

# Board Performance and Governance in Small Not-for-Profits: Report for Participants

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## Executive Summary

This study explores governance challenges in small not-for-profits (NFP), and identifies resources and potential strategies to address these challenges. The study's primary motivation is that while all organisations need effective governance, small NFPs receive less governance research and resources than their circumstances and social contribution warrant. This study reviewed existing governance resources, and conducted several geographically-dispersed focus groups with directors and CEOs of small NFPs (less than \$10 million revenue). While the study found little research and guidance specific to small NFP governance, it also found evidence small NFPs face distinctive governance challenges. These are not necessarily due to different governance *principles*, but rather due to a different *organisational context* in which governance principles are implemented. Examples include:

- Greater reliance on fewer funders, and so particular risks of financial instability, cash flow and / or 'funder capture';
- Limited access to specialist financial and human resources skills, so more challenges to implementing robust *controls* in these areas;
- Greater reliance on board expertise to fill gaps in operational skills or capacities, and so greater importance of board recruitment; and
- More limited time, skills or resources for longer-term strategic planning.

The study recommends policies, research and resources more closely targeted at the needs of small NFPs. The main recommendations are for:

1. *More focus on small NFPs by policy-makers.* This includes direct policy consultation with small NFP staff, volunteers and stakeholders;
2. *Dedicated governance resources for small NFPs.* Resources should be affordable, accessible and credible, with the ACNC well placed to provide these resources; and
3. *Additional academic and industry research.* More research needed to define small NFPs and better understand and address their specific governance challenges.

## Acknowledgements

Chartered Accountants Australia and New Zealand (CAANZ) have funded this research. We are very grateful for this financial contribution as well as CAANZ's foresight in supporting this research. Thanks also to Dr David Wild for research assistance on this project.

We also warmly acknowledge, and thank, all participants in the research focus groups for taking time to provide us with their insights. Although this initial report only summarises broad themes and initial findings from these discussions, we will continue to develop this project to assist developing and addressing the range of challenges and suggestions raised.

## 1. Introduction

While good corporative governance is essential to any organisation, different governance arrangements are often effective for organisations of different size, purpose, culture and circumstances. For example, organisations must prioritise governance elements according to the risk represented, likelihood of outcome and the impacts they may cause, such as in Occupational Health and Safety or clinical governance. Organisational cultures must then prioritise the most relevant governance processes in the context of resources and their assessment of that risk. Leaders – from the board down – must also engage with these governance structures, and genuinely, effectively and transparently demonstrate good governance behaviours. Organisations must also engage their staff and volunteers, and monitor performance against specific organisational standards and goals.

Arguably, NFPs have more complex and significant governance challenges than organisations in other sectors. NFPs support some of Australia’s most vulnerable people and also receive taxpayer funds from all levels of government to further public policy. Aside from the generic reality that ‘one (governance) size-does not-fit all’, NFPs face more limited capacity and resources to collectively address governance priorities. This can stem from resource constraints within NFPs themselves, but also from limitations imposed by funders, or by the limited social infrastructure in their sector.

There is no evidence NFP governance is more or less effective than similar sized for-profit organisations. However, the clinical and other human services NFPs often deliver can mean poor governance affects more vulnerable people reliant on their services and support. Poor governance outcomes can also have several external impacts, including on: government budgets for health care and other services; people’s opportunities for economic engagement; and – by affecting service quality – the level of support end users require over the medium to longer terms.

Although the effects of organisational size on NFP governance are not well-researched, size – by revenue and balance sheet – appears to be one factor that might affect NFPs’ capacity to meet governance challenges. However, many small NFPs provide critical services and support that could, if things go wrong, significantly impact clients. This ‘critical services’ dimension suggests smaller NFPs may need governance resources and structures that, at first glance, appear disproportionate to their financial size.

Against this background, this project had two main aims:

1. To assess the current governance challenges smaller NFPs face, and what strategies they are using to meet these challenges; and
2. To identify what further governance resources or strategies may assist smaller NFPs in future.

