An effective Board can make a huge impact on an organisation’s performance. In the case of the not-for-profit sector where resources are often strained, an effective Board is critical. Hay Group’s latest study examines what separates the best from the rest >>
## Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Executive summary</td>
<td>2</td>
</tr>
<tr>
<td>About the research</td>
<td>3</td>
</tr>
<tr>
<td>Situation analysis: The challenges for the sector</td>
<td>3</td>
</tr>
<tr>
<td>Board effectiveness in the not-for-profit context</td>
<td>6</td>
</tr>
<tr>
<td>1. Articulating the Board’s purpose</td>
<td>7</td>
</tr>
<tr>
<td>2. Capability mix</td>
<td>9</td>
</tr>
<tr>
<td>3. Roles and relationships</td>
<td>11</td>
</tr>
<tr>
<td>4. Performance and development</td>
<td>13</td>
</tr>
<tr>
<td>Overview: How to achieve effectiveness in the sector</td>
<td>15</td>
</tr>
</tbody>
</table>
Executive summary

The rapid and continuing growth of the not-for-profit sector in Australia and New Zealand is placing new demands on Boards and management. These demands must be met if the growth is to be sustained.

The so-called ‘third sector’, like all other sectors within the economy, is experiencing a period of significant transformation.

Increasingly the sector is being required to grow and develop as well as apply successful management strategies aimed at maintaining financial capability to sustain the work of the organisation. Pragmatic business decision-making processes are always required in this context.

In a recent research study, Hay Group has examined the sector’s experience of this transformation and growth, and in particular, the challenges this is posing to Boards and senior management.

The roles and responsibilities of the Board in the not-for-profit sector are similar to those in the private sector, as are the fiduciary obligations. Yet there are distinct differences and challenges for not-for-profit Boards, and these differences are becoming more apparent as the sector grows and organisations take on a ‘corporatised’ governance structure.

As Boards navigate more high stakes decisions and risks, the effectiveness of the Board comes under increasing scrutiny.

This research provides a useful framework for the development of Boards in the not-for-profit sector.

Four key factors were identified as having the greatest influence on Board effectiveness:

- Effective Boards put energy into articulating a clear Board purpose; and they remain focused on that.
- The right capability mix to meet the challenges facing not-for-profit Boards is critical and this includes specific knowledge and experience as well as the right attitude and behaviour among Board Directors.
- Relationships between Chairs, CEOs, Board Directors and management are particularly important in not-for-profit organisations and while the management of boundaries consumes a great deal of energy, the pay-back is worthwhile.
- Director performance management is generally ‘underdone’ and some approaches add more value than others.
The not-for-profit sector in both Australia and NZ is surprisingly large. In Australia alone, there are an estimated 600,000 entities in the not-for-profit sector making it larger than the communications industry, agriculture or tourism. The sector employs 900,000 paid staff which is approximately eight per cent of national employment according to the latest ABS Labour Force Survey.¹ In addition, the 59,000 not-for-profit organisations termed as being “economically significant” by the Australian Government’s Office for the not-for-profit sector, contribute about $43 billion to the Australian GDP. In New Zealand the story is similar with the not-for-profit sector contributing about 4.9 per cent (or $NZ6.95 billion)² to NZ GDP and has more than 105,000 paid employees.

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² This includes the offset contribution of unpaid voluntary staff - New Zealand Office of Community and Voluntary Sector
The sector is experiencing a period of steep growth, stimulated by a number of fundamental drivers including:

- Unemployment, particularly long-term unemployed following the global recession. While Australia’s unemployment levels have remained low and steady around the current 5.1 per cent levels long-term unemployment still persists. New Zealand has experienced much higher levels most recently trending higher at 6.7 per cent.³
- The needs of an ageing population and increased focus and funding by governments.
- Response to natural disasters with Australia experiencing flood, fire and cyclone devastation and New Zealand suffering the catastrophic earthquake in and around Christchurch.
- An estimated 12.8 per cent of Australians live below the internationally accepted poverty line⁴ and an average of 15 per cent of the population in New Zealand lived in poverty (less than half of the median household income) in 2011⁵.

Shifts in the broader social policy context are also contributing to the growth and dynamism of the sector. The Australian Government in recent times has made public and policy commitment to finding solutions to social exclusion and to the active economic and social participation of all Australians in community life. They are looking to the not-for-profit sector (along with private and government sectors) to provide community education, services and opportunities to support this participation.

A Productivity Commission report entitled Contribution to the not-for-profit sector, released in 2010, put forward a number of reforms in the light of this policy emphasis, incorporating improved knowledge management and sharing of experiences across organisations, clearer governance and accountability, more effective sector development to stimulate cooperation between organisations, building of skills in governance and a greater emphasis on social innovation to develop new ways of tackling social problems.

