

CHAPTER 7: STAKEHOLDERS

The more the merrier?

SUMMARY OF KEY FINDINGS IN THIS CHAPTER:

Range of stakeholders

- The survey results show that there are a multiplicity of stakeholders in NFP companies.
- Members most frequently cited stakeholder (in the top 2 for 10 out of 11 activity groups and third for the other) even though only 46% of respondents identified their organisations as member-serving.
- Whilst a comparison between principal activities of the organisation and whom they perceive to be their stakeholders reveals some variations, these variations do not provide a clear basis for requiring different levels or types of accountability under the *Corporations Act 2001* (Cth).

Tension between stakeholders

- The data bears out the notion that NFP companies are 'object driven'. The most common cause of reported conflict was the tension between NFP objectives and business models.
- Other tension arose from a lack of understanding by some Board members of their role. Namely, to act in the organisation's best interest rather than promoting their own personal profile among members, for example, in a trade association.

Complaints to ASIC

- There are proportionately more complaints to ASIC about companies limited by guarantee than other types of companies. Most of these concern 'internal management issues'. These complaints may be the result of conflicts that arise in the course of balancing the different needs of a range of stakeholders.

Remedies

- The fact that NFP companies are 'object driven' has not been taken into account by recent corporate law reforms. The mechanisms that members have to initiate proceedings for breaches of the objects clauses are too restrictive and reforms are needed.

RECOMMENDATIONS

Reform of members' remedies

The special position of members in NFP companies should be further considered in the context of remedies. Members in NFP organisations do not have the same economic power as members of 'for-profit' companies. Nor do they have recourse to a range of shareholder remedies such as selling their shares. Thus members' ability to constrain the actions of Board members and officers of the company, or to ensure that action is taken following a breach of the constitution, is limited. In addition, one of the unique characteristics of NFP organisations is the range of stakeholders with a legitimate interest in the organisation. The public, donors, clients and volunteers all have special stakes in ensuring that the mission of the NFP organisation is pursued and that the organisation's funds are not distributed to members.

The consequences of a breach of NFP objects should be reconsidered, as the mission is what drives an NFP. In this regard we suggest that the following specific reforms be considered:

- All NFP companies should be required to have a 'non-distribution' clause.
- Objects clauses should be compulsory for all NFP companies (not just those holding a licence to omit the word 'limited' from their name).
- Directors should have a specific duty to ensure that the company pursues these objects.
- A breach of the objects clause should be an express ground for bringing an action under s 232 (the oppression remedy) and, possibly, also under s 236 (the statutory derivative action). Modification of s 232 in this way would enable ASIC to initiate action under s 234 on the basis of a complaint by a member or other stakeholder (for example, if in the public interest).

Other remedies

It is desirable that NFP organisations and their members have access to expert, low-cost alternative dispute-resolution procedures. This is a valuable role that could be undertaken by the NFP advisory body recommended in this Report (see Chapter 4, Regulatory Framework).

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1. INTRODUCTION

The issue of good corporate governance and accountability has always been an important one. Historically, major corporate collapses have often prompted legislative amendments¹ and corporate soul searching - the recent reaction to the collapse of HIH et al is merely the most recent example. As in the 'for-profit' sector,² there has also been some soul searching in the NFP sector.³ The UK *Review of Charities and the Wider Not-For-Profit Sector 2002*, found that charities and NFP organisations should be encouraged to be open and accountable to stakeholders. It stated:

This will both promote public confidence and help them ensure that they are most effectively serving their chosen constituencies, however, defined.⁴

Any examination of accountability necessarily involves a consideration of accountability to whom? In Australia, not much is known about the stakeholders of NFP organisations. We might speculate that the types of institutions, bodies and individuals with an interest in the governance of NFP organisations, and whose interests NFP organisations take into account, differ from those that of 'for-profit' organisations. It would also be reasonable to speculate that the number of stakeholders a NFP organisation must take into account is greater than for 'for-profit' organisations.

The issue of how a NFP organisation can be accountable to a range of different stakeholders is vexed. Interviewed at the *Summit on Non-Profit Leadership*, Professor Mark Lyons said:

One of the difficult questions is just who are constituents or stakeholders. If you are an organisation that deals with, say, youth homelessness, is it just young homeless people? Is it they and their parents, when the parents are often the reason why they're homeless? Is it schools? How do you define constituency and put a border around it to determine who you would seek to invite to membership - and that means voting, as opposed to inviting to be supporters without any democratic responsibility for the maintenance of the organisation.⁵

In terms of company law requirements, the laws governing the question of in whose interests directors must govern are the same for all companies, whether they are companies limited by guarantee or for 'for-profit' companies.

Many of the issues concerning accountability and disclosure are discussed in the Chapter 8, Disclosure. In this Chapter, the main stakeholders of the surveyed NFP organisations are identified and some regulatory issues arising from the list of stakeholders that are identified are discussed.

It may be that the types of accountability to different stakeholders should differ. However, the need to be accountable to a range of stakeholders should be balanced with the requirement that the reporting and decision-making processes of NFP organisations be manageable and not overly complex or burdensome.

Note: All references in this Report to small and large organisations or companies are based on the definition of "small" and "large" (proprietary companies) as contained in s 45A of the *Corporations Act 2001* (Cth), unless detailed otherwise.

¹ The *Bubble Act* was introduced after many fraudulent promotions of companies to investors. When the 'bubble' burst, the market collapsed and Parliament (over)reacted by introducing the Act. The *Bubble Act* prohibited people claiming corporate status unless incorporated by Act of Parliament or Royal Charter. The Act was repealed in 1825.

² For publicly listed companies, this soul searching has resulted in the Australian Stock Exchange's new 'Principles of Good Governance and Best Practice Recommendations', March 2003. Executive general manager and Chair of the Australian Stock Exchange's Corporate Governance Council (CGC), Karen Hamilton, addressed a lunch hosted by the Financial Executives International of Australia, in Sydney on 18 February. She said that company management needed to be 'alive to the concerns of key stakeholders' and to make sure the processes they have in place to monitor such relationships comply with the law: (19/2/2003) Ross Kendall, 'ASX governance guidelines to include CSR', *Ethical Investor* at <<http://www.ethicalinvestor.com.au/>>.

³ The growing number of Codes of Conduct and Ethical Guidelines that are becoming part of the agreements between funding bodies and NFPs is evidence of this. For a report on Codes of Conduct in the philanthropic sector see the feature titled 'Aspiring to Greater Transparency', *Australian Philanthropy*, Winter 2002, Issue 48.

⁴ 'Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector', Strategy Unit Report, September 2002, p. 30, 3.9.

⁵ T. Wallace, 'Mixed Business', *Australian Financial Review BOSS*, November 2001, p. 50.

2. METHODOLOGICAL ISSUES

Two methodological issues warrant brief mention in relation to the survey questions on stakeholders. First, the method of data collection was by survey. While this approach is a useful way to obtain a relatively accurate cross-sectional snapshot of the NFP terrain, it is nonetheless a 'heavy-metal' technique. The stakeholder questions used some open-ended questions to try to unpack the details behind the responses. For instance, to capture the myriad of possibilities of stakeholder types, respondents were asked to name their various stakeholders rather than choosing them from a pre-defined set of broad options. We were simply unable to predict the level of specificity or detail that respondents would need. This open-ended interpretive approach provided high-quality data but at a cost: responses had to be individually coded, which was an extremely time-intensive task. The coding process was further complicated by the fact that often respondents sometimes wrote acronyms that were unknown to us.

Second, respondents were asked only to name their 'three most important stakeholders'. The object, therefore, was not to gain information about the full range of organisations that might be thought of as stakeholders. The decision to choose salience over exhaustive lists was made for pragmatic reasons.

3. STAKEHOLDER THEORY OF CORPORATE GOVERNANCE

Within this still emerging literature the concepts stakeholder, stakeholder model, stakeholder management, and stakeholder theory are explained and used by different authors in very different ways. The normative or rights-based construct perceives stakeholders as all those who can affect or be affected by the operations of the organisation. Proponents of this understanding of the stakeholder theory generally accept of the following ideas:

- Stakeholders are people or groups with legitimate interests in procedural and/or substantive aspects of corporate activity. Stakeholders are identified by their interests in the corporation, whether the corporation has any corresponding functional interest in them.
- The interests of all stakeholders are of intrinsic value. That is, each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as the shareowners.⁶

The descriptive or instrumental understanding of stakeholders, which reflects the managerial perspective of the theory, sees stakeholders as those groups and individuals who have a 'legitimate' or 'contractual' interest in the affairs of the organisation. Donaldson & Preston define this understanding as follows:

The stakeholder theory is managerial in the broad sense of that term. It does not simply describe existing situations or predict cause-effect relationships; it also recommends attitudes, structures, and practices that, taken together, constitute stakeholder management. Stakeholder management requires, as its key attribute, simultaneous attention to the legitimate interests of all appropriate stakeholders, both the establishment of organizational structures and general policies and in case-by-case decision making... Stakeholder theory does not necessarily presume that managers are the only rightful locus of corporate control and governance. Nor does the requirement of simultaneous attention to stakeholder interests resolve the longstanding problem of identifying stakeholders and evaluating their legitimate 'stakes' in the corporation. The theory does not imply that all stakeholders (however they may be identified) should be equally involved in all processes and decisions.⁷

The question asked in the survey about the company's stakeholders defines 'stakeholder' as 'those groups of people, other organisations, or even an individual who have a direct and legitimate interest in monitoring the activities and good management of the company'. This explanation of stakeholders reflects the descriptive or instrumental tradition. This may have influenced the responses received.

⁶ T. Donaldson & L. Preston, 'The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications', 1995, 20(1) *Academy of Management Review*, 65 - 91, at 67.

⁷ See n. 6.

4. RANGE OF STAKEHOLDERS

4.1. Survey question

6. Who are the company's stakeholders?

By the word 'stakeholder' we mean those groups of people, other organisations, or even an individual who have a direct and legitimate interest in monitoring the activities and good management of the company. By way of example, the company's members, clients to whom the company provides services or, in the case of a church-based company, the church to which it is affiliated.

