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## Article

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*Article*

# **Leasehold: An Institutional Framework for Understanding Nonprofit Governance in a Civil Society Context**

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**Abstract:** Nonprofit organizations play a role in the creation of a society that is civil, and it is an important one that neither the state nor for-profit organizations undertake. This raises the question of governance and accountability, which is often addressed by looking to agency-based models from the private sector. The acknowledged problem is that the agency's notion of owners does not translate well to nonprofits. Adapting the concept of leasehold (wherein the managers and organization operate with broad autonomy, using resources supplied by supporters in exchange for the promise that specific societal value will be created, and are accountable for doing so) allows for a more flexible and responsive arrangement. It also suggests a mechanism whereby many independent nonprofits taking multiple approaches help civil society evolve.

**Keywords:** nonprofit; governance; agency theory; leasehold model; civil society

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## **1. Introduction**

This paper explores the governance of individual organizations and their connectedness within a society. The challenge comes from the recursive nature of the process by which society shapes organizations, which then shape society, which subsequently shapes organizations—in a continuing cycle. However, how can we best understand the governance of nonprofit organizations in such a context? In a number of ways, the agency model fails to recognize the complexity of nonprofit organizations, creating the need for a framework that better captures their social embeddedness and

dynamic environments. One such alternative is explored which leads to an ecological understanding of the governance of nonprofit organizations within a society.

The notion of civil society may be thought of in two intertwined but distinct ways. First, at its broadest, the notion encompasses the conditions and practices required for a society to be deemed decent. The actual criteria vary across time, place, and culture. Those whose conditions are considered may not include all people living within the footprint of the society (e.g., outcasts). This perspective is associated with a conversation which has been evolving since Aristotle about human need, community, dignity, justice, and what is required beyond government contributions to create a civil society.

Second, civil society is used as synonymous with “civil sector”, the aggregate of social purpose organizations (generally nonprofits) working to foster conditions that result in a more civil society, as the term was used in the preceding paragraph [1–3]. This is the sense in which the United Nations uses the term when speaking of partnering with civil society in development efforts [4,5]. Of course, not everything that makes a society civil is the product of nonprofit organizations. Government provides services such as police, education, and public sanitation. The goods and services provided by commercial enterprises create much that is associated with what is civil in a society, although doing so primarily for those who can pay. Food, housing, education, and healthcare are examples of services that may be provided by government, nonprofit, or for-profit organizations. The civil sector might be seen as filling those needs not otherwise served, resulting in a different agenda in different contexts.

Thinking of nonprofits as a vehicle for filling gaps suggests a marginal or ephemeral role. Yet, such organizations are abundant and often enduring, if not individually as a category of organizations. A society’s civility may be measured by its treatment of those with limited financial and political resources. It is precisely those who are least able to meet their needs by making purchases or influencing government who are caught in the gaps nonprofit organizations address. Thus, there is an inherent role for nonprofits in societies.

However, how and in whose interest are nonprofit organizations governed? Viewed from a societal perspective, these organizations perform a necessary function. Government, industry, and members of the community at large may look to them to fill roles not otherwise performed. Yet, nonprofit organizations are separate from government and commerce. They are independent and not under the control of the other sectors.

If nonprofit organizations address gaps and if filling those gaps is integral to a society’s being civil, the mechanisms by which nonprofit organizations are accountable has significance beyond the individual organization itself. Surely, the performance of such work would not be left to chance. This leads some [6–9] to suggest that nonprofit organizations are a product of the polity—so the state governs nonprofits. Certainly, nonprofits do not exist without the sufferance of government, and they are subject to its regulation. However, for-profit enterprises also require the sufferance of the state and are subject to its regulation, yet in only a few socio-political systems could one say the state governs such enterprises. In addition, it is a fact that nonprofits are private organizations, albeit ones serving societal purposes, that makes the question of organizational governance compelling.

In rare cases, nonprofit organizations are created and maintained with funds from an individual, a family, or a for-profit corporation to address a specific societal need. Such organizations are authorized under the law, accountable to the entity providing the funds, and expected to pursue a coherent strategy to address the stated purpose. In this regard, their governance is quite like that of a for-profit

organization, responsible to its owners, who would be expected to see to the nonprofit organization's operation and performance.

