Assessing the Effects of Management Practices of Not-for-Profit Corporations in Southeast Wisconsin and Their Influences on Organizational Performance

Dr. Gary F. Keller

Abstract-The not-for-profit sector’s role in the American economy is substantial. In 2009 there were more than 1,569,572 tax-exempt organizations accounting for 8.11% of all wages and salaries paid in the United States. Public charities reported nearly $2.6 trillion in total assets in 2007 and individuals gave $229.28 billion in 2008 to not-for-profits (National Center for Charitable Statistics, 2010). Considering the magnitude and financial impact that not-for-profit organizations (NPO) have on local communities and the national economy, it is vital to assess how these organizations are managed and what if any effect management practices have an on their performance. However, a central problem that economists have faced when endeavoring to account for the effect of management is calculating how management practices affect an entity’s performance. The purpose of this quantitative research investigation was to study the impact of 18 management practices defined as “operations (three practices), monitoring (five practices), targets (five practices), and incentives (five practices)” (Bloom & Van Reenen, 2007, 1393 - 1397) on the performance of NPOs in the metropolitan area of southeast Wisconsin. The basis of this research project was derived from a study (Keller, 2009) conducted of for-profit firms located in the same geographical area in late 2008. An examination of the survey data of NPOs demonstrated that management practices had a strongly significant effect on the organizational performance of not-for-profit organizations at the 2.85E-07 level of significance.

Keywords-Management Practices, Economic Performance, Economic Measurement of Management, Not-For-Profit Performance Measurements, Management Theory

I. INTRODUCTION

The need to demonstrate the effectiveness of any business or organization worthy of attracting resources and transforming them into valued products/services is that entity’s primary mission. A variety of methods have evolved over time to measure a for-profit enterprise’s performance. Economists have typically studied how well a firm manages the factors of production under its control while accountants and financial analysts scrutinize a variety of analytical tests to determine current and future performance. Many NPOs have adopted many of the commercial sector’s economic and accounting/financial techniques to gauge their performance. However, an issue that plagues the analysis of for-profit and cannot calculate the effect of management on agency performance. Similarly, accountants and financial analysts can compute the outcome of fiscal transactions; however, not-for-profit businesses is the effect that management has on enterprise performance. While economists can account for nearly all of the factors of production, the discipline the professions cannot accurately attribute the effect that managerial decisions have on generating the financial numbers.

The type of data collected for this study was quantitative (interval and ratio scale) derived by a survey instrument that was closely patterned after one used and extensively validated by Bloom and Van Reenen (2006, 2007). The authors sought to develop an instrument that reliably calculated the connection between management practices and economic performance (Bloom & Van Reenen, 2007). They developed an 18 question survey that investigated the quality of management practices using a Likert-type 1 to 5 rating scale.

The purpose of this quantitative study was to determine whether an NPO’s management practices, defined by Bloom and Van Reenen (2007) as operations, monitoring, targets and incentives, were related to their economic performance defined as increases/decreases in the number of employees. This economic performance criteria was selected as a proxy for financial gain and a strategic success factor for the following reasons: a) an NPO’s primary goal is to financially break even, therefore year over year financial gain may not be a significant indicator of positive financial success, indeed a profit may be anathema to the organization; b) contributions toward an ongoing capital campaign or special project could distort an organization’s financial position; c) a deficit due to special circumstances could also distort an organization’s financial position; d) the gain/loss of employees provides a quantifiable insight into the entity’s relative effectiveness and if the organization’s products/services were in demand, constant or declining.

To accomplish the goal of studying the impact of management practices on the performance of NPOs in the metropolitan areas of southeast Wisconsin a critical review of the relevant peer-reviewed and scholarly literature was conducted. A survey composed of 15 general organizational identifier questions and 18 management practices was sent to the chief executive officers of 100 qualified NPOs in the metropolitan areas of southeast Wisconsin. The population

About-Cardinal Stritch University
(e-mail: gfkeller@stritch.edu)
was limited to organizations listed on the unemployment compensation data base of the State of Wisconsin and excluded governmental, religious, health care and education (school systems and colleges/universities) organizations. The survey instrument was based on Bloom and Van Reenan’s instrument which assessed the effect that management practices had on large firms’ economic performance and modified by the author in the 2009 survey.