In addition, the National Compact: working together was launched in March 2010. The Compact is an agreement between the Government and the not-for-profit sector that seeks to pursue the social inclusion agenda through a strong relationship between not-for-profit organisations and the Government, based on collaboration and respect.

The New Zealand Government’s Office of Community and Voluntary Sector undertakes similar approaches.

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³ Source: www.tradingeconomics.com
⁴ Source: Poverty in Australia Report by The Australian Council of Social Service, 2012
⁵ Source: ‘New Zealand inequality at highest level,’ The New Zealand Herald, August 2012
Overall the Government commitment to the sector is indicative of its importance to both the social and financial health of the two nations.

In this context, not-for-profit organisations will seek opportunities to grow in size and scale, share knowledge and develop and execute new and innovative models of care through joint ventures and partnerships. Large not-for-profit organisations have always had to face significant and complex commercial decisions (e.g. major capital investments) but this new context poses additional challenges.

Top management in the sector will also face significant leadership challenges. The skills required to lead organisations into this future will include a deep understanding of community and how to engage it around social inclusion of the whole sector, not just the individual organisation's place in it. This new context will also require more agile organisations and therefore more agile Boards. It will be about managing the risks and complexities associated with growth and bringing organisations together, creating a culture of collaboration – and any major corporate will tell you how challenging that is. This puts a spotlight on the role and impact of an effective Board in the sector. Boards will now need to focus on their own performance in setting strategic direction and protecting the organisation's long term value, while they ensure that the CEO and management team are setting the organisation up for performance and sustainability.
An effective Board can make a huge impact on an organisation's performance. In the case of the not-for-profit sector where resources are often strained, an effective Board is critical. The not-for-profit sector experiences many unique challenges that can put additional pressure on this effectiveness.

Firstly, by its nature (while some Boards in the sector remunerate their directors), many organisations in the not-for-profit sector offer opportunities for those with a strong personal connection to the cause to generously donate their time, talents and passion to the responsibilities of the Board. The passion behind the cause has long been the lifeblood of the sector, and yet today Boards cannot function on passion alone. Increasingly, Boards are required to make significant commercial and large-scale financial decisions that demand a sophisticated set of skills, knowledge and adherence to governance principles.

Yet a Board that takes this emphasis toward commercial imperatives so far that the core purpose and connection to the cause is marginalised will also fail to be effective in a not-for-profit context. Effectiveness requires a delicate balance between the core beliefs that ground them to their work and the commercial prerequisites for governance.

A strong and sincere connection to the cause is also vital for Board members in their role as ambassadors for the organisation in public life.

More than ever, Boards will be challenged to deliver the right leadership bench strength in the senior management ranks to respond to this context, in an environment where competition for leadership talent is intense.
1. Articulating the Board’s purpose

Our research revealed that the fundamental functions of the Board – that of setting strategic direction, ensuring effective governance, appointing the CEO, guaranteeing financial soundness and legal compliance and setting risk parameters – were cited by the majority of respondents as being the core purpose of the Board they are associated with.

However, a smaller subset of respondents provided a few additional perspectives on their Board’s ‘value-add’:

- Developing (at a high level) the culture of the organisation – defining culture, in particular by the Board’s own behaviour and performance, was seen as vital to the internal and external perceptions of the organisation.
- Holding management to account to deliver a strategy, through the appropriate level of questioning – there appeared to be a perceived need for the Board to hold management to account by applying an appropriate balance of questioning and challenging from an operational perspective.
- Championing their organisations in the external environment – management, in particular CEOs, saw the Board’s role as championing the organisation externally by becoming ambassadors who can represent the organisation and uphold the values and purpose in a public forum.

It was the inclusion of such value-adds that correlated to those identified as having an effective Board. While the absence of these elements also correlated to ineffective Boards.

When Boards focus on strategy and governance alone, it is simply threshold. In comparison, Boards that discuss and articulate their purpose, including their unique value-add, hold their directors accountable to their defined purpose and keep the focus of their agenda on this, have highly engaged members.

Our study showed a strong link between having a clear purpose and focus, well-managed meetings, good boundary management and a really good chairperson, as the key conditions that enable effectiveness.
Once the purpose of the Board is clearly articulated, the next challenge is the accountability that will transform the purpose to mandate – in other words, ensuring the members of the Board appreciate their collective and individual responsibility in realising this overarching purpose in the decisions they make, and indeed in every aspect of their function.

A clear purpose is challenging, consequential and compelling. When this is attained it has the ability to engage Board members. The not-for-profit sector, by its nature, does not have incentives like shareholder value or profit targets to drive accountability, so it often doesn’t have the 'checks and balances' that come with fiscal performance-based accountability in a more structured full-profit Board. As a result, risk can be multiplied where these checks and balances are missing. However, we find that when the purpose is clear and challenging, it has the effect of ‘hooking in’ directors.

