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Edited by Klaus J. Hopt and Thomas Von Hippel

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PART I

Economic findings and theories on nonprofit organizations

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1

What kind of nonprofit sector, what kind of society?

Comparative policy reflections

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I Introduction

In the course of the last decade, most developed market economies in North America, Europe and Asia-Pacific have seen a general increase in the economic importance of nonprofit organizations as providers of health, social, educational and cultural services of many kinds.¹ On average, the nonprofit sector accounts for about 6% of total employment in OECD countries, or nearly 10% with volunteer work factored in (Anheier, 2005).

¹ This paper uses the terms nonprofit organizations, NGOs and voluntary organization or nonprofit sector interchangeably.

While their economic function, particularly in terms of service provision, has been a common, though often overlooked feature of nonprofits in most developed countries (see Salamon, 1995), nonprofit organizations since the 1990s have become subjects of a more complex policy dialogue that involves three broad perspectives:

- (1) nonprofits are increasingly part of new public management approaches and what could be called a mixed economy of welfare and development. Expanded contracting of nonprofit organizations in governmental welfare provision, voucher programmes, or client/user empowerment projects are examples of this development.
- (2) they are seen as central to civil society approaches, specifically the Neo-Tocquevillian emphasis on the nexus between social capital and economic and social development. Attempts to revive a sense of community and belonging, enhance civic mindedness and engagement, including volunteering and charitable giving, are illustrative of this perspective.
- (3) nonprofits are part of a wider social accountability perspective that sees nonprofits as instruments of greater transparency, heightened accountability and improved governance of public institutions. Such mechanisms include citizen advisory boards, community councils, participatory budgeting, public expenditure tracking, and monitoring of public service delivery.

As we will see, the three perspectives make strong and specific claims about the role of nonprofit organizations; while all perspectives occupy key positions in current policy debates across many countries and international institutions, they have major implications that remain somewhat unconnected analytically and reflect different interests and approaches.

A Nonprofits as service providers

The first development is the rise of nonprofits as service providers as part of public-private partnerships. Under the rubric of new public management (NPM) and the rise of markets and quasi-markets in areas that have hitherto been part of the state, nonprofits have become instruments of public sector reform. Indeed, NPM developed in response to what was regarded as inefficient and ineffective government bureaucracies (Kettl, 2000), and has since the early 1990s changed the way in which public administration operates in both developed and developing countries.

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Specifically, Hood (1995: 96) has identified seven principles of NPM:

- (1) reorganization of the public sector into corporate units organized along product or service lines – in essence the shift from a unitary, functional form to a multi-divisional form;
- (2) emphasis on contract-based competitive provision, with internal markets and term contracts – the introduction of “managed markets” with the public agencies as funder and contract manager, and private for-profit and nonprofit providers as contractors;
- (3) stress on private-sector styles of management practice, including more flexible hiring and firing, greater use of marketing, and improved budget policies;
- (4) stress on discipline and frugality in resource use, including a better cost and revenue accounting;
- (5) more emphasis on visible hands-on top management, fewer middle management levels, and increased span of control for executive management;
- (6) greater use of explicit, formal standards and performance measures; and
- (7) greater emphasis on output rather than input controls.

The rise of neo-liberalism and the NPM thrust third-sector institutions into the middle of the public debate over the appropriate role of government in today’s society. In the process, this had led to experimentation with new contracting models (McLaughlin, Osborne, and Ferlie, 2002), new forms of “constructed markets” and “managed competition” (LeGrand, 1999), and efforts to systematize the terms of engagement between the nonprofit sector and the state such as New Labour’s “Compact” in the UK (Mulgan, 1999; Plowden, 2001) or the French policy of “insertion” to cope with the problems of the long-term unemployed in France (Archambault, 1996). More generally, activists across the political spectrum have come to see cooperation with third-sector institutions as a critical part of a middle, or “third”, way between sole reliance on the market and sole reliance on the state to cope with public problems (Giddens 1999).