II. LITERATURE REVIEW

The challenge to manage and measure the effectiveness of any organization is complex and frequently a highly subjective task. The for-profit sector created commonly accepted accounting and financial standards that indicate the economic performance of a firm. However, evaluating the utility of NPOs has been a historical challenge, given the sector’s purpose of producing social well-being for public stakeholders compared to the for-profit’s objective of producing wealth for private shareholders. As the number of NPOs increased to deal with a myriad of social issues, so did the competition for support and the need to demonstrate how NPOs utilized contributed resources. It was not long before the NPO sector adopted the commercial sector’s accounting and financial gold standards to gauge institutional output.

In addition to utilizing commonly accepted financial standards, NPOs also attempted to apply many for-profit managerial theorems onto their institutions. But which management practice was the equivalent of a commonly accepted accounting practice? Furnham (2005) catalogued 24 different management practices ranging from Empowerment to Theory Z that were introduced in the last half century. Additionally, during the last 40 years many of the best known management theorists translated their principles for use in the charitable sector. Examples include McConkey (1973) Management by Objectives (MBO); Deming, Out of the Crisis (1986) TQM and many of its derivatives such as ISO, Six Sigma and etc.; Drucker (1990) Managing the Non Profit Organization; Buckmaster (1999) Benchmarking; Kaplan (2001) the Balanced Scorecard; Sanger (2008) and Field (2009) Data Drive Performance Measurement and Lewis (2003) a hybrid of all of the evolving management theories.

Unfortunately many commercial management theories have not always produced the best solutions for NPOs (Rojas, 2000). Speckbacher (2003) noted that one reason commercial concepts did not always succeed in the NPO sector was because the assumptions underlying the economic and organizational models were alien to the missions of many NPOs. For example, outsourcing certain functions (ex. a call center, food preparation, and security services) may save a for-profit firm a considerable sum of money but could be an operational and public relations disaster for a community based shelter for homeless or abused persons. Herman and Renz (2004) offered that “finding the right fit among (management) practices is more important than doing things the “right way” (p. 694). Herman and Renz (2008) also conducted an extensive literature review of nonprofit organizational effectiveness and highlighted nine conclusions, including one which stated that it was unlikely there were universally applicable best practices for all NPO boards and management.

A further issue has clouded the topic of evaluating the impact that management practices have on firm or organizational performance is the lack of a precise definition of performance. Ritchie and Kolodinsky (2003) asserted that agreement about NPOs financial performance measurement and overall performance evaluation was elusive. Folan, Browne and Jagdev (2007) argued that there is no precise definition of the meaning of performance in the context of management science and as a result financial measurements continue to be the default indicators of managerial quality. Young (2007) claimed that while profitability is an unambiguous criterion for commercial ventures, no comparable standard exists for NPOs. While NPOs are required to break even, a surplus may or may not be a sign of achievement due to the nature of the organization’s mission and legal (501(c)(3)) tax exempt status.

While economists, accountants and financial analysts have been able to count the tangible factors of production, the effect of management on organizational performance remains elusive and therefore frequently discounted in both the for-profit and NPO sectors. Hubbard (2006) noted that decisions to use technology and other economic assets are management functions and therefore corporate economic performance is a directly related to the quality of its management rather than a mere outcome of the aggregate of corporate activities. Hubbard cited the work of Alfred Chandler Jr. and David Landes who argued that professional management was the key factor for the United States’ rise to economic prominence compared to its European rivals. “Through the microeconomic perspective, management is, at heart, a choice made by each firm” (p. 30).

A seminal study by Bloom and Van Reenen (2006) found that the approach taken by managers had the foremost influence on enterprise performance. Firms with superior management were associated with higher productivity, return on equity and market capitalization. Bloom and Van Reenen (2007) found that there was no single management practice that provided the key to improved firm performance. Rather, it was the average score of 18 management practices grouped into “four areas: operations (three practices), monitoring (five practices), targets (five practices), and incentives (five practices)” (p. 1361) when compared to a firm’s economic success that provided the most accurate indicator of success. Bloom and Van Reenen’s innovative survey tool and robust methodology demonstrated a statistically valid correlation between management practices and firm performance.

