THE INFLUENCE OF FINANCIAL MANAGEMENT PRACTICES, BOARD EFFECTIVENESS AND ACCOUNTABILITY TOWARDS PERFORMANCE: EMPIRICAL TEST OF NON-PROFIT ORGANIZATIONS

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Abstract

Non-profit organizations (NPOs) rely on a variety of activities and resource providers to support their mission-related work. Prior researches on the factors influencing the performance of non-profit organizations were largely based on conceptual argument with no empirical support. The Resource-Dependency Theory (RDT) has suggested that external resources of organizations affect NPOs performance. In the light of RDT, this paper examines how financial management practices, level of accountability and board effectiveness affect the performance of NPOs. Based on the analysis from 107 questionnaires received from top level management of NPOs, the finding revealed that there is significant positive relationship between the financial management practices, board effectiveness and the performance of NPOs. This provides an indication that for NPOs to sustain and remain relevant, they need to adopt adequate level of financial management and appoint only board that are actively involved in NPOs strategic direction. This study is important to provide guidelines to NPOs on the strategies that need to be adopted to enhance their performance.

Keywords: performance of non-profit organizations, resource dependency theory

Introduction

Non-profit organizations (NPOs) or so-called "third" sector plays important roles in communities around the world in various areas ranging from education, healthcare, disaster relief, social work and overall improvement of human condition (Liu, 2010; Seo, 2011).Over the past decade, many parties have come to regard the importance of measurement of charity effectiveness and transparency as there was issue of dissatisfaction of donors with the performances of NPOs(Iwaarden et al., 2009; Wetherington, 2010). NPOs' past performance have been used by donors in deciding which NPOs they should donate. Donors are now requesting more information about what is actually happening to their money (Mitchell, 2009). Moreover, the charity watchdog and rating groups emerged to assist donors in evaluating the more donation-worthy charities in which they compile public information for various charities into a searchable database often freely available through a web site (Kelly, 2008; Mitchell, 2009).

NPOs have to exercise accountability at its highest in managing their day-to-day activities(Gray et al., 2006; Torres and Pina, 2003).Shepeard (2007) reported that approximately 2% of the $260 billion dollars donated to NPOs in 2005 was lost to executive director fraud, waste, and abuse. This indicates the lack of accountability in the management of NPOs. If the private entities have to be accountable towards their shareholders, the NPOs also have to be accountable towards the public indirectly (Kilby, 2006). Jamali et al. (2010) demonstrated that accountability and transparency of NPOs are crucial for the sustainability of NPOs. Past studies on accountability tended to focus on the role of accountability in improving the performance of private sector organization (Demirag, Dubnick, & Khadaroo, 2004; Hall, 2005; Orfgen, 2008). Studies that examined the relationship between accountability and performance of NPO are not widely available.

Generally NPOs survivals depend highly on donation from government, businesses, corporations, foundations, institutions, individuals, fees and lending (Corbett, 2006; Leather, 2011). According to a study by Soobaroyen and Sannassee (2007), about 44 % of the NPO relies primarily on public and corporate donations meanwhile 24% depend on some form of government funding. As such, the management of NPOs needs to strategize and to be actively involved in generating fund (MohdNasir, 2009). Effective boards enable firms to minimize dependence or gain resources which subsequently improve firm's performance.

In the context of NPOs, strong board is critical for increasing the effectiveness of their organization; a nonprofit can only sustain high performance over the long term when it has a great board. When boards move beyond policy setting and fundraising and devote time to providing expertise, helping managers get access to people and resources, and building managerial capacity, their organizations benefit the most[3].Prior reviews of the board of directors literature concluded that Resource Dependence Theory (RDT) is supported more often than other board perspectives (Zahra & Pearce, 1989), including, agency theory. Past studies agreed that ability of board to provide access to resources otherwise unavailable to the firm will be positively associated to firm'sperformance (Geer, 2009; Matthew, 2011). However, these studies mainly focused on private entity. Effective boards were argued to safeguard the donors fund by monitoring the decision made by the management for the benefits of NPOs and society at large (Bryant & Davis, 2011; Callen, Klein, & Tinkelman, 2010).

Past studies suggested that financial management practices facilitates management to strategize and position their organization above the average industry performance (Simmonds, 1981 & 1982). Within the accounting literature, the role of financial management is to provide information for planning, control and evaluation of production activities (Choe, 2002). Financial Management provides managers with valuable information to support the firm's goal and objectives (Bromwich, 1990; Bromwich & Bhimani, 1994; Guilding, Cravens & Tayles, 2000). Conceptually, the role of financial management practices in enhancing organizational performance is well established in literature. However, to date little empirical research has been done to test this relationship especially in the context of NPOs.

Studies that focused on NPOs in Malaysia had been extensive. However, the scope of these studies were limited to financial reporting of NPOs (Mohd Nasir, 2009) governance of NPOs (Atan et al, 2013),accountability in faith based NPO (Afiffuddin, et al, 2010); management accounting practice and risk management practices (Abdul Rasid and Abdul Rahman, 2009), types of

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health services provided by religious organizations(Sen, 1994**)** and financial management and accounting of mosques (Diptyana, 2009). From those literatures, it can be concluded that there is a lack of research to investigate the factors contributing to the performance of NPOs. Hence, this study aims to examine whether financial management practices, board effectiveness and accountability positively contribute to NPO's performance.

The remainder of this paper is structured as follows. The next section provides a review of relevant literature. Section 3 highlights hypotheses underpinning this study. Research framework is explained in Section 4. Section 5 outlines the methodology andresearch design. The results and discussions are presented in section 6. A conclusion and recommendations are provided in the last section

NPOS in Malaysia

As at November 2011, in Malaysia, there are 47,376 NPOs registered under Registrar of Society (ROS). The functions of ROS are to control and monitor NPOs and to ensure they comply with society policies, rules and procedures. Non-profit organizations may be formed either as a charitable corporation or as societies/associations. There are 13 categories of NPOs (1) Religious (2) Welfare; (3) Social and recreation; (4) Women; (5) Culture; (6) Mutual benefit societies; (7) trade associations; (8) Youth; (9) Sports (10) education; (11) political; (12) employment associations (13) general. As at December 2011, there were more than 45,000 parent societies have been registered as well as more than 50,000 branch societies all over Malaysia.

The importance of non-profits in Malaysia is merely to deliver the services to the public (Atan et al, 2013).This indicates the roles of non-profit organizations are to contribute to the common goods that facilitate ethical life in protecting the environment and provide space for more debate in the public sphere (Hashim et al., 2010). These organizations represent the public concern over these issues thus becoming the intermediary to fill up the gap between government and the people. They may not offer any comprehensive solutions to the problems, hence advocating improvements at the top (Hashim et al., 2010).

Literature Review and Hypotheses Development

Financial Management Practices and Financial Performance

Previous studies provided a strong support on the positive effects of financial management practices and firm's financial performance (Douglas and Judge, 2001; Easton and Jarrell, 1998; Hendricks and Singhal, 1996). Quality management practices can improve business performance by improving operational performance thus reducing costs (Sousa and Voss, 2002). Abernethy and Stoelwinder (1991) have used contingency theory to argue that organizations perform more effectively if structures and control systems are designed to match contextual variables conceptualized stating that among the examples of effective formal systems is budgeting system. Study conducted based on a sample of 192 subunit managers in four large Australian not-for-profit hospitals discovered that there are beneficial effects on performance when budgeting as one of financial management practices is used by subunit managers in organization. The findings show that budgeting variable has a significant influence on the performance of non-for-profit hospitals sector in Australia. Bakar and Ismail (2011) found that majority of agencies have a 'good' financial management system, with Federal agencies performing better than their counterparts at the state level. Baharin et al, (2011) discovered that there is positive impact of employees' involvement and management practices on organization's financial performance. Victoria et al., (2004) also has found a significant positive relationship between management practices and financial performance, measured in terms of revenues collection. Hence, the following hypothesis is proposed:

> ***H1**: There is a positive relationship between financial management practices and performance of NPOs.*

Board of Directors' Effectiveness and Financial Performance

Although agency theory is the predominant theory used in the research on boards of directors (Dalton, Hitt, & Certo, 2007; Dalton et al., 1999; Zahra & Pearce, 1989), this is the area of RDT's greatest research influence. Pfeffer and Salancikn (1978) asserted that boards enable firms to minimize dependence or gain resources. Prior reviews of the board of directors literature concluded that RDT is supported more often than other board perspectives (e.g., Dalton et al., 1999; Zahra & Pearce, 1989), including agency theory. RDT contends that effective board plays an important role as a link to the external environment (Pfeffer and Salancikn, 1978) an by this can uphold the ability to acquire and maintain resources for an organizational survival.Past studies agreed that ability of board to provide access to resources otherwise unavailable to the firm will be positively associated to firm's performance (Geer, 2009; Matthew, 2011).Past studies that examine the effects of board effectiveness on firm's performance discovered a positive relationship between board effectiveness and firm's performance (Fiegener et al, 2000; Daily and Dalton, 1992). Northcott and Smith (2011) discussed the implication of board effectiveness on financial performance of the organization where the board responsibilities are broad including monitoring accountability in organization in order to protect funder's interests and to lead the organization to good financial performance and overall company's performance. Matthew (2006) found that non-profit board effectiveness had an association with the financial vulnerability of the organization and was identified as statistically significant. Hence, the following hypothesis is proposed:

> ***H2**: There is a significant positive relationship between board of directors' effectiveness and performance of NPO*

Accountability and Financial Performance

The main principle of RDT is that the organizations depend on financial resources to support the NPOs activities. Corporations, government and donors are the external stakeholders that the NPOs depend on for various tangible and intangible resources. Similarly, NPOs accountability underpins the relationship between NPOs and their stakeholders. The stakeholders' approach explains the right to accountability from those that have authority over an organization to anyone who has been affected by the organization's policies, and hence NPOs accountability to their stakeholders (Ruhaya&Saunah, 2009) as fund providers.

The importance of accountability in non-profit organizations has been emphasized over time (Roberts &Scapens, 1985;Ebrahim, 2003; Christensen, 2004). Nonprofits are often scrutinized and under pressure due to rising expectations of effectiveness, efficiency and transparency (Lichtsteiner & Lutz, 2012) and the need to justify not only what services they deliver but also how they operate. They are being forced to be more accountable for the manner in which they spend their resources. Justification based on mission alone is no longer sufficient and must be supported through a demonstration of programmatic and fiscal accountability (Christensen & Ebrahim, 2004). Voluntary mechanisms such as codes of conduct, certification programs and other standard-setting mechanisms (Gugerty, 2009) are seen as the means to discharge the voluntary accountability.

Accountability can affect firm's performance by encouraging cooperation and knowledge sharing within the organization perceived as desirable (Suchman, 1995). Saunah et al (2012) found that there is a significant difference in financial performance between funded and non-funded charity organizations. This will give evidence to resource providers in making decision towards disbursing their funds and resources to these NGOs. Consequently, a lack of accountability reduces support and commitment. Such scenario hinders others to collaborate and share knowledge and support, which is critical for enhancing firm's performance. Past studies that examined the effect of accountability on performance have been extensive and have discovered positive relationship between accountability and firm's performance (Tan and Kao, 1999;Crossland& Chen, 2013).Hence, the following hypothesis is proposed:

> ***H3****: There is significant positive relationship between accountability and performance of NPOs.*

Based on Resource Dependency Theory of variables affecting an organization's performance as explained above, Figure 1 illustrates the framework that underpins this study. The framework indicates that the financial performance of NPOs were determined by financial management practices, board effectiveness and accountability.

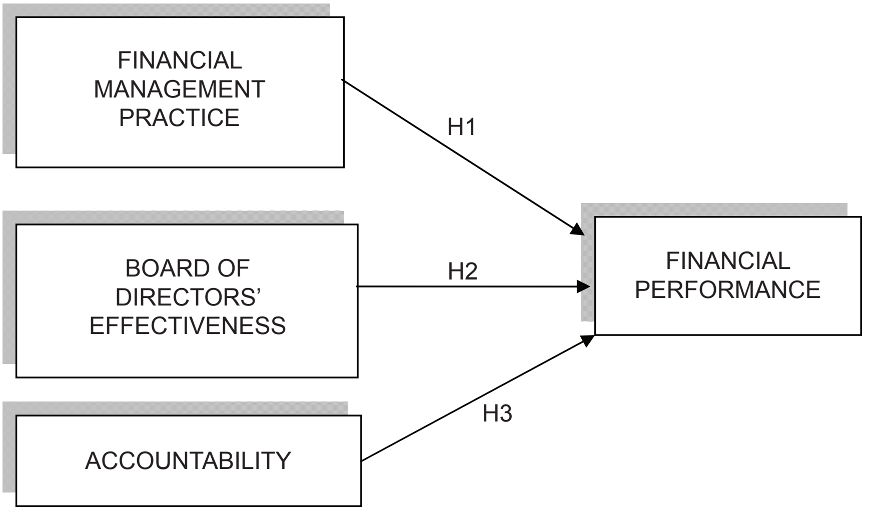

Figure 1:Conceptual Framework of Factors Influencing the Performance of Non-Profit Organization

Research Methodology

Sample

A total of 360 sets of questionnaire were distributed to the accountants as representative of NPOs registered under ROS. The questionnaires were distributed based on randomly selected sample. However, only 107 were returned which represents 30% response rate. This study adapted a formula for calculating sample size requirements provided by Tabachnick and Fidell (2001) that takes into account the number of independent variables used in the study $N > 50 + 8m$ (where m = number of independent variables) (Francis, 2003; VanVoorhis & Morgan, 2007). Since this study used three independent variables, sample size required is at least 74. The sample size indicates that it is able to make general statement and valid to represent the population in Malaysia.

Measurement of Variables

Part 1 of the questionnaire required respondents to provide their opinion on the level of financial management that is being practiced by their organization. Nine questions adopted fromBarrett (2008); Landry (1982); Murphy (2007) and Zietlow (1985) were asked to measure the financial management practices by the respective NPOs. Respondents were requested to provide their feedbacks on a seven points Likert scales from 1 being *"strongly disagree"* to 7 being *"strongly agree"*. Respondents were asked whether their organization uses a computerized accounting/recordkeeping, prepares cash flow projections, prepares annual financial statements, submits annual financial statement to *Registrar of Society,* prepares financial reports in an accurate and timely manner, prepares budget, employs qualified and knowledgeable staff for record keeping, communicates yearly budget to all employees and employs cost benefit analysis for fund raising activities.

Part 2 of the questionnaire required respondents to express their opinion to measure BOD effectiveness. There were ten questions which were adopted from Geer (2009); Gollmar (2008); Jaskyte (2012) and Landry (1982). Respondents were asked whether BOD in the organization understand and respond well to their roles and responsibilities, establish policies and plans to achieve the organization's goals, implement performance measures that focus on short- term and on long- term success, involve in fund raising activities, review the completed annual financial audit, actively involved in organization strategy implementation, shape the direction for the nonprofit through its mission, strategy, and key policies; ensure that the leadership, resources, and finances in place commensurate with the vision; and that the board monitor performance and ensure prompt corrective action when needed.

Part 3 of the questionnaire assess the level of accountability. There were twelve questions adopted from Barrett et al (2008); Geer (2009); Murphy (2007) and Seo (2011)to measure the accountability. The respondents were asked whether in their organization funds were used properly and in the manner authorized, comply to requirements of the relevant department at the State and Federal levels, report any serious incidences which may have negative impact on the public to the higher authority, welcome monitoring visits from funding and oversight agencies, provides complaints and redress mechanisms, provide opportunities to assess performance reports, prepares regular reporting system on the achievements and results of its programs or projects against their objectives.

Part 4 measured performance of NPOs. Respondents were asked to assess their NPOs' performance for the past three years as compared to other NPOs of similar size using a seven point scale of 1 being "much worse" and 7 "much better" in terms of revenue collection, cost reduction, revenue per employees and cost per employees.

Result and Discussion

Table 1 shows the demographic profile of the respondents. From 107 respondents, 73 (68.2%) were male and 34 (31.8%) were female respondents. As for job position of respondents in the organization, most of them (64.5%) were holding president/vice president and top management position which is 32 (29.9%) and 37 (34.6%) respectively, followed by other positions at middle management23 (21.5%), lower management 5(4.7%), and 10 (9.3%) supporting staff. As shown in Table 1most of the male respondents were also holding president/vice president or top management position.

Table 1: Demographic Profile of Respondents

		Job position					Total
		President / Vice President	Top Management	Middle Management	Lower Management	Supporting staff	
Gender	Male	26	27	11	3	6	73
	Female	6	10	12	2	4	34
Total		32	37	23	5	10	107

Of the 360 questionnaires distributed, 107 were returned representing a response rate of 30%. Prior to testing the hypotheses, tests of reliability and normality were performed. SPSS package version 19 was used to perform the reliability test for each construct. Table 2 summarizes the results of Skewness, Kurtosis, Reliability and Pearson Correlation Coefficients. The coefficient alpha of each construct was compared to the cut-off value of .70 suggested by Nunnaly(1978). Skewness and kurtosis test were carried out to confirm the normality of data distribution. The z-value for skewness and kurtosis for all the variables range from 0.486 to 0.8755 indicating that normality could be assumed at the .01 probability level.

Table 2 : Summary of the Finding of Skewness, Kurtosis, Reliability and Pearson Correlation Coefficients

	Skew ness	Kurtosis	Reliability	Performance	Fin Mgt Practices	Board effectiveness	Accountability
Performance	0.486	-0.364	.901	1			
Financial Mgt practices	0.766	0.596	936	.577** .000	1		
BOD Effectiveness	0.687	0.210	.934	.566** .000	.445** .000	1	
Accountability	0.855	1.529	.834	.454** .000	.454** .000	.529** .000	1

Variables	Coefficients	Std Error	t-stat	p-value	VIF	Tolerance
(Constant)	.400	.243	1.643	.103		
FMP	.408	.091	4.472	.000	1.359	.736
BOD	.398	.102	3.890	.000	1.499	.667
ACC	.134	.119	1.120	.265	1.513	.661
R					0.677	
R^2					0.459	
AdjustedR^2					0.443	
F-statistic (p-value)					0.000	

The results of the correlation test provides a preliminary finding on a significant positive relationship between financial management practices and financial performance (r = .577, p = 0.000); board effectiveness and financial performance (r = 0.454, p = 0.000); accountability and financial performance (r = 334, p = 0.000)

Table 3: Regression Results on Financial Performance

Variables	Coefficients	Std Error	t-stat	p-value	VIF	Tolerance
(Constant)	.400	.243	1.643	.103		
FMP	.408	.091	4.472	.000	1.359	.736
BOD	.398	.102	3.890	.000	1.499	.667
ACC	.134	.119	1.120	.265	1.513	.661
R					0.677	
R^2					0.459	
AdjustedR^2					0.443	
F-statistic (p-value)					0.000	