At the other extreme, one sees the spontaneous emergence of groups addressing needs within their communities. Pre-organizational forms may emerge in response to specific needs which last as long as the needs animate participation. An example would be Mexican villagers setting up tolls on state highways to extract funds to pay for the materials they then use to repair the road, which the state had failed to do. The emergence of such entities is largely unguided and may be ungoverned in that there is no accountability to anyone beyond the immediate actors. While these are common enough, they do not account for the many nonprofit organizations established to address enduring categories of needs with the expectation that they will sustain themselves overtime.

Most nonprofits are found in a middle ground, existing as formal organizations (in a sociological and legal sense), deriving resources from a number of sources (*i.e.*, multiple individual donors, foundations, government contracts, in-kind contributions from the community, volunteers). Thus, accountability to a single owner is not really an option. In contrast to situations wherein people unite to achieve a particular result and then disband, these organizations are expected to achieve their purposes over time. This requires governance to guide adaptation and growth as well as performance: an enduring private enterprise producing results of societal value integral to a civil society.

## **2. Finding an Appropriate Institutional Framework for Governing Nonprofit Organizations in a Civil Society**

The nonprofit organizations which comprise the civil sector are numerous, pursue a range of goals, and do so with varying levels of competence [10]. While they share the characteristic of having a societal purpose, there are many different versions. The inconsistencies and even conflicting aims among them certainly do not suggest an efficient use of resources. The absence of any clear coordinating mechanism moving this population of organizations into concerted and coordinated action would be frustrating to anyone desiring the sector address a particular societal deficiency. However, the idiosyncratic nature of such organizations allows them in aggregate to discover and address a range of needs for which government and for-profit organizations are ill-suited. They can be responsive and innovative. It is not just a matter of executing solutions which are generally recognized, but allowing for the emergence of solutions or even discovery of problems that may not have been considered before.

The lack of efficiency and seeming dependence on nonprofit organizations in shaping the future character of a civil society may pique government interest in controlling them. It may seem natural to those involved with public policy for the state to assume a superordinate role governing nonprofits (*i.e.*, [6]). Yet, it was the limitations of the state and commercial enterprises that sparked the need for nonprofit organizations, so it is hard to see them being the animating force to meet the needs they have left unaddressed.

As nonprofit organizations are independent and private, they resemble for-profit organizations in some respects. Thus, one might reasonably look to corporate governance for guidance. Yet, for-profit organizations have as a central part of their purpose the creation and distribution of financial value. Even if financial gain of the owners is not their exclusive purpose, it is among the significant outcomes

and consequently occupies a central position in corporate governance. Nonprofit organizations serve a societal purpose. So while they need to achieve financial equilibrium to be sustainable, there is no need to distribute surplus and no external “owners”. There is no reason to maximize financial performance. Societal performance should provide the meaningful indicators of performance. Yet, much of current practice is guided by an effort to apply a model drawn from corporate governance which emphasizes financial accountability.

### *2.1. The Logic of the Agency Model*

Just because the corporate model is imperfect does not preclude its being useful. Unfortunately, in its usual form of the agency model [11,12], many of the weaknesses in the model for corporations are even more relevant to nonprofit organizations [13,14].

The logic of agency as it has been applied in corporate governance is that owners allow executive managers use of their capital to pursue the owners’ interests through the value created by the organization. The model focuses attention on the potentially uncorrelated interests of managers and owners, the greater information and expertise of managers, and the struggle to induce managers to provide the information that would allow owners to hold them accountable. The owners’ interests are generally assumed to be financial and executive compensation is used to align the interests [15]. Broad directions of the firm (in the form of strategy) and major capital commitments must be approved by the board to assure compatibility with the owners’ interests [12,16].

While agency is at the root of many ideas associated with for-profit governance [17,18], it is a limited and somewhat flawed narrative. Even so, one can see a similar underlying logic in approaches to non-profit governance.