The outcome of the literature review revealed several important topics. The first is both the for-profit and not-for-profit sectors have endeavored over the decades to design systems that accurately depict the performance of an enterprise. The most accepted methods to achieve that goal have been accounting, financial or economic metrics. The second theme is the not-for-profit sector has borrowed many of the measurement techniques from the commercial sector that may or may not be appropriate to gauge organizational
effectiveness, given the charitable and “not-for-profit” mission of NPOs. The third matter is the dilemma that both the for-profit and not-for-profit sectors face when accounting for the effect that management practices have on agency performance. In short, the literature was replete in demarcating management theory and financial measurements. However, few if any scholars have been able to demonstrate a connection between the two elements. Of all of the classic factors of production, management was among the most difficult to quantify. Management was said to matter but evaluated similar to the way electrical engineers explain the impact of electricity on various systems, i.e., the outcome is known; however, the exact composition of electric current remains a mystery.

III. DEFINITION OF MANAGEMENT PRACTICES

An assortment of management theories developed in America during its industrial take-off period. Management practitioners and academics ranging from Frederick W. Taylor, The Principles of Scientific Management (1911) to Peter Drucker, The Effective Executive) 1967 to W. Edwards Deming, Out of the Crisis (1986) to Robert S. Kaplan and David P. Norton, The Balanced Scorecard (1996) have attempted to formulate concise methods that would insure predictable corporate success. Furnham (2005) catalogued 24 different management approaches ranging from Empowerment to Theory Z. However, while many authors continue to offer recommendations to derive success, the search for the managerial equivalent of absolute zero goes on and on. Folan, Browne and Jagdev (2007) argued that there is no precise definition of the meaning of performance in the context of management science. Consequently, financial measurements are generally regarded as the only reliable indicators of managerial quality. However, Hubbard (2006) noted that decisions to use technology and other economic assets are management functions and therefore corporate economic performance is a directly related to the quality of its management rather than a mere outcome of the aggregate of corporate activities.

The notion that a single set of management practices and performance indicators may have led theorists and practitioners to seek solutions using alchemy rather than using an integrated systematic approach. Bloom and Van Reenen (2006 and 2007) conducted several studies that sought to correlate if management practices affected corporate performance. Both studies by Bloom and Van Reenen (2007) affirmed that certain management practices have an effect on firm growth and found that “better management practices are significantly associated with higher productivity, profitability, Tobin’s Q, sales growth rates, and firm-survival rates” (p. 1352). Bloom and Van Reenen also found that there was no single management practice that provided the key to improved firm performance. Rather, it was the average score of 18 management practices grouped into “four areas: operations (three practices), monitoring (five practices), targets (five practices), and incentives (five practices)” (p. 1361) when compared to a firm’s economic success that provided the most accurate indicator of success.

IV. DEFINITION OF A NOT FOR PROFIT ORGANIZATION

The definition of a not-for-profit organization according to the Internal Revenue Service is “An organization may qualify for exemption from federal income tax if it is organized and operated exclusively for one or more of the following purposes. Religious. Charitable. Scientific. Testing for public safety. Literary. Educational. Fostering national or international amateur sports competition (but only if none of its activities involve providing athletic facilities or equipment. The prevention of cruelty to children or animals...To qualify, the organization must be a corporation, community chest, fund, or foundation. A trust is a fund or foundation and will qualify” (IRS, 2010). There are 4 other qualifying organizational types; social welfare organizations; labor unions, farm bureaus and others; business leagues; and social and recreational clubs.