The project initially had a broader remit to identify governance tools, training and other investments to better serve all NFPs. However, our preliminary research highlighted how a

single governance model or resource set is unlikely to fit all types of NFPs, and that few governance resources or models were explicitly adapted to, or scaled by, size. Yet over 60% of Australian charities alone (as a sub-set of the NFP sector) have revenue of less than \$250,000. Hence, small NFPs deliver numerous services without close investigation of, or resources tailored for, these organisations' specific governance challenges and needs. As identified above, this not only impacts the organisation and those charged with governance, it also impacts those vulnerable people who rely on these organisations for support.

One issue in researching small NFP governance is defining 'small' NFPs. Any definition of a 'small' NFP is ultimately arbitrary and purpose-specific. Our working definition – revenue of \$10 million or less – aimed to resonate with NFP directors and staff themselves, and also to provide results relevant to a wide range of participants and stakeholders. The \$10m threshold may seem large relative to small business for-profits. Yet NFPs have distinct organisational profiles, including high overheads, funder-determined operational requirements, risks (in human terms) and high potential impact of failure, which makes them not directly comparable to small businesses. In particular, high overheads and high risk can impair even NFPs with multi-million-dollar revenue from investing in governance arrangements commensurate with the risk and social impact of their services. Additionally, funders (usually governments) can require assurance over their particular interest and limit the use of funds with respect to expenditure categories. The larger cohort is consistent with the study's aim to support governance in NFPs that may deliver critical services without resources or support proportionate to the governance challenges and demands these services raise.

This report summarises: key academic and industry research (Section 2); the project's research methods (Section 3); the main findings (Section 4); and, recommendations for future resources and research (Section 5).

## **2. Literature Overview**

### **2.1 Academic:**

Academic literature has long recognised that the NFP sector is diverse (e.g. Ostrower and Stone, 2010; Kramer, 1981), and that governance practices depend on both an organisation's size and the context in which it operates (Conforth, 2012). For example, Cornforth and Simpson (2002) found that NFP board size and composition, board structures, formalization, and various board problems, all vary by size. Rochester (2003) argues organisations with few or no staff face distinctive challenges to recruiting and maintaining an effective board. Consequently, Kumar and Nunan (2002) suggest, smaller NFP boards need distinctive types of support.

However, despite recognising that small NFP governance can be distinct, there is relatively little academic research that investigates in what *specific ways* small NFP governance is distinct, or proposes *strategies* or *resources* to help small NFPs meet internal or external governance challenges and stakeholder demands. One particularly pressing need is to

develop a more in-depth understanding of the specific organisational and social context of governance in small NFPs. As Conforth (2012) shows, academic research on NFP governance typically uses large-sample surveys to study characteristics like board size and experience across the whole NFP sector. In addition to focusing on boards of large organisations (Ostrower and Stone, 2006), survey data alone reveals limited information about internal board practices and challenges. Interview and case-based studies of directors' and CEOs' experiences in specific NFP organisations and contexts (e.g. Parker, 2003) can provide a more detailed account of directors' and CEOs' experiences of governance 'on the ground' in small NFPs.

Consequently, while there are numerous surveys of NFP governance in general, directors and CEOs of small NFPs need to interpret these general results with some caution (Ostrower and Stone, 2010). For instance, LeRoux and Wright (2010) use a large survey to test how different board practices affect NFPs' strategic decision making. However, not only do LeRoux and Wright (2010) not distinguish their results by NFP size, they also make the problematic assumption that small size is a proxy for, or indicator of, low organisational professionalism.

One survey-based study that does investigate governance in smaller<sup>2</sup> NFPs more directly is Ostrower's (2008) survey of United States (US) NFPs, which asks CEOs of smaller NFPs for their views of their board's practices and effectiveness. Ostrower's (2008) study highlights difficulties smaller NFP boards face in recruiting board members with the skills their organisation needs. The study also finds that smaller NFP boards exercised less oversight of their organisations' finances and service delivery, and also assessed their own board performance less frequently. Ostrower (2008) recommends directors of small NFPs oversee organisational finances, and assess organisational performance, more actively, and also that small NFPs cultivate a board culture that encourages directors to adopt this more active role. Nonetheless, as it only surveyed US-based CEOs, the study provides only an indicative insight into the governance challenges directors and CEOs of small NFPs face in the contemporary Australian social and social-policy context.