If measuring performance is problematic in for-profit organizations, it is bound to be more problematic for nonprofit organizations where societal performance is central to their reason for being. Measuring social performance has been an active concern in the nonprofit community [19]. It has been pressed by funders seeking to understand what value their support has generated. As there are a large number of possible outcomes (and ways to achieve those outcomes), the fact that multiple measures exist does not of itself constitute a problem. The more pressing question is who decides which measures to use when assessing a specific organization’s performance.

The central notion in agency theory is that the managers act on behalf of the principals, so the principals’ interests determine the definition and measures of performance [20,21]. This is a problem for nonprofits which are not “owned”. Sometimes this is addressed metaphorically, by thinking of nonprofit organization as acting on behalf of those they serve or of the broader society. The board of directors is then understood to govern on their behalf. While this may work as a metaphor, it has practical limitations, as there is no one to hold the board to account. Hence, the board is left to use their best judgment. This is not unlike what is sometimes found in for-profit organizations where boards are in the thrall of senior executives [22] in essence extending the agency problem to the board as well as senior management. In the absence of accountability for performance, there is the risk the board will adopt a least common denominator of allowable practices and minimal criteria. Whether as regulations or norms the minimal criteria are easiest to craft around issues of financial stewardship. While financial stewardship is important, it is not necessarily correlated with maximizing the societal value

created. These are not new problems. Others have noted the difficulty determining the measures to use to hold nonprofit organizations and their managers accountable [21]. However, an absence of identifiable owners and uncertainty about appropriate measures are central to the problem of applying the agency model to nonprofits.

As the difficulties span the sectors, perhaps the problem is with the agency model itself. While agency in contemporary parlance is treated as an element of capitalism (as those who contribute capital are privileged above others) the principal–agent relationship actually is grounded in a more primitive conception of authority relations, that of master and servant. The principal could also be the government with managers acting as agents of the state [23]. Perhaps, it would be useful to consider a different framework.

## 2.2. *Leasehold as an Alternative*

Early examples of agency (*i.e.*, [24]) spoke of overseers managing agricultural operations at a distance on behalf of an owner. An alternative model of long standing is a leasehold, in which the owner grants the right to use the land for specific purpose and to manage it as if it were the leaseholder's own for an extended period of time in exchange for a rent (possibly a portion of what is produced on the land) and an agreement to maintain the property.

Over the years the concept has expanded to include other forms of property—for example, the right to an apartment on land belonging to someone else. Long terms leases are common for major equipment. Such capital leases may even be treated as assets of the business. Rent may take the form of a share of the value created, and there may be covenants regarding operating in ways that maintain the integrity of the asset. Over time, tenant's rights have expanded, particularly with respect to extending the term of the lease.

The underlying logic is that managers are accountable to those from whom they have agreed to accept resources critical to the creation of value and to whom they have made a commitment for the right to use the resource [14]. Those who provide financial capital need not be viewed as the only ones to whom the organization is accountable. Such an approach may be particularly useful in nonprofit organizations where a range of resources are required.

Under a leasehold arrangement, executives initiate mission and strategy, as opposed to the agency model in which basic directions and interests to be served are defined by owners. To execute strategy, they must secure access to the resources necessary to do so. In a commercial setting, these resources might include future infusions of capital, lines of credit, technology, patents, and access to distribution channels. Nonprofits might require access to client populations, expertise, alliances with other nonprofits and agencies, and donors. In the case of mission driven work, those who supply resources may do so in whole or in part because they agree with the organization's mission and the way it has chosen to pursue it [25]. The value for which they contribute resources may be the societal value created as the nonprofit fulfills its intended purpose.

Once freed of the necessity to privilege those who contribute financial capital above those who provide other critical resources, there is at least one other approach that has been proposed as an alternative to agency—stakeholder theory, where management is expected to take account of the impact of decisions on those significantly affected by the actions of the firm [26–29]. Owners, the

members of the board, and management are expected to grant some accommodation for those needs. When the needs of stakeholders conflict with the interests the organization is striving to serve, the stakeholders' needs are apt to suffer [27,30,31]. Similarly, the senior leadership of nonprofit organizations may consult clients, advocates, or community members before making a decision, but there is no accountability to them. The leadership is not obligated to incorporate their views or those of any other stakeholder group. Nor is there any commitment to share information on the results. Stakeholder theory essentially operates within the assumptions of agency. While stakeholders may acquire legal rights which compel the firm to address certain interests, the firm still has no direct accountability to anyone other than principals.

