Introduction: the frontiers of economics and nonprofit management research

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While closely related, the literatures on management of nonprofit organizations and the economics of nonprofits do not sufficiently intersect and cross-fertilize. The former is an interdisciplinary collection that draws heavily on business management and public administration research, practitioner experience, sociology of organizations and other social science fields, and diverse methodologies including case studies, surveys, grounded theory and statistical testing based on a variety of behavioral theories, hypotheses and models. The latter, in contrast, is more homogeneous and specialized, based largely on a common theoretical framework, postulates of rational decision making and focused on issues that can be understood as manifestations of a desire to make the most efficient use of scarce resources. To a substantial degree, the economics literature is also less generally accessible, requiring understanding of basic concepts such as marginal analysis and opportunity cost, the mathematics of constrained optimization and the subtleties of econometric modeling. Despite the fact that many economists interested in nonprofit organizations have made extra efforts to write for general audiences and to participate in interdisciplinary forums devoted to nonprofit issues, the full benefits of their thinking have not yet been felt in the general nonprofit management research arena. Nor have economists fully benefited from fresh perspectives on nonprofit decision-making issues that emanate from other disciplines as well as experience in practice.

The foregoing is evident with respect to many of the topics addressed in this book. Issues such as the pricing of services, competition, labor compensation, outsourcing, product diversification, asset diversification, franchising, internal organizational architecture, risk management and performance assessment are natural areas of intersection between economics and management research. In each of these areas, our authors demonstrate that general understanding from the nonprofit management research literature has not fully benefited from the thinking that economists can bring to the table. Yet they also find in every case that economic analysis as applied to traditional areas of market activity is not sufficient to encompass the nuances arising in the nonprofit arena. For example, as Seaman points out in Chapter 10, pricing in the business sector rarely embraces strategies intended to advance a social mission at the sacrifice of additional profits, and as Oster explains in Chapter 13, it is the portfolio of loss-making and profitable initiatives intended to advance a social mission in a nonprofit organization that should underlie its product diversification strategy, not simply the seeking of additional profitable opportunities or the enhancing of market power through monopolistic competition. Similarly, Preston and Sacks demonstrate in Chapter 8 that more than marginal labor productivity is involved in determining nonprofit wages, while Cordes and Coventry, in Chapter 17, introduce the notion of 'mission-related benefits and costs' to adapt traditional cost–benefit analysis to the particular venues of nonprofits focused on social missions less comprehensive than society as a whole.

Alaimo in Chapter 12 notes that outsourcing by nonprofits is not a simple (make-or-buy) decision focused on comparing salient transaction, production and purchasing costs of in-house versus external provision, but rather must account for the more nuanced concerns of trust and identity associated with losing control over, and identifying with, the core mission. Young and Faulk in Chapter 15 demonstrate that franchising in the nonprofit sector is not a straightforward matter of implementing a structure that optimizes the control of the central organization as principal over the branches or franchisees as agents, but rather one of determining who are the principals and who are the agents in the first place, and how the intended direction or directions of unilateral or mutual accountability are best imbedded into a federated structure. Finally, both Brown in Chapter 7 and Irvin in Chapter 6 challenge the traditional notions of competition and monopoly in the economics literature by demonstrating how these issues are qualitatively different in the nonprofit arena, in the first instance by having to understand mixed industries and the circumstances under which nonprofits compete with government and for-profit organizations, and in the second instance by understanding where it makes sense for nonprofits to collaborate rather than to compete with one another.

In all of these instances, our authors bring new perspectives to the decision-making arena of nonprofit management by applying economic concepts, tools and ideas, and by summarizing and extending what is known from research to date. At the same time, they are stretching the domain of the economics discipline itself by applying these principles and tools to territory that is less natural to it, though demonstrably quite fertile.

This book also encompasses a set of chapters that address topics peculiarly nonprofit in character, thus not encountered in traditional economics or business research, yet also highly amenable to economic analysis. In some of these areas the authors build on already substantial literatures, while others are more pristine, hence requiring pioneering effort to map the territory and suggest productive avenues of inquiry. The former category includes Tinkelman's review in Chapter 2 of the phenomenon of 'crowding out' (or potentially 'crowding in') between one source of nonprofit revenue and another – e.g. between government funding and charitable donations. While much work has been done on this subject, it is also true that results to date are neither definitive nor comprehensive. In particular, this research has focused on just a few of the possible combinations of income types and has hardly scratched the interactions of earned and charitable income, or other combinations of investment income, in-kind and volunteer contributions, and government funding.