Bearing this definition in mind, please indicate;

- who you regard as the company's **most important stakeholder(s)** (up to a maximum of three)
- **weight their importance out of 100** (for example, 1 = 40%, 2 = 30%, 3 = 30%—total 100%) and
- **complete the associated questions for each of them**

6.1.1 Stakeholder A

(description)

% importance

Number of respondents = Stakeholder A 1491, Stakeholder B 967, Stakeholder C 669

This question was repeated for Stakeholders B and C.

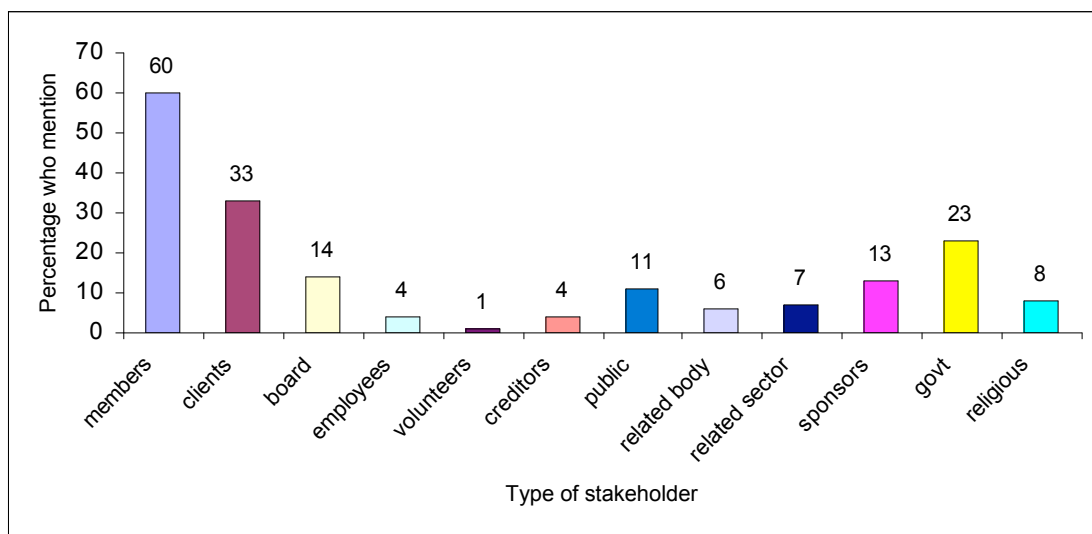
4.2. Survey results - overall pattern

As an initial step, all the stakeholder data was combined in order to analyse the overall stakeholder pattern without distinguishing between stakeholder A, B and C, as per the survey question.

As Figure 1 shows, members were the most often cited stakeholder even though 46% of respondents said they were primarily public-serving rather than member-serving. So for the respondent NFP group as a whole, members (60%), clients (33%) and government (this included, local, State and Federal) (23%), were clearly viewed as the most important stakeholders.

Interestingly, volunteers were almost never within the company's most important three stakeholders (1%) although 86% of respondents had at least one volunteer.

Figure 1: Overall stakeholder profile



The overall stakeholder data (that is, stakeholders A, B, and C combined) was cross-tabulated with data about respondents' principal activity and other key factors. This was done to examine any further distinctions between NFPs that might be instructive when considering the value of creating categories for legislation. These results follow.

4.3. Members

4.3.1. SURVEY RESULTS

'Members' were important stakeholders for all respondent groups, regardless of their principal activity. They were found to be in the top two for 10 of the 11 main activity groups. The remaining activity group, Other Human Services organisations, rated members third. Whilst this might be expected for organisations like Sports and Recreation organisations (shown in Figure 2), which are virtually all member-serving (93% of Sport and Recreation respondents were member-serving), it was a more interesting result for those 46% of all respondents who said they were primarily public-serving. For example, in Health companies (Figure 3) 'members' were the most frequently cited stakeholder, even though 79% of Health companies said they were primarily public-serving bodies.

Figure 2: Stakeholder type, Sports/Recreation (n=281)

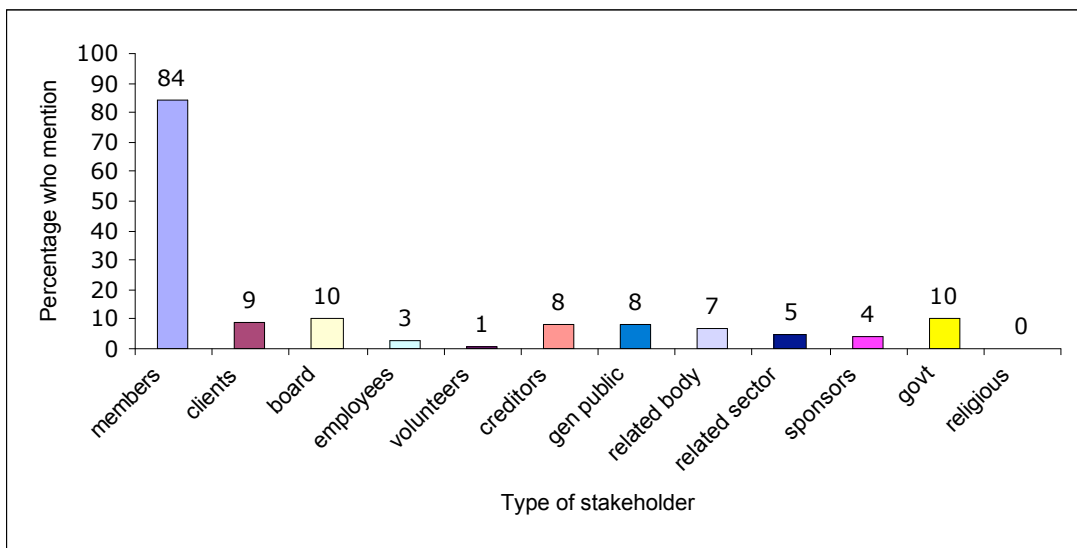
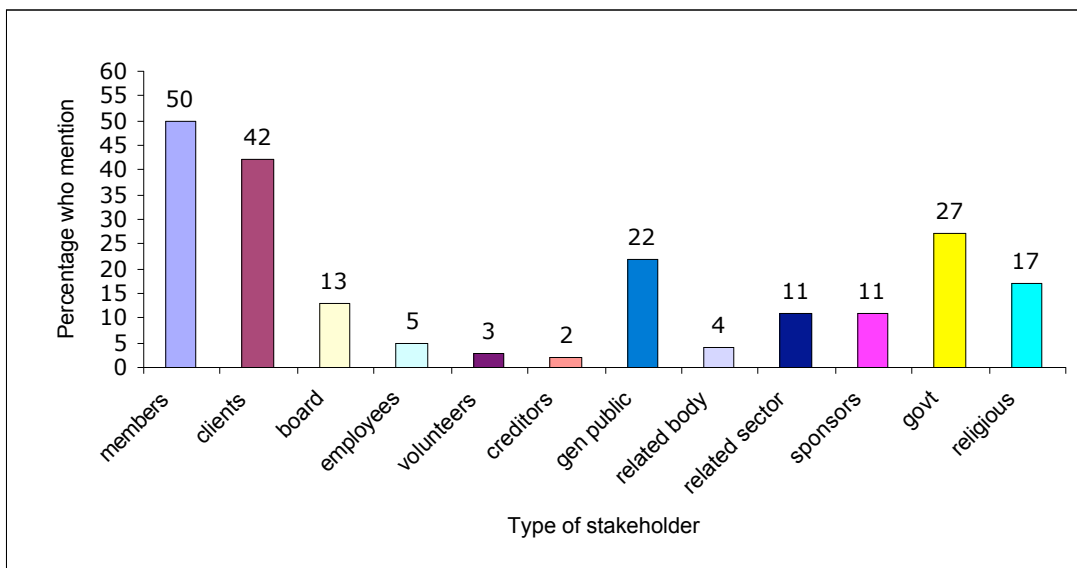


Figure 3: Stakeholder type, Health (n=92)



4.3.2. OBSERVATIONS - ACCOUNTABILITY TO MEMBERS

Members are considered an important stakeholder amongst all types of NFP companies limited by guarantee. As NFP companies do not have shareholders, members have a privileged place within the organisation. Nevertheless, the members' type of accountability and the influence over decision making will differ in different types of organisations. For an Environmental organisation, a large membership will give the organisation greater political sway, and membership subscriptions are a source of funding. However, the organisation is not primarily aimed at serving its members. Rather, its purpose is to conserve the environment. Likewise, a Community Service organisation might say that members are a primary stakeholder, yet they generally do not restrict their services only to members. Other organisations, such as Other Human Services organisations, do not see members as their primary stakeholders. A comment from one respondent was:

Our primary 'stakeholders' are NOT our members. Rather they are 'clients' (missionaries and their spouses/families) and supporters (prayer and financial).

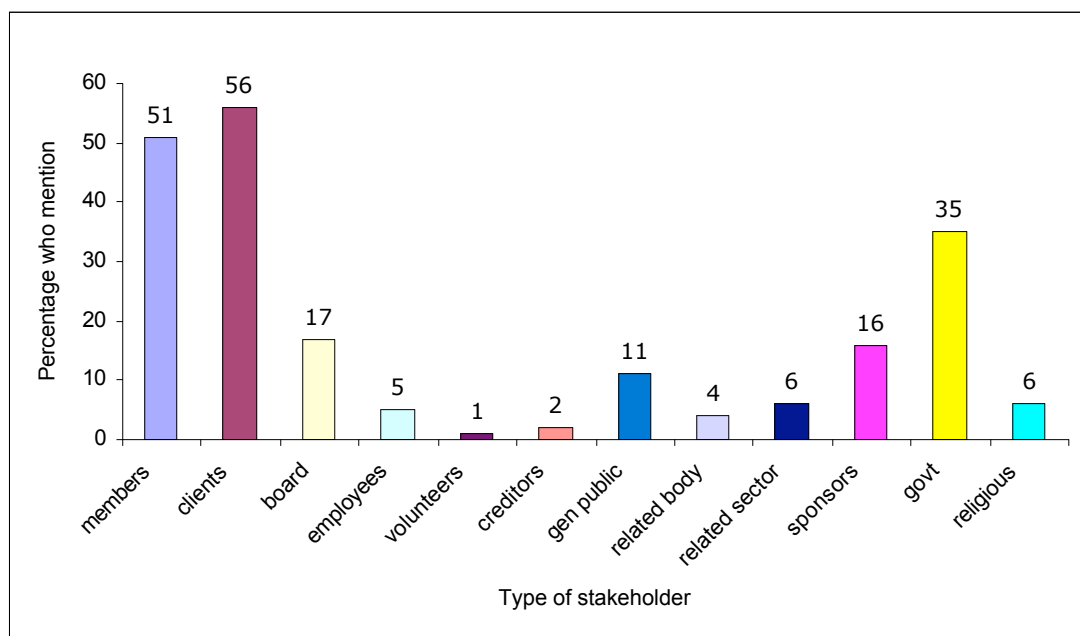
This raises some complex questions that point to problems with the current legal structure of NFP organisations incorporated as companies limited guarantee. Members have privileged legal status. They are able to determine the direction of the organisation,⁸ and the Board is primarily accountable to its members. However, the members may not be the primary stakeholder. Rather, the clients may be. As Leat asks, 'if they provide equal rights for members and non-members, why should members pay to join?'⁹