Leasehold allows that organizations may commit themselves to be accountable to parties other than owners. Those who allow their resources to be used by the firm based on the commitment it will create and distribute value (whether financial or societal) have a claim as part of the governance of the organization [32]. It is important to recognize the distinction between those who make an ongoing contribution of resources with an expectation the organization will create some specific value *versus* suppliers who sell goods and services to the organization as a series of individual and self-contained transactions. Leasehold implies a relational contract rather than a transactional one. The relationship is centered on the value the organization proposes to create.

Such an arrangement still allows management to operate with broad discretion. The strategy developed with the advice and concurrence of the board determines which resources are critical and the approach to be used to secure them. When resources are secured by the promise to create value and achieve outcomes that are aligned with the interests of those supplying the resources, management needs to maintain the relationships, by demonstrating that the value expected has been created. Unlike agency relations wherein managers have an incentive to obscure results because the interests of principals and agents are not aligned [12,33], here managers initiate the goal setting and performance management process. They determine both the resources that are most critical and whose support is necessary to access those resources. Supporting the relationships by sharing performance information would be consistent with their interests and those of the resource providers. The organization is accountable to those with which it has established a mutual commitment.

The enterprise and its leadership are viewed as a unit. It formulates purpose, develops the organization's capacity to create value, and delivers that value in the relevant communities. It is accountable to resource providers for the performance that induced their support; recognizing the range of resources required in nonprofits may be more varied than those usually considered in for-profit organizations. Thus, while a donor to Covenant House will expect prudent management of funds, the more fundamental concern is that children who were living on the street will be housed, fed, and protected. Local government may offer funding and other support through its agencies with the expectation this will lead to reduced homelessness. The reporting needs to provide information that credibly communicates the results.

Table 1 summarizes the key differences between the agency and leasehold models.

**Table 1.** Key distinctions between agency and leasehold models.

Model	Type of Relationship	Parties to Relationship	Nature of Resources
Agency	Based on a transaction between principal and agent. Creating incentives to align agents' interests with those of principals is a major consideration.	Board of directors press principals' interests and monitor agents' behavior	Primarily financial. View other resources as fungible.
Leasehold	Based on enduring relationship, with shared interest in the value the organization proposes to create.	Board oversees management's efforts to maintain the organization's sustainability with respect to its environment and the integrity of its relationships with key resource providers.	Open to a variety of resources, based on their importance to the organization's capacity to create value.

### 3. Implications for Nonprofit Governance

What are the implications for the way we think of governance? In an agency framework, the broad purpose and envisioned outcomes are grounded in the principal's interest. The leasehold perspective envisions purpose and intended outcomes emerging from senior leadership's interaction with the environment. The organization's plans to achieve its goals must appeal to a range of supporters whose contributions are necessary for the plan to succeed. Whether the support is secured, as are traditional corporate investors, through promises of financial return or outcomes beneficial to a broader community, the organization's commitments make it accountable to those with whom it has established a relationship to secure the resources on which it will depend. If sufficient support cannot be secured, the plans will need to be altered and conceivably even the mission modified. While the same result might occur under an agency model there is the presumption that the directors and executives will check with the owners, a task made prohibitive in a for-profit corporation because of the number of owners and the speed with which shares change hands. Ownership is even more elusive in a nonprofit. Leasehold assigns the authority and obligation to adapt to management and the board. Reflecting on the implications for governance, one might conclude that leasehold is actually more descriptive of current practice than is agency.