Rochester (2003) provides one of the few interview-based investigations of small NFP governance, which interviewed United Kingdom NFPs with four or fewer employees. Alongside challenges recruiting skilled and motivated board members, Rochester (2003) finds these small NFPs risk workload being concentrated in too few hands, and face difficulties engaging in long-term planning due to uncertain funding. However, he also finds unique strengths of small NFPs, including the capacity to attract more 'flexible and imaginative leadership' (p. 124). Effective boards, Rochester finds (2003), balanced hands-on management with strategic planning, shared governance workloads, and accessed external resources when needed. However, as a UK-based study of especially small NFPs, there is need for further research into how widely these results reflect the experiences of NFPs of other types (e.g. more employees) and in other contexts (e.g. Australia).

## **2.2 Industry:**

Industry research<sup>3</sup> into NFP governance has dramatically increased in most English-speaking countries over the last ten years, and includes numerous governance topics and practical guides for NFP governance. Notable examples are the Australian Institute of Company Directors' (AICD's) annual [NFP governance and performance study](#), and the growing body of [research and governance guidance](#) published by the Australian Charities and Not-for-profits Commission (ACNC), which includes both governance standards and broader guidance (e.g. ACNC, 2013a; b)

However, while these are important and useful resources, industry research to date has not focused on governance in small NFPs in any detail. One barrier to such research is defining 'small' NFPs. Corry (2010) argues the entire NFP sector is inherently unsuited to definition; and far less to demarcation by organisational size. Also, 'small' is sometimes implicitly – or explicitly, as in LeRoux and Wright's (2010) research cited above – linked to potentially pejorative ideas as unprofessionalism, limited activities, high volunteerism (Corry, 2010) or a lack of resources (Deloitte, 2013), even where there is no evidence to support such associations.

Some industry research analyses how NFP size affects particular outcomes like philanthropic giving or the number of board members per organisation (Stanford, 2015). Where reports do use size to analyse their results, size categories (i.e. definitions) are typically *ad hoc*, based on accepted turnover levels (e.g. AICD, 2017) or an arbitrary line (e.g. the largest 500 charities) (Hudson and Ashworth, 2013). No industry research has sought to establish an acceptable definition of size in a NFP governance context.

Industry research to date also invariably reinforces key problems and challenges NFPs face, often in high level narratives, but without assessing or prioritising how relevant each challenge is to small NFPs. For instance, Deloitte (2013) notes NFPs becoming more complex and growing, and Stanford (2015) raises concerns about insufficient director engagement, understanding and time. The AICD (2017) considers issues such as paying directors, a lack of culture management and a lack of pro-active governance. While these are all perennial concerns, few reports propose solutions for any NFPs, far less solutions or strategies tailored to small NFPs. Indeed, while the AICD (2017) report is one of the most significant surveys of NFP directors in the English-speaking world, only 22% of respondents are associated with small and very small NFPs.<sup>4</sup>

Overall, there is a significant gap in industry research in understanding small NFPs, the specific challenges small NFPs face and proposing solutions or strategies to meet these challenges. This research is an initial step towards addressing this gap, with the longer-term aim of developing further research and resources that assist small NFPs become more resilient and effective in delivering their critical social services and contributions.

### 3. Methods

The project comprises three stages.

**Stage 1** reviewed existing NFP governance resources.<sup>5</sup> The review identified numerous NFP governance resources, including high-quality, Australia-specific resources from the AICD, ACNC and Governance Institute of Australia. However, most guides provided either comprehensive or issue-specific (e.g. 'board composition' and 'conflicts of interest') guidance for all NFPs, rather than specifically addressing small NFPs.