4.4. Clients

4.4.1. SURVEY RESULTS

'Clients' were found to be one of the top three stakeholders for all principal activity groups except Religious, Philanthropic, Sports & Recreational and Environmental respondents. As Figure 4 shows, 'clients' were the most cited stakeholder for Community Services respondents (ahead of 'general public' at 22%). This is an interesting result given that 83% of Community Services respondents said that they were public-serving. It might be concluded, therefore, that this type of organisation believes that they serve the public by serving their specific client group. This finding assists in clarifying the meaning of 'public-serving' for NFP organisations. The notion of 'public' is not some undifferentiated public, but rather, specific, targeted segments of the community.

Figure 4: Stakeholder type, Community Service (n=264)



⁸ For example, by determining the objects contained in the company's constitution.

⁹ See D. Leat, *Managing Across: Similarities and Differences Between For-Profit and Voluntary Non-profit Organisations*, City Business School, 1993 p. 44.

4.4.2. OBSERVATIONS - ACCOUNTABILITY TO CLIENTS

The importance of clients compared with other stakeholders may be indicative of a recent trend towards 'client-centric' service amongst NFP organisations. This result, as with the results for 'members',¹⁰ demonstrates that NFP organisations may be overcoming the 'paternalistic' brand they have often been charged with in the past. Leat, for example, observed a decade ago that 'many voluntary organisations have been accused of combining a mission of serving consumers with a paternalistic ethos which has effectively ignored service recipients as key constituents'.¹¹

This is the result of a few factors:

- market mechanisms have been applied to the NFP sector
- there has been a change of culture
- an organisation's legitimacy and funding is often dependent upon their doing so.¹²

4.5. Volunteers

4.5.1. SURVEY RESULTS

Volunteers were almost never included within respondents' most important three stakeholders (1%). This data does not reflect the importance of volunteers to NFP companies. The survey results showed that NFP companies rely heavily on volunteers. Eighty-six per cent of respondent companies had at least one volunteer, 38% have 20 or more, and thirty-one organisations had more than 1,000 volunteers. The results also showed that the vast majority of directors of NFP companies are voluntary - 92% of respondents did not pay their directors.¹³

4.5.2. OBSERVATIONS- ACCOUNTABILITY TO VOLUNTEERS

It is possible that many respondents, particularly member-serving respondents such as Sports and Recreation organisations, do not distinguish between members and volunteers. The volunteers of a Tennis Club, for example, are most likely its members. Yet this will not always be the case. Further inquiry into the way that volunteers' interests and concerns are taken into account by NFP organisations would be interesting in light of these results.

There are some additional legal issues that arise in relation to volunteer work in NFP organisations. Pro Bono Australia, for example, received legal advice revealing that volunteers are often not covered by Workcover.¹⁴

4.6. Government

4.6.1. SURVEY RESULTS

'Government' was cited in the top four for all groups except Philanthropic (9%) and Religious (1%).

¹⁰ See Heading 4.3.

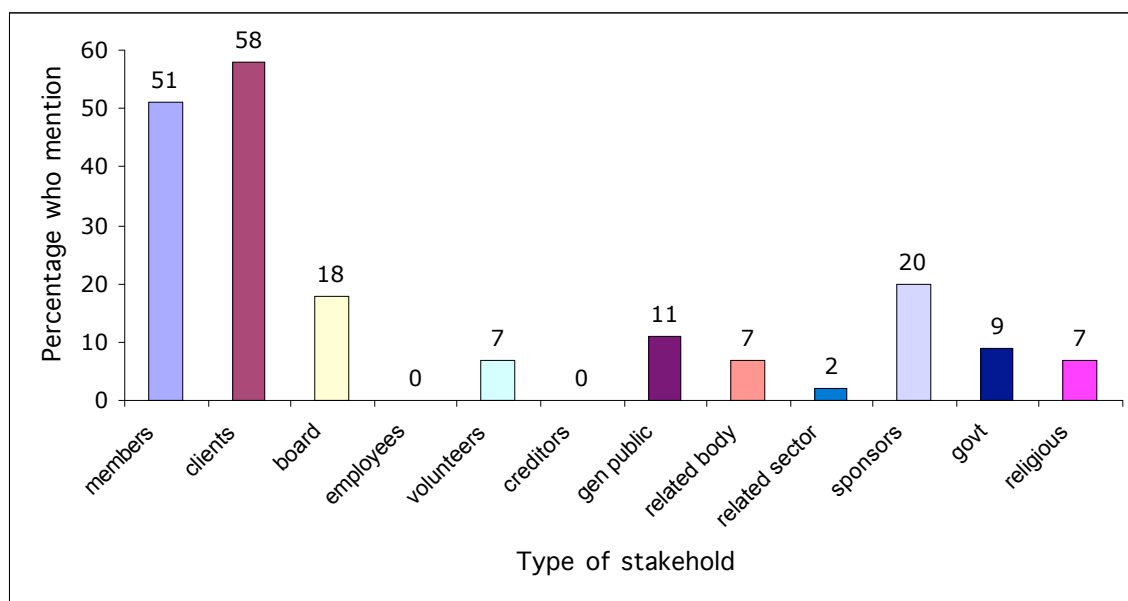
¹¹ See Leat, n. 9, p. 42.

¹² Leat points out NFP organisations have been used increasingly by local authorities to fulfil legal requirements to 'consult the community'. Having neither the time or resources nor the channels of communication to do so themselves, local authorities have turned to voluntary organisations as an easy and available vehicle for fulfilling their legal responsibilities: Leat, n. 9, p. 46.

¹³ See Chapter 1, Profile Data.

¹⁴ 'Volunteers - Covered by 'Workcover'?', Pro Bono Australia Not-for-Profit Newsletter, Volume 6, Edition 7 - 9/23/02 at <<http://www.probonoaustralia.com.au/new/NewsletterPrint.asp>>.

Figure 5: Stakeholder type, Philanthropic (n=45)



4.6.2. OBSERVATIONS - ACCOUNTABILITY TO GOVERNMENT

The result for Philanthropic organisations (shown in Figure 5) is noteworthy (although the small number of respondents to this question, n=45 should be borne in mind). It can be assumed that almost all Philanthropic organisations have charitable status, which enables them to enjoy taxation benefits. It is reasonable to expect that such a taxation concession would give rise to the ‘government’ or ‘general public’ having a legitimate interest in their governance and that they would, therefore, cite government more frequently than they have. This is bearing in mind that the definition of stakeholder provided in the survey was ‘groups of people, other organisations, or even an individual who have a direct and legitimate interest in monitoring the activities and good management of the company’.

On the other hand, many Philanthropic organisations feel that their independence from government is crucial for them to play a proper role within a liberal pluralist society. Therefore they do not think of government as a primary stakeholder. Further, many philanthropic bodies are established to serve a specific client group in society, and like Community Service organisations, might privilege that relationship over any stakeholder relationship they have with the ‘general public’ or ‘government’. It is nevertheless significant that the ‘general public’ or the ‘government’ did not rate within the top four stakeholders for Philanthropic organisations, and this may be an interesting topic for further inquiry.

Further issues concerning accountability to government are discussed in the Chapter 8, Disclosure.

4.7. General public

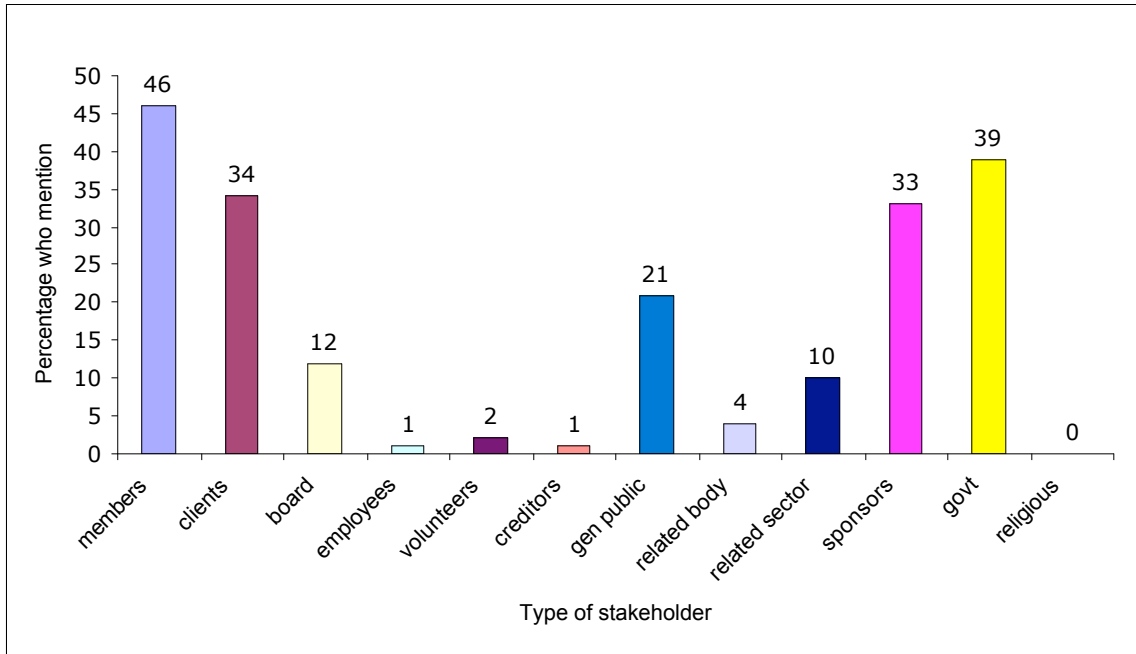
4.7.1. SURVEY RESULTS

The overall frequency with which ‘general public’ was cited as a stakeholder was 11%. Those groups mentioning ‘general public’ more frequently were Health organisations (22%, see Figure 3), Arts and Cultural organisations (21%, shown in Figure 6), and Environmental organisations (33%). These organisations are all predominately public-serving, therefore this response might be expected.