One distinction is evident in the way strategy is enacted within nonprofit organizations. In an agency framework, mission is sometimes seen as a surrogate for the owners' interest, in the sense that mission interprets the interests to be served [34]. This leads to the selection of programs which are taken as a direct expression of mission. The budget and resource acquisition processes are derived from the needs of the programs. The focus of senior leadership becomes program performance and sustainability. The foundational questions of mission and value creation are subsumed by the focus on programs. It is not unusual to find nonprofits speaking of the financial and associated performance measures required by funders of particular programs as if they were the organization's strategy. In a curious irony, this makes nonprofit organizations more Schumpeterian than for-profits, in so far as they live or die based on specific program initiatives. This occurs where the organizations operate consistent with agency theory principles, locking activities in place based on the owners' presumed agenda, without a clear mechanism to guide fundamental adjustment in light of a changing situation. This contrasts with the leasehold approach which focuses on value creation. The key strategy question



is how to develop the capacities to create value (societal value, relevant to the mission). While nonprofit organizations often use this term to mean overhead capacity for management activity, here it is applied in a manner more consistent with its use in business strategy as the capacity to create value. The capacity to create value is something to be nurtured and maintained. It may lead to modification of programs, propagation of new ones, and the termination of obsolete ones. It is relevant to the way resources are used, thus tying budget and mission together in strategy.

Such a construction of strategy and governance are not without peril. It can lead one to think of nonprofits as guided by internal, isolated, and idiosyncratic forces. The extent to which this is a problem depends on the accountability, which in leasehold is to critical resource providers. Where they do not see the expected value created, their support will wane, compelling a response from management. The transparency and openness one would hope to see in organizations is integral to a leasehold approach, as there is an affirmative motivation to share information with the key resource providers (and those who might become resource providers in the future).

This is not to suggest the board and senior management's task is simple. Recognizing changes within the communities served, acknowledging and implementing change in the value created to meet these changing needs, and developing relationships to address the consequent changes in the resource requirements is a substantial governance challenge. Even in a relatively tranquil environment recognizing, balancing, and confronting differences in expectation and priority among different critical resource providers is a key governance task.

For-profit enterprises think in terms of the markets with which they interact. Farmers go to financial markets to secure funds to plant, grow, and harvest. They enter labor markets to hire people to help with the harvest. They then bring their products "to market". Interactions with such markets are seen as exerting a discipline upon organizations, compelling them to be responsive to needs within society—a push from the invisible hand.

Nonprofit organizations interface with markets as well. In some cases, they are the same markets faced by for-profits (*i.e.*, labor, real estate, credit). However, some are quite different. If a nonprofit organization requires volunteers to provide its services or to create broad-based advocacy, it must attract unpaid participants, presumably by the quality of the experience and shared interest in the value being created. If an organization proposes to shelter the homeless, it must attract clients who need to be housed. Certainly, there are instances where members of the target group decline the opportunity (*i.e.*, people avoid homeless shelters which are perceived to be dangerous). If a farm cooperative is offering to aggregate the production of small farms into lots large enough for the wholesale market, it works only if the small farmers trust the cooperative and if wholesalers are willing to do business with it. These are choices made in the context of competing alternatives.

Thus, each nonprofit organization fashions a proposition designed to appeal in the markets in which it operates, including non-financial markets. If it does not secure the volunteers, access the populations it would serve, and acquire donations (monetary or otherwise) it will need to adapt. The flexibility to do so in a timely manner is inherent in the concept of leasehold. Each nonprofit has the opportunity to evolve unique responses to its challenges. The interests of resource suppliers create pressure for innovation, fostering improvement in the sector as a whole.

#### 4. Leasehold and the Evolution of a Robust Civil Society

While each nonprofit organization is governed separately, the process of governance operates across the sector. The notion of a large number of independent organizations adapting in light of their particular missions, capabilities, perceptions of their circumstances, and unique network of resource providers presents a prospect that is at once exciting and distressing [35,36].

The excitement comes from the variety of nonprofit organizations, relatively free to propose how they will address social issues and meet human needs. Nonprofits may emerge as small, specifically targeted entities coalescing in response to the needs experienced in the community that develop the ability to marshal resources to meet those needs. The sector is characterized by partnerships and alliances which connect nonprofits around common interests and foster cross-organization learning [37]. Such an ecology of organizations makes the sector robust in the face of shocks from the environment.

The distress stems from a lack of efficiency for the services being provided at any one moment. If one believes there is an optimal blend of services to be provided, it opens the possibility that there are specific best-practices for doing so, and all the experimentation and idiosyncrasy may be seen as wasteful. This echoes an argument similar to that regarding centrally planned *versus* free market economies, although it may be easier to gain consensus on what constitutes a well-functioning economy than a civil society.