Organisations in the commercial sector generally remunerate their directors, as do some Boards in the not-for-profit sector. Where this is not the case, in the absence of a shareholder, to whom the Board is accountable, a clear purpose is mandatory. One recommendation that arose from the research was the creation of a “purpose statement” that serves as a manifesto and a constant reminder for the organisation to adhere to. This should address, not only the purpose of the organisation, but start at the top with the purpose of the Board.
2. Capability mix

It is evident that Boards in the sector treat their membership and collective skill base with a great deal of importance.

Perceived gaps in the capacity of Boards are acutely felt, particularly in the areas of governance, marketing, sector knowledge and corporate experience. Respondents who perceived real gaps in the capability and skill mix of their Boards also described a direct connection between this and the overall performance of the Board.

In order to ensure that Boards have the right calibre of individual there is a significant emphasis on recruitment.

Chairs of effective Boards spend considerable time and investment in the recruitment of the right directors and Board members. The payoff is huge as there can be serious repercussions from a lack of skill on the Board.

Getting the right mix involves finding people with the ability to think strategically and also understand the whole sector at a sophisticated level. Given the need to make high-value investment decisions, Boards now also need commercial experience within their ranks, with people who are experienced at making complex commercial decisions and managing high risk (such as property investment, acquisitions and commercial partnerships). It is significant that this was identified by some as the key missing link in their Board’s capability mix.

“35 per cent of respondents said they had real capability and skill gaps, and consequently their organisation was not as effective as it could or should be”
Some respondents surveyed described particular attributes that they looked for when creating the right mix. Sector experience, especially when combined with business and commercial know-how was mentioned by many as a key criterion. Many of our respondents commented on the value that can be added by a director who has experience of organisational change, mergers and acquisitions, others spoke of the contribution that can be made to Board work by a member from the organisation’s stakeholder community or constituency, such as a young person in an organisation that primarily supports young people.

Organisational governance was also identified by the respondents as a critical gap – having a sufficient level of governance experience, across the Board to ensure that the organisation is well managed and financially sound. So too, were the interpersonal skills and behavioural competencies, such as:

- the ability to work collaboratively and respectfully,
- a willingness to embrace a challenging workload,
- a commitment to, and understanding of the organisation’s cause.

Board members in the not-for-profit sector need to be well-informed, well-prepared and embrace challenging workloads, which may be in addition to other Board responsibilities. Despite the stated need for Board members to possess higher levels of professional skills there was a very strong belief among respondents that the right people are those with a commitment and understanding of ‘the cause’, even a deep connection and belief in “why we are here”.

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<tr>
<th>The attributes considered mandatory by respondents to make for an outstanding Chair were:</th>
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<tbody>
<tr>
<td>- Being an effective leader</td>
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<td>- Managing meetings well</td>
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<td>- Ensuring full skills of the Board are used</td>
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<td>- Chair and CEO having constructive/positive relationship</td>
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<td>- Remaining focused on clarity around role and contribution</td>
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<td>- Ensuring the right level of formal and informal interaction between the Board and management</td>
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<td>- Ensuring that the Board has a clearly articulated purpose around which all Directors are aligned</td>
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3. Roles and relationships

The management of the relationship between the CEO and the Board, and management and the Board, is seen as pivotal to the success or failure of a not-for-profit meeting its objectives.

The Board and the CEO
In most cases, the relationship between the Board and the CEO was described by respondents as both critical and very positive.

The Board and management
Some of the respondents indicated that the Board needed to ensure that the boundaries between Board and the management were more clearly defined and observed.

Indeed a comment made by a number of respondents was that they felt the Board was least effective when it fell into ‘management space’. When boundaries were unclear Board members could “become meddlesome” and become inappropriately involved at the operational level. But, at the opposite extreme, Boards that are too removed or too passive could be equally problematic. As one respondent said, “We are least effective when we are too hands-off, when we take the advice of the CEO too readily”. Again a delicate balance is required.

There were a number of comments that indicated communication channels between the Board and management were sometimes prone to blockages and access was not always as easy as they would like.

In fact, open access was a common theme, with a number of respondents saying that when they have greater connections to management (not just the CEO), it builds organisational understanding among directors and develops a productive relationship which has a positive impact on Board performance.
A key component of running an effective organisation involves providing cohesion between management and the Board to offer a productive and constructive working relationship. While a vast majority of respondents (82 per cent) agreed that this was the case with regard to the Board and the CEO, the relationship between the Board and management generally was seen to be less effective.

The Chair and CEO
Maintaining a healthy, productive and respectful relationship between the Chair and CEO is critical. The Chair plays a crucial role in articulating and managing around blockages and boundaries, but when this role is not well played, there is a perception that the Board performance is sub-optimal.