The low percentage of respondents citing ‘general public’ as a stakeholder is particularly interesting for those organisations with PBI status (27% of respondents).

The comments raised under the Heading 4.6.2, are also relevant to ‘general public’ as a stakeholder.

Figure 6: Stakeholder type, Arts and Cultural (n=95)

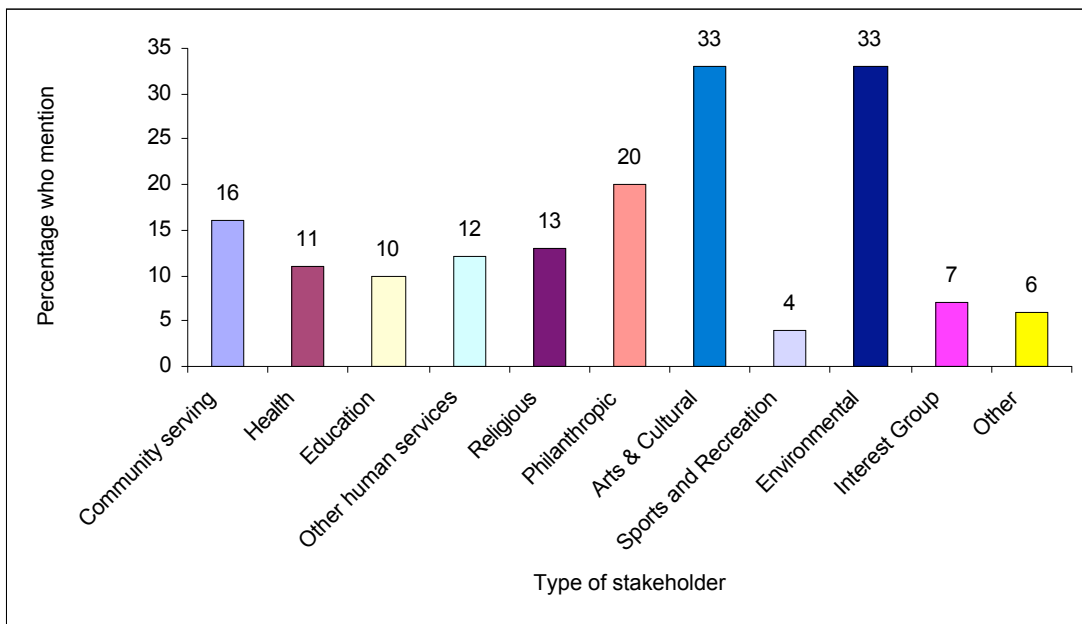


4.8. Sponsors

4.8.1. SURVEY RESULTS

Overall, only 13% of respondents mentioned 'sponsors' as a stakeholder. (By sponsors, we mean donors and grantees). Arts and Cultural and Environmental organisations mentioned 'sponsors' most frequently as a stakeholder - 33% of both. Sports and Recreation organisations (Figure 7) were least likely to mention sponsors as a stakeholder - only 4%

Figure 7: Percentage mentioning 'sponsors' as a stakeholder



4.8.2. OBSERVATIONS - ACCOUNTABILITY TO SPONSORS/FUNDERS

Sponsors or funders of NFP bodies may be made up of a variety of groups with diverse characteristics, demands and expectations. In general, sponsors may include individual donors, corporate donors, trusts and philanthropic bodies, and all levels of government. These broad groups may be further separated into different governmental departments, and different types of corporate and individual donors.¹⁵ (Note: in this Report, 'government' as a donor is included in the category 'government', not 'sponsor'.) Each of these sub-constituencies is likely to have different expectations, values and priorities in funding the organisation.

Those who fund an organisation are clearly in a special position to demand accountability, and it is likely that this will be mandatory and with sanction. The right to require accountability may be contractual, and funders may apply the sanction of withdrawing financial support.

The task of managing the requirements of various funders may increase the complexity of managing an organisation. On the other hand, the greater the number of funders, the less likely it is that any one funder will possess real sanctions in relation to the direction and conduct of the organisation. Indeed, the very variety of funders and their expectations may enable the organisation to claim legitimacy whatever it chooses to do.¹⁶

A funder's ability to require meaningful accountability will also be limited by their understanding of the operations of the organisation. Indeed, one reason why a government department might fund an organisation is precisely because they lack the capacity to provide the service themselves. While they may be able to require fiscal accountability, they may be unable to require real process or programme accountability. If an organisation does not rely on one funder then it may have the power to insist upon an unrestricted grant.¹⁷

4.9. Related bodies

4.9.1. SURVEY RESULTS

The overall frequency with which all respondents to this question mentioned 'related bodies' as a stakeholder was 6%. Interest Group organisations (n=100) mentioned related bodies most frequently - 12%.

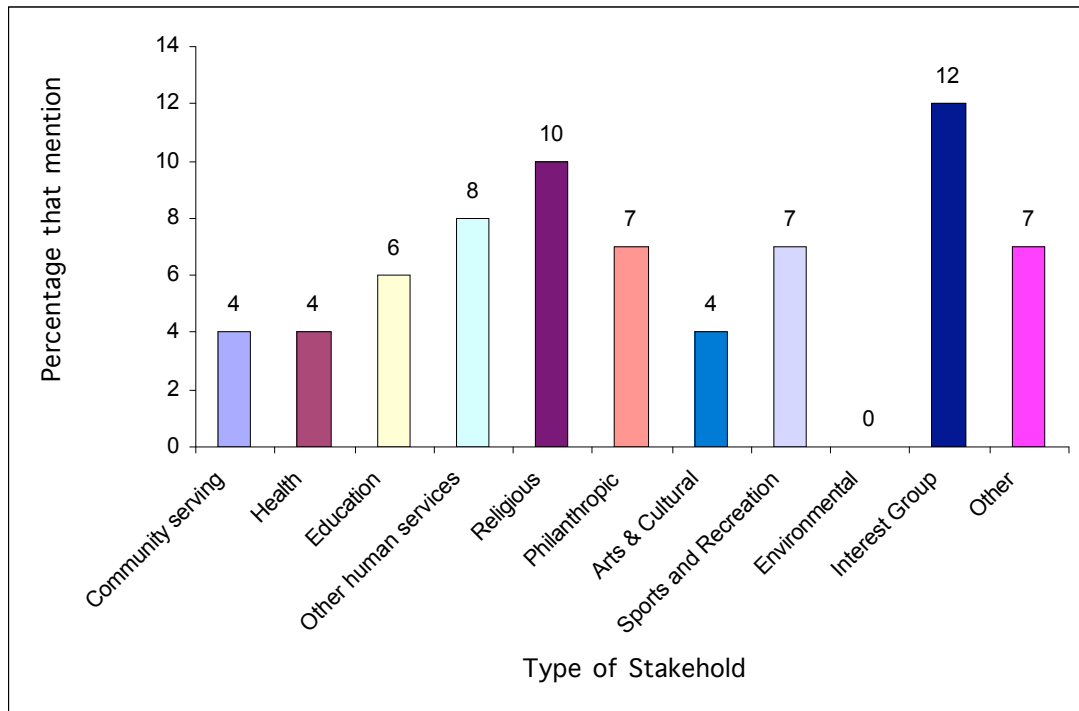
The data reported in Chapter 3, Legal Structure shows that while group structures are par for the course in listed public companies and even in medium-size businesses, they were uncommon among our respondent NFP companies. The profile data showed that only 14% were part of a group structure and, even within that 14%, the majority only had one or two related entities. (For example, one proprietary company or one foundation.) Further, 74% of respondents had only individuals as members and not all peak bodies had organisations as members. Philanthropic bodies were most likely to be part of a group structure (29%), with 86% of their 'related bodies' being trusts or foundations. Only 13% of Interest Group organisations had related bodies.

¹⁵ Leat, n. 9, p. 44.

¹⁶ Leat, n. 9 p. 45.

¹⁷ This is the case for some organisations seeking to maintain independence from funders. For example, a health organisation may accept funding from a pharmaceutical company on the basis that the grant is unrestricted.