**Stage 2** entailed four in-depth focus groups with CEOs and Directors from small NFPs, and some additional senior staff, in three capital cities (See Appendix A). Each focus group began with open-ended questions about what governance issues mattered most to participants (e.g. what 'kept them up at night').<sup>6</sup> The groups then addressed some or all of what Gilchrist and Tye (2015) label the four elements or 'pillars' of governance:

1. *Governance Maturity*: How the board functions, interacts with management and assesses performance;
2. *Service Quality*: How services are managed and evaluated;
3. *Financial Sustainability*: Financial management, measurement and control; and
4. *Human Resources*: How staff (employees and volunteers) are recruited, managed and assessed.

**Stage 3** analysed research findings, using computer aided analysis (NVIVO 11) to identify key themes and issues.

### 4. Focus Group Findings

Our findings cover three main areas: structural inhibitors to good governance (4.1); internal governance practices or 'pillars' (4.2); and, participants' prospective solutions (4.3).

#### 4.1 Structural inhibitors to good governance.

Structural inhibitors refer here to processes, arrangements and expectations in the NFP sector or the environment in which they operate that impact organisational governance. Key themes participants raised include:

- *Concerns over a 'one size fits all' perspective.* Public and policy discussions of NFP governance often failed to recognise the different context in which smaller NFPs operate, and therefore the differences in governance. While *principles* were similar, many participants thought these principles needed to be *applied* differently in smaller NFPs:

There's a huge continuum. So, BHP Billiton, some of their risk analysis matrices have, are we going to have the potential to kill 100 people if this thing goes wrong. You're not going to use those matrices for a small organisation but you might use a single fatality - *Participant 1A*

I think the smaller organisations are probably done a disadvantage to by having to adhere to some of the governance arrangements of the larger organisations. You don't need them and you don't want them - *1B*

- *Recognising small NFPs' role and contributions.* Many participants were concerned that smaller NFPs' contributions and needs were not always recognised, especially relative to larger NFPs. This did not, however, mean endorsing policy or funding support for all small NFPs. Several participants also expressed concern that there were too many small NFPs in some service areas.
- *Funding arrangements.* Participants were concerned about uncertain funding tenure. While this concern is well documented in broader NFP research, small NFPs:
  - depended on fewer (e.g. 1 or 2) funding streams, and so are more vulnerable to funding cuts and / or funder capture; and
  - with less in-house expertise, may need more support to meet accreditation and other standards:
 

I'd like to think that all organisations would be required to meet a certain standard, but be assisted to do that and provided with some sort of training, some sort of financial assistance to help bring in experts to assist – 2A.
- *Regulatory and reporting processes.* Participants questioned whether these are still 'fit-for-purpose'. The limited resources in smaller NFPs also affect reporting capacities:
 

From an audit and financial perspective, there has to be segregation of duties. That's one of the things we've found difficult, it comes up in every audit report because it's kind of an obvious thing that you don't have one person doing too much of the process. Yet, you don't have the resources available to satisfy that requirement - 4A.

#### **4.2 Internal governance practices or pillars**

Internal governance practices refer to an organisation's governance culture, systems and processes. As noted above, we followed Gilchrist and Tye (2015) in distinguishing four 'pillars' of internal organisational governance.

##### Governance Maturity:

- *Board skills and capabilities:* Participants' main 'governance maturity' concern was attracting the right mix of board skills and capacities. While all NFPs need the right skill and capacity mix, smaller NFPs are often reliant on their board's skills to fill gaps in operational expertise:
 

When we have a shortfall in [Human Resource] capabilities, we say let's get a director that's got some HR skills - 3A.

Participants recognised this practice challenges the traditional separation of duties between the board and management. However, several participants argued small NFPs need greater flexibility than formal governance divisions allow:

It's not only legitimate; in fact it's absolutely necessary for the smaller end of the market. I'm not talking about teeny-weeny ones, I'm talking about... \$1 million, \$2 million income. It's absolutely necessary at times, because the operational people don't have the skills. We don't have enough people there because it's run on a shoestring - 3B.

- *Board Performance Measurement.* Although some small NFPs conducted detailed, formal reviews of board performance assessment, most – consistent with Ostrower’s (2008; 2010) findings in the US – used more partial or *ad hoc* measures of board performance.

There was no consensus about what constituted a high-performing board. Themes included cultural (e.g. commitments and values) and strategic (e.g. setting measurable and effective goals) principles, as well as basic operational benchmarks like attending meetings and reading board papers.

