

# **The Effects of Funding Sources on Agency Costs in Not-for-Profits**

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## **ABSTRACT**

I examine the relation between governance and agency costs in not-for-profits (NFPs). Resource dependency theory suggests that NFP governance is determined by the demand for monitoring by fund providers (Vermeer, Raghunandan, and Forgione 2006). More restrictive funds are associated with greater monitoring and vice-versa. I hypothesize that (1) NFPs deriving a higher proportion of their revenue from government grants (a restrictive funding source) exhibit lower agency costs and (2) NFPs deriving a higher proportion of their revenue from investment income (a discretionary funding source) exhibit higher agency costs. To test these hypotheses, I analyze funding compositions of 38,316 NFP-year observations from 1992 to 2006. Consistent with my hypotheses, I find that NFPs that derive a greater proportion of their revenue from government grants pay lower CEO compensation and have higher program expense ratios. On the other hand, NFPs that derive a greater proportion of their revenue from investment income pay higher CEO compensation and have lower program expense ratios.

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