Figure 8: Percentage mentioning 'related body' as a stakeholder



4.9.2. OBSERVATIONS - ACCOUNTABILITY TO A RELATED BODY

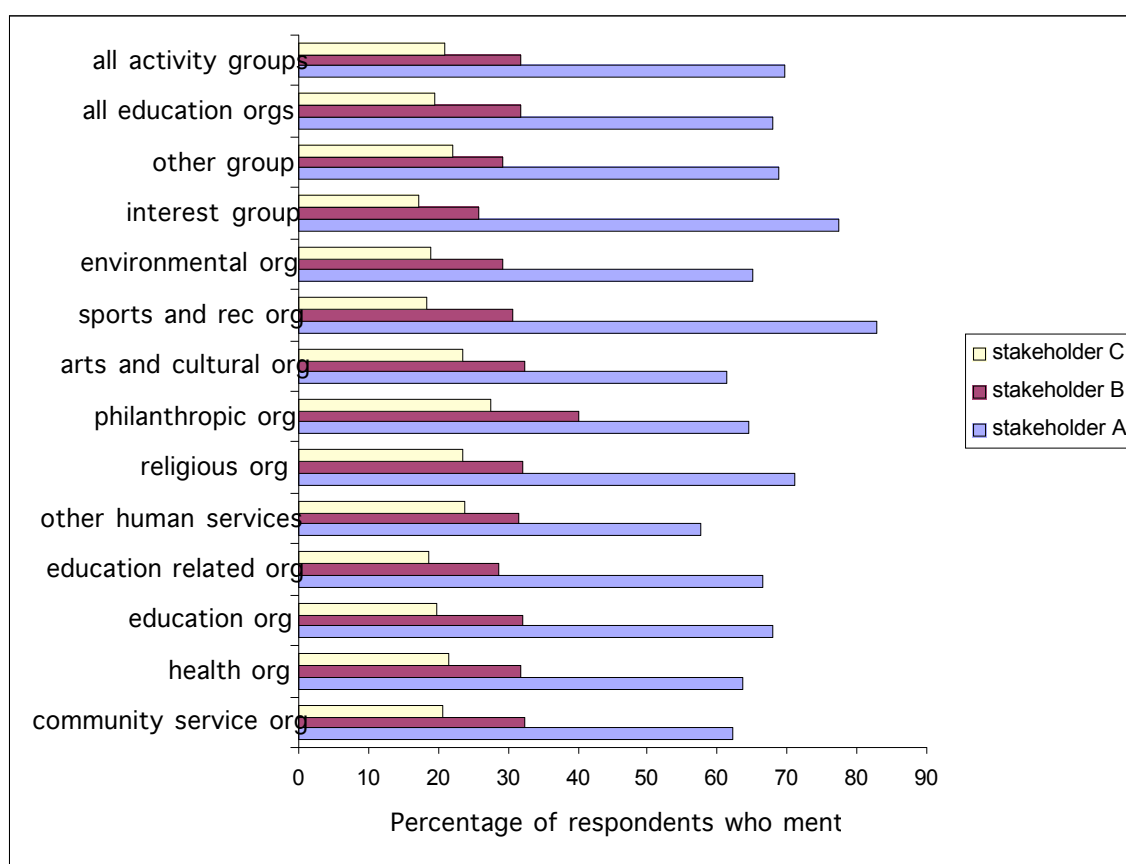
Those respondents who mentioned a related body as a stakeholder are most likely to be peak bodies, with the related bodies being their branches. Another example of a related body is the trading arm of a church body. The existence of related bodies raises problems in reconciling overall standards and accountability with flexibility and a measure of autonomy. Not only do branches have to be accountable to headquarters, but branches may demand accountability from headquarters. Furthermore, a peak body may have some members that are companies and others that are incorporated associations. This means that the laws regulating the member organisations will differ significantly, and make the provision of training and advice complex.

4.10. Importance of stakeholders A, B and C compared

Respondents were asked to rate the importance of each stakeholder they named. Figure 9 shows that for each activity group, Stakeholder A was rated the most important, Stakeholder B was the second most important, and Stakeholder C was the third most important. There were exceptions within each group based on principal activity. Some did not rank their stakeholders from A to C, but overall this pattern prevailed.

While this data is not particularly significant in itself, it is helpful because it confirms that further comparison between respondents based on factors such as public-serving or member-serving is possible.

Figure 9: Importance of stakeholder A, B and C for each activity group



4.11. Significant differences - member-serving or public-serving

The pattern of stakeholders for member-serving organisations was compared with public-serving organisations. As expected, in member-serving organisations, 'members' are very clearly the key stakeholder. The 'government' and the 'general public' are regarded as considerably less important in member-serving organisations, compared with public-serving organisations. In public-serving organisations 'clients' (44%) and 'members' (44%) ranked at a fairly similar level to 'government' (32%). However, the 'government' and 'public' (17%) rank lower than might have been expected for public-serving companies.

Table 1: Member-serving vs public-serving

Member-serving (n = 801)		Public-serving (n = 647)	
members	74%	members	44%
clients	24%	clients	44%
government	17%	government	32%
public	6%	public	17%

4.12. Significant differences - receipt of government income

Respondents who reported receiving government income were compared with those who received none. The results demonstrate that the presence of any government funding seems to create a significant stakeholder relationship. It also meant that the 'general public' became more significant.

This result most likely reflects the effect of government funding contracts, which often have extensive reporting obligations.

Table 2: Government income vs no government income

Government income (n = 634)		No government income (n =816)	
Members	49%	members	70%
Clients	47%	clients	23%
Government	43%	government	8%
Public	14%	public	8%

4.13. Conclusions - range of stakeholders

The data reported in this Chapter reveals that there is a very broad range of stakeholders whose legitimate interests in the organisation must be taken into account. The question of stakeholders is directly relevant to the issue of accountability. The issue of how an NFP organisation can be accountable to a range of different stakeholders is vexed.

The results about membership support Lyons’ observation¹⁸ that defining constituencies and determining the basis of membership is a difficult issue for NFP companies. Although members have a privileged legal place within NFP companies, they were not found to be the primary stakeholder for all organisations. This raises important questions about how other important stakeholders influence the decisions of the organisation and demand accountability.

The term accountability has many different meanings. In legal terms, it has implications in terms of in whose interests decisions must be made, and concerning disclosure requirements. That is, who NFP organisations provide reports to, who they ought to report to, and how that disclosure occurs.

Analysis of the results based on distinctions between respondents revealed that the stakeholders NFP organisations consider to be important differs, based according to the principal activity of the organisation. However, our view is that the variations do not provide a clear basis for requiring different levels or types of disclosure under the *Corporations Act 2001* (Cth).

5. CLASSIFICATION OF NFP STAKEHOLDERS

As mentioned under Heading 2, the data reported in this Chapter concerns those individuals, groups or bodies that respondents themselves consider to be stakeholders (‘the Survey Stakeholder List’). These may or may not be the same as those with whom they actually have a formal relationship of accountability. Australian researchers Flack & Ryan, also note this ‘decoupling’ of a formal notion of accountability from what is perceived to be ‘their real accountabilities to donors, supporters, service users’ in their recent case study of a hospital foundation.¹⁹ We thought it worthwhile to compare the Survey Stakeholder list with that compiled by Flack & Ryan.

5.1. Comparison of survey data with other classification research

A comparison of bodies or people named in the Survey Stakeholder List with Flack & Ryan’s typology is shown in Table 3. The comparison suggests that the survey results reported in this Chapter can add to the existing literature by pointing towards a hierarchy or prioritisation of stakeholders based on the views of NFP respondents.

At first glance, the comparison reveals significant omissions in the Survey Stakeholder List. But upon closer analysis, there are, in fact, few substantive differences.

¹⁸ See Lyons as quoted under Heading 1, see n. 5.

¹⁹ T. Flack, & C. Ryan, ‘Accountability of Charitable Organisations: Meanings and Mechanisms’, Conference presentation at ANZTS, Auckland, November 2002, unpublished, p. 14.

Table 3: Comparison of Flack & Ryan’s typology with the Survey Stakeholder List²⁰

Flack & Ryan’s typology	Stakeholder Survey List, % who mention as one of up to 3 stakeholders
<i>Inside stakeholders (providers of resources)</i>	
Board members	Board (14%)
members	members (60%)
employees	employees (4%)
professional staff	
paid workers	
volunteers	volunteers (1%)
purchasers/users of services	clients (33%)
creditors	creditors (4%)
suppliers of goods and services	
donors	sponsors (13%)
private grant makers	
government funders	
<i>Outside stakeholders (parties performing a review or oversight function)</i>	
government regulators (accountability agents for general public)	government (23%)
media (accountability ‘watchdog’ for general public)	
professional bodies	
labour unions	
employer groups or ‘Peak bodies’	related bodies (6%)
analysts and advisors	
special interest groups/minorities	
charity ‘watchdog’ organisations	
community/general public	general public (11%)
	religious body (8%)

5.2. Observations on the comparison

In making the comparison between Flack & Ryan’s typology and the Survey Stakeholder List it is important to bear in mind in the methods used in conducting and interpreting the survey data from which the Survey Stakeholder List has been compiled. The survey respondents were limited to naming three stakeholders and thus did not have an opportunity to list all the stakeholders who might have a legitimate interest in their organisation, or to whom they have a duty to report. In presenting the results, the aim was to reduce the survey responses to (approximately) the ten most common, rather than presenting an exhaustive list. Flack & Ryan’s typology does not prioritise stakeholders, as was the task for the respondents in the survey, it merely lists them.

Bearing in mind these methodological differences, a comparison of the two lists is instructive. Flack & Ryan divide stakeholders into ‘inside stakeholders’ (providers of resources) and ‘outside stakeholders’ (parties providing a review of oversight function). They acknowledge that this distinction may be problematic for the NFP sector because their stakeholder list has been drawn largely from literature in the ‘for-profit’ and government sectors.²¹ Seven out of 12 of the stakeholders listed in the Survey Stakeholder List are ‘inside stakeholders’ according to Flack &

²⁰ Adapted from T. Flack. & C. Ryan, 2002, n. 19, p. 5. Flack & Ryan’s typology represents a literature survey. The original table includes a column for authors.

²¹ Flack & Ryan, n. 19, p. 5.

Ryan's typology. The 'inside stakeholders' mentioned by our survey respondents were members (60%), clients (33%), the Board (14%), employees (4%), creditors (4%), sponsors/donors (13%) and volunteers (1%). Other 'inside stakeholders' listed by Flack & Ryan were mentioned by survey respondents. It is necessary to take into account that our coding used slightly different terminology:

- The term 'sponsors' used in the survey stakeholder list includes donors, private grant makers and government funders. Flack & Ryan distinguish between government regulators and government funders, a distinction that would have been useful for our survey.
- The term 'clients' in the Survey Stakeholder List correlates with purchasers/users of services.
- The Survey Stakeholder List makes no distinction between types of employees, whether they are employees, professional staff or paid workers.

The 'outside stakeholders' mentioned by the respondents to the survey include:

- government, which in turn included State, Federal and Local government, as well as ASIC and funding departments (23%)
- public, which includes local community groups or subsections of the general public (11%) and peak bodies (included under the category 'related bodies' (6%) in the Survey Stakeholder List)

Religious body (8%) is not included on Flack & Ryan's typology, but is included on the Survey Stakeholder List.

The respondents to the survey did not mention the media, professional bodies, labour unions, employer groups, analysts and advisors, charity watchdogs or special interest group/minorities. (If charity watchdogs were government based, they were included under the 'government' category in the survey.) Labour unions and employer groups may be less relevant to many NFP organisations because of the high level of reliance upon volunteers, rather than employees. Nevertheless, some of these bodies, particularly labour unions and employer groups, have a legitimate (often legal) interest in NFP companies, and any consideration of reporting requirements should take them into account.

Flack & Ryan have carried out a comprehensive synthesis of the academic literature on the topic, and, despite differences between the survey and their typology, there is significant overlap.