These developments have not only affected the policy position of third-sector organizations in advanced market economies. Similar shifts are also evident in the developing world, where they have been encouraged by structural adjustment policies pursued by the World Bank and northern aid agencies as well as by widespread frustrations on the part of development experts with top-down development policies pursued by corrupt or ineffective governments. This has led to a new policy agenda stressing

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increased support for the private sector, both for-profit and nonprofit, to promote economic advance and governmental reform (Clarke, 2003; UNDP, 2002).

The NPM principles above have to be seen in the wider context of two factors: the first is the degree of distinctiveness from the private sector in the sense that public management is based on equity considerations, and primarily about managing public and semi-public goods that carry the potential of market failures – here the question becomes the extent to which nonprofits as service providers can compensate tendencies towards greater inequity and more frequent market failures; and the second is the need for rules separating political and managerial decision-making to establish and maintain some “buffer” between politics and service provision for greater accountability and transparency. Here the question becomes the extent to which nonprofits can contribute not only towards creating a buffer but also in demanding better governance, accountability and transparency, which is emphasized in the third perspective.

In any case, NPM brought, among other changes, concerns about outcomes versus outputs, efficiency versus effectiveness, as well as accountability and performance measurement to the management of nonprofits. With the rise of NPM, the emphasis on service provision and instruments of privatization casts nonprofits essentially in a neo-liberal role. They have become tools of public sector reform guided by the simple equation: “less government = less bureaucracy = more flexibility = greater efficiency” (Kettl, 2000). What NPM has done is to change the established role of nonprofit organizations as providers of services addressing special demands for quasi-public goods to complement and supplement state provision increasingly to that of an equal partner, and sometimes even that of competitor along with business firms.

In short, thanks to the NPM and associated neo-liberal economic policies, nonprofits are no longer seen as the poor cousin of the state or as some outmoded organizational form complementing state provision on the margins by meeting limited special demands for quasi-public goods (see Weisbrod, 1988; Esping-Anderson, 1990). Rather, they have moved to the centre of the policy debate and have come to be viewed as central instruments of development and welfare state reform.

B Nonprofits and civil society

The second trend is the (re)discovery of civil society, and the growing awareness among policy-makers and scholars that the very social fabric

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of society is changing in many countries. Where the NPM argument focuses on the service role of nonprofits, the latter focuses on their social-integrative and participatory function and the contribution they make to community building. According to this line of thinking, economic growth and democratic government depend critically on the presence of “social capital”, on the existence of bonds of trust and norms of reciprocity that can facilitate social interaction (Coleman, 1990: 300–21; Putnam, 2000; Fukuyama, 1995). Without such norms, contracts cannot be enforced or compromises sustained. Hence markets and democratic institutions cannot easily develop or flourish.

This line of argument was powerfully validated through an analysis of the progress of governmental decentralization policies in Italy by Putnam and associates (1993). They found that the regions with high levels of trust and civic engagement were also the regions that exhibited the highest levels of political stability, governmental effectiveness, and economic growth. “For political stability, for government effectiveness, and even for economic progress”, he therefore concluded, “social capital may be even more important than physical or human capital” (Putnam *et al.*, 1993: 183). Fukuyama (1995) came to a similar conclusion in an analysis of the US, Germany, and Japan. Differential rates of economic progress among these countries, he argued, could be traced to variations in the levels of “sociability” and social trust. Most important for our purposes, Putnam *et al.* (1993) traced the higher levels of trust in northern Italy compared to southern Italy to the far denser networks of voluntary associations in the former as compared to the latter, confirming a conclusion reached nearly 170 years earlier by the Frenchman Alexis de Tocqueville in his study of the US.

In the developed world, the decline of traditional membership organizations such as unions, political parties, and churches, and alleged erosions in social capital and interpersonal trust as well as institutional confidence, and other factors bring with them a profound awareness of uncertainty and a concern about social stability (see Putnam, 2002; Wollebeck and Selle, 2007). In the developing world, debates about social exclusion, failing states, and social disintegration bring up similar expectations where civil society is to serve as the panacea to counteract social disintegration and the negative impact of individualism and modernization on social cohesion (see World Bank, 2002; Glasius *et al.*, 2004).