- *Fit-for-purpose risk and governance structures:* Participants raised concerns that focusing on the most significant organisational risks can be difficult, and that apparent cost burdens may be misleading. That is, comparisons of service value for funder money between small and large NFPs, such as the percentage of total revenue an NFP spends on administration, may not communicate the efficiency, effectiveness or social impact of these organisations. Additionally, the traditional governance *foci* may not be relevant for small organisations (e.g. clinical risk versus financial risk) and the costs of extensive formal governance systems may not deliver adequate returns.

### Financial Sustainability

- *Funding and cash flow.* Alongside board composition and performance, financial stability was participants’ most significant governance concern. Issues participants raised include:
  - managing funding beyond 12 months, especially for NFPs heavily reliant on short term government contracts. This funding instability has flow-on effects on staff recruitment and retention;
  - the challenge of diversifying funding, and potentially taking bigger risks, without compromising core services or mission; and
  - maintaining cash flow and cash balances in an environment of declining revenue, especially for self-sustaining organisations.

- *Financial skills:* Related to board skills, small NFPs often struggled to find sufficient board expertise to meet financial demands. In some cases, this include sufficient board financial literacy as well as longer-term strategic planning:

What we're doing now, is we bring the treasurer down a day before and she sits with the CFO and [she] gets a briefing and then comes to board meetings and tries to give a report. But she doesn't really understand, regrettably - 3C.

- *Financial controls:* While most participants reported strong financial management practices, participants also observed how a limited number of staff, and potential constraints on financial expertise, can constrain financial controls. The following example was from a participant’s partner NFP:

[In the partner small NFP] the CEO was actually doing all the payments, was doing all the finance stuff, and the board weren't questioning anything at all. He wasn't using the money on his own



and spending it, it was just that there was nobody looking to make sure money was coming in to pay all the bills - 3D.

### Service Quality

- Participants were generally confident about the service quality they deliver. This may reflect the systems of provider and service review NFPs typically face through accreditation and funding requirements.
- However, beyond externally imposed requirements, there was significant variation in the capacity of smaller NFPs to conduct longer-term strategic service planning and review. This appeared to depend again on the skills available on the board or from management at any particular historical juncture:

When I came on board we didn't have a strategic plan. It was one of the first things I did, we had a full, by any other measure full corporate strategic plan which included all of the main result areas and targets - 3E.

- Participants shared the sector-wide concern with funders' focus on measuring outputs rather than outcomes.

### Human Resources

- Beyond board recruitment, participants were less concerned about human resources more broadly, at least as a governance issue.
- The main human resources issue participants raised was the importance of organisational culture in enabling effective governance. This included the need to establish a clear vision and purpose, and also the challenge of communicating expectations throughout the organisation.
- One specific challenge was managing volunteers: How to maintain performance and accountability, but also retain engagement? While this is again a sector wide issue, smaller NFPs potentially drew from a smaller pool of volunteers and other contributors, so may have less capacity to replace volunteers or staff that lose interest or commitment.

### **4.3 Participants' proposed solutions**

A key part of this project's approach was to investigate what resources or support participants 'on the ground' in small NFP practice would find useful, rather than developing resources external stakeholders deem valuable.

The main proposals participants considered were:

- *Affordable, accessible and specific training* for directors and senior staff focused on governance in small NFP organisations and contexts. Participants particularly emphasised the need for a *credible* provider to ensure NFP directors and staff can be confident of the results. Participants widely endorsed the ACNC as a potential provider that would be credible in this way.

- *Governance principles tailored to small NFPs* was considered and largely endorsed. However, several participants also stressed the need for all NFPs to meet basic standards. Consequently, participants focused on the need for basic governance principles to be tailored to the small NFP *context*.
- *A central resource repository* – a ‘one stop shop’ for resources for small NFP boards and organisations – was widely endorsed. The ACNC was again nominated as a potential reputable and accessible provider of such resources.
- *Paying board members* was considered, but participants did not reach consensus.
- *Mentoring*: There was strong support for a scheme in which experienced directors mentored less experienced directors. Again, there was support for a credible, central organisation like the ACNC to facilitate such as scheme.

## 5. Recommendations

While only an exploratory study, the findings provide an indicative case for more policy, practice and research focus on the governance needs of smaller NFPs. Three proposals / recommendations are:

### **1. Further engage small NFPs in policy advice and development processes**

One surprising initial finding of the research was the dearth of existing discussions of smaller NFPs’ governance needs and challenges in industry resources and guides. This preliminary research finding supported the contention that small NFPs at least face distinctive resource *constraints* and *context* in meeting the shared aspiration for effective and accountable NFP governance.

Given the evolving NFP policy domain, and the limited ‘voice’ of smaller NFPs, this report recommends policy makers and standard-setters consider initiatives specifically targeted to incorporate smaller NFPs’ views and experiences in future policy initiatives. This might include:

1. targeted representation of smaller NFPs in policy consultation and advisory forums; and
2. specific policy consultation with smaller NFPs on key policy issues in their sectors.

### **2. Dedicated small NFPs governance resources**

The initial findings suggest that while small NFPs accept similar principles of good governance (e.g. transparency, assessment, financial stewardship etc.) to other NFPs, they face unique contextual constraints and demands in delivering on these principles. These included less, or less stable, access to high-level board and operational skills, and fewer resources to seek external professional advice when needed.

“Dedicated resources” does not necessarily mean more governance guides, but rather *easily accessible, targeted* and *low cost* (in money and time) resources that can be used by NFPs to

meet specific governance issues. Rather than more complex governance guides, more 'active' initiatives like low cost training, a mentoring scheme and a credible, central repository for small NFP materials better fit these criteria. Participants widely endorsed the ACNC to either provide or co-ordinate these resources. Resources with a co-ordinating function, such as a mentoring scheme, would require relatively little up-front cost, with potentially extensive and self-perpetuating benefits.

### **3. Additional academic and industry research**

Neither industry nor academic NFP governance research has adequately articulated or analysed the governance demands and context of small NFPs, especially with a view to proposing strategies or 'solutions' to respond to these challenges.

Key issues for future research include, but are not limited to:

- *the definition of small NFPs*: What constitutes a 'small' NFP for the purposes of delineating the issues outlined above;
- *comparative analysis of governance issues and challenges*;
- *policy implications* e.g. for generic governance policies like the ACNC Act, or for specific initiatives like the NDIS in which small NFPs play a critical role;
- *policy strategies or initiatives* to address existing challenges;
- *sector specific research* e.g. are there unique issues in small NFP governance in health services; and,
- *Training and development*: Are there unique needs for training and development in small NFPs, including how such materials are delivered?

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## Appendix A: Participant / Focus group details

Groups Location	Participants	Roles			Revenue			
		CEO	Director	Other	<250 K	250 – 1M	>1 - 10m	Not stated
Perth	8	6	2	0	2	0	4	2
Sydney (2 groups)	11	2	7	2	2	4	5	0
Melbourne	8	2	5	1	2	3	3	0
<b>TOTAL</b>	<b>27</b>	<b>10</b>	<b>14</b>	<b>3</b>	<b>6</b>	<b>7</b>	<b>12</b>	<b>2</b>

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<sup>1</sup> Prof Martinov Bennie and Dr Dale Tweedie are from Macquarie University, Sydney, and Prof. David Gilchrist is from the University of Western Australia.

<sup>2</sup> Ostrower (2008) focuses on 'mid-size boards'. However, Ostrower (2008) defines mid-sized as NFPs with budgets of \$500,000 to \$5 million USD. So while excluding an important set of small NFPs under \$500,000, these NFPs falls within the definition of small NFPs used in this study.

<sup>3</sup> Research conducted outside universities, typically without formal, double-blind peer review and more focused on practical outcomes or guidance.

<sup>4</sup> Small NFPs in this study were arbitrarily defined by revenue of \$250,000 or less.

<sup>5</sup> Full list of NFP governance resources available by request to the authors.

<sup>6</sup> All focus groups contributors are to be kept anonymous.