6. TENSION BETWEEN STAKEHOLDERS

6.1. Survey question

- 6.2.4 Has there been any significant tension between this stakeholder (or any individual within the group) and the company OR between this stakeholder and any other stakeholder in the company?
- yes
- no

Number of respondents = Stakeholder A 1533, Stakeholder B 988, Stakeholder C 672

- 6.2.5 If 'yes', please explain the nature of the tension and, if it has been resolved, how it was resolved.

Number of respondents = 123 in total

6.2. Survey results

6.2.1. QUANTITATIVE DATA

For Stakeholder A, 12% reported some tension between Stakeholder A and the company or between Stakeholder A and any other stakeholder in the company. This rate was similar for Stakeholders B and C - Stakeholder B 14% and Stakeholder C 13%.

6.2.2. QUALITATIVE DATA

One hundred and twenty-three respondents wrote a comment giving some detail about the nature of the tensions between the company and the stakeholder, or the tension between stakeholders. Analysis of these comments revealed two broad categories of tension. They were 'organisational mission vs business model' and 'stakeholder self interest vs organisational interest'.

Of those respondents commenting, the predominant group (49 out of 123) could be classified in the first group. Namely, tension between the requirement to take on business strategies in order to remain viable, while still meeting the organisation's NFP objects or mission. By way of illustration, one respondent wrote that there had been this type of conflict between the company and volunteers:

In order to remain a viable company, we have had to employ normal business models. This new attitude has conflicted with stakeholders' perceptions of what the company should stand for. Only partially resolved.

In relation to the way this type of conflict had arisen with funding bodies, one respondent wrote:

The company straddles two worlds: social justice and commercial reality. Funding bodies have seen that by aligning with one, we damage the other. Mainly resolved now, by explaining we do no different to them.

In relation to this type of conflict with sector affiliates, the comment was:

These stakeholders think the company has abandoned its original aims in pursuit of money. Partially resolved by explaining that without money we will not be able to continue in business. (Amazingly, this really does require explanation!)

It needs to be noted that the respondents to the questionnaire were mainly 'managers' or CEOs, people who are charged with the responsibility of sound financial management, and not volunteers, who might have different views on this issue.

6.3. Tension between NFP mission vs business model

6.3.1. OBSERVATIONS

Anecdotal evidence suggests that there is a growing tension within many NFP organisations between:

- the requirement to take on business strategies in order to remain viable
- meeting the organisation's NFP objects or mission.

By way of a recent example, an article in *The Age* in January 2003²² reported a conflict that arose between volunteers in Shepparton and the head office of St Vincent de Paul. The conflict led to the dismissal of the Sandhurst branch by the Board of St Vincent's via a fax, a move that volunteers found 'more fitting a boardroom than one of Australia's biggest and best-loved charities'. Peter Ellingsen, the reporter, described the nature of the crisis as follows:

...Vinnies...is just one of many non-profit groups caught in an identity crisis. Government cuts, compassion fatigue and corporatisation of welfare, have left charities unsure of whether they are businesses or benevolent collectives.²³

This tension increases as organisations grow and take on more traditional 'for-profit' 'management strategies. The tension may also be exacerbated by the requirements of funding bodies - whether private or government-based - that have a legitimate interest in the financial soundness of management strategies. In an environment of intense competition between NFP bodies for funding, closer attention is being paid to efficiency and effectiveness, and there is an increasingly professional and analytical approach to what is done, why and at what cost.²⁴

Leat argues that this pressure for more 'management' also stems from the sector's changing relationship with government and its role in relation to public policy and service provision. Like the conservative governments in the UK, which Leat examines, the Coalition Government in Australia has emphasised 'partnership' with both the NFP and 'for-profit' sectors in a wide range of service provision areas. There has been a large scale contracting-out of services, notably in employment services, which has increased the size of the sector in terms of income and the number of bodies.

A survey carried out by the Australian Management Corporation in 2002 found that there was clear evidence of a move toward government funding. The survey also identified that the

²² P. Ellingsen, 'Charity gives itself heartache', *The Age*, Perspective, 9 January 2003, p. 9.

²³ *The Age*, n. 22.

²⁴ D. Leat, above, n. 9, p. 5.

competition between organisations for public support was intense and continuing to increase.²⁵ This increased competition for funds is likely to lead to less co-operation between charities.²⁶

There is no consensus within the sector regarding how to deal with the tensions, or whether indeed, the tensions are real, as Ellingsen's article, and the many subsequent letters to the editor that it generated, identified:

As government and public money has dried up, they have been forced to turn to business or to accept government contracts, and that has meant adopting corporate manners. For some...the shift towards 'partnerships' with business and government is positive. Social entrepreneurs, as the new charity chiefs are now called, are the future, says McClure, who chaired a Federal Government welfare inquiry.

But there are others, like former Brotherhood of St Laurence director, David Scott, who see the move as further marginalisation of the poor, and a way of limiting the advocacy role charities have traditionally played.²⁷

Many of the respondents' comments in this section reported a similar source of tension.

6.3.2. IS THERE REAL TENSION BETWEEN NFP MISSION AND BUSINESS MODELS?

This issue is relevant to any question of whether NFP organisations should be treated differently under company law than 'for-profit' companies.

Some would argue that differences between NFP objects and 'for-profit' management strategies are exaggerated. This was certainly the view of some respondents (see, Heading 6.2.2). Leat questions the 'not concerned with profit' vs 'driven by profit' distinction between NFPs and for-profit organisations. She argues that:²⁸

- in both sectors 'profit' is an unclear concept - its meaning and measurement vary
- some NFPs and parts of others generate profit/surplus - even if they cannot distribute that profit
- the timescale over which 'for-profit' organisations attempt to maximise profit varies
- it is debatable whether profit maximisation is the primary goal for all types of 'for-profit' organisations in all types of markets. Maximising sales and/or growth may be equally, if not more, important.

Further, she points out that 'the financial liability of for-profit entrepreneurs is likely to be hedged by financial institutions, whereas in non-profits risk may be less well insured'.²⁹ When this risk is taken into account, it makes sense that NFP organisations may need to be particularly careful to ensure that the long-term financial surety of the organisation is firmed up.

Despite these caveats, it remains the case that profit and financial measures alone are an inadequate and inappropriate basis for measuring performance in NFP organisations. Moss Kanter & Summers³⁰ point out that the real difference between 'for-profit' and NFP organisations in establishing performance indicators lies not so much in the lack of profit, but rather the intangible nature of what is typically provided by NFP organisations.

Whilst the measurement of performance is not easy in any organisation, profit, as a marker, can be measured easily. Because it is seen by 'for-profits' as a good test of market satisfaction and of the capacity of an organisation to run itself efficiently, profits are generally the main measure of performance. NFP organisations, in contrast, define themselves not by their financial returns but by the services they offer. These services are often intangible and difficult to measure and clients, employees, managers, volunteers and donor/funders may make different judgments with regard to their quality. This has led Moss Kanter & Summers to argue that it is not lack of profit per se, but rather the centrality of (intangible) social values over (objective) financial values that complicates management for NFP organisations.³¹

²⁵ 'Your guide to Victoria's Not-for-Profit Organisations', advertising feature in *The Age*, Monday, 3 June 2002. See Heading 3.2.3 in Chapter 6, Disclosure, for further information about the survey.

²⁶ For example see comments by Commissioner Doug Davis (Salvation Army, Melbourne): 'We were always competitive, but now it's absolutely the case, it's crystal clear it's the case. 'Australia - Salvation Inc - Inside the Salvation Army', *The Australian*, Dossier, 23 June 2001.

²⁷ *The Age*, n. 22.

²⁸ D. Leat, n. 9, p. 1.

²⁹ D. Leat, as above, n. 9.

³⁰ R. Moss Kanter & D.V. Summers, 'Doing Well While Doing Good: Dilemmas of Performance Measurement in Non-profit Organisations and the Need for a Multiple-Constituency Approach', in W.W. Powell (ed.), *The Nonprofit Sector; A Research Handbook*, Yale University Press, New Haven, CT, 1987.

³¹ Kanter & Summers, n. 30.

Within the current contract culture, NFP organisations may have to learn to juggle the intangible goals of public benefit/service with the more tangible objectives of acquiring contracts and satisfying a variety of paying and non-paying customers within the constraints of the real cost of financial survival. If profit is nothing more than the real cost of staying in business, then profit is likely to be of increasing concern to NFP organisations.³²

6.4. Tension between self interest vs company's interests

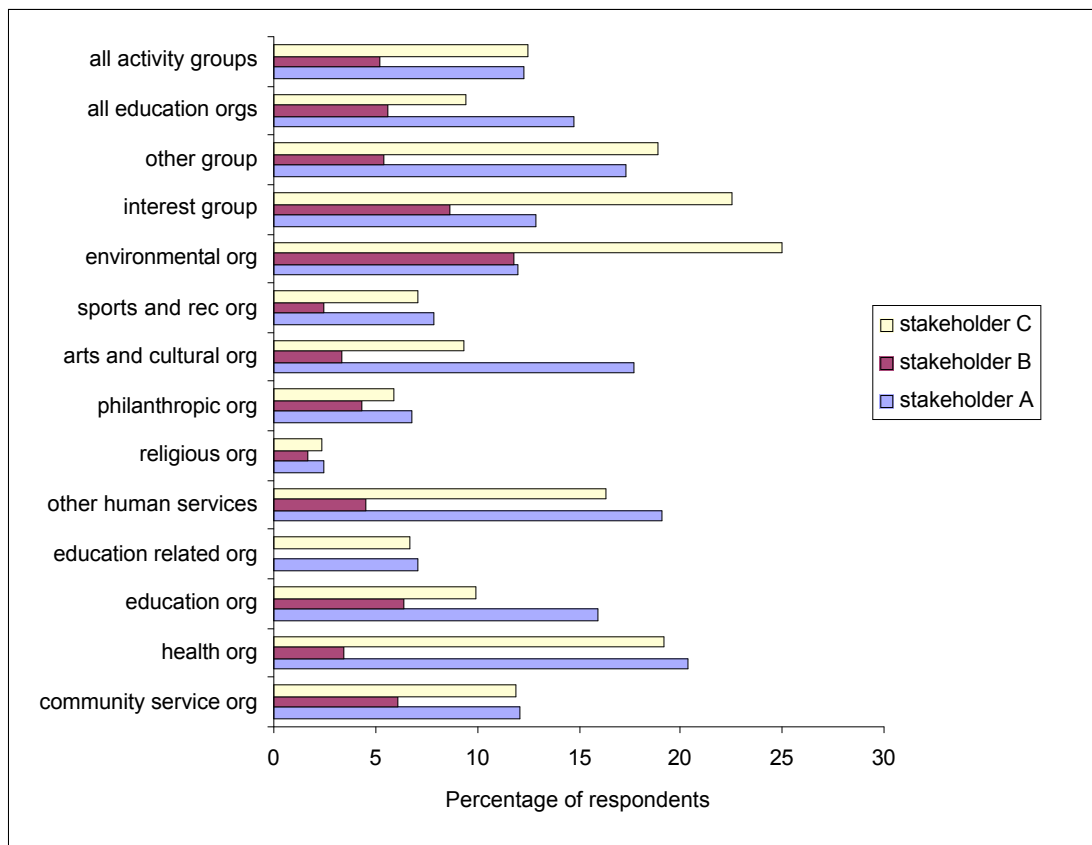
Another cause of tension some respondents reported was a lack of understanding of the role/duties of a Board of directors. These respondents reported some conflict between the self-interest of the director (for example, wanting to promote their personal profile among members in a trade association) and the company's interest.