The issue of ‘boundary management’ is ultimately a balancing act. Board members need to be engaged in what the organisation is doing in order to be effective, gain respect, build productive relationships and even to spark new creative ideas. Yet this involvement must be respectful, helpful and not an interfering or disruptive force. It takes a high degree of professional maturity to appreciate and respect such a delicate balance, especially in a sector where passion and enthusiasm to be involved in the cause is almost second nature.

“65 per cent of respondents agreed that there was a positive and constructive relationship between Board and management. 20 per cent of the responses were neutral, with comments indicating that this was due to the fact that Boards did not interact much with management and that most communication was through the CEO.”
4. Performance and development

We found that evaluating the performance of directors and Boards as a whole is generally underdone in the sector. And among the organisations that do support their directors with development, there appears to be a broad spectrum of activity ranging from very little to a great deal of development activity.

“Only 41 per cent of not-for-profit Boards annually review their performance, with few adopting any kind of formal self-evaluation.”

At the lower end (doing less), respondents talked about individual director appraisals being done occasionally (but not generally) via a one-on-one session between individual Directors and the Chair. Some Boards arrange periodic development seminars on topics of interest and importance.

Around the middle point of the spectrum (doing regular reviews and offering a range of development opportunities) respondents spoke of regular self-assessments, online learning modules and increased contact between management and directors as a conscious development strategy.

At the higher end (investing a lot of time and effort) respondents described the application of bi-annual self-assessment and review with the Chair, support for additional learning internally or externally and periodic seminars around specific development issues (e.g. financial, management and governance).

Evaluating the Board’s performance, specifically how closely its work is aligned to the core focus and purpose (outlined earlier), was considered “important” by all respondents, but is not a universal discipline. Significantly, of the Boards who best met the criteria for high effectiveness, the Chairs and CEOs reported that they adopted the practice of regularly reviewing Board performance. Some would do so at every meeting by evaluating how the meeting had gone, with the aim to ensure the focus was sharp, and that every decision stemmed from or reinforced the core purpose. This practice of alignment and evaluation had an enormous benefit and powerful effect on engagement and performance.
One CEO described the fact that these reviews of ‘how we’re doing’ has enabled his Board to re-think meeting frequency and the ways in which different meetings are used, which has been very positive.

The data revealed a very strong correlation between the degree of seriousness with which development is undertaken and respondents’ perception of their Board’s effectiveness. It was seen that some degree of managed regular development is about holding Directors accountable, which leads to higher levels of effectiveness.

Very few respondents reported using external parties to support them either in individual Director or whole of Board development, though a number felt that as their Board continues on its ‘professionalising’ agenda, this would become more and more important.

Another question is: Should the Board be responsible for providing development, training and review, or is this incumbent on the individual Board member to seek this out for themselves? The research identified that while there is considerable “on the job” development forged through exposure and experience, without Board-led development opportunities and rigorous review processes, it will be an area that continues to be underdone.

“Only three per cent appeared to apply the accepted corporate feedback mechanisms and 360 degree appraisals of individual Board members.”

“Comments from respondents indicated reluctance on the part of Boards to undertake assessment, with one stating: “There is nothing in place for this Board. Three members are highly resistant to the idea”.”
Overview: How to achieve effectiveness in the sector

Being ‘effective’ is an ongoing objective for any Board; a goal requiring constant commitment and calibration.

Indeed it can be likened to a progressive journey through four stages:

1. Base purpose
2. Value add
3. Awareness and development
4. Continuous review

For the not-for-profit sector, this journey towards Board effectiveness requires a balanced and sensitive approach.

The underlying intent of the not-for-profit organisation is a deep commitment to a special cause, which is often one that is shared by members of the Board and management on a personal level. As such, pursuing a ‘corporate path’ towards Board effectiveness can potentially overlook the central vision or disrupt the cultural dynamics.

The sector requires Boards to manage their ‘bench strength’ with expertise in governance and commercial know-how as well as diverse, yet complementary skills and perspectives present among Directors; all the while keeping the organisation’s true cause, culture and moral purpose in sharp focus.
The framework for Board effectiveness outlined in this paper brings together four interdependent components, which, when applied in combination and given the appropriate degree of focus, can prove the difference between a disciplined, responsive, respectful and strategic Board and a Board that is less effective.

Each of the four elements outlined within this paper are equally important and symbiotic.

- Clarity of Board purpose
- Capability talent mix
- Boundary management of roles and relationships
- Board performance and development

Focusing in on a single component may be helpful and achieve a degree of improvement in that area. Yet Hay Group’s research found that not-for-profit Boards that place priority on all four components – are also those who achieve a high degree of effectiveness in the longer term.
Hay Group is a global management consulting firm that works with leaders to transform strategy into reality. We develop talent, organise people to be more effective and motivate them to perform at their best. Our focus is on making change happen and helping people and organisations realise their potential.

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