effectiveness, using archival data and questionnaire data from individuals associated with 25 developmental disabilities organizations and 34 health and welfare charities. Subject to major caveats about their data source, they found differences in effectiveness scores between types of stakeholders: "The correlations of each stakeholder group's judgments in relation to the other groups show rather low agreement (or no agreement, in one case)" (p. 196).

Olson (2000) studied the relation between various aspects of board characteristics at 43 independent colleges and the colleges' gifts and total revenues. He found a significant positive relationship between board size and total gifts (but not revenues). He noted that nonprofit boards often fill both a monitoring role, parallel to that of for-profit boards, and a resource acquisition role. His findings were consistent with larger boards, with more outside contacts, functioning more effectively in helping the organization to obtain resources. He also found board tenure and the number of members with executive backgrounds to be positively associated with at least one of his performance measures.

#### Implications of the Extant Literatures for This Study

The empirical for-profit studies relating firm performance to the proportion of outsiders on the board are essentially irrelevant for donation-reliant U.S. charities, because those charities normally have no more than one insider on the board. This is due to the influence of monitoring organizations, such as the BBB Wise Giving Alliance, whose standards call for nonprofit boards to have, at most, one staff member. Far more important for our purposes is the study by Klein (1998), which provided limited evidence that board composition, proxied by board committee composition, affects organizational performance; and the study by Yermack (1996), which implied that board size alone may affect organizational performance.

The nonprofit literature suggests that the role of board members vis-à-vis the charity's external environment may influence the efficiency of the organization. Specifically, there is limited evidence suggesting that the monitoring role of board members may be tempered by the organization's more strategic needs. This suggests that board members most able to deal with these needs are more likely to play a role on committees dedicated to those needs. Because fundraising is often a strategic need for nonprofits, major donors may be placed on the fundraising committees of those organizations heavily dependent on outside fundraising rather than on monitoring committees, because of their presumed comparative advantage at raising funds. In addition, unlike Yermack's (1996) findings, Olson's (2000) findings suggested that larger nonprofit boards may be associated with more efficiency through their better ability at obtaining resources.

The literature advocating a multiple constituency approach to understanding nonprofits has suggested that there is no single organizational or board effectiveness criterion that all stakeholders perceive similarly. Rather, each group measures effectiveness on the basis of criteria and impressions most relevant to it. This literature has provided significant motivation for our study that investigates whether the data are consistent with donors on the board using ratios as effectiveness measures to influence the organization toward the donor point of view. Whether such behavior by donors is functional or dysfunctional behavior is beyond the scope of this study.

### SAMPLE COLLECTION AND DATA DESCRIPTION

The data for this study come from two sources. Financial data were obtained from a large database of regulatory filings maintained by the New York State Department of Law. Governance data were obtained by a mail survey of organizations selected from the New York State database.

New York State requires all organizations soliciting more than \$25,000 annually in the state to file annual financial reports, unless the organization qualifies for exemption on religious or other grounds. As a consequence, the New York State database contains national as well as local organizations. The database maintains key financial statistics based on these annual reports for each organization for a period of up to 3 years. The financial reports of these organizations follow *generally accepted accounting principles* with certain minor exceptions, and they are publicly available. If the organization solicits over \$100,000 annually in donations, the financial reports must be audited. The latter requirement, as well as the more comprehensive nature of the New York State report, means that the New York State data dominate the alternative federal Form 990 data that contain unaudited financial information.<sup>4</sup>

In performing this study, financial data appearing on the December 1994, November 1995, and June 1996 databases are used to select organizations for the mail survey. Together, these databases contain information from over 7,000 organizations reporting nonzero revenues for fiscal year 1992 to fiscal year 1994, the latest complete year available at the time the survey was mailed. Financial data for 1994 contained in these databases are used in the analysis. Financial data for 1995 and 1996 used in the analysis are from the reports entitled *Where the Money Goes—The AG's Report for 1997* and *Where the Money Goes—The AG's Report for 1998* (New York State Office of the Attorney General, 1998, 1999).

To select organizations from the database for the mail survey, two criteria were imposed. The organization received over \$2.5 million in 1992 direct contributions (private donations less funds raised by other organizations, such as United Way), and direct contributions exceeded 10% of total 1992 receipts. These sample criteria were chosen for two reasons. First, because the study analyzes the influence of major donors on nonprofit governance, it was

decided to focus on organizations with significant donations. Second, the efficiency metrics used in this study may be less useful to donors of small organizations or organizations that do not rely on donations for a significant portion of their revenues (Tinkelman, 1996, 1999). These criteria reduced the initial sample to 473 organizations.<sup>5</sup>

Although the focus on larger organizations does affect the potential for generalizing the results of this study, large nonprofits are economically quite significant. Crittenden (2000) indicated that in 1998, "Fewer than 4 percent of nonprofits (excluding foundations) that report to the IRS have expenses higher than \$10 million, but are responsible for more than three-quarters of the sector's assets" (p. 164). Also, given our focus on these ratios, we chose a sample for which the data are more likely to be reliable. Tinkelman (1999), in particular, found that donor sensitivity to expense ratios was greater in the type of sample analyzed here.

The survey was mailed in the summer of 1995 to the 473 organizations meeting the selection criteria. The survey responses were prepared by organizational staff members in each of the organizations that agreed to be surveyed. Typically, the staff member responsible was at the executive director or corporate secretary level, because no one else had the data. In no case did board members fill out the survey. Anonymity of the response was guaranteed by committing to publish aggregate results only, without reference to specific organizations. In total, we received 123 replies, a 26.0% response rate. This response rate is similar to that of the "popular" nonprofit survey sponsored by the National Center for Nonprofit Boards (Slesinger & Moyers, 1995). Respondents were telephoned when the replies were incomplete or ambiguous.