To distinguish the many types of 501 (c) (3) organizations a classification system was developed, the National Taxonomy of Exempt Entities (NTEE). The system is similar to classification system (National Industrial Code, NIC) the IRS uses to differentiate the many types of businesses in the for-profit sector. The NTEE is a system used by the IRS and the National Center for Charitable Statistics to classify nonprofit organizations. The NTEE classification system divides nonprofit organizations into 26 major groups under 10 wide-ranging categories. The classification system is useful because it:

- facilitates the collection, tabulation, presentation, and analysis of data by the types of organizations and their activities
- promotes uniformity and comparability in the presentation of statistical and other data collected by various public and private agencies
- provides better quality information as the basis for public policy debate and decision-making for the nonprofit sector and for society at large (NCCS, 2010). Among the most important definitions of a NPO is its ultimate purpose for existence and exemption from paying taxes as well as providing contributors to a not-for-profit entity with a tax deduction. According to the Dictionary of Accounting Terms a not-for-profit organization is a:

Group, institution, or corporation formed for the purpose of providing goods and services under a policy where no individual (e.g., stockholder, trustee) will share in any profits or losses of the organization. Profit is not the primary goal of nonprofit entities. Profit may develop, however, under a different name (e.g., surplus, increase in fund balance). Assets are typically provided by sources that do not expect repayment or economic return. Usually, there are restrictions on resources obtained. Examples of nonprofit organizations are governments, charities, universities, religious institutions, and some hospitals. Most nonprofit organizations have been granted exemption from federal taxes by the Internal Revenue Service. Many of these
organizations refer to themselves according to the IRS Code section under which they receive exempt status (i.e., 502(c)(3) organization). This identification lets donors know that their contributions to this organization may be deductible for income tax purposes (Siegel & Shim, 2010)

V. METHODOLOGY

The purpose of this quantitative research investigation was to study the impact of 18 management practices defined as “operations (three practices), monitoring (five practices), targets (five practices), and incentives (five practices)” (Bloom & Van Reenen, 2007, 1393 - 1397) on the performance of NPOs in the metropolitan area of southeast, Wisconsin. Norse (1968) recommended the use of employment data as a proxy for firm economic performance. This economic performance criteria was selected as a proxy for financial gain and a strategic success factor in this study for the following reasons: a) an NPO’s primary goal is to financially break even, therefore year over year financial gain may not be a significant indicator of positive financial success, indeed a profit may be anathema to the organization; b) contributions toward an ongoing capital campaign or special project could distort an organization’s financial position; c) a deficit due to special circumstances could also distort an organization’s financial position; d) the gain/loss of employees provides an insight into the relative effectiveness and if the organization’s products/services were in demand, constant or decline.

In this research project, employment data was requested of respondents to the survey instrument. The type of data collected was quantitative (interval and ratio scale) derived by a survey instrument the author used in a study (Keller, 2009) conducted of the for-profit sector in the metropolitan area of southeast, Wisconsin. This survey instrument was closely patterned after one used and extensively validated by Bloom and Van Reenen (2006, 2007). The author received Bloom’s permission to utilize his methodology in a direct mail survey format. The survey was tailored to provide respondents with descriptive choices linked to an interval scale rather than simply asking the respondent to rate a given management trait on a 1-5 Likert scale. An example is provided below.

A. USE OF MODERN WORKFLOW SYSTEMS

Using a scale of 1 to 5, circle the response that best describes your organization.

1) Few modern workflow systems techniques (e.g., ISO standards, Just In Time Inventory, lean manufacturing, automation, total quality management, Six Sigma, automation, flexible manpower, support systems, attitudes and behavior) have been introduced or have been introduced in an as needed manner.

2) The organization infrequently tries some modern production or workflow systems techniques.

3) Some aspects of modern workflow systems techniques have been introduced, through informal/isolated change programs.

4) The organization uses many modern workflow systems.

5) All major aspects of modern workflow systems have been introduced in a formal way.

Below are the null and alternative hypotheses that directed this analysis.

H1o. There is no difference in the organizational performance based on management practices of NPOs located in the metropolitan area of southeast Wisconsin.

H1a. There is a difference in organizational performance based on management practices of NPOs located in the metropolitan area of southeast Wisconsin.

On February 9, 2010 a survey instrument was sent to the Executive Directors of 100 qualified NPOs in the metropolitan area of southeast Wisconsin. The qualified NPOs (100) included those derived from the Unemployment Compensation data bases for Racine and Kenosha counties. The survey instrument was used to sample 100% of the eligible population of 100 organizations excluding governmental units, schools, health care agencies and colleges/universities. The data was analyzed using a Student T-Test to determine whether to accept or reject the null hypothesis. A Student T-Test was selected to analyze the data due to the small sample size (Zikmund, 2003). A .05 level of significance was used to determine significance.