6.5. Significant differences - principal activity

It was assumed that the issues raised in the discussion under Heading 6.3 would not be as contentious for all types of organisations. We might assume, for example, that most Sport and Recreation organisations would not feel the same pressure to balance business objectives and NFP objectives, because the two are not in conflict in the context of an organisation that operates primarily to provide a service to its members. This assumption was borne out by the statistics, as seen in Figure 10.

Perhaps predictably, Health organisations, Other Human Services and Environmental organisations experience the highest level of tension with stakeholders, or between stakeholders. Religious organisations reported the lowest level of tension with stakeholders or between stakeholders, followed by Education, Sports and Recreation organisations. It might be assumed that for a Religious organisation (as opposed to a Community Service or Other Human Services organisation that has religious underpinnings) the aims are consistent amongst stakeholders, reducing the likelihood of conflict.

Figure 10: Significant tension between this stakeholder and company or between this stakeholder and any other stakeholder in the company, based on principal activity

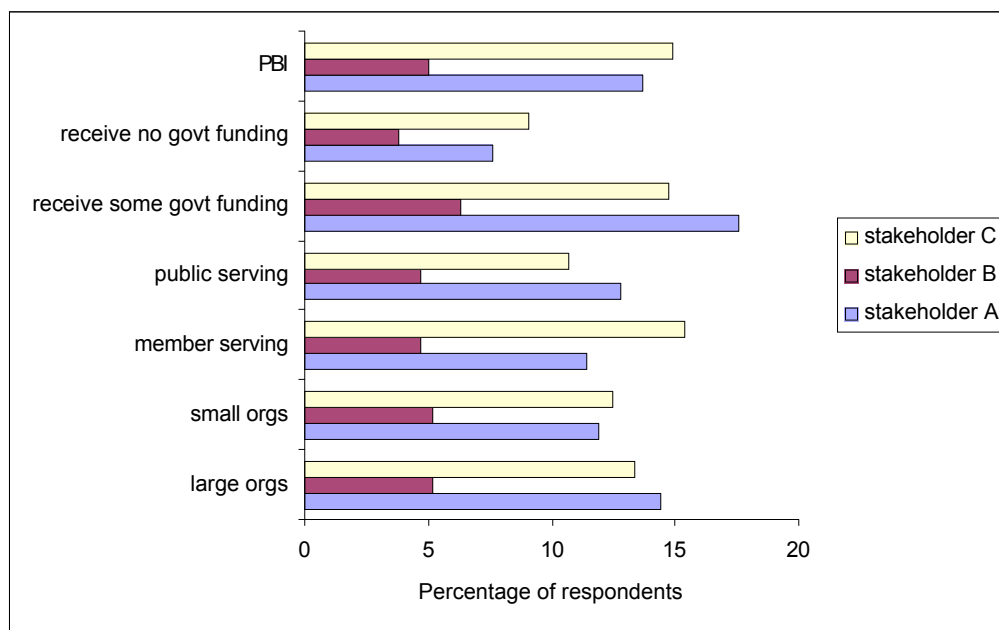


³² P. Drucker, *The Practice of Management*, Pan Books, London, 1968.

6.6. Significant differences - other key indicators

The results (Figure 11) show that the presence of government funding increases the incidence of tension or conflict significantly.³³ Overall, the incidence of tension was greater for member-serving organisations than public-serving organisations.³⁴ However, in the case of Stakeholder A, the tension was greater for public-serving organisations.

Figure 11: Significant tension between this stakeholder and company or between this stakeholder and any other stakeholder in the company, based on key indicators



7. COMPLAINTS TO ASIC

7.1. Data

To complement the survey results, statistics on complaints were obtained from ASIC so as to examine the nature and extent of conflicts that result in complaints. Between July 1998 and August 2002, 4.4% of complaints to ASIC were about companies limited by guarantee, compared with 0.7 % of all other companies (that is, companies other than companies limited by guarantee).³⁵ In other words, a disproportionately high number of complaints are received about companies limited by guarantee.

According to ASIC, most of the complaints it receives about companies limited by guarantee ‘concerned internal management issues’. Most complainants raised specific concerns about the structure and conduct of meetings, or issues related to the company’s financial records.³⁶ On the basis of the information provided by ASIC, it is difficult to assess what reasons might lie behind complaints about financial records etc. It is not possible to say whether or not the data from ASIC supports conclusions drawn from the survey data that the company’s mission/purpose is the main cause of stakeholder tension. If a member of an NFP reports to ASIC regarding the manner in which their company is raising or spending funds, this is not, of itself, likely to result in any action by ASIC as the company/its directors will not have acted in breach of the *Corporations Act 2001* (Cth). Alternatively, making a complaint about improper financial reporting is likely to attract more attention from ASIC.

³³ The differences between the incidence of tension in organisations receiving government funding compared with those that don’t were: 16% (n= 112/63) for Stakeholder A, 11% (n= 78/47) for Stakeholder B and 5.6% (n= 59/22) for Stakeholder C.

³⁴ The differences between member-serving and public-serving organisations were: Stakeholder A, -1.4% (n= 92/84); Stakeholder B, 6.3% (n= 74/53); Stakeholder C, 4.7% (n= 45/37).

³⁵ This data was provided by ASIC. Of these complaints, 5% were investigated, 14% resulted in surveillance, and 30% were resolved by information provided/negotiation. Forty-nine per cent were analysed, assessed and recorded.

³⁶ See, n. 35.

7.2. Observation

The survey data bears out the notion that NFP companies are 'object driven' rather than 'profit driven'. It is not surprising, then, that tension might arise about the nature of the company's mission and whether or not the directors are fulfilling it, rather than whether there has been an adequate return on investment. The success of an 'object driven' organisation is inherently harder to measure. The survey data and the information received from ASIC support the thesis that, because NFP companies have a greater number of stakeholders than 'for-profit' companies, balancing the different needs of these stakeholders gives rise to additional and different tensions.

8. REMEDIES FOR MEMBERS OF NFP COMPANIES

8.1. Implications of previous reforms

The fact that companies limited by guarantee are largely object-driven, rather than profit-driven has been ignored in the Australian company law reform process. Changes to the *Corporations Act 2001* (Cth) in July 1998 had the effect of 'downgrading' the consequences for directors who breach the company's object clause.³⁷ Prior to the amendments, a contravention of an objects clause could be relied upon in s 162(7):

- the prosecution of a person for an offence under the former Corporations Law (s 162(7)(c))
- an application to the court for a management banning under s 230 (former s 162(7)(d))
- an application for an oppression order (now s 246(AA) (former s 162(7)(e))
- an application for a statutory injunction under s1324 (former s 162(7)(f))
- proceedings by the company or a member against the present or former officers of the company (former s 162(7)(g))
- an application by ASIC or a member to wind up the company (former 162(7)(h).

Since these amendments, breaching an objects clause does not constitute a breach of the *Corporations Act 2001*(Cth). It can no longer be relied upon to form the basis of these actions, for example, to obtain a statutory injunction to prevent the execution of a contract that is in breach of an express object. A breach of the objects clause is now treated in the same way as any other breach of the company's constitution.

The argument underlying the amending Act was that a member could still enforce objects by bringing an action against a director for breach of the company's constitution or a breach of directors' duties. However, the legislation does not make this clear. In any case, the options open to members are procedurally quite difficult.

Consider the position of a member of a NFP organisation. Before action can be taken in the company's name, the member would need to obtain the requisite majority at a general meeting to remove the existing directors - this can itself be a difficult task. Otherwise, the member would need to bring a statutory derivative action (s 236), which requires the action to be carried out in the company's name. Even if a member succeeds in obtaining leave to bring such an action,³⁸ the court is not bound to require the company to bear the costs of the proceeding.³⁹ Alternatively, if a member were to commence a personal action in his or her own name there would be considerable personal expense and it is unclear whether a personal right arises simply from a breach of an objects clause. What member of a NFP organisation is likely to have the incentive, determination or funds to be able to take such action or to rally a sufficient number of fellow members to do so?

It is more likely that an action in the name of the company will only be taken when matters have deteriorated to the point where a liquidator or administrator is appointed. Indeed, if the member does not take action when a breach occurs, there may be other undesirable consequences for the member – for example, tax exempt status (under taxation or stamp duty laws) may be lost, or ASIC may revoke the company's licence to omit the word 'limited' from its name.⁴⁰

³⁷ See S. Woodward, 'Not-for-profit companies - some implications of recent corporate law reforms', *Company and Securities Law Journal*, Vol. 17, September 1999.

³⁸ See s 237 of the *Corporations Act 2001* (Cth).

³⁹ See s 242 of the *Corporations Act 2001* (Cth).

⁴⁰ See S. Woodward 'Ultra Vires' over simplified - changes to company powers under the Second Simplification Bill', 1997, 15 *CSLJ* 162 at pp. 170 - 1.