The ideological elements of the answer to the question of what constitutes “well-functioning” is another source of tension in the sector. The variation and limited control over independent actors can be experienced as subversive. This is all the more likely as nonprofit organizations endeavor to meet needs that are not addressed by government or profit seeking enterprises. The concern arises not so much because the needs are unmet but where they are not valued. Effort to address these needs can be experienced as a threat. The organization which coalesces to meet such needs has the potential to advance alternate values, which may spawn activism. Those who are aligned with the existing values and institutions might reasonably see this as a challenge to the current order. This may set the stage for efforts to rein in the formation, innovation, and value creation of nonprofit organizations, limiting their ability to address societal needs, particularly as new needs emerge.

It would be naive to imagine nonprofits are entities which exclusively emerge organically from the citizenry in response to social needs. There are specific instances which do not conform to the leasehold model. These departures are distinctive and highlight such organizations as unlike their counterparts in the sector. There are nonprofits established based on an *a priori* definition of what is needed by society and funded at levels that eliminate the need to respond to local influence. These may be established by resource rich institutions, individuals, political actors, or even the state. While engaged in meeting human needs they may represent a position reinforcing or critiquing the existing social order. A similar concern is sometimes expressed about large, international NGOs, where neither their mission nor accountability is specific to the particular society in which they operate [38]. From a leasehold perspective, the problem is that these organizations are established with such abundant resources that they do not need to attenuate their behavior to the requirements of local resource suppliers, clients, or institutions. The accountability is to a superordinate entity rather than a network of influences in the society where they operate. As such, it may be more appropriate to apply agency theory to these organizations, as they functionally have owners. However, this is a special case.

It is also possible for ideological, political, religious or deep pocketed organizations to fund and foster the early development of nonprofits which are expected to eventually engage their communities through mutually beneficial interaction with local sources of support. Countless schools and medical facilities have been established in this way, the initial support serving very much as the leasehold from which these nonprofit were built. The challenge is recognizing the moment to step back and allow the board to broaden its engagement with and commitments to the multiple resource providers in its community.

Both nonprofit organizations and civil society itself should be understood to evolve. Each plays a role in shaping the other. In this manner, one might view civil society as an ecological system in which organizations (governmental, for-profit, and nonprofit) form and in aggregate create the value from which a civil society is crafted.

The governance of nonprofit organizations is not the manifestation of a drive to achieve a single goal. Rather, it is to create value, which fits among a set of interdependencies that determine the potential ends and means of a successful organization. The relevance of what each organization creates is based on a context created by institutions which are themselves in flux. The organization's sustainability depends on its ongoing articulation with these elements.

The leasehold approach provides a logic for understanding the organic development of nonprofit organizations and for their adaptively responding to the needs of society. While an organization's leadership that is not beholden to a single master may complicate the notion of accountability, it does direct attention to the organization's dynamic interdependence with its environment and its reliance on multiple sources of support with potentially varying interests. Over time, the sources of support may change, the needs in society may change, but the leasehold perspective provides a framework for understanding how nonprofit organizations are able to continue.

## 5. Conclusions

Conventional thinking on civil society guides us either to consider organizations, their strategies, and their obligations or to view the population of nonprofit institutions which comprise the sector. There are disciplinary antecedents to the preference for one perspective over the other. The question one is addressing at the moment may also lead to the frame of reference. However, this dichotomy results in separate sets of assumptions that guide analysis and action.

The leasehold model describes a process by which individual organizations are woven into the tapestry of society. Its threads are the individuals, groups, and institutions with which the nonprofit organization has ongoing relationships and particularly those on whose resources it depends. The organization's purpose and behavior is shaped by these connections. Similarly, the organization influences the elements of society with which it interacts. This is unlike agency which suggests idiosyncratic organizations, engaged in competition at multiple levels, to serve the interests of a narrow group of principals. Governance of civil society is not so much a matter of a thousand blooms contending as it is a matter of the eco-system of a forest evolving in light of the organisms present and the conditions which change with time.

## Conflicts of Interest

The author declares no conflict of interest.

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