VI. FINDINGS/DISCUSSION

A survey composed of 15 general organizational identifier questions and 18 management practices was sent to the chief executive officers of 100 qualified NPOs in the metropolitan areas of southeast Wisconsin. The population was limited to organizations listed on the unemployment compensation data base of the State of Wisconsin and excluded governmental, religious, health care and education (school systems and colleges/universities) organizations. The response rate to the mailing of the survey was 20 surveys or a response rate of 20%. In aggregate, 70% of the organizations who responded to the survey reported no change (35%) or increases of between 1% to 10% or greater (35%) in the number of employees. The data indicated that the survey was completed by a high number of senior level organizational leaders. Of those responding to the survey, 59% identified themselves as the Executive Director, President or Treasurer of the organization. The data also indicated that 7 (35%) of respondents to the survey were social/human services agencies, 3 (15%) were economic development organizations and 3 (15%) were educational organizations.

The researcher used a Student T-Test to determine whether to accept or reject the null hypothesis in this study.

H1o. There is no difference in the organizational performance based on management practices of NPOs located in the metropolitan area of southeast Wisconsin.

H1a. There is a difference in organizational performance based on management practices of NPOs located in the metropolitan area of southeast Wisconsin.
The Student T-Test was used to assess whether employment growth is an indicator for organizational performance. The Student T-Test results for the Null Hypothesis was significant beyond the .001 level (.000000285). This extremely small P value was strongly sufficient to reject the Null Hypothesis and accept the Alternative Hypothesis.

As described in the Methodology section, Norse (1968) recommended the use of employment data as a proxy for economic performance. Growth in the number of employees was used as a proxy for organizational performance because many NPO organizations have a variety of revenue (earned and contributed) streams that could distort the fiscal status of the organization. For example a social service agency could receive a large contribution for a restricted endowment. While the gift would enhance the fiscal status of the entity, it may not have an immediate or persistent impact on the organization’s day to day operational performance.

The results from the survey provided important insights into the operational realities of NPOs. During the period 2005 – 2008:

Most NPOs are small businesses; 68%, employed between 1-50 employees; 21% employed between 51-200.

82% of respondents claimed that earned revenue decreased between 1% -10% and 11% reported no change in earned revenue. However, during the same time period, 42% reported no change in contributed revenue and 32% reported increases between 1-10% and 10% reported increases greater than 10%.

Question 15 of the survey asked respondents to rank from 1 (lowest) to a 5 (highest) the factors that are vital to their organization’s success (financial resources, employees, management practices, materials, technology). When the results were averaged, respondents ordered the following factors as vital to their firms’ success. Note: Low 1 to 5 high.

1. Capital
2. Technology
3. Management Practices
4. Employees
5. Materials

At first glance, the respondents’ ranking of the success factors was somewhat surprising considering the missions of NPOs. One explanation for the curious ordering of materials being the most important success factor may reflect the diversity of organizations in the survey sample (from an adult literacy group to a municipal zoo) and a growing trend in NPO agencies, social entrepreneurship. Many NPOs are attempting to generate earned revenue via creation of products/services that provide a new revenue stream to diversity away from dependence on contributions, funding from United Way type funding agencies, and fees for services which oftentimes do not fully recover the service provider’s costs.

The ranking of management practices by respondents as the third most vital success factor is curious given the strongly significant correlation of management practices and organizational performance. One explanation for this ranking may be an increasing managerial skill level and sophistication in NPO corporate leadership. This phenomenon may be a result of the inclusion of talented for-profit leaders serving on the boards of directors of NPOs and the growing trend of NPO executives securing management degrees and ongoing training.