The organizations that replied to the survey are similar in size and in reliance on direct contributions to the nonresponders, but they are somewhat less local in focus. The mean 1994 total revenues of the replying and nonreplying organizations are \$23.6 million and \$25.1 million, respectively. In both cases, the mean 1994 direct contribution is \$13.0 million. The mean percentages of 1994 expenses devoted to program costs for replying and nonreplying organizations are 78.1% and 75.8%, respectively. Of the replying organizations, 43.1% have addresses in New York State, and 51.3% of the nonreplying organizations have New York addresses. The replying organizations are concentrated in the areas of health (19.5%), fundraising or support organizations such as the United Way (18.7%), social welfare (17.1%), cultural-educational organizations (14.6%), and public policy (13.8%). The nonreplies are concentrated in similar categories, with somewhat greater representation in the public policy (17.5%) and cultural-educational categories (19.8%), and somewhat less in the health category (15.8%). Overall, the two samples appear similar in size, location, and expense ratios, reducing the probability of self-selection bias.

Table 1 and Table 2 present summary statistics of the governance variables. Table 1 contains descriptive data regarding characteristics of the boards,

**Table 1. Characteristics of Nonprofit Boards—Selected Summary Data<sup>a</sup>**

<i>Board Size</i>		
	Mean	28.1
	Median	25.0
	Maximum	105.0
Number of board meetings per year (median) <sup>b</sup>	3-5	
Women as % of board (median)	10-30%	
Board members with over 5 years service as % of board (median)	51-75%	
<i>Median % of Board Members Serving on:</i>		
	Other nonprofit boards	51%-75%
	For-profit boards <sup>c</sup>	Under 25%
<i>Composition of Board</i>		
	<i>Mean</i>	<i>Percentage</i>
Staff	0.6	2%
Major donors	7.2	26%
Persons with professional skills	10.4	37%
Well-known individuals	5.0	18%
Other	4.9	17%
Total	28.1	100%

a. The summary data in this table are based on a sample size of 123 organizations.

b. The survey asked for ranges rather than point estimates for some of the data.

c. There were numerous nonreplies to this question.

whereas Table 2 contains descriptive data on the existence and composition of board committees.

As shown in Table 1, the mean (median) board has 28.1 (25) members. By comparison to for-profit boards, nonprofit boards tend to be larger and to be numerically dominated by outsiders rather than staff. Average for-profit board size is about half of that of nonprofit boards. The proportion of inside directors, the equivalent of our staff category, on for-profit boards averages from 22% to 36% (excluding affiliated directors) depending on the specific breakdown (Klein, 1998; Yermack, 1996).

The mean number of paid staff on the board is only 0.6. Generally, the respondents report either one or no staff members on the board, consistent with the requirements of nonprofit rating agencies. The survey responses also suggest that board members have developed some relevant experience in managing nonprofit organizations—the median organization reports that between 51% and 75% of board members have served over 5 years, and the same percentage also serve on other nonprofit boards. Boards most often met between three and five times per year (55%), with most of the remaining boards meeting either two or “six to eight” times per year. This is in contrast to the findings of Klein (1998), who reported that the median number of annual meetings in her for-profit sample is eight. The median percentage of women on the board is from 10% to 30%.

**Table 2. Characteristics of Committees—Selected Summary Data<sup>a</sup>**

<i>Committee</i>	<i>% of Respondents With This Committee</i>	<i>Mean (Median) No. of Members on Committee</i>	<i>Mean (Median) No. of Staff Members</i>	<i>Mean (Median) % of Members Who Are Major Donors</i>	<i>Mean (Median) % of Members With Professional Skills</i>
Audit	35.0%	4.9 (4.0)	0.3 (0.0)	14.0% (0.0%)	64.9% (67.0%)
Fundraising	61.8	24.6 (9.0)	0.5 (0.0)	31.0 (29.0)	34.8 (33.0)
Executive	85.4	8.8 (8.0)	0.5 (0.0)	21.2 (8.0)	37.3 (33.0)
Finance	70.7	8.1 (7.0)	0.5 (0.0)	18.2 (10.0)	52.1 (50.0)
Investment	40.6	5.9 (5.0)	0.4 (0.0)	15.5 (0.0)	62.9 (67.0)
Nominating	71.5	6.2 (5.5)	0.2 (0.0)	22.4 (0.0)	31.4 (25.0)
Compensation	35.8	5.6 (5.0)	0.5 (0.0)	15.8 (0.0)	43.6 (43.0)
Program	56.9	10.8 (9.0)	0.6 (0.0)	14.8 (0.0)	46.2 (40.0)
Board		28.1 (25.0)	0.6 (0.0)	25.6 (9.5)	37.0 (33.0)

a. The summary data in this table are based on a sample size of 123 organizations.

*Note:* Of the respondents, 27.6% noted they had committees other than those listed, including committees dealing with planning and with building matters. The figures cited in the table are the means (medians) of the organizations with the specified committees:

Audit Committee: Hires/fires/supervises auditors.

Fundraising Committee: Coordinates efforts to raise donated funds, whether by direct mail, telephone campaigns, direct personal solicitation of donors, or by special fundraising events, such as dinners.

Executive: Acts in place of the board when the board cannot, or chooses not to, meet.

Finance: Oversees the financial management of the organization, including the organization's budgeting and financial reporting processes. This committee often has the functions of an audit committee if there is no separate audit committee, and sometimes the functions of a compensation committee if there is no separate compensation committee.

Investment: Oversees the organization's investments, which are typically in marketable securities.

Nominating: Nominates new officers and people for the board.

Compensation: Oversees executive pay and benefits issues.

Program: Oversees one or more of the organization's operating programs.

In the survey, respondents were asked to categorize board members and board committee members by the primary reason for which these individuals had been selected for membership. Specifically, respondents to the survey were asked to declare whether the primary reason for selection to the board (or committee) was the member's status as an employee, a major donor, a well-known person who enhances the organization's image (e.g., a celebrity), a person with a useful professional skill (e.g., an investment advisor), or another reason. The other category will typically include retired staff, ex-officio members from parent or affiliated organizations, and some individuals who are interested in the mission and who have the intelligence and social skills to make them desirable board members. When a person fit equally into two categories, fractions were used. It is worth noting that neither the New York State report nor the federal Form 990 provides data identifying the composition of nonprofit boards. This can only be done by survey.

Exactly who is a "major" donor was left to the discretion of the organization staff member who filled out the survey. Although this induces noise in the measure, any definition of a major donor must be organizationally dependent. A major donor to one organization may be "small fry" to another organization, and any external criterion of what constitutes a major donor is likely to be quite arbitrary.

The largest single category of board member is *persons with a useful professional skill*. These constituted 37% of the boards on average. *Major donors* constituted 26%, and *well-known individuals* constituted 18%.

As shown in Table 2, nonprofit organizations vary widely as to board committee types and compositions. The most common committee is the executive committee, which is present in 85.4% of the organizations. Finance and nominating committees are the next most common (present in over 70% of the organizations), but audit and compensation committees are present in only 35.0% and 35.8% of the organizations, respectively.

The composition of board committees may differ from that of the board for a number of potential reasons. First, people with particular skills or interests are likely to gravitate toward certain committees. Second, nonprofit organizations sometimes allow people other than board members to serve on committees, presumably as a way of mobilizing volunteer labor. Depending on the committee, up to 64% of the respondents had at least one non-board member serving on committees. Third, the motive for selecting a person to the board need not be the same as the reason for selecting that person to serve on a particular committee.

Major donors are best represented on the fundraising, nominating, and executive committees, where, on average, they make up 31.0%, 22.4%, and 21.2% of the members, respectively, and they are least represented on audit and program committees, where they make up only 14.0% and 14.8% of the committees, respectively. People with particular professional skills are most highly represented on the audit, investment, and finance committees (64.9%, 62.9%, and 52.1%, respectively), and they are least represented on the

fundraising and nominating committees (34.8% and 31.4%, respectively). Respondents mentioned skills such as accounting and investment expertise as being the major factors in selecting members of the audit, finance, and investment committees.

The committees least likely to give membership to people other than board members are the audit and nominating committees (not tabulated), which only allow non-board membership in 31% and 20% of the responses, respectively. This was substantially lower than the 51% to 64% range for the other committees. These committees also had lower staff representation than other committees.

## HYPOTHESES AND EMPIRICAL RESULTS—THE BOARD

### Hypotheses

This section of the article uses multivariate regression analysis to test three conjectures proposed by the literature concerning the relationship between organizational efficiency and the composition of the board of directors. Following Weisbrod and Dominguez (1986), Posnett and Sandler (1989), Callen (1994), and Tinkelman (1996, 1998, 1999), among others, nonprofit organizational efficiency is measured by the log ratio of administrative expenses to total expenses, by the log ratio of fundraising expenses to total expenses, and by the log ratio of total expenses to program expenses. All three metrics increase in organizational inefficiency. Total expenses are the sum of administrative expenses, fundraising expenses, and program expenses. The data for calculating these ratios are taken from the New York State Department of Law data filings. Separate ratios for each organization are calculated for fiscal 1995 and 1996.

According to the Financial Accounting Standards Board, *Financial Statements of Not-For-Profit Organizations* (1993), *administrative expenses* are those expenses associated with the management and general activities of the organization including “oversight, business management, general record keeping, budgeting, financing, and related administrative activities, and all management and administration except for direct conduct of program service or fundraising activities.” *Fundraising expenses* are those expenses associated with the efforts to raise donated funds including salaries of fund-raisers, fundraising fees if fundraising is outsourced, fundraising dinners expenses, fundraising brochures, and telephone and direct mailing expenses associated with fundraising activities.

A caveat concerning this breakdown of expenses is in order here. The classification of expenses into administrative, fundraising, and program expense categories requires judgment, especially when organizations incur joint costs to carry out multiple functions. The accounting allocation of joint costs incurred in mailing materials that serve both a public education and a

fundraising purpose has been controversial for many years. At the time of this study, the relevant accounting standard (AICPA Statement of Position 87-2; AICPA, 1987) required organizations with such costs to disclose additional information about them. Tinkelman (1998), in a study of a sample of organizations chosen because of their high expected levels of joint costs, found evidence consistent with large donors using this additional information to refine their judgments of organizational efficiency. The use of judgment in allocating expenses and the use of judgment by financial statement users in interpreting such data are sources of possible measurement error in the efficiency metrics tested in this article.

Following Fama and Jensen (1983), our first hypothesis is that the greater the proportion of major donors on the board, the greater is the organization's efficiency in minimizing nonprogram expenses and its components. Williamson (1983) predicted no relationship between the presence of major donors on the board and organizational efficiency.

Following Olson (2000), our second hypothesis is that the log of board size is positively related to efficiency in obtaining resources through fundraising efforts and thus negatively related to our efficiency ratios.

Third, following Pfeffer and Salancik (1978), we test whether organizations relying principally on private donations (rather than governmental and internal sources) are less efficient because board members of such organizations are more likely to be concerned with the external fundraising environment rather than with internal efficiency issues. The alternative point of view is that donors (and nonprofit rating organizations) may penalize administratively inefficient organizations, so that those organizations most dependent on outside donations try hardest to appear efficient. The proportion of direct contributions is taken from the New York State data.

Consonant with the accounting and finance literatures (e.g., Callen & Falk, 1993), our models control for the organization's debt capitalization (as a proportion of total assets). The effect of debt capitalization is difficult to predict. One argument is that organizations financed by a larger proportion of debt will be monitored more extensively by the debt holders and are, therefore, likely to be more efficient. Because interest is an administrative expense, however, a high debt level could decrease overall efficiency as measured in this study, potentially yielding confounding results. Unfortunately, the New York database does not report interest expense separately. Debt and total assets are obtained from the New York State database.

We also control for organizational size. Tinkelman (1996) suggested that larger, better-established nonprofit organizations tend to be more efficient. Therefore, we predict a negative relation between the efficiency metrics and total assets.

Finally, following Weisbrod and Dominguez (1986) and Posnett and Sandler (1989), we control for organizational type. *Organizational type* is taken from the New York State database. We include industry dummies for the five most common types of organizations in our sample: health, support (which

includes organizations like United Way that raise financing for other organizations), cultural-educational, public policy, and social welfare. Because only support organizations show significance, the regressions below include the support organization dummy variable only. These organizations are unique in that they spend relatively little on their own programs, and they tend to have much larger boards than the others.

It is interesting to note that there are no significant differences in our sample among health, cultural-educational, public policy, and social welfare organizations in explaining variations in the efficiency metrics or in the sensitivity of these metrics to donor membership on boards. This is consistent with Tinkelman (1999) who found that donor sensitivity to the price of donations is unrelated to organizational type after controlling for such factors as the percent of direct contributions.

As robustness tests, we also included a number of other board characteristics as control variables, such as average board tenure. An alternative proxy to organizational size, the log of the organization's age, was also tried. None of these variables proved significant.

#### Summary Statistics

Of the 123 survey responses received, only 119 proved usable because of missing governance data. Missing financial data from the NYS database further limited the sample sizes. The final sample sizes are 95 organizations for 1995 and 108 organizations for 1996, respectively. Because of missing financial data, one additional 1996 data point was dropped from the board data in the regressions below.

Table 3 shows 1996 data bivariate Spearman correlations (and related  $p$  values) for the variables used in the board-level regressions below. The 1995 Spearman and Pearson correlations for 1995 and 1996 are qualitatively similar and are not shown. It is interesting that the proportion of major donors on the board is positively correlated with the size of the board and with the size of the organization, and it is negatively correlated with the proportion of direct contributions. Intuitively, these results suggest that large boards may be formed to mobilize fundraising support and that major donors are most useful in such activities, consistent with Olson (2000). Not surprisingly, because fundraising and administrative expense ratios are components of total expenses, they are positively correlated with the program expenses ratio.

#### Administrative Expense Efficiency

Separate ordinary least squares (OLS) regressions are estimated for 1994, 1995, and 1996. Pooling the regressions would not be meaningful because the same 1995 governance data are used in all regressions. In fact, nonprofit boards tend to be very stable. As Table 1 indicates, between 51% and 75% of board members in the median organization serve five years on the board.

**Table 3. Spearman Correlations (*p* values)—1996 Data**

	<i>Major Donors</i>	<i>Board Size</i>	<i>Direct Contributions</i>	<i>Debt to Assets</i>	<i>Total Assets</i>	<i>Support Dummy</i>	<i>Fundraising Expenses Ratio</i>	<i>Administrative Expenses Ratio</i>
Program expenses ratio	-0.13 (0.17)	0.04 (0.74)	-0.04 (0.69)	0.08 (0.39)	-0.06 (0.55)	-0.26 (0.01)	0.39 (0.00)	0.18 (0.07)
Major donors		0.46 (0.00)	-0.19 (0.05)	-0.08 (0.40)	0.45 (0.00)	-0.06 (0.54)	0.04 (0.68)	0.15 (0.12)
Board size			-0.28 (0.00)	0.12 (0.21)	0.34 (0.00)	0.03 (0.72)	0.27 (0.01)	0.34 (0.00)
Direct contributions				-0.07 (0.45)	-0.57 (0.00)	0.04 (0.66)	-0.00 (0.98)	-0.58 (0.00)
Debt to assets					-0.14 (0.15)	-0.08 (0.42)	0.36 (0.00)	0.20 (0.04)
Total assets						-0.08 (0.41)	0.18 (0.06)	0.69 (0.00)
Support dummy						-0.20 (0.04)	-0.19 (0.05)	
Fundraising expenses ratio								0.44 (0.00)

*Note:* Figures in parentheses are two-tailed *p* values.

The correlations are based on *n* = 108 observations (organizations).

Administrative expenses ratio is measured as the log proportion of administrative expenses to total expenses.

Fundraising expenses ratio is measured as the log proportion of fundraising expenses to total expenses.

Program expenses ratio is measured as the log proportion of total expenses to program expenses.

Major donors are measured as the log proportion of the board who are major donors.

Board size is measured as the log of board size.

Direct contributions is measured as the proportion of direct contributions to income.

Debt to assets is measured as the proportion of total liabilities to total assets.

Total assets are measured as the log of prior year total assets.

Support industry is a dummy variable equal to 1 if the organization is a support organization (e.g., United Way) and 0 otherwise.

**Table 4. Regressions of Administrative Expenses, Fundraising Expenses, and Program Expenses Ratios on Board—Organizational Characteristics**

	<i>Administrative Expenses Ratio</i>		<i>Fundraising Expenses Ratio</i>		<i>Program Expenses Ratio</i>	
	1996	1995	1996	1995	1996	1995
Intercept	-3.306 (0.000)	-2.855 (0.104)	-2.573 (0.209)	-1.575 (0.478)	0.219 (0.221)	0.394 (0.034)
Major donors (-)	-0.517 (0.104)	-0.742 (0.098)	-0.816 (0.284)	-1.077 (0.210)	-0.156 (0.021)	-0.144 (0.043)
Board size (+)	0.101 (0.305)	0.204 (0.170)	0.643 (0.007)	0.622 (0.031)	0.022 (0.282)	0.011 (0.648)
Direct contributions	-0.955 (0.000)	-0.911 (0.009)	1.114 (0.051)	1.108 (0.095)	-0.003 (0.947)	0.010 (0.858)
Debt to assets (-)	-0.105 (0.675)	0.063 (0.856)	0.824 (0.173)	0.055 (0.934)	-0.000 (0.997)	0.001 (0.987)
Total assets (-)	0.078 (0.093)	0.036 (0.564)	-0.181 (0.105)	-0.233 (0.055)	-0.000 (0.968)	-0.009 (0.348)
Support industry	-0.315 (0.045)	-0.626 (0.005)	-0.926 (0.015)	-1.262 (0.004)	-0.091 (0.007)	-0.105 (0.003)
<i>N</i>	107	95	107	95	107	95
Adj. R <sup>2</sup>	0.271	0.168	0.157	0.148	0.058	0.084
<i>F</i> -test <i>p</i> value	0.000	0.001	0.001	0.002	0.061	0.032

*Note:* Figures in parentheses are two-tailed *p* values

*N* = Number of observations (organizations)

Administrative expenses ratio is measured as the log proportion of administrative expenses to total expenses.

Fundraising expenses ratio is measured as the log proportion of fundraising expenses to total expenses.

Program expenses ratio is measured as the log proportion of total expenses to program expenses.

Major donors are measured as the proportion of the board who are major donors.

Board size is measured as the log of board size.

Direct contributions is measured as the proportion of direct contributions to income.

Debt to assets is measured as the proportion of total liabilities to total assets.

Total assets are measured as the log of prior year total assets.

Support industry is a dummy variable equal to 1 if the organization is support organization (e.g., United Way) and 0 otherwise.

Table 4 shows the regression results for each of three dependent variables, namely, administrative, fundraising, and program expenses ratios, for 1995 and 1996. Fairly similar results (not shown) obtain for 1994.

Although these ratios sum to one, the equations need not be estimated as a system, nor should an adding-up constraint be imposed on the estimation procedure. Specifically, because the regressors are the same throughout equations and because there are no cross-equation *parameter* restrictions (as opposed to the adding-up constraint that restricts the variables and not the parameters), any system estimation procedure such as *seemingly unrelated regressions* (SUR) or *full information maximum likelihood* (FIML) necessarily yields the same results as equation-by-equation OLS estimation. Moreover, because the data satisfy the adding-up constraint by construction (and so it is not a constraint to be tested), the individual OLS coefficient estimates must satisfy this constraint as well in that the predicted values of the three regressions will add up to satisfy the constraint. The independent variables in Table 4 are based on the hypotheses developed above. If the hypothesized sign is unambiguous, then it is shown in parentheses beside each independent variable. Negative coefficients denote greater efficiency.

In the first two columns of Table 4, the log proportion of administrative expenses to total expenses is regressed on the proportion of major donors on the board, the log of board size, the proportion of funds raised from direct contributions, the proportion of total liabilities to total assets, the log of total assets (as of the beginning of the year), and the support organization dummy. The regressions yield three results concerning administrative expense efficiency that are fairly consistent throughout both years. First, the major donors coefficient is negative and statistically significant at around the 5% significance level for a one-tailed test.<sup>6</sup> This is consistent with the Fama-Jensen (1983) conjecture that major donors monitor the efficiency of nonprofit organizations in that the greater the proportion of major donors on the board, the lower the administrative expenses are as a proportion of total expenses. Second, the proportion of direct contributions is negative and highly statistically significant. Thus, the greater the proportion of funds raised from direct contributions, the more efficient the organization is in minimizing administrative expenses. This finding is consistent with the argument that donors (and nonprofit rating organizations) penalize administratively inefficient organizations, so that those organizations most dependent on outside donations try hardest to appear efficient. The inclusion of fundraising costs in total expenses is not the cause of this result, because a similar result obtains when the dependent variable is defined as the log of program expenses divided by administrative expenses. Third, support organizations (like United Way) have significantly less administrative to total expenses in comparison with the other four organizational types. As noted above, additional independent variables, which differentiated among the other organizational types, did not have significant coefficients, nor did their inclusion affect the other results. The other independent variables are not consistently significant among the two years.

#### Fundraising Expense Efficiency

In the middle two columns of Table 4, the log ratio of fundraising expenses to total expenses is the dependent variable. Again, a negative coefficient denotes greater efficiency. What appears to affect fundraising efficiency is quite different from what affects administrative expense efficiency. Although the proportion of major donors on the board is negatively related to the proportion of fundraising expenses, the effect is not significant at conventional levels in both years. There are four statistically significant effects, however, that are consistent throughout both years. First, the larger the board, the less efficient the organization is with respect to fundraising expenses. Although this is consistent with Yermack's (1996) finding, the reason that large boards are inefficient may be very different in the case of nonprofits. If, after controlling for major donors, the board is still large, then it is very likely that the nonprofit raises money from a wide public, implying the need for significant fundraising costs. Indeed, this is consistent with the negative correlation in Table 3 between board size and reliance on private donations. Second, direct contributions are positively related to fundraising inefficiency. Third, larger organizations are significantly more efficient when it comes to fundraising expenses. Fourth, as in the case of administrative expenses, support organizations are significantly more efficient with respect to fundraising costs.

#### Program Expense Efficiency

An efficient organization minimizes nonprogram expenses relative to program expenses so that the greater the ratio of total expenses (comprising program and nonprogram expenses) is to program expenses, the more inefficient is the organization. In the last two columns of Table 4, the log proportion of total expenses to program expenses is the dependent variable. These regressions, it should be noted, are far less significant overall in terms of the F test than the separate regressions for administrative and fundraising efficiencies. This is probably because administrative and fundraising expenses, components of total expenses, are really distinct concepts and are explained by different factors. Nevertheless, the regressions for program expense efficiency are consistent with the Fama-Jensen (1983) conjecture for both years. Organizations with a larger proportion of major donors on the board are significantly more efficient than organizations with a smaller proportion. The coefficient estimates are also fairly stable for both years. The support organization dummy is also negative and significant in both years. Otherwise, none of the other factors—board size, organization size, or the external environment—significantly affects overall nonprogram expense efficiency.

Because the regressions are cross-sectional in nature, causality is a potential issue. Although the results are consistent with Fama and Jensen (1983), they are also consistent with the hypothesis that major donors gravitate to more efficient organizations. The causality problem is, however, mitigated to some

extent by the stability of the regression coefficients over the two-year period that includes lead and contemporaneous financial data. In particular, if major donors gravitate to more efficient organizations, one should expect the 1995 data to show larger and more significant regression coefficients (relating the program expenses ratio and major donors) by comparison to the 1996 data. This is because the major donor data are of 1995 vintage. Without perfect foresight, 1995 donors are less likely to gravitate to 1996 efficient organizations by comparison to 1995 efficient organizations. In fact, the 1995 data do not yield larger and more significant regression coefficients by comparison to the 1996 data.

We tested the robustness of these results by deleting the independent variables from the above regressions one at a time and in groups. Also, additional control variables were added such as the number of board meetings per year, the number of board committees, and the existence of a strategic planning committee. None of these specifications, however, affected the qualitative results of Table 4.

## HYPOTHESES AND RESULTS—BOARD COMMITTEES

### Board Committees Versus the Board

Despite the extensive literatures on for-profit boards, little is known about board committee composition. Even less is known about nonprofit board committees. The extant nonprofit literature has indicated that organizational efficiency may be unaffected by the existence of board committees. The for-profit literature (Klein, 1998) has implied that committee composition matters.

At the potential risk of oversimplification, conceptually, committees are selected in one of two ways. Board tasks may simply be allocated to smaller committees because of division of labor without any real linkage between board members' interests and/or expertise and their specific committee assignments. If this is the case, committee composition is essentially irrelevant. Major donors are no more likely to be effective monitors on a committee than on the board. Alternatively, the board may efficiently allocate individuals to committees based on their expertise and interest. Thus, if a particular major donor is on a specific committee, it is because the major donor is more likely to be effective there. In this case, the major donor's membership on a specific committee gives a more accurate picture of his/her true role on the board. Hence, knowledge of the proportion of major donors on specific committees would provide a better test of the Fama-Jensen (1983) conjecture.

This section of the article extends and tests the hypotheses developed in the previous section to board committee composition. In particular, by extension of the Fama-Jensen (1983) argument, we hypothesize that organizational efficiencies—measured separately as administrative, fundraising, and program

expense efficiencies—are higher when major donors are more highly represented on committees with important monitoring roles, namely, the nominating, compensation, finance, and auditing committees.

#### Univariate Tests

First, we examine if boards assign committee memberships randomly or if they place members according to their abilities to deal with the organization's economic needs. Based on the proportions summarized in Table 2, Table 5 presents results of *t* tests of the hypothesis that the differences between the percentages of particular member types (major donors, staff, and professionals) on specific committees and the related percentage on the board are random. Wilcoxon tests are also performed. The results, except when specifically discussed, are qualitatively the same as the *t* tests and are not shown. Committees are also grouped into two categories, those most strongly related to the monitoring function (audit, finance, compensation, and nominating) and those most strongly related to organizational productivity (fundraising, investment, and program).<sup>7</sup> The executive committee is assumed to belong to both groups, and it is shown separately.<sup>8</sup> The same hypothesis is tested for these aggregate categories.

Major donors tend to be more highly represented on the fundraising committee than on the board, with the mean percentage membership almost 10% higher, significant at the 0.001 level for the *t* test (although the Wilcoxon test is not significant at conventional levels). This is consistent with Table 4, which shows a negative (albeit statistically insignificant) relationship between fundraising costs and the proportion of major donors on the board; that is, major donors have contacts and knowledge that are useful in fundraising. Major donors are *underrepresented* on the audit, finance, investment, and program committees at significance levels of 0.10 or better. They are not significantly over- or underrepresented on the nominating, compensation, and executive committees; nor are they significantly over- or underrepresented on the aggregated monitoring or productivity committees when considered as a pool. Thus, the univariate tests do not support the hypothesis that donors gain disproportionate membership on monitoring committees as one might expect if the Fama-Jensen (1983) conjecture is correct.

People with professional skills are heavily concentrated on the audit, finance, investment, program, and compensation committees, all at significance levels of 5% or better for the *t* test (but insignificant for the program and compensation committees at conventional levels for the Wilcoxon). Based on the survey replies, these either tended to be people with business experience relevant to finance, investment, or audit matters, or people with professional skills directly related to the mission of the organizations (e.g., medical or research professionals). These people are underrepresented on the nominating and fundraising committees at *p* values of 0.005 and 0.054, respectively. Because the committees heavily represented by professional types are part of

**Table 5. Significance Tests—Differences Between Percentage Committee and Board Membership Mean Values**

<i>Committee</i>	<i>% Major Donors</i>	<i>% Staff</i>	<i>% Professional Skills</i>
Audit	-0.103 (0.012)	0.027 (0.147)	0.276 (0.000)
Finance	-0.030 (0.097)	0.051 (0.000)	0.147 (0.000)
Compensation	-0.045 (0.218)	0.060 (0.042)	0.106 (0.036)
Nominating	0.028 (0.260)	0.037 (0.001)	-0.090 (0.005)
Aggregate of monitoring committees	-0.016 (0.329)	0.008 (0.406)	-0.045 (0.300)
Fundraising	0.096 (0.001)	0.034 (0.003)	-0.068 (0.054)
Investment	-0.099 (0.001)	0.069 (0.003)	0.247 (0.000)
Program	-0.072 (0.029)	0.062 (0.001)	0.103 (0.011)
Aggregate of productivity-related committees	-0.001 (0.979)	0.045 (0.000)	0.053 (0.089)
Executive committee	0.020 (0.274)	0.041 (0.000)	-0.008 (0.654)
Comparing monitoring to productivity-related committees	-0.008 (0.639)	-0.028 (0.003)	-0.105 (0.117)

*Note:* Figures in parentheses are two-tailed  $p$  values. The means shown are the means of the differences between the percentage of the committee made up of a particular type of member, and the corresponding board percentage. Standard  $t$  tests were used to compute the two-tailed  $p$  values.

both the monitoring and productivity committee groupings, there are no significant differences in representation of professionals in these two groups of committees.

Staff representation appears to be higher on the committees than on the board. For seven of the eight committees, the percentages of staff on the committees were significantly higher at the 5% level or better than the staff percentage on the board. The only exception was the audit committee. Partly as a result, staff membership was significantly lower on monitoring committees than on productivity-related committees. These results should be treated cautiously, due to the low levels of staff involved. For example, if organizations typically had one staff member on the board that also served on all committees, the percentage representation would generally be higher at the committee level due to the smaller size of committees.

Based on chi-square tests (not shown), we find that the percentage of donors and professionals do not vary significantly among committees (including monitoring and productivity aggregates). The percentage of staff, on the other hand, varies considerably among committees, principally because staff is not involved to any great extent on the monitoring committees.

#### Multivariate Tests

Table 6 presents regressions that are similar to those of Table 4 except that the percentages of major donors on seven separate board committees replace the percentage of major donors on the board. The committees are audit, fundraising, finance, investment, compensation, nominating, and program.

**Table 6. Regressions of Administrative Expenses, Fundraising Expenses, and Nonprogram Expenses Ratios on the Proportion of Major Donors on Various Committees**

	<i>Administrative Expenses Ratio</i>		<i>Fundraising Expenses Ratio</i>		<i>Program Expenses Ratio</i>	
	1996	1995	1996	1995	1996	1995
Intercept	-2.953 (0.001)	-2.413 (0.057)	-1.815 (0.407)	-0.933 (0.711)	0.384 (0.084)	0.482 (0.023)
Board size (+)	0.145 (0.142)	0.206 (0.162)	0.507 (0.041)	0.486 (0.100)	0.022 (0.315)	0.005 (0.842)
Direct contributions	-1.103 (0.000)	-1.109(0.003)	1.073 (0.075)	1.140 (0.120)	-0.015 (0.780)	-0.031 (0.603)
Debt to assets (-)	-0.197 (0.424)	-0.029 (0.933)	0.873 (0.159)	0.070 (0.919)	-0.010 (0.847)	-0.007 (0.904)
Total assets (-)	0.056 (0.250)	0.013 (0.850)	-0.215 (0.076)	-0.266 (0.053)	-0.008 (0.455)	-0.013 (0.246)
Support industry	-0.293 (0.068)	-0.685 (0.003)	-0.994 (0.014)	-1.240 (0.006)	-0.080 (0.024)	-0.097 (0.010)
Audit committee (-)	0.871 (0.058)	1.086 (0.151)	0.499 (0.661)	1.548 (0.294)	0.182 (0.071)	0.168 (0.179)
Fundraising committee (-)	0.026 (0.933)	0.587 (0.178)	0.872 (0.265)	0.823 (0.345)	-0.007 (0.914)	0.029 (0.684)
Finance committee (-)	-1.296 (0.017)	-1.875 (0.012)	-1.787 (0.186)	-1.946 (0.189)	-0.210 (0.078)	-0.140 (0.255)
Investment committee (-)	-0.035 (0.944)	0.220 (0.776)	0.925 (0.467)	0.445 (0.773)	-0.009 (0.938)	-0.099 (0.442)
Compensation committee (-)	-0.096 (0.803)	0.271 (0.628)	0.114 (0.906)	0.106 (0.924)	-0.012 (0.885)	0.007 (0.937)
Nominating committee (-)	-0.108 (0.807)	-0.438 (0.494)	0.054 (0.961)	0.140 (0.913)	-0.006 (0.950)	0.027 (0.800)
Program committee (-)	0.328 (0.529)	0.413 (0.595)	0.614 (0.637)	0.614 (0.692)	0.097 (0.396)	-0.063 (0.622)
<i>N</i>	108	95	108	95	108	95
Adj. R <sup>2</sup>	0.319	0.222	0.128	0.108	0.017	0.048
<i>F</i> -test <i>p</i> value	0.000	0.001	0.013	0.040	0.329	0.187

*Note:* Figures in parentheses are two-tailed *p* values.

*N* = Number of observations (organizations)

Administrative expenses ratio is measured as the log proportion of administrative expenses to total expenses.

Fundraising expenses ratio is measured as the log proportion of fundraising expenses to total expenses.

Program expenses ratio is measured as the log proportion of total expenses to program expenses.

Major donors are measured as the proportion of the board who are major donors.

Board size is measured as the log of board size.

Direct contributions is measured as the proportion of direct contributions to income

Debt to assets is measured as the proportion of total liabilities to total assets

Total assets are measured as the log of prior year total asset

Support industry is a dummy variable equal to 1 if the organization is a support organization (e.g., United Way) and 0 otherwise

All committee variables (e.g., Audit Committee) denote the proportion of major donors on that committee.

Table 6 indicates that with the exception of the finance committee, major donor representation on board committees is unrelated to the efficiency metrics. The proportion of major donors on the finance committee is, however, significantly associated with administrative expense efficiency for both years. Furthermore, the remaining results in Table 6 are consistent with the results reported in Table 4. Specifically, the signs, magnitudes, and significance levels for the other independent variables (other than the major donor proportions) in the committee regressions are similar to those reported for the board as a whole. Thus, the proportion of major donors on the board and the proportion of major donors on the various committees appear to be orthogonal to the other independent variables in Tables 4 and 6.

In nonprofit organizations, finance committees are responsible for budgets, fiscal policy, and overall expenditures. Often, they also act in the capacity of the organization's audit committee. Although major donors are not overrepresented on this committee, the regressions indicate an association between their membership and reduced administrative expense ratios. Specifically, the negative and significant coefficient relating the administrative expense ratio and the percentage of major donors on the finance committee is consistent with Fama and Jensen's (1983) view that major donors can influence management expenses by having representation on the appropriate committee.

## CONCLUSION

Based on a sample of large U.S. nonprofit charities, this study finds that the proportion of administrative (program) expenses to total expenses tends to decrease (increase) with the proportion of major donors on the board of directors. This statistically significant association is consistent with the Fama-Jensen (1983) conjecture that major donors monitor nonprofit organizations in parallel fashion to the monitoring of for-profit organizations by large shareholders. Nevertheless, a caveat is in order here given the cross-sectional nature of the regressions. Causality is always an issue—major donors may be the cause, or, alternatively, major donors may be drawn to more efficient organizations.

