2005

TROPMAN REPORTS

Applied Research about the Pittsburgh Region's Nonprofit Sector

THE **FORBES** FUNDS

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THE FORBES FUNDS *has commissioned, published, and distributed widely more than 30 applied research studies during the past five years alone. We invest in research, just as we invest in people and organizations, precisely because the findings allow all of us who are concerned not only about "doing good" but also about "doing well" to act upon data and knowledge rather than anecdote and occurrence.*

Around here, we emphasize the word "applied," for we have sought to implement programs and have even adjusted our grantmaking practices based upon what our researchers have uncovered. That said, what's more critical is that you also take action. Whether you're an executive, trustee, grantmaker, or consultant, you can find some information among the 22 TROPMAN REPORTS *issued since 2002 that will advance your own practices.*

Add to those past TROPMAN REPORTS *the four printed herein. The various researchers' findings offer novel analysis about compliance costs; elucidate why organizations undertake capacity-building efforts (and why only some really succeed); and push forward sector-wide opportunities whereby we might improve the delivery of services to our community.*

In service,
The Forbes Funds

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AMY THOMAS

LESLEY WILLIAMS

THE FORBES FUNDS HELPS YOU SERVE THE COMMUNITY
BY ENCOURAGING NONPROFITS TO WORK EFFECTIVELY, SMARTLY, AND COLLECTIVELY
— IN A WORD, **BETTER**.

A BRIEF HISTORY

Founding Director, Elmer J. Tropman

The Forbes Funds was established in 1982 to provide emergency financial assistance to nonprofit organizations that were experiencing funding interruptions or short-term cash flow problems. Under the leadership of our founding director, Elmer J. Tropman, The Forbes Funds also provided management consultation to small nonprofit organizations and conducted regional research to identify unmet needs in the human service sector. The Forbes Funds provided an important service during a particularly turbulent time when many nonprofit organizations were struggling to adjust to a new domestic policy agenda as well as to significant changes in federal and state funding priorities and procedures.

By the late 1980s, while continuing to provide loan guarantees, we shifted our emphasis to long-term capacity-building in the nonprofit sector. During this time, The Forbes Funds focused on helping nonprofits improve administrative skills and infrastructure, with special emphasis on long-range planning and strategic management. Through our grantmaking, we helped nonprofit organizations secure technical assistance to address such matters as strategic planning, financial management, and board governance.

Beginning in 1996, The Forbes Funds advanced efforts to support management capacity-building and strategic planning, while also addressing such sector-wide issues as inter-agency partnerships and mergers. Additionally, we provided support for local universities and colleges to train nonprofit staff and boards.

Beginning in 2001, The Forbes Funds embarked on an ambitious strategy to enhance the management capacity of the nonprofit sector, especially human service and community development organizations, through three complementary activities: grantmaking; applied research; and sector leadership activities.

Today, we support capacity-building initiatives for human service and community development agencies; fund research critical to responsive, innovative, and sound nonprofit management; and encourage and celebrate exemplary practices in the nonprofit sector.

2005 TROPMAN REPORTS
Applied Research about the Pittsburgh Region's Nonprofit Sector

The Cost of Meeting Compliance:
A Case Study of Challenges, Time Investments, and Dollars Spent

Envisioning Pittsburgh's nonprofit sector as innovative, informed, and engaged, The Forbes Funds advances capacity-building within and among the region's nonprofit organizations.

The Copeland Fund for Nonprofit Management
The mission of The Copeland Fund for Nonprofit Management is to strengthen the management and policymaking capacity of nonprofit human service organizations to serve better the needs of their communities.
- Management Enhancement Grants
- Emergency Grants
- Cohort (Professional Development) Grants

The Tropman Fund for Nonprofit Research
The mission of The Tropman Fund for Nonprofit Research is to support applied research on strategic issues that are likely to have profound effects on nonprofit management and governance, especially among human service and community development organizations.
- Applied Research Projects
- Annual Research Conference

The Wishart Fund for Nonprofit Leadership
The mission of The Wishart Fund for Nonprofit Leadership is to encourage pioneering nonprofit leadership by promoting public learning and discussion about issues critical to ethical and effective management, as well as by celebrating exemplary practices.
- Leadership Roundtables
- The Frieda Shapira Medal
- Alfred W. Wishart, Jr., Award for Excellence in Nonprofit Management

Management, especially how it relates to staff time investments tracking outcomes and reporting results, is not clearly understood across the nonprofit sector (Gawande & Wheeler, 1999). To date, there is no systematic study that examines investments made by nonprofit staff to meet funder compliance. Recently, the Stanford Project on the Evolution of Nonprofits (SPEN) at Stanford University completed a two-year investigation of nonprofits in the Bay Area and found that many funders differ in their demands for meeting compliance, which created conflicting demands (Gammal, Simard, Hwang, & Powell, 2005). However, the study did not examine the amount of time nonprofit leaders spend on such activities or how much of the funding resources are used toward such activities. Thus, both nonprofits and funders alike have not been able to quantify, in dollars, how much is invested in meeting compliance. To address this gap, The Forbes Funds commissioned Sandraluz Lara-Cinisomo to conduct a research case study of one Pittsburgh-area nonprofit to determine how the organization makes staffing decisions and carries out compliance-related activities; how much time is invested in these tasks; and how this time translates into dollars spent.

This study is guided by five research questions:

1. How are staffing decisions, as they relate to compliance tasks, made?
2. What are the staffing challenges in meeting funder compliance?
3. What are the data challenges in meeting funder compliance?
4. What is the subjective experience of staff who are meeting compliance?
5. What are the overall costs, in time and dollars, of meeting compliance?

Research Design
Qualitative and quantitative data was collected to answer the five study questions.

Site
Providing for Families[1] (PFF) serves communities in Western Pennsylvania. Like many nonprofits in the Pittsburgh area, PFF receives funding from a variety of agencies, including the county, state, private foundations, and the United Way. Each of these funding sources provides for a range of services. In some instances, one funding source may provide for numerous programs, while other funders may limit the activities. Staff interviewed in this study, all of whom engage in compliance, may be paid by numerous funding sources. Therefore, results of this study are for combined funding for fiscal year 2004–2005, rather than by funder type or source.

[1] Pseudonym

Sample

For this study, three types of employees were interviewed: Directors, Supervisors, and Field Staff. These individuals were selected because they are directly involved in funder compliance activities.[2] Individual interviews were conducted with Directors and Supervisors. Focus group interviews were conducted with Field Staff. A total of 41 staff members were interviewed: seven Directors, seven Supervisors, and 27 Field Staff.

Procedures

A structured interview consisting of open- and closed-ended questions was administered to Directors and Supervisors. Field Staff were interviewed in focus groups because these types of discussions allow researchers to get at participants' insights regarding complex issues (Keim, Swanson, Cann, & Salinas, 1999), such as challenges in meeting funder compliance. Focus groups also included open- and closed-ended questions and included a demographic survey.

Data Analysis

Qualitative Analysis: The qualitative data was aggregated and summarized to provide an overall perspective for all staff.

The purpose of the qualitative interview was to provide funders with real life experiences. For each open-ended question, responses were grouped into meaningful categories. Those derived categories were used to summarize the qualitative data.

Quantitative Analysis: Evaluations of nonprofits have not considered the costs of meeting compliance. Yet, cost information is essential for understanding the resources required to meet compliance and for analyzing the cost-effectiveness of a nonprofit. Cost was calculated for hours spent carrying out compliance tasks for fiscal year 2004–2005. The amount of time management and field staff spent on compliance tasks was calculated, including wages invested on these activities and as a total.

Findings

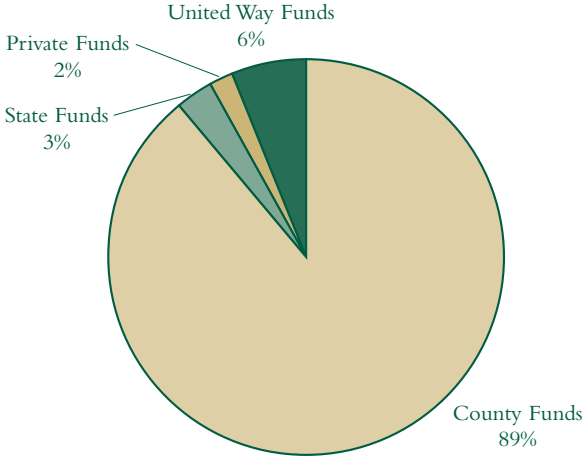
Descriptive Statistics

An equal proportion of Directors and Supervisors were interviewed (17%), with 66 percent of the participants belonging to the third type of employee, Field Staff. The majority (63%) of the participants were white, non-Hispanic, followed by black, non-Hispanic (32%). A very small sample of Hispanics and "other" were also interviewed. The vast majority of the participants had a college degree or higher. More than half of the sample was female (78%). Participants' ages ranged from 24 to 57 years of age with a mean of 37.61. Personnel salaries show that the mean annual income for Directors was $69,000. On average, Supervisors earn $43,475 per year. The mean annual income for Field Staff is $29,821. On average, staff at all levels reported 46.26 hours per week.

Agency Revenue

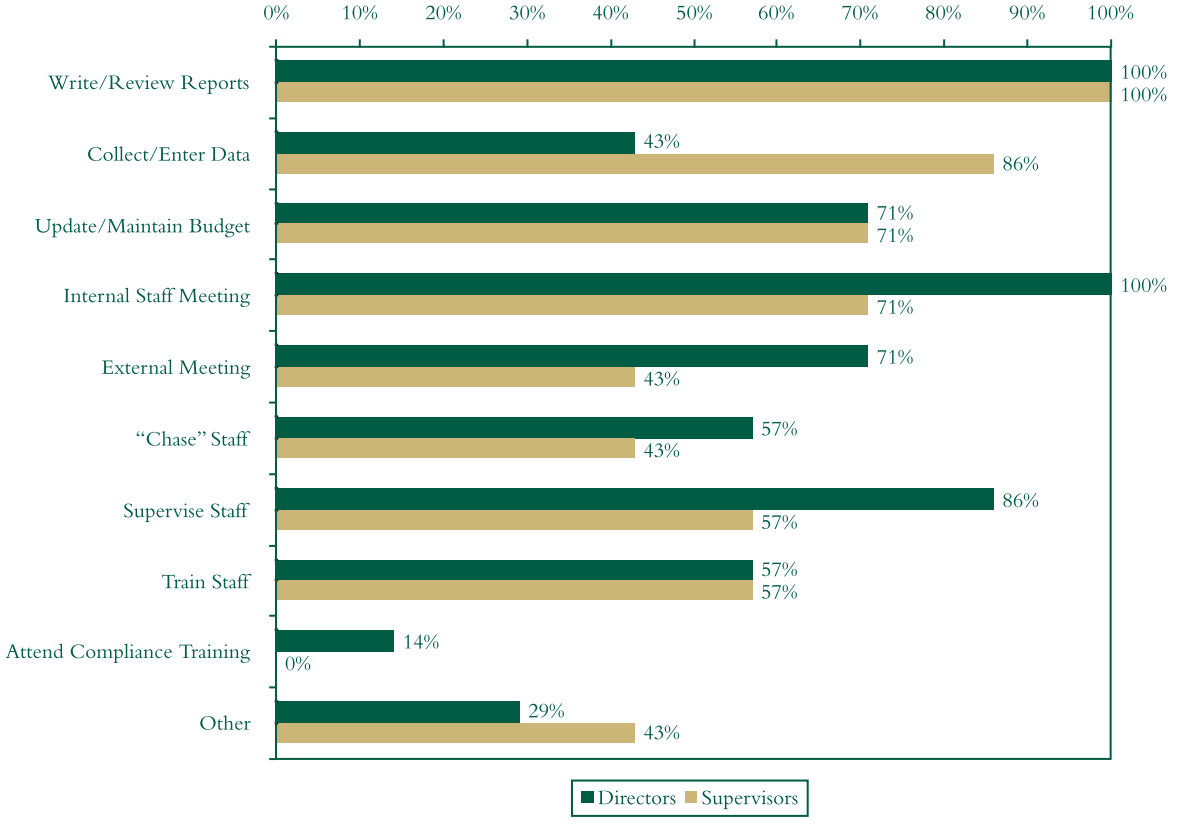
Providing for Families is a nonprofit organization that has several sources of revenue. Figure 1 shows the distribution of the four major revenue sources: county, state, private- and United Way funds. Revenue from the county includes funds that are provided through government and the Office of Children, Youth, and Families. State funds are comprised only of VOCA (Victims of Crime Acts). Private funds include foundation dollars and restricted grants. United Way dollars are comprised of donations and allocations by and through the United Way. The total revenue from these funding sources is $6,554,518. The vast majority (89%) of the agency's revenue is comprised of county funds, which pays for the majority of the programs offered by the organization. The smallest proportion of revenue comes from private funds, totaling $418,636. Clearly, all funds also go toward paying for non-wage benefits, facilities expenses, and other operating costs. However, for the purposes of this report, revenue from these sources was used only to determine the percent of revenue used to pay for time invested in compliance activities.

Figure 1. Distribution of Agency Revenue Sources Included in Study



[2] Administrative Assistants often provide support for such activities. However, for the purpose of this study, Administrative Assistants were not interviewed.

FIGURE 2. DISTRIBUTION OF MANAGEMENT ENGAGEMENT IN COMPLIANCE ACTIVITIES



Compliance Tasks

Staff were asked to describe the types of compliance activities they engaged in during the last fiscal year. The majority of those activities fell within one of the ten categories listed in Figure 2. The figure provides a summary of management staff, which includes Directors and Supervisors, engaged in the various compliance tasks. Results for Field Staff, who were interviewed as a group in focus group discussions, are reported below. Without exception, there was no discrepancy within groups primarily because focus groups were organized by program type, such as on-site therapists and in-home therapists, where personnel have the same responsibilities.

Figure 2 shows that all management staff are responsible for writing reports and reviewing staff reports. The majority of Supervisors (86%) are responsible for collecting and entering data, such as the number of families serviced. An equal proportion of Directors and Supervisors (71%) are engaged in budgetary tasks, such as tracking program expenses. In contrast, the majority of Directors (57%) are responsible for attending external meetings regarding funder compliance or related to compliance. More than half of the Directors reported having to "chase" the staff they supervised, including Supervisors, for data and reports necessary for funder compliance. While it may be implied that Directors and Supervisors are responsible for other staff, only 86 percent and 57 percent, respectively, said they supervise tasks regarding compliance activities. Equal proportions (57%) said they train staff on funder compliance tasks, such as writing reports or collecting data.

Only 14 percent of the Directors said they attend training sessions specifically regarding compliance regulations; none of the Supervisors reported engaging in this activity. Twenty-nine percent of Directors and 43 percent of Supervisors said they carry out "Other" compliance activities, such as responding to funder requests and calling clients.

All Field Staff reported writing reports. The majority (60%) of the groups said they collect and enter data to meet funder compliance updates and maintain the budget. Sixty percent said they train other staff on compliance activities. Eighty percent said they attend internal staff meetings. In contrast, 60 percent said they do not attend external compliance trainings. Fewer than half said they spend time chasing staff for information or supervising other staff.

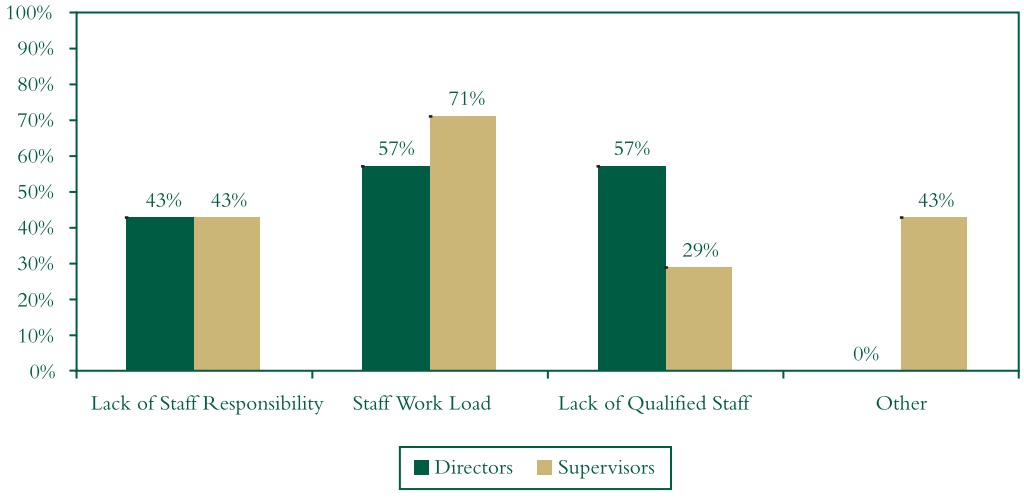
Staffing Decisions Related to Compliance

With the exception of one Director, all other Management staff said they were responsible for delegating compliance tasks to staff. For those who reported delegating tasks, all said they delegate based on staff job descriptions. One Director reported using additional criteria for delegating tasks, such as individual staff skills, staff ability, flexibility, and receptiveness to requests. Two Supervisors said they also use staff members' prior experience and training as criteria.

Staffing Challenges to Meeting Compliance

Management staff were asked about the staffing challenges they face with regard to compliance activities. Four staffing challenges were derived from the qualitative data collected

FIGURE 3. STAFFING CHALLENGES REPORTED BY MANAGEMENT



from Directors and Supervisors: Lack of Staff Responsibility, Staff Work Load, Lack of Qualified Staff, and Other minor challenges (see Figure 3). Results indicate that a higher proportion (57%) of Directors than Supervisors feel that Lack of Qualified Staff is a staffing challenge. In comparison, more Supervisors (71%) said that Staff Work Load was a challenge to getting staff members to carry out the required compliance activities. Clearly, this discrepancy reflects the role Directors and Supervisors have within the Agency. Directors are responsible for overall management of their respective programs and for providing a summary of program results reported by Supervisors and Field Staff and may have little to no contact with Field Staff. Supervisors, on the other hand, have regularly scheduled meetings with Field Staff, which provides an opportunity to learn about the challenges faced by their staff.

Interestingly, the majority of Field Staff reported a lack of training on compliance activities. The results indicate that all 27 Field Staff members who participated in the focus group discussions said they were not trained by their direct Supervisor to write reports, collect or enter data, or maintain or track their budget (i.e., expenses). Instead, 69 percent of participants said they were informally trained by a peer from their respective teams. Thirty-one percent said they experienced no formal or informal training.

General Compliance Challenges

All staff respondents were asked about the general challenges they face when carrying out the various compliance activities. Staff reported four primary challenges to meeting compliance, including Funder Requirements, Lack of Agency Protocol, Internal Staff, and Other minor challenges, including case management load. Results indicate that the challenges reported by Management and Field Staff differ. Management sees a Lack of Agency Protocol as the primary barrier to meeting funder compliance. In contrast, Field Staff see Funder Requirements as the main challenge.

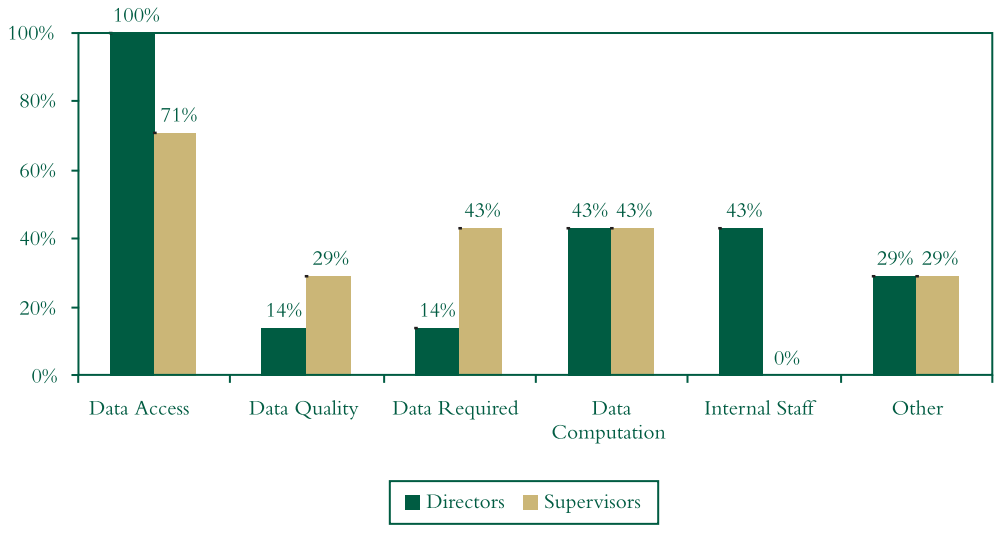
Data Challenges

Staff were asked about the data challenges they experience when meeting funder compliance. Six types of data challenges emerged from the data: Data Access within the Agency, Data Quality within the Agency, Data Required by the Funding Source, Data Computation methods necessary for staff, Internal Staff, such as reluctant personnel, and Other data challenges, including personal conflicts with sharing client data. Figure 4 shows that all Directors perceive a lack of access to the data as a challenge to meeting funder compliance; close to three quarters of Supervisors agree with this perception. With regard to other data challenges, Directors see issues related to data computation as another barrier. In addition, Directors said that reluctant staff also create data challenges. Supervisors reported data requirements and data computation methods as additional challenges.

TABLE 1. DISTRIBUTION OF GENERAL CHALLENGES

DESCRIPTION	DIRECTORS (N=7)	SUPERVISORS (N=7)	FOCUS GROUPS (N=5)
Funder Requirements	43	43	80
Lack of Agency Protocol	71	71	60
Internal Staff	43	14	60
Other	14	29	40

FIGURE 4. DATA CHALLENGES REPORTED BY MANAGEMENT



Focus group participants reported data challenges that fell within three categories: data quality, data type, and "other" (results not shown). All focus groups reported "quality of internal data" as a challenge. Twenty percent of focus groups reported data type as a challenge; 20 percent also reported "other" data challenges.

Staff Subjective Experiences

According to individual interviews with Management and focus group discussions with Field Staff, five types of experiences were derived from the data: stressful due to funder requests; stressful due to a lack of agency protocol related to compliance activities; routine; rewarding as a result of serving families or completing a required report; and other, including challenges when working with uncooperative clients. Table 2 shows results for this research question. More than half of Directors interviewed said their most recent compliance task was stressful due to funder requirements. In contrast, Supervisors said their most recent experience was stressful due to a lack of agency protocol, but also perceived the task as routine or part of the job. Directors may feel more strain by requests made by funders because they are often the contact person for a given funder. Supervisors are primarily responsible for supervising staff and providing results to their respective Director.

Interestingly, Field Staff said they felt stress related to funder requirements because they are responsible for collecting data requested by the funding source and can be penalized for not adequately responding to those requests.

Cost of Meeting Compliance

To calculate the cost of meeting funder compliance, staff hours on related tasks were collected, as were staff annual salaries. During the last fiscal year (2004–2005), respondents spent close to 44 percent of their time on compliance activities. Translated into dollars, the Agency spent $742,556 or 11 percent of the annual budget ($6,554,518) on compliance or salaries of staff related to compliance. The annual budget includes funds from four primary sources, including the county, the state or VOCA, private funds or foundations, and the United Way. Figure 5 shows the average annual amount spent for each task for Management Staff. Results indicate that the largest average expenditure goes toward paying for time spent writing and reviewing reports. The smallest investment was attending trainings related to compliance.

RECOMMENDATIONS

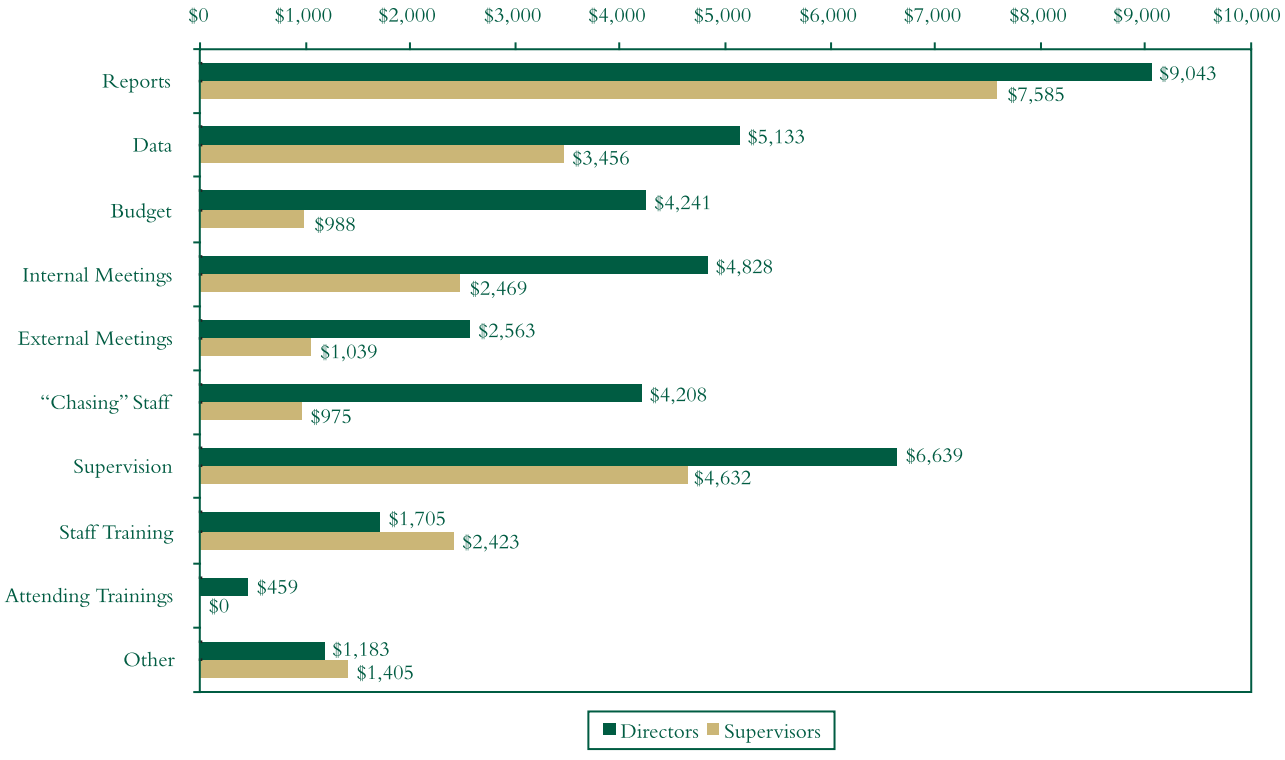
It is clear that internal measures are necessary for decreasing the strain on staff and increasing staff performance with regard

TABLE 2. DISTRIBUTION OF STAFF'S SUBJECTIVE EXPERIENCE

DESCRIPTION	DIRECTORS[3] (N=5)	SUPERVISORS[4] (N=6)	FOCUS GROUPS (N=5)
Stressful due to funder requests	60	16	80
Stressful due to lack of agency protocol	40	67	20
Routine	20	67	20
Rewarding	0	16	40
Other	20	0	40

[3] Two Directors did not provide a response to this question.
[4] One Supervisor did not provide a response to this question.

FIGURE 5. AVERAGE ANNUAL EXPENDITURES ON COMPLIANCE TASK FOR MANAGEMENT STAFF



to compliance activities. Additionally, while the study site has plans to launch an agency-wide data system, vital infrastructure and personnel matters must be addressed prior to or in conjunction with the data system, such as developing a clear internal protocol for meeting funder compliance. It is recommended that other nonprofits in the region use the data collected herein to examine the challenges their respective staff face in meeting funder compliance and provide solutions to those barriers, which may save the organization substantial staff time and financial investments.

With regard to funders, it is recommended that funders, large and small, evaluate their data collection methods, as well as type of requests, to ensure they collect pertinent data that will inform all parties involved (e.g., agency, funder, client, and staff). Put plainly, funders who know agency services and staff demands well are better positioned to make simple and specific requests that elicit meaningful and useful information.

ACKNOWLEDGEMENTS

I want to thank the Executive Director at Providing for Families for opening his doors and books for this study. In addition, I would like to thank the staff at PFF for their candid responses and time. This study could not have been possible without their participation.

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WHY ENGAGE?

Understanding the Incentive to Build Nonprofit Capacity

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- Alfred W. Wishart, Jr., Award for Excellence in Nonprofit Management

ABOUT CAPACITY-BUILDING: GRANTMAKERS FOR EFFECTIVE ORGANIZATIONS (GEO) DEFINES ORGANIZATIONAL EFFECTIVENESS AS AN ORGANIZATION'S ABILITY TO FULFILL ITS MISSION MEASURABLY THROUGH A BLEND OF SOUND MANAGEMENT, STRONG GOVERNANCE, AND A PERSISTENT REDEDICATION TO ASSESSING AND ACHIEVING RESULTS.

The literature regarding nonprofit capacity building is expanding as funders, infrastructure support organizations, researchers, and others interested in strengthening the sector work to develop a better understanding of how to build organizational capacity effectively. In the spirit of this inquiry, The Forbes Funds commissioned Judith Millesen, at the Voinovich Center for Leadership and Public Affairs at Ohio University, and Angela Bies, at the Bush School of Government & Public Service at Texas A&M University, to examine the incentives associated with engagement in capacity building. Specifically, the research team used organizational theory to frame an examination of the ways in which environmental characteristics, institutional attributes, and financial characteristics relate to the incentive to engage in capacity building.

The research presented in this report develops a comprehensive, empirical understanding of the incentive to engage in nonprofit capacity-building initiatives and addresses four key questions:

1. What are the primary incentives to (and, by extension, barriers to) nonprofit capacity building?
2. How do these incentives moderate (either facilitate or impede) engagement in nonprofit capacity building?
3. How do these incentives moderate processes of organizational change associated with nonprofit capacity building?
4. Do organizational attributes such as subfield focus, CEO tenure, or organizational age relate to issues of incentives?

THEORETICAL BACKGROUND

A common theme that runs through all three parts of a recent report on capacity building published by the Urban Institute (De Vita & Fleming, 2001) is how theory can be used to understand capacity building better. Specifically, the Urban Institute's Elizabeth Boris asserts "that the challenge faced by researchers is to sift through the growing body of

experience on capacity building, link them to theory, and make this knowledge accessible and useful to practitioners and funders" (2001: 85). In direct response to calls for theory-based research, four mainstream organizational theories — **strategic management theory**, **resource dependence theory**, **agency theory**, and **institutional theory** — provide the framework for an analysis of capacity-building incentives. Four theories are used because, although each theory takes into account the critical relationship between the organization and its environment, each focuses on a different set of antecedent conditions to the actual capacity-building relationship, thereby painting an incomplete picture of a highly complex phenomenon.

Strategic management refers to the general process of "adapting the organization to its environment to better accomplish organizational purposes."[1] From a strategic management perspective, organizations make deliberate choices regarding mission, goals, resources, systems, and structures in order to better position themselves vis-à-vis the environment. The theory would predict that managers enthusiastically engage in capacity building to maximize resource use, structure the organization for optimal performance, and take advantage of external opportunities in ways that are responsive to constituent expectations.

Like strategic management theory, a **resource dependence** approach emphasizes the proactive role of the manager in shaping the organizational environment. However, unlike strategic management, resource dependence theory explicitly recognizes that there are likely to be power relationships that can restrict access to the resources necessary to implement meaningful change. Resource dependence theory would predict that nonprofit managers engage in capacity building in order to secure the resources needed for survival vis-à-vis their organizational competitors.

Agency theory uses the metaphor of a contract to describe the relationship between a principal, an agent, and a stakeholder. In a principal-agent relationship, principals delegate to agents the authority to act in a way that is consistent with the interests of the principal or the stakeholders. From an agency perspective, nonprofit managers are coerced into engaging in capacity-building activities so they can demonstrate their ability, worthiness, and success to those with accountability concerns.

The central premise of **institutional theory** is that organizations of the same type become increasingly isomorphic, or similar, to those in their environment over time. Institutional isomorphism occurs through coercive (dictatorial pressure to conform), mimetic (imitation as a response to uncertainty), or normative (stemming from professionalization) processes, each with their own set of antecedents. Table 1 summarizes the predictions each theory makes about why a nonprofit organization might engage in capacity building.

Methodology

A four-stage, multi-method research design was used to collect archival, qualitative, and quantitative data. Archival data included an environmental scan of the Pittsburgh capacity-building industry; review of promotional materials and web sites of local capacity-building providers and programs; and research into the funding priorities, grantmaking guidelines, and application procedures for seven of the major foundations in the region. Qualitative data was collected from 19 nonprofit executives who participated in one of five focus groups, and interviews were conducted with four foundation executives and 34 capacity-building professionals representing 31 different organizations. Quantitative data were collected from more than 200 Pittsburgh-area nonprofit organizations that responded to a web-based or mail survey.

Findings

In analyzing these data, it became apparent that no one theory could completely explain the incentive to engage in capacity building for two key reasons. First, theory-based analysis draws attention to the fact that some behavior can be interpreted using multiple theoretical perspectives. For example, while it certainly may be the case that nonprofit organizations engage in capacity building to satisfy contractual requirements, nonprofits may also seek technical assistance to improve programming and accomplish mission-related goals and objectives. Second, and more interestingly, the data collected for this study suggest incentives to engage in capacity building occur simultaneously and evolve over time. Two examples illustrate and describe this finding: simultaneous incentives and evolving incentives.

Simultaneous Incentives

Different theoretical perspectives can be used to interpret how nonprofit executives respond to complex expectations. Focusing on the theoretical interpretation of executive behavior has important implications for how to structure incentives, particularly because different rationales require distinct incentives to encourage capacity building. The challenge is to understand the motivating incentive so the interaction can be appropriately managed. The following quotation, from an executive director of a large human service organization, illustrates this point.

> *Now we have over a dozen projects that have people with them who we want to keep employed, and so from a programmatic perspective we need to keep reflecting on*

[1] Hodge, B. J. & Anthony, W. P. (1988). *Organization theory*. Boston, MA: Allyn and Bacon, Inc., 239.

TABLE 1. THEORY-BASED PREDICTIONS REGARDING THE INCENTIVE TO ENGAGE IN CAPACITY BUILDING

	STRATEGIC MANAGEMENT	RESOURCE DEPENDENCE	AGENCY THEORY	INSTITUTIONAL THEORY
Theoretical Premise	Organizations make deliberate choices about the external environment with regard to the organization's purpose, philosophy, and mission; key goals and objectives; allocation decisions; resources; and developing organizational structures and systems.	Organizations pursue various strategies to resist being controlled and constrained by other organizations, to mitigate dependent relationships, and to reduce environmental uncertainty.	Organizations respond as in a principal-agent relationship, where principals delegate to agents the authority to act in a way that is consistent with the interests of the principal or the stakeholders.	Organizations of the same type become increasingly isomorphic, or similar, to those in their environment over time. Institutional isomorphism occurs through coercive, mimetic, or normative processes.
Management Posture	Proactive	Proactive	Reactive	Reactive
Impetus to Engage	Internal forces	Internal forces	External forces	External forces
Basis for Engagement	Survival	Survival	Coercion	Normative reasons
Primary Purpose	Make better decisions	Secure resources	Appease funders	Seek legitimacy
Primary Use	Make strategic choices about internal operations and external opportunities	Create linkages; reduce environmental uncertainty; seek additional funding	Report to convey information to funders -OR- To conceal information from funders	Use is routinized -OR- Use is symbolic
Strengths	Holistic, proactive view of management operations	Highlights the need to align the organization and the environment	Promotes continuous goal assessment	Promotes legitimacy, reputation, and networking
Weaknesses	Overemphasizes rationalization and planning	Emphasizes only resource-based sources of power and control	Rooted in distrust	Compliance is often ritualistic, not purposive

> *what we do and ask ourselves does this still make sense? Are we doing what we are supposed to be doing?…Are we doing what the funders want to see?…You know there is board pressure. They have expectations as well…our clients also drive [some of our decision-making].*

Strategic management theory asserts that managers will willingly undertake capacity building so that they can improve decision making in ways that strengthen programs and in ways that are responsive to stakeholder expectations. From a strategic management perspective, this particular executive director is likely to respond to incentives that reward capacity-building efforts, especially given his reflection regarding organizational focus ("Does this make sense? Are we doing what we should be doing?").

Resource dependence theory focuses on the power relationships that restrict access to resources. The executive director in this example clearly recognizes there are resource dependencies to which he must attend ("Are we doing what the funder wants to see?"); this response, in turn, has important implications for the funding community and the structuring of incentives. Specifically, it is often assumed that organizations operating primarily from a resource dependence perspective are only building capacity because doing so provides income. Yet, as noted above, strategic management theory presumes organizations engage to enhance performance. *An important implication for the funding community is to structure incentives in ways that encourage strategic capacity building and discourage opportunistic engagement.*

The executive director also recognizes there are other stakeholders who have expectations for performance (e.g., the board and the clients), consistent with what institutional theory might predict. This means there may be an incentive to engage in capacity building that originates from these various stakeholders. In order to avoid tacit compliance to external expectations, there must be some type of accountability mechanism built into the process (consistent with what agency theory might predict). For example, when the board requires and sets aside funding for building organizational capacity, it must also insist upon some sort of evaluation report that demonstrates appreciable change in ways that are consistent with constituent expectations.

Evolving Incentives

Teasing out the "initial" and the "durable" incentive to engage proves to be especially difficult. What this means is not only are there multiple incentives to engage in capacity building that occur simultaneously, it is also that these incentives change or evolve over time. A story told by one of the capacity builders provides some insight. The capacity builder explained that an executive came to her because a funder required that executive to build management capacity. As the capacity builder made clear, the executive was very good at what she did (at least from a technical aspect), yet she was not a "great" manager.

If this were the only information the capacity builder had to go on, she might assume that the executive's motivations should be interpreted through an agency theory lens — the funder mandated compliance in an attempt to minimize agency costs associated with making a grant. From an agency perspective, the executive may have an individual motivation to engage in the training, or the executive may simply be complying with the mandate from the funder. The bottom line, however, at least from an agency perspective, is that unless required by the funder, there would have been no incentive to engage in the training. In this situation, it could be argued that the capacity builder's "client" is actually the funder, for it is the funder who is bearing the costs and benefiting from the interaction. This has profound implications for the interaction between the capacity builder and the nonprofit executive because the underlying assumption guiding the interaction presumes that neither is sufficiently motivated to "be in this for the long haul." From an agency perspective, both are interested in fulfilling the short-term expectations of their contracts, rather than embarking upon intensive efforts to build long-term, sustainable capacity.

When the capacity builder interviewed the executive prior to undertaking the management training (as requested by the funder), the capacity builder learned more about the executive's motivations. The executive did acknowledge that the initial incentive to engage was to comply with the funder's request, yet she also noted that in talking with colleagues and peers, it became apparent that capacity building could be leveraged to secure future financial contributions. This suggests that although the initial incentive was to comply with an external mandate, the information received from peers further advanced the executive's desire to copy practices others had found to be successful. This example provides two different theory-based interpretations of the incentive to engage, each with very different implications.

Institutional theory predicts that organizations will ritualistically undertake specific activities in an effort to be deemed legitimate by those external to the organization. The executive admitted she was hoping to leverage the training so that she could acquire additional funding. It could be argued that engaging in the training would provide the executive with the legitimacy needed to appease a demanding funding community that recognizes and rewards capacity building. The problem is that when the primary incentive is to gain legitimacy, conforming to external expectations (i.e., mimicking the successful behavior of others) is not likely to result in substantive changes in behavior or organizational operations. Thus, from an institutional theory perspective, the interaction between the parties and the implications are similar to what agency theory might predict.

Alternatively, resource dependence theory predicts nonprofit managers will proactively seek capacity building initiatives to promote organizational performance so they can secure

the resources needed for survival. Implicit in the resource dependence perspective is that the organization is hoping to alter the power dynamics that restrict access to resources. This means that savvy managers will want to demonstrate any appreciable change resulting from their participation in capacity-building initiatives. Moreover, given that estimations of organizational effectiveness and legitimacy are externally conferred (often by those in power or those providing the resources), these changes are likely to be consistent with mission-related goals and objectives.

The deterministic frameworks of both agency and institutional theory provide some insight as to why many nonprofit executives complain about "one-size-fits-all" approaches to capacity building (Millesen & Bies, 2004). Capacity builders who believe that clients engage in the capacity-building initiatives only to satisfy the expectations of those external to the organization might shy away from developing unique, context-specific programs tailored to meet the individual needs of a specific organization. If, however, the capacity builder were to interpret the legitimacy-seeking behavior using the underlying assumptions of resource dependence theory or even strategic management theory, the outcomes (both in the training agenda and in management behavior as a result of the training) might be different. Both perspectives arguably predict managers will aggressively seek ways to improve chances of survival in an increasingly complex and competitive environment. As such, resource dependence theory would predict that managers are more likely to embrace practices that give them a competitive edge.

Thinking of incentives as simultaneous influences or evolving processes may be what is needed to institutionalize a "culture of continuous improvement," particularly because, as these data suggest, initial incentives are likely to be very different from the enduring motivation to engage in ongoing continual improvement. What starts as a response to an agency-related mandate or a reaction to resource dependencies can ultimately evolve into a strategic management orientation that becomes institutionalized over time.

Understanding the incentive to engage in capacity building is unexpectedly complex, having elements that reflect the underlying theories of all four theoretical perspectives used to inform this study. The four theories present distinct views about how organizations operate and, as such, each provides different insight and suggests different strategies for the primary stakeholders in a capacity-building relationship. Some information is more practical for funders, some more useful for organizations, and still some more helpful for practitioners. Consequently, structuring incentives in ways that embrace the assumptions of these theories is going to be largely dependent upon on what an organization, or a funder, is hoping to achieve.

Implications

The theory-driven research presented here highlights the complex and dynamic nature of the incentives related to engaging in nonprofit capacity building. The findings suggest it is critical to structure incentives in ways that integrate the assumptions of more than one theory. Possibilities include:

- Encourage incentives to build capacity throughout the organization;
- Develop "soft" incentives that promote mutual benefit;
- Promote incentives that recognize managerial complexity;
- Offer incentives that discourage competition and promote collaboration;
- Create incentives that integrate the assumptions of multiple theoretical perspectives and evolve over time; and
- Establish incentives that recognize and build upon the foundation community's predisposition to provide programmatic support.

READ THE COMPLEMENTARY ANALYSIS TO THIS STUDY: 2005 TROPMAN REPORT VOLUME 4, NUMBER 3 — *Nonprofit "Capacity-Building Orientation": The Role of Learning in Building Nonprofit Performance*. ALSO, FOR MORE INFORMATION ABOUT THE CRITICAL MATTERS FACING NONPROFIT TRUSTEES AND STAFF AND THE RESULTING NEED FOR CAPACITY BUILDING, POINT YOUR BROWSER TO WWW.FORBESFUNDS.ORG AND DOWNLOAD A COPY OF *Facing the Futures: Building Robust Nonprofits in the Pittsburgh Region*, BY DR. PAUL C. LIGHT, NEW YORK UNIVERSITY AND THE BROOKINGS INSTITUTION.

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Amidst increasing attention to nonprofit performance, interest in nonprofit capacity-building activities has understandably intensified. A natural outgrowth of this interest is an expansion in the number and range of nonprofit capacity-building providers and approaches. In response to this growth, The Forbes Funds, in 2004, commissioned Judith Millesen, at the Voinovich Center for Public Affairs and Leadership at Ohio University, and Angela Bies, at the Bush School of Government & Public Service at Texas A&M University, to examine the quality of Pittsburgh's capacity-building industry and to identify the characteristics of effective capacity-building initiatives.

This study expands on that earlier research by investigating questions of why and how nonprofit organizations engage in capacity building, as well as the ways in which organizational, managerial, and financial characteristics relate to capacity building. The current literature on nonprofits provides useful theoretical insight to understanding externally driven mechanisms for improvement, and, by extension, insight into incentives for engagement in capacity building. What is less well explored are the internal mechanisms that drive and motivate boards, managers, and key staff to pursue capacity building as ongoing and integrated processes of organizational change and capacity improvement. Learning theory provides such insight.

This study addresses the following research questions:

1. What factors predict higher levels of engagement in capacity building by nonprofit organizations?
2. What factors predict higher levels of organizational capacity?

Drawing on capacity-building processes outlined in previous research,[1] Millesen and Bies utilize herein a pragmatic framework, informed by a "learning organization" paradigm and defined by social, structural, and technological dimensions.[2] The social dimension

[1] Millesen, J., & Bies, A. (2004). *An analysis of the Pittsburgh region's capacity-building industry: Who is doing what for whom and to what end?* Tropman Report: Applied research about the Pittsburgh Region's Nonprofit Section, (3) 3, 9–14. Millesen and Bies identified capacity-building processes as having a "general organizational orientation toward self-assessment and change with appreciable improvements in organizational performance." They further detailed this orientation as involving "organizational leaders who believe that capacity building is a good use of organizational resources, crucial to success, central to achieving mission-related goals and objectives, and useful for organizational improvement." From this, Millesen and Bies posited that this orientation was important to capacity-building engagement, based on processes of learning, and related to leveraging organizational change.

[2] See Senge, P. (1990). *The fifth discipline*. New York: Doubleday for practical approach to learning organization paradigm, based in part on organizational learning theory. See Argyris, C. & Schön, D. (1974). *Theory in practice: Increasing professional effectiveness*. San Francisco: Jossey-Bass, for seminal work on organizational learning. See also Argyris, C. & Schön, D. (1996). *Organizational learning II: Theory, method, and practice*. Reading, MA: Addison-Wesley for contemporary work on organizational learning.

involves leadership participation, managerial discretion or strategic choice, and the empowerment of employees. The structural dimension involves organizational policies and practices oriented toward shared leadership, employee participation, and horizontal integration within organizations. The technological dimension involves firm-specific expertise and decision-making based on evidence or data.

Method, Data Sources, and Measures

Data are derived from a three-stage multi-method research methodology and data collection strategy. This strategy utilizes archival data, rich qualitative data, and multi-variate quantitative data from a survey completed by 208 Allegheny County nonprofit organizations. The survey measured nonprofit capacity-building orientation, levels of capacity-building engagement, and nonprofit organization capacity.

Context

Before examining the factors associated with engagement in capacity building and organizational capacity, it is useful first to detail the measures utilized and, in turn, describe the sample in terms of the levels of these measures.

Nonprofit Capacity-Building Orientation.
Based on the learning organization paradigm, 11 survey questions were utilized to measure the social, structural, and technological dimensions of nonprofit capacity-building orientation. These 11 items were summed and added to create a combined scale, "Capacity-Building Orientation," ranging from 0 to 11, with 0 being a low level of orientation and 11 being a high level of orientation. The sample is modestly skewed toward this learning orientation, with the mean "Capacity-Building Orientation" score being 6.133. The scale was found to have an acceptable reliability score of .84. Examples of questions related to the social dimension are: "Our management team prioritizes capacity-building initiatives," and "Our board is supportive of capacity-building initiatives." Examples of questions related to the structural dimension include: "Capacity building is part of our organizational orientation," "We have enough time for capacity building," and "Capacity building is a good use of organizational resources." Examples of questions related to the technological dimension include: "It is important for us to have employees with nonprofit management-related degrees," "We build capacity through our internal ability to solve problems," and "Capacity building has helped us to gather information about how to improve our programs."

Organizational Characteristics.
The sample can be described by a number of relevant organizational characteristics. Respondents include human service (38%), educational (17%), economic and community development (11%), health (10%), and arts/culture (8%) agencies. The sample is evenly distributed in terms of organizational age, organizational size measured by annual expenses, and in terms of financial measures such as the diversity of revenue sources. The average (mean) age of respondent CEOs was 48 years old, with an organizational tenure of 9.16 years. This group was predominately Caucasian (76%), highly educated (67% with advanced degrees), and almost equally split in terms of gender (48.5% female, 50.5% male).

Engagement in Capacity Building.
Engagement in capacity building can be conceived of in the variety of ways that nonprofits make financial, human resource, and other organizational investments in capacity building. Nearly half of the respondents (46.0%) reported reimbursing employees for continuing education expenses. In the past two years, more than 58.4 percent indicated they had hired a consultant, 59.9 percent said that they had attended a workshop, training, or seminar, and 55.4 percent claimed they had participated in a peer-learning initiative. More than one third of respondents (39.1%) indicated that staff members spend at least one full day per month dedicated to professional development, and that in the preceding 12-month period, the organization had invested an average of $41,502 in capacity-building initiatives, with the most frequent investment at a level of $15,000. On average, 2.7 percent of annual operating expenses were devoted to capacity-building expenditures.

Nonprofit Organization Capacity.
The work of Paul Connolly and Peter York was utilized to frame nonprofit organization capacity into "four core capabilities essential to any nonprofit," including: 1) adaptive capacity; 2) leadership capacity; 3) management capacity; and 4) technical capacity. Adaptive capacity encompasses planning, assessment, evaluation, and collaboration. Leadership capacity refers to board and executive leadership. Management capacity is associated with effective use of human, operational, and volunteer resources. Technical capacity is related to the implementation of core organizational and programmatic functions. Each of the four areas of nonprofit organization capacity was first measured; these measures were then summed to create a combined scale to measure overall nonprofit organization capacity.

Findings

Table 1 provides a summary of factors predictive of engagement in nonprofit capacity building. Table 2 provides a summary of factors predictive of nonprofit organization capacity. Each table includes only those factors with statistically significant values, the direction of the relationship, and a related statement of the finding.[3] A discussion of key findings follows the tables.

[3] For a thorough presentation of the statistical analysis and related quantitative findings, please see the technical report associated with this Tropman Report, which is available on The Forbes Funds website, www.forbesfunds.org.

TABLE 1. WHAT FACTORS PREDICT ENGAGEMENT IN CAPACITY BUILDING? SUMMARY OF MULTIPLE REGRESSION ANALYSIS, SIGNIFICANT FINDINGS

Factors Predicