NOT-FOR-PROFIT ORGANISATIONS

Several papers in the ACCA Qualification may feature questions on not-for-profit organisations. At the Fundamentals level, these include Papers F1, F5, F7 and F8. At the Professional level they include Papers P2, P3 and P5. Although many of the principles of management and organisation apply to most business models, not-for-profit organisations have numerous features that distinguish them from the profit maximising organisations often assumed in conventional economic theory.

This article explains some of these features. In this, the first part of the article, we broadly describe the generic characteristics of not-for-profit organisations. The second part of the article will take a specific and deeper look at charities, which are one of the more important types of not-for-profit organisations.

WHAT IS A NOT-FOR-PROFIT ORGANISATION?

It would be simplistic to assume that any organisation that does not pursue profit as an objective is a not-for-profit organisation. This is an incorrect assumption, as many such organisations do make a profit every year and overtly include this in their formal plans. Quite often, they will describe their profit as a 'surplus' rather than a profit, but as either term can be defined as an excess of income over expenditure, the difference may be considered rather semantic.

Not-for-profit organisations are distinguished from profit maximising organisations by three characteristics. First, most not-for-profit organisations do not have external shareholders providing risk capital for the business. Second, and building on the first point, they do not distribute dividends, so any profit (or surplus) that is generated is retained by the business as a further source of capital. Third, their objectives usually include some social, cultural, philanthropic, welfare or environmental dimension, which in their absence, would not be readily provided efficiently through the workings of the market system.

TYPES OF NOT-FOR-PROFIT ORGANISATION

Not-for-profit organisations exist in both the public sector and the private sector. Most, but not all, public sector organisations do not have profit as their primary objective and were established in order to provide what economists refer to as public goods. These are mainly services that would not be available at the right price to those who need to use them (such as medical care, museums, art galleries and some forms of transportation), or could not be provided at all through the market (such as defence and regulation of markets and businesses). Private sector examples include most forms of charity and self-help organisations, such as housing associations that provide housing for low income and minority groups, sports associations (many football supporters' trusts are set up as industrial and provident societies), scientific research foundations and environmental groups.

CORPORATE FORM

Not-for-profit organisations can be established as incorporated or unincorporated bodies. The common business forms include the following:

- in the public sector, they may be departments or agents of government
- some public sector bodies are established as private companies limited by guarantee, including the Financial Services Authority (the UK financial services regulator)
- in the private sector they may be established as cooperatives, industrial or provident societies (a specific type of mutual organisation, owned by its members), by trust, as limited companies or simply as clubs or associations.

A cooperative is a body owned by its members, and usually governed on the basis of ‘one member, one vote’.

A trust is an entity specifically constituted to achieve certain objectives. The trustees are appointed by the founders to manage the funds and ensure compliance with the objectives of the trust. Many private foundations (charities that do not solicit funds from the general public) are set up as trusts.

FORMATION, CONSTITUTION AND OBJECTIVES

Not-for-profit organisations are invariably set up with a purpose or set of purposes in mind, and the organisation will be expected to pursue such objectives beyond the lifetime of the founders. On establishment, the founders will decide on the type of organisation and put in place a constitution that will reflect their goals. The constitutional base of the organisation will be dictated by its legal form.

If it is a company, it will have a Memorandum and Articles of Association, with the contents of the latter entrenched to ensure that the objectives cannot be altered easily in the future. Not-for-profit organisations that are not companies most commonly have a set of Rules, which are broadly equivalent to Articles of Association.

As with any type of organisation, the objectives of not-for-profit organisations are laid down by the founders and their successors in management. Unlike profit maximisers, however, the broad strategic objectives of not-for-profit organisations will tend not to change over time.

The purposes of the latter are most often dictated by the underlying founding principles. Within these broad objectives, however, the focus of activity may change quite markedly. For example, during the 1990s the British Know-How Fund, which was established by the UK government to provide development aid, switched its focus away from the emerging central European nations in favour of African nations.

It is important to recognise that although not-for-profit organisations do not maximise profit as a primary objective, many are expected to be self-financing and, therefore, generate profit in order to survive and grow. Even if their activities rely to some extent on external grants or subventions, the providers of this finance invariably expect the organisation to be as financially self-reliant as possible.

As the performance of not-for-profit organisations cannot be properly assessed by conventional accounting ratios, such as ROCE, ROI, etc, it often has to be assessed with reference to other measures. Most not-for-profit organisations rely on measures that estimate the performance of the organisation in relation to:

- effectiveness – the extent to which the organisation achieves its objectives
- economy – the ability of the organisation to optimise the use of its productive resources (often assessed in relation to cost containment)
- efficiency – the ‘output’ of the organisation per unit of resource consumed.

Many service-orientated organisations use ‘value for money’ indicators that can be used to assess performance against objectives. Where the organisation has public accountability, performance measures can also be published to demonstrate that funds have been used in the most cost-effective manner.

It is important within an exam question to read the clues given by the examiner regarding what is important to the organisation and what are its guiding principles, and to use these when assessing the performance of the organisation.

MANAGEMENT

The management structure of not-for-profit organisations resembles that of profit maximisers, though the terms used to describe certain bodies and officers may differ somewhat.

While limited companies have a board of directors comprising executive and non-executive directors, many not-for-profit organisations are managed by a Council or Board of Management whose role is to ensure adherence to the founding objectives. In recent times there has been some convergence between how companies and not-for-profit organisations are managed, including increasing reliance on non-executive officers (notably in respect of the scrutiny or oversight role) and the employment of ‘career’ executives to run the business on a daily basis.

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