The neo-Tocquevillian approach emphasizes the social integrative and participatory function of non-profits as well as their indirect contributions toward community building. They are linked to the perspective of a

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“strong and vibrant civil society characterised by a social infrastructure of dense networks of face-to-face relationships that cross-cut existing social cleavages such as race, ethnicity, class, sexual orientation, and gender that will underpin strong and responsive democratic government” (Edwards, Foley, and Diani, 2001: 17). Norms of reciprocity, citizenship, and trust are embodied in networks of civic engagement and associations, and closely tied to the notion of a functioning democracy (see Milner, 2002).

Put simply, the essence of the neo-Tocquevillian approach is: civic engagement creates social capital, which is good for society, the economy and the political system as well. Thus, civil society is not only a bulwark against a state that could become too powerful, or a mechanism that creates social accountability (see below), it is much more than that: a general principle of societal constitution based on communal responsibility, social trust, and self-organization.

Thus, nonprofits form the social infrastructure of civil society, and create as well as facilitate a sense of trust and social inclusion (Putnam, 2000; Halpern, 1999; Offe and Fuchs, 2002). Indeed, as Anheier and Kendall (2002) report, the relationship between interpersonal trust and membership in voluntary associations (as a major form of civic engagement) is a persistent research finding cross-nationally. The 1999–2000 wave of the European Value Survey (Halman, 2001) shows that for twenty-eight of the thirty-two participating countries, a positive and significant relationship exists between the number of associational memberships² held and interpersonal trust.³ The data of the European Value Survey reveal a striking pattern: respondents with three or more memberships were twice as likely to state that they trust people than those holding no memberships. Overall, there is almost a linear relationship between increases in membership and the likelihood of trusting people.

In the US, a similar pattern emerges in relation to the question: “Do you think that most people would try to take advantage of you if they got a chance, or would you say that most people try to be fair?”⁴ Results show that every second (46%) respondent with no memberships felt that

² This includes memberships in health and social welfare associations, religious/church organizations, education, arts, music or cultural associations, trade unions and professional associations, local community groups and social clubs, environmental and human rights groups, youth clubs, women’s groups, political parties, peace groups, sports and recreational clubs, among others.

³ Trust is measured by the following questions: “Generally speaking, would you say that most people can be trusted or that you need to be very careful when dealing with people?”

⁴ World Value Survey, 2000. United States Survey, conducted by Gallup for Virginia Hodgkinson, Helmut K. Anheier, and Ronald Ingehart.

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people would try to take advantage, as opposed to every third (37%) for those with three memberships, and nearly every fourth (29%) for those with five or more memberships. Conversely, 70% of respondents with five or more memberships felt that people tend to be fair, compared to only 54% for those with no memberships.⁵

The main argument is that civic engagement creates greater opportunities for repeated “trust-building” encounters among like-minded individuals, an experience that is subsequently generalized to other situations such as business or politics. Thus, the neo-Tocquevillian case for civic engagement is largely an argument based on the positive and often indirect outcomes of associationalism and public participation.

C Social accountability

Whereas nonprofits are corporations under NPM and associations in the neo-Tocquevillian perspectives, they are vehicles of reformed citizenship the social accountability debate. The role of nonprofits is both to affirm and strengthen accountability relationships between citizens and the state.

Social accountability is an approach in which citizens and civil society organizations participate directly or indirectly in exacting accountability from private and public institutions, including NGOs. Businesses, governments, the media, and NGOs are held accountable for their actions and the social, political, or environmental impact they may have. Social accountability refers to a broad range of actions and mechanisms that citizens, communities, independent media and civil society organizations can use to hold public officials and civic leaders accountable (Malena *et al.*, 2004). Such mechanisms include participatory budgeting, public expenditure tracking, monitoring of public service delivery, investigative journalism, public commissions, and citizen advisory boards. They complement and reinforce conventional mechanisms of accountability such as political checks and balances, accounting and auditing systems, administrative rules, and legal procedures.

In this sense, social accountability is about affirming and operationalizing direct accountability relationships between: (i) citizens and the state, (ii) citizens and businesses, and (iii) businesses and the state, and (iv) NGOs and relevant stakeholders (see Social Accountability International at www.sa-intl.org). The globalizing media is increasingly playing a dynamic role, not only helping to broaden the capabilities of social

⁵ See also Putnam’s analysis of trust in the US (2000: 139).