The proportion of administrative expenses to total expenses also decreases with the proportion of direct contributions to total income. This statistical association is consistent with the donors (and nonprofit rating organizations) penalizing administratively inefficient organizations, so that those organizations most dependent on outside donations try hardest to appear efficient. Finally, support organizations (like United Way) have significantly less administrative to total expenses in comparison with other organizational types.

This study also finds that the proportion of fundraising expenses to total expenses increases significantly with board size and decreases with organizational size. Although the proportion of fundraising expenses decreases with the proportion of major donors on the board, the effect is not statistically

significant. As in the case of administrative expenses, support organizations are significantly more efficient with respect to fundraising costs by comparison to other organizational forms. In contrast, neither fundraising efficiency nor administrative expense efficiency differs throughout the other four organizational types, indicating that the relationship of donor behavior to these efficiency variables is surprisingly independent of organizational mission. Overall, these results suggest that except for support organizations, the factors that govern administrative expense efficiency differ from those that govern fundraising expense efficiency.

Aggregating administrative and fundraising expenses, the ratio of total expenses to program expenses is significantly and negatively related to the proportion of major donors on the board consistent with the Fama-Jensen (1983) conjecture. Except for support organizations, none of the other factors is significantly related to the program expenses ratio.

None of the three efficiency metrics is associated with the number of board meetings per year, the number of board committees, or the existence of a strategic committee. It is, of course, possible that the low power of the tests in this study yield these negative results.

As far as board committees are concerned, the univariate tests do not support the hypothesis that major donors gain disproportionate membership on monitoring committees. In fact, major donors appear to be underrepresented on monitoring committees (e.g., audit) by comparison to their representation on the board. Be that as it may, the multivariate tests show that the percentage of major donors on the board's finance committee is positively related to the organization's administrative expense efficiency. Because the finance committee is typically responsible for budgets, fiscal policy, and overall expenditures, the multivariate results are very much consistent with the Fama-Jensen (1983) conjecture. This study also suggests that, with the exception of the finance committee, it is the presence of major donors on the board that matters and not their presence on committees.

It is worth noting that the results of this study are consistent with two views of nonprofit organizations. They are consistent with a multiple constituency model wherein the donor constituency attempts to evaluate organizations on fiscal grounds by focusing on specific ratio indicators of organizational efficiency. These results are also consistent with an institutional theory model in which nonprofit donors (and management) focus on these ratios because of the widely held beliefs by influential external observers that such ratios are in fact meaningful performance metrics in a nonprofit environment.

Finally, there is a need for some words of caution about the implications of this study for nonprofit management. It is not clear that actions by donors to reduce charities' administrative spending are always wise. Excessive focus by donors on efficiency indicator ratios may lead to dysfunctional managerial behavior. There are those who believe that nonprofits tend to underinvest in necessary infrastructure in a misguided attempt to show high program-expense ratios. Managers and boards may need to find alternative measures

of effectiveness, and they should educate major donors about the problems of overfocusing on narrow ratios. Furthermore, this study implies that there is a relationship between board composition and organizational efficiency on average only and for the specific sample analyzed. Unfortunately, there are well-known cases in which boards have failed to properly monitor the organization despite large donors sitting on the board and its related committees. The analysis of such failures is a worthy subject for future research, but it is beyond the scope of this study.

## NOTES

1. Organizational efficiency rather than effectiveness is the subject matter of this study. For a review of the literature on measuring organizational effectiveness, see Forbes (1998).

2. Of course, there are alternative mechanisms for monitoring the organization. In contrast to publicly traded companies, nonprofits cannot be monitored by institutional shareholders, managerial equity ownership, stock-based incentive compensation schemes, or the takeover market. Instead, donors' monitoring mechanisms include extensive reporting and communications requirements, personal involvement in program planning and evaluation, community advisory groups, and direct program observation.

3. The latter is also called *price efficiency* in the literature because it measures the "price" paid by the donor to ensure the provision of charitable output to donees. Equivalently, but more commonly, the price of charitable output is defined as total expenses divided by one minus the sum of the ratio of administrative and fundraising expenses. Unfortunately, more theoretically defensible production theoretic measures of efficiency, such as those derived from stochastic frontier estimation procedures or data envelopment analysis, require input-output data that are simply unavailable for all but a very few U.S. nonprofits.

4. Earlier studies using New York State regulatory data include Grimes (1977), Ben Ner and Van Hoomissen (1993), and Tinkelman (1996, 1998, 1999). Data problems with Form 990 data are well-known; see Herman and Renz (1997) and Froelich and Knoepfle (1996), although later research by Froelich, Knoepfle, and Pollak (2000) found some contrary evidence. In any case, this study is designed to avoid a possible problem by using audited data.

5. For a more representative survey of nonprofit boards, see Slesinger and Moyers (1995).

6. The tables show two-tailed *p* values because not all of the variables can be signed a priori.

7. The breakdown of specific committees into these two categories is based on the for-profit environment and literature and is likely to carry over to the nonprofit arena. Regarding the for-profit environment, the audit and compensation committees are the board's primary monitoring committees. In recognition of their role as monitors, the NYSE, NASDAQ, Business Roundtable, and American Law Institute require or advocate that either or both committees be composed solely of directors independent of managers. Similarly, the Business Roundtable and the American Law Institute advocate nominating committees with independent directors only. This suggests that nominating committees are viewed as having primarily a monitoring function. In support of this assertion, Klein (1998) and Shivdasani and Yermack (1999) provided evidence that board independence and audit and compensation committee independence are negatively related to whether the CEO is a member of the board's nominating committee.

8. Because the significance tests are computed only when the specific committee exists, the comparisons between committee and board composition do not suffer from the same potential selection biases as do the figures in Table 2.

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