

# 'Supply' of non-profit organisations: overview of economic approaches

Marc Jegers  
marc.jegers@vub.ac.be



Vrije Universiteit Brussel

# Content

Definition

Demand

Supply: simple organisations

Supply: complex organisations

# Definition

Organisation whose owners, directors, and/or staff are not entitled to (a part of) the organisation's profits

*Non-distribution constraint*  
(Hansmann, 1987)

# Definition

$npo \neq SE$

SE:

- focus on social objectives and market mechanisms (Young, 2009)
- focus on community participation, economic risk taking (Defourny, Nyssens, 2012)

$npo \not\subset SE, SE \not\subset npo$

# Demand (concise overview)

## Transaction cost based:

Market failure

Contract failure

Client control

## Public goods

## Advocacy

## Stochastic demand (Holtmann, 1983)

## Employee motives (Francois, 2001)

# Supply: simple organisations

status of theory on npo supply:

'even more embryonic than the demand side theory'

# Supply: simple organisations

Simple organisation:

founder = entrepreneur  
= manager

# Supply: simple organisations

$$\text{utility}_{\text{entr}} (\text{founding}) > \text{utility}_{\text{entr}} (\text{not founding})$$

Assumption:

there are potential entrepreneurs whose utility is affected by organisational output



# Supply: simple organisations

## **Other effects (Ben-Ner, Van Hoomissen, 1991):**

### Market and product characteristics:

supply of public good or service (-)

'trust' characteristics of good or service (+)

expected utility (+)

### Personal and social characteristics:

income (+)

education (+)

specificity of individual demand (+)

social cohesion (+) (but: endogeneity (Badelt, 1997))

(not equally important)

# Supply: simple organisations

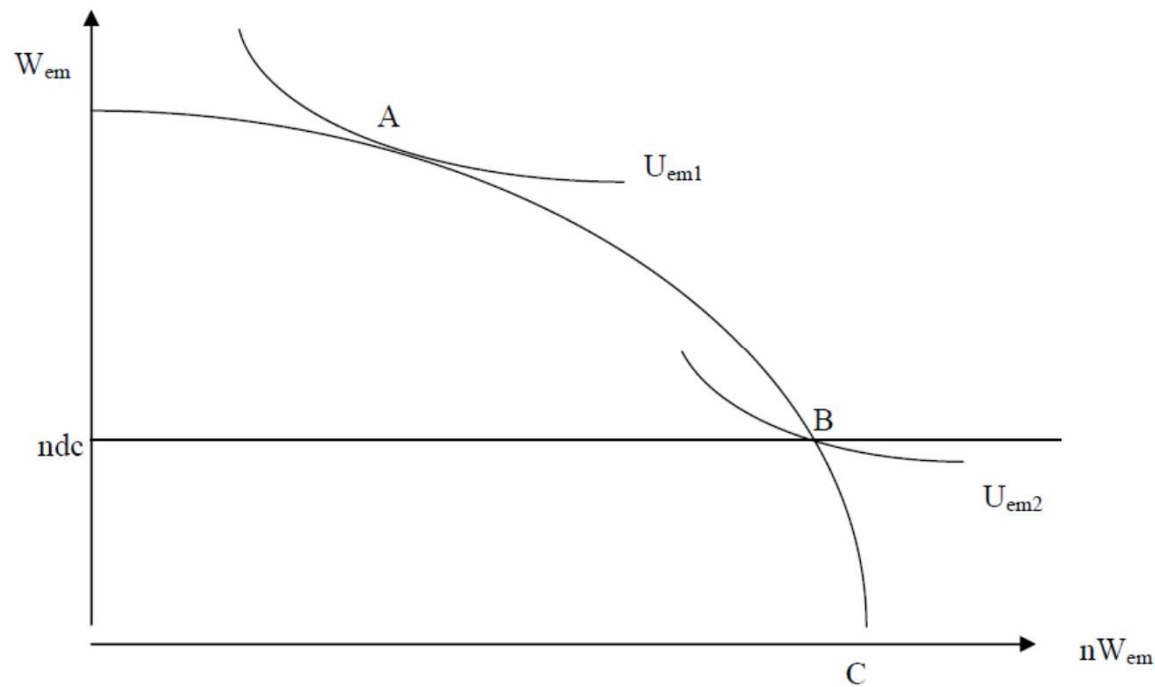
Very few economic models:

without altruism: Borjas et al. (1983)

with altruism: Bilodeau, Slivinski (1996)

# Supply: simple organisations

Figure 4.1 Institutional choice by an entrepreneur-manager



Source: based on Borjas *et al.* (1983)

# Supply: simple organisations

other model without altruism:  
Glaeser, Shleifer (2001)

BUT: npo is organisation in  
which the entrepreneur 'is  
forced to spend [profits] on  
perquisites'

# Supply: simple organisations

Bilodeau, Slivinski (1996): on public goods. If

$$U_{i,f} < U_{i,n} < U_{i,m} < U_{i,a}$$

and two non-identical potential entrepreneurs: at least one of them will found a npo

# Supply: simple organisations

Founding is one thing, survive another.  
Minimal conditions for survival  
(Anheier, Ben-Ner, 1997):

- healthy financial basis

- social legitimacy (credible to stakeholders)

- sufficiently efficient compared to other institutional forms

# Supply: complex organisations

Complexity leads to chain:

(original) founders/stakeholders -

board (including volunteers)-

management-employees-

operational volunteers

without founders: no 'supply'

# Supply: complex organisations

**Economic approach:** principal-agent theory (including stakeholder theory):

'a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties are utility maximisers there is good reason to believe that the agent will not always act in the best interests of the principal' (Jensen, Meckling, 1976)



# Supply: complex organisations

- Each intermediate link is both principal and agent.
- Founder(s) can also consider other stakeholders (e.g. beneficiaries) as principals

# Supply: complex organisations

Founder should know 'first best' organisational outcome might be impossible. If 'second best' is still acceptable, organisation will be founded.

# Supply: complex organisations

Main principal studied in the literature: board

Other principals casually studied in the literature: donors, beneficiaries

# Supply: complex organisations

Power balance between board  
(b) and management (m)  
(review by Ostrower, Stone  
(2006))

# Supply: complex organisations

## Individual variables:

gender (more female board members, less board influence)

prestige/wealth board members (b)

managerial tenure (m)

managerial credentials (m)

# Supply: complex organisations

## Organisational variables:

age (m)

size (m)

complexity and

bureaucratisation (m)

# Supply: complex organisations

## Environmental variables

more complex organisational ties,  
more fragmented power  
financial dependence on board  
members (b)  
stability (m)  
governmental funding (m)

# Supply: complex organisations

Note: fair performance based remuneration schemes difficult to design: output definition, output measurement.



# Source

Managerial economics of non-profit organisations

VUBPRESS, Brussels, 2011

Chapters 3,4,5