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accountability movements, but also as an actor itself in holding parties in question to account.

Social accountability both complements and enhances conventional mechanisms of accountability so that “internal” (state) and “external” (social) mechanisms of accountability could be mutually reinforcing. Similarly, while social accountability emphasizes vertical bottom-up action, it also reinforces vertical top-down (i.e. from regulatory agencies or boards) and horizontal (i.e. from peers or other similar organizations) accountability mechanisms as people demand more access to information. Another key feature of social accountability mechanisms is their use of a range of formal and informal rewards and sanctions, including public pressure.

Social accountability has become an important policy issue for three reasons (based on Malena *et al.*, 2004). The first is the crisis of democratic governance (Gaventa, 2004), and the growing disillusionment among citizens with governments’ perceived lacking in responsiveness, abusing discretion, and taken to corruption and favoritism (Narayan *et al.*, 2000; World Bank, 2001). In many developing countries, the effectiveness of conventional mechanisms of accountability such as elections has proved limited, as has the capacity of government to hold businesses accountable (World Bank, 2004). The hope is that social accountability mechanisms will allow ordinary citizens to access information, voice their needs, and demand accountability between elections, and strengthen calls for greater corporate social responsibility and business ethics. Emerging social accountability practices enhance the ability of citizens to move beyond mere protest toward engaging with bureaucrats, politicians, and business leaders in a more informed, organized, constructive, and systematic manner, thus increasing the chances of effecting positive change.

Second, social accountability is important as a tool for increased effectiveness by improving public service delivery and more informed policy design, in particular in the context of NPM. As governments fail to deliver services and adhere to terms of contracts or formulate policies in a discretionary and non-transparent manner, social accountability mechanisms enhance the availability of information, strengthen citizen voice, and promote dialogue and consultation. As NPM frequently involves privatization of public functions, social accountability mechanisms become important in monitoring nonprofit as well as for-profit service delivery.

Third, social accountability initiatives can lead to empowerment, particularly of poor people, i.e. the expansion of individual freedom of choice

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and action (World Bank, 2001). By providing critical information on rights and entitlements and soliciting systematic feedback from poor people, social accountability mechanisms provide a means to increase and aggregate the voice of disadvantaged and vulnerable groups.

II Implications

It becomes clear from the discussion above that nonprofits emerge as major players or components in each of these three perspectives: they are service providers, vehicles for civic engagement, and a mechanism to force greater social accountability. What are some of the major implications of these policy perspectives? New public management, which privileges the service provider and vanguard roles over those of value guardian and advocacy, has three major implications for nonprofits.

The first one is commercialization. Nonprofit services become more commercial in a broad number of fields such as social services, health care, education, and culture (Anheier, 2005). This is a process that began in the early 1990s and is likely to continue to quicken, as public budgets in most countries will be under significant pressure to cut spending and economize. Non-profits are likely to experience a shift in revenue structure, with greater internal emphasis on financial and revenue management, and marketing and branding. The commercialization of nonprofits will be reinforced by pressure from government and other funders to become more “professional” in service delivery and financial management. Increasingly part of contract regimes with state agencies and businesses, nonprofits will become more “corporate” and will, over time, begin to resemble more closely social enterprises than voluntary organizations (see Hasenfeld and Gidron, 2005).

This leads to the second implication: the issue of organizational form. Sooner or later, nonprofit managers will ask whether current tax and corporate laws for nonprofits are still adequate, and they will explore how far can they can “push the limits” of the nonprofit form and associated aspects around related and unrelated income, equity capital, return on investment, etc. Conversions into for-profit status and greater use of income generating subsidiaries will become more frequent in the future, as currently experienced in the health care field. Many countries are considering legal changes that would make it easier for nonprofits to function as economic actors. Examples include the recent review of the voluntary sector by the current Labour government in Britain (Strategy Unit, 2002), in particular the discussion of a future “public benefit corporation” to replace charity