Similarly, substantial work has been done on the vexing issue of assessing the economic value of volunteer labor, but a full consensus on how this should be done continues to be elusive. Leete reviews this issue in Chapter 16, noting that despite the importance of such labor for the nonprofit sector, only a small share of such organizations place a value on that labor. Her insights on how this might be rectified should prove valuable to nonprofit managers, and enlightening to economists who have not been following this debate. Perhaps the most extensive literature applies to the modeling of the economic behavior of nonprofit organizations – or, in economists' terms, identifying the 'objective function' that substitutes for profit maximization in the nonprofit setting. Hughes and Luksetich comprehensively review these issues in Chapter 9, contributing significantly to our understanding of this complex and often contradictory literature where deriving useful guides to nonprofit management in setting strategy and efficiently deploying unpriced resources is especially challenging. Another challenge for management is addressed by Valentinov in Chapter 14, where he probes the increasingly mature but inconsistently helpful transactions cost literature. The organizational economics tradition of comparing the governance mechanisms of market, hybrids and hierarchy has not yet been adequately incorporated into the economic theory of nonprofit organizations. Valentinov advances this long-overdue integration and assesses how nonprofits can best decide to integrate or separate their internal divisions devoted to mission-impacting versus mission-supporting work. This is a critical area for nonprofit management decision making in any substantial (multi-product) nonprofit operation.

Somewhat less guidance is available from previous research on other nonprofit-specific economic issues. These include the issue of income diversification, as discussed by Chang and Tuckman in Chapter 1, i.e. what can be said to guide management on the best balance of funding from charitable, market, government, investment and in-kind sources? Similar questions apply to the behavior of charitable foundations, as considered by Sansing in Chapter 3 and how these institutions should deploy their assets and spend from their corpuses of endowed funds. He also focuses on the particular regulatory requirements applying to private foundations and how these influence the grant-making behavior of these institutions. How indeed nonprofits should account for their unique capital structures and income and expense flows, taking into consideration the social as well as the market value of their assets and programs, is described by Mook and Handy in Chapter 18.

The market value of assets is much on the mind of Bowman in Chapter 5, who addresses the subject of nonprofit asset diversification. Asset diversification is a subject of intense scrutiny in the economics literature applying to for-profits, featuring some common concerns across the sectors such as risk management and productive efficiency. But the issue takes a different twist in the nonprofit arena, where certain assets such as reputation capital and financial endowments are of more prominent concern, and where other assets such as physical plant can have intrinsic social value (such as cultural and historical significance) superseding the marginal contributions they may make to organizational income or profits. In these various areas, economic thinking and analysis contribute much to conceptual understanding, both building on and stretching the for-profit and generic literatures, and pointing the way to productive avenues of future, management-relevant research. A related area where the academic literature has not kept pace in the nonprofit sector with developments in the for-profit sector is capital structure – the critically important mix of debt, capital gains and internally accumulated funds available to an organization to fund capital investment projects, be they tangible buildings or the accumulation of intangible assets linked to philanthropic ventures. Yetman addresses these issues in Chapter 4, including a discussion of how we might overcome the knowledge gap on this issue as applied to the nonprofit sector. And speaking of knowledge gaps, Grace was given the unenviable task in Chapter 11 of suggesting how the well-developed principles of risk management can be applied to nonprofit organizations, where quantifying the tolerance for risk seems especially difficult. He stresses that risk management is a set of proactive approaches that can strengthen and maintain an organization's reputation and opportunities, even in adverse states of the world, and that it is important to think of risk as a matter of overlapping but distinct categories.

Similar observations apply to another cluster of topics that relate more closely to public policy affecting nonprofits than to daily management decision making. The last section of the book is devoted to such topics, where, again, the richness of previous literature varies considerably. Chapter 21 by Sjoquist and Stoycheva addresses the almost untouched landscape of the economic analysis of the impact of property taxes on nonprofit behavior, setting forth a fresh and important new agenda for research. Similarly, Ortmann and Myslivecek in Chapter 19 creatively address certification and self-regulation as two distinct processes of quality assessment, exploring their differences and similarities and the consequences of such differences for the establishment and enforcement of quality standards in the nonprofit sector, and fundamentally, the very trustworthiness of the entire sector.

The economic research literature is somewhat richer in the area of government funding and tax policy towards nonprofits, especially at the federal level. Rushton in Chapter 20 focuses on the tax side, including important analyses of the unrelated business income tax and tax incentives for charitable giving, while Toepler in Chapter 22 concentrates on governmental expenditures, both delineating what we have learned about the impacts of these policies and how they affect the management and behavior of the nonprofit organizations affected by them.

Not all areas of fertile overlap between economics and management could be incorporated into this volume, including the increasingly vibrant research using experimental design methods and behavioral economics challenges to rational choice modeling orthodoxy, a challenge that generally finds great sympathy among the less rigidly defined scholars in the broader management tradition. But if there is a ‘bottom line’ to all of this, it is that economics, as the science of understanding how resources are deployed and utilized to produce social value, and which has sharp and probing analytical tools at its disposal, has been only modestly applied to date to the critical management and policy questions affecting nonprofit organizations, and in turn the contributions this sector makes to the overall welfare of our society. More than anything else, our authors have described a rich agenda of questions and topics that, if addressed by economists at both the applied and theoretical levels, can further enhance the impact and value of the economists’ way of thinking, expand the domain of contributions of the economics profession, and add new sophistication and depth to the tools that nonprofit managers and leaders have at their disposal to effectively guide their organizations in an environment of perennially limited resources.