VII. IMPLICATIONS OF FINDINGS

A review of the data showed that management practices were correlated to organizational performance of NPO organizations located in southeastern, Wisconsin. Despite the strongly significant statistical correlation between management practices and organizational performance, NPO respondents did not rank management practices as the number one success factor for their agency. As mentioned previously, this disparity may represent a growing trend in the evolution of the management ability of NPOs. This study was conducted while the American economy entered the recession of 2008-2010. A bifurcated assessment of the revenue condition of NPOs was revealed. On the one hand, earned revenue (revenue derived from operations) decreased in 82% of the organizations and 11% reported no change. Only one organization reported an increase in earned revenue. The experience of NPOs during the economic recession mirrors that of their for-profit counterparts who also experienced significant earnings from ongoing operations. On the other hand, contributed revenue (donations) increased in 42% of the organizations and 42% reported no change in contributed income. It is reasonable to conclude that donors continued to support the missions of charitable organizations even during difficult economic times and therefore contributed income served to sustain these agencies throughout hard economic times.

VIII. IMPLICATIONS FOR NPOs

It was the author’s goal to ascertain if the management practices of NPOs located in southeast Wisconsin had an affect on their performance. The data strongly supported the conclusion in the affirmative. Over the past several decades academic and professional institutions, the donor community, individual and corporate contributors, foundations, NPO boards of directors, practitioners and community stakeholders have advocated for improved management of NPO agencies. The results of this study clearly indicate that agencies whose leadership have learned and utilize contemporary management practices produces positive results. The seeming linear relationship between management practices and organizational performance should not be taken for granted. Frequently the lure of the deployment of technology, secure sources of funding or a mentality of “too well known and revered in the community to fail” lulls boards of directors and senior management into a dangerous, phlegmatic mindset. As competition for donor support becomes increasingly strong (now driven by social media networks, rivalry from legitimate and illegal Internet sources and well published natural disasters such as the Haiti earthquake) even better management practices and performance must be pursued by NPOs to survive and flourish.
IX. IMPLICATIONS FOR ACADEMIC INSTITUTIONS

Academic institutions need to continuously adjust their curricula to consider the evolving needs of NPOs. Many academic and professional organizations view teaching management solely for those who work in the for-profit sector. There may be opportunities to develop state of the art majors/minors for prospective and practicing NPO managers. Continuous improvement of ongoing management offerings (in-person and on-line) for NPO employees is also vital. What may be an appropriate practice in the for-profit sector may simply not be applicable or desirable in the NPO sector. Frequently the jargon and superficial understanding of for-profit practices (ex. enterprise performance evaluated strictly by analytical means) is applied onto an NPO and either distorts or becomes toxic to the agency’s mission.

X. IMPLICATIONS FOR MANAGERS

NPO managers must continue the progress that contemporary management practices have made to the success of many organizations. However, as noted above, the application of management practices germane to NPOs is an evolutionary process. As NPOs work in more complex situations and in partnership with many types of entities, funding sources and stakeholders, new managerial techniques and theories need to be developed, documented, tested and taught. For example, the Haiti earthquake quickly stimulated record amounts of contributions from sources around the world driven in large part due to communications and the ability of millions of cell phone users to become donors in nanoseconds. How the Red Cross, international financial institutions and suppliers of relief goods and services were connected to deliver results should be an excellent case study in contributor-logistics-communication-management of a crisis. What lessons can be learned by all NPOs from the Haiti disaster?

XI. IMPLICATIONS FOR BOARDS OF DIRECTORS

As the management competence of NPO managers continues to improve, it is vital for their Boards of Directors to upgrade their management skills as well. Frequently a struggle for the direction develops at an NPO. Sometimes, well intentioned individuals serve on Boards to actualize their zeal for a particular cause; however, ardor may conflict with the business of conducting the NPO thus leading to conflict with its professionally educated managers. In other cases, the business professional joins a board to provide service to a community based agency and may solely focus on analytical results thus leading the organization away from its institutional soul and those who it was established to serve. All too frequently the composition of contemporary NPO boards is reflective of who can secure financial support and regrettably board meetings are focused not on how the entity is performing its stated mission but rather if the annual financial goal is being achieved. Simply hiring a professional management team and relying on them for direction and guidance is not enough. Boards need to have a balanced composition reflecting the agency’s stakeholders, friend and fund raisers and knowledge subject matter experts. Ultimately, the Board of Directors must realize it has fiduciary responsibility of the agency and in conjunction and cooperation with the entity’s professional management forge the way forward.

XII. REFERENCES