8.2. Oppression remedy

If a member of a NFP organisation that has (at least arguably) breached its express objects or acted in breach of an express limitation on its powers, it is not clear from the wording of s 232 of the *Corporations Act 2001* (Cth) that this will be sufficient to establish an action for oppression under that provision. Certainly the possible orders the court can make are wide enough to cover any possible remedy a member of an NFP company could want.⁴¹ However, we suggest that neither the criteria of 'contrary to the interests of members as a whole' (s 232(d)) nor 'oppressive to, or unfairly prejudicial to, or unfairly discriminatory against, a member' (s 232(e)) would cover the NFP objects situation. We are not aware of any relevant case law on this issue. In any event, costs are again at the court's discretion and thus, it will only be a passionate or foolhardy, but necessarily well-resourced member(s) who would bring an action on the current wording.⁴²

8.3. Vexatious members

It is important to consider the other side of the coin - the vexatious member. Often members in NFP organisations feel passionately about the organisation's cause. In a member-serving organisation they may have a personal interest in an issue such as how teams are selected or which fundraising activities are carried out. The limited resources of an NFP company could be depleted quickly by the need to defend a vexatious claim.

8.4. Importance of members' remedies

It is necessary to provide remedies for members in an NFP organisation as an accountability mechanism so that they can ensure that the organisation continues to pursue its mission. However, a fine balance needs to be achieved. The range of accountability mechanisms are more limited in an NFP organisations than in 'for-profit' companies, particularly in large listed companies where additional mechanisms are in force.⁴³ In contrast, the financial resources of an NFP company are often limited. It is not in the public good for these limited resources to be expended defending vexatious legal actions by members. An early 'filter', based on the merits of the claim is desirable, such as the need to apply for leave under s 237 *Corporations Act 2001* (Cth)

8.5. Recommendations - remedies

Reform of members' remedies

The special position of members in NFP companies should be considered further in the context of remedies. Members of NFP organisations do not have the same economic power as members of 'for-profit' companies. Nor do they have recourse to a range of shareholder remedies such as selling their shares. Thus members' ability to constrain the actions of Board members and officers of the company, or to ensure that action is taken following a breach of the constitution, is limited. In addition, one of the unique characteristics of NFP organisations is the range of stakeholders with a legitimate interest in the organisation. The public, donors, clients and volunteers all have special stakes in ensuring that the mission of the NFP organisation is pursued and that the organisation's funds are not distributed to members.

The consequences of a breach of NFP objects should be reconsidered, as their mission is what drives NFP organisations. In this regard we suggest that the following specific reforms be considered:

- All NFP companies should be required to have a 'non-distribution' clause.
- Objects clauses should be compulsory for all NFP companies (not just those holding a licence to omit the word 'limited' from their name).
- The directors should have a specific duty to ensure that the company pursues these objects.
- A breach of the objects clause should be an express ground for bringing an action under s 232 of the *Corporations Act 2001* (Cth) (the oppression remedy) and, possibly, also under s 236 (the statutory derivative action). Modification of s 232 in this way would also enable ASIC to initiate action under s 234 on the basis of a complaint by a member or other stakeholder, for example, if it were considered to be in the public interest.

⁴¹ See s 233 of the *Corporations Act 2001* (Cth).

⁴² We would like to thank Professor Elizabeth Boros, Monash University, for her insightful comments on this aspect of the Report.

⁴³ Other accountability mechanisms include stock exchange regulation, dividends/returns to members and the influence of institutional investors.

8.5.1. REQUIREMENT FOR OBJECTS CLAUSES AND DUTY TO PURSUE THEM

In relation to the requirement in our recommendation for including objects clauses, it is worth noting that the UK Report 'Private Action, Public Benefit' includes such a requirement for the recommended 'Community Interest Company'. It also states 'directors would be under a duty to pursue them'.⁴⁴

8.5.2. OPPRESSIONS REMEDY

If a breach of an objects clause was an express ground for an action for oppression under s 232, this would also enable ASIC to initiate an application based on its investigations into the company's affairs (see s 234(e)). This is an important point. If the objects of an NFP company, its mission, are not being followed by the directors, and the members (who may be the same people as the directors) are for whatever reason not opposed to this course, with this new provision, it would be possible for ASIC to take action. For example, if it had received a serious complaint from a client, donor or member of the public about the organisation's operations, ASIC would act as the necessary 'filter' against vexatious or minor complaints. Bearing in mind that the organisation may continue to benefit from taxation exemptions (on income, stamp duty etc) while acting contrary to its NFP objects, there is a public policy reason for giving this enforcement option to ASIC.⁴⁵

Actions under either s 232 (oppression) or s 236 (statutory derivative action) give the court power to dismiss quickly any vexatious claim and wide discretion in relation to ordering the payment of costs. While costs will always be a barrier, particularly in the NFP context (a member is not protecting an investment), the contribution of organisations such as PILCH⁴⁶ and community legal centres, do help in this regard.

8.5.3. NON-DISTRIBUTION CLAUSES

We are aware of Australian Taxation Office administrative practices that require certain types NFP organisations to have clauses in their constitution or rules that prohibit distribution to members of profits or any surplus on a winding up. Some, but not all, of the State and Territory incorporated associations' Acts have such restrictions, see Appendix 5, Comparative Table. At best there is considerable inconsistency. These clauses need to be entrenched in some way so that a majority of members cannot amend the clause. We recommend that all NFP organisations⁴⁷, or at least those enjoying preferential taxation treatment, be required to have such clauses. In this regard, we note a practical example cited by Professor McGregor-Lowndes:

Another example is the distribution of nonprofit clubs and societies that have enjoyed tax exemption over the years and received government grants to establish their facilities. Clubs such as lawn bowling clubs are being disbanded. Some are able to alter their constitution to permit the remaining members on dissolution to receive any surplus funds. This has occurred in several lawn bowling clubs and appears to be entirely within the law. However, the question has to be asked, What benefit should the community investment in the way of taxation exemptions, rates rebates, concessional leases of land and government grants also receive from the surplus assets. As our population's interest changes even more rapidly, this will be a pressing issue.⁴⁸

Feedback from sector

Further, the indications we have received suggest that this recommendation will be supported the sector. Ms Woodward and Ms Marshall were invited to present a seminar about the Project on behalf of Freehills, solicitors, as part of their pro bono services. This seminar was held in Sydney on 17 June 2003 and was attended by approximately 70 people from a variety of NFP organisations, as well as some advisors to NFP organisations. After a presentation about the

⁴⁴ UK Strategic Unit Report, 'Private Action, Public Benefit', n. 4, para. 5.28 and recently released draft *Companies (Audit, Investigations and Community Enterprise) Bill*, see <http://www.dti.gov.uk/cld/companies_audit_etc_bill/>

⁴⁵ The authors would like to thank Professor Elizabeth Boros, Monash University, for her helpful comments on members' remedies.

⁴⁶ Public Law Interest Clearing House, a Victorian NFP organisation that arranges pro bono legal advice for many other NFP organisations, at <www.pilch.org.au>. There are similar organisations in Queensland and New South Wales.

⁴⁷ Consideration would have to be given to the treatment of trading organisations, for example, those operating on the cooperative model even though they are companies limited by guarantee.

⁴⁸ See Professor Myles McGregor-Lowndes, 'Regulatory Infrastructure for Nonprofit Organisations', Working Paper PONC97, August 2000, Queensland University of Technology, p. 19.

Project, people were divided into groups to discuss some of the preliminary recommendations. There was clear agreement from participants that the rules of a NFP organisation should include a compulsory non-distribution clause as this 'defines a not-for-profit body'.

8.6. Recommendation - access to dispute resolution services

Other remedies

It is desirable that NFP organisations and their members have access to expert, low-cost alternative dispute-resolution procedures. This is a valuable role that could be undertaken by the independent NFP advisory body recommended in this Report (see Chapter 4, Regulatory Framework).

Given that the nature of tension and disputes between stakeholders in NFP organisations is often different to those experienced in 'for-profits' (see, for example, Heading 7), the need for access to low-cost alternative dispute resolution procedures such as mediation is important. It is also a practical way of increasing access and preventing limited resources being used to resolve disputes with stakeholders such as members.

9. CONCLUSION

The survey questions reported in this Chapter have provided new insights into the nature of this important NFP group and their stakeholders. It is hoped that this data will contribute to the ongoing debate about transparency and accountability.

Whilst some of the findings were expected, such as findings about the multiplicity of NFP stakeholders, others were less expected. More surprising findings included those where:

- Volunteers were frequently not considered to be important stakeholders by the respondents (1%), despite the fact that 86% of organisations had volunteers.
- The distinction between public-serving and member-serving organisations did not translate into a significant difference between stakeholders. Clients and members ranked at a fairly similar level to government as stakeholders for public-serving organisations.

Our findings bring into contrast significant differences in profile between Australian NFP companies limited by guarantee and 'for-profits'. NFP companies have a large range of stakeholders whose interests and needs they take into account. This can render the current Australian regulatory scheme unwieldy because it serves as a less relevant but additional layer on top of the reporting that NFP organisations make to stakeholders. One respondent's comments encapsulate these tensions:

The [Corporations] Act is written and administered in such a way as to attempt to protect the shareholder and to a limited extent creditors. The concept of stakeholders seems alien.

If the concept of stakeholders being alien to the reporting requirements under the *Corporations Act* there are wider implications than simply the *Corporations Act 2001* (Cth) failing to take into account the range of bodies to whom NFP companies report. It also points to a fundamental difference between NFP companies and 'for-profit' companies. The primary reason that NFP stakeholders and 'for-profit' stakeholders differ is because the objects or mission of the organisation differ. NFP companies are generally established with the object or mission of serving the interests of certain stakeholders, whether they are the members of a club or the clients of a welfare organisation. Any consideration of NFP accountability must take include an assessment of the extent to which the NFP objects or mission have been met. Only then will stakeholders' legitimate interests in NFP companies have been taken into account.

Recommendations to amend the *Corporations Act* have been made to reflect the special position of members and stakeholders in NFP companies in the context of remedies. Members of NFP organisations do not have the economic power of members of 'for-profit' companies, nor recourse to the range of shareholder remedies, such as selling their shares. The ability of members to constrain the actions of Board members and officers of the company, or to ensure that action is taken following a breach of the constitution, is limited. It is recommended that the consequence of a breach of NFP objects needs to be reconsidered so as to reflect the importance of the mission to the NFP organisation, and make recourse to remedies more accessible to NFP members and stakeholders.