** Significant at 5% level

Table 3 exhibits the results of regression analysis. Regression test examines the linear relationship between the dependent variable of financial performance and the independent variables; financial management practices, board of directors' effectiveness and accountability. Based on the results of F-Test for overall significance of the model, the regression was statistically significant at 5% (28.493, p = 0.000). This shows that there is a linear relationship between independent variables and dependent variable. In addition, this result means that there is evidence that at least one independent variable affects dependent variable. The R^2 value of 45.4 % means that variance in the financial performance in organization was explained by the variation of financial management practices, board of directors' effectiveness and accountability. The adjusted R^2 of.443 means that 44.3% of NPOs' performance is explained by the variation in financial management practices, board of directors' effectiveness and accountability taking into account the sample size and number of independent variables. In this study, the VIF values as shown in the table are all well below 10 and the tolerance statistics are all above 0.2, therefore, it can be concluded that there is no collinearly within the data.

Hypothesis 1 proposed that there is a significant positive relationship between financial management practices and financial performance of NPO. Table 3 exhibits that (B = -0.408, t= 4.472, p = 0.00). Hence Hypothesis 1 was accepted. This means that financial management practices contribute significantly to financial performance.

Hypothesis 2 proposed that there is a significant positive relationship between board of directors' effectiveness and financial performance of NPO. Result in Table 3 exhibits the coefficient = 0.398 t= 3.890, p= 0.00 and hence H2 is accepted. Findings in this study support the study by Findlay-Thompson (2009) who found that board of directors of NPOs in Nova Scotia does have a statistically significant effect on revenue per employee.

Hypothesis 3 proposed a positive relationship between accountability and financial performance. Table 3 exhibited that the coefficient =0.134, t= 1.120, p= 0.265. Hence this study rejects H3. Therefore, the result shows that accountability has no impact on the financial performance in organization. Finding for this variable is consistent with (Ferenc & Monika, n.d.; Jamali et al., 2010)who found that there is no relationship between accountability and financial performance.

Conclusions

This paper aims to determine the factors influencing the non-profit financial performance. Three variables were chosen namely, financial management practices, board effectiveness and accountability. The results show that financial management practices and board effectiveness are important determinants to financial performance of NPOs in Malaysia. The finding also discovers that accountability does not have significant impact on the financial performance.

This study contributes to managerial implications for managers especially in NPOs setting. The findings of this study could be used by NPOs especially in Malaysia on factors deemed important to enhance financial performance. The findings imply that NPOs need to adopt adequate level of financial management practice that enable planning, monitoring and evaluation in running their organizations. Financial management practices enhance transparency of the NPOs which enhance donors' confident to contribute more fund to the organization. Jokipii (2010) proved that lack of control has increased the numbers of business failure. Similarly, lack of financial management practices indicate poor control management in NPOsin reporting the transactions such as receiving income, authorization, recording of financial transactions, and periodic reconciliation will affect the report of financial performance.

The findings also provide indication that NPOs need to recognize the importance of effective board members. As such it is important for NPO to appoint only those board members that are willing to be actively involved in designing and implementing strategy for improving its financial performance. Active involvement of board members in fund raising activities facilitates continuous flow of fund to organization. With substantial and growing pressures on NPOs it is crucial for board to accomplish and ensure that it contributes as much as it can to the NPOs by identifying opportunities for improvement.

This study is not without limitations First, to measure the variables, respondents were asked to rate subjectively on a seven point Likert scale. These evaluations are subject to personal bias and judgment errors. Future research should include data collection from multiple sources.

Second, this study provides a cross-sectional picture at a single point in time, which means the recommendations are applicable only if external variables are unaffected. Nonetheless, the findings of the factors affecting NPOs performance do shed light on the understanding of the impact of financial management practices, board effectiveness and accountability on performance. Third, the sample was drawn from a single industry, namely NPOs. Although this sampling frame allowed control for environmental factors and provide results for a major sector, the findings may not be generalized to other sectors. Replication of this study by further research on NPOs in other countries and in different government jurisdictions would help to determine the generalization of the combined influences of other factors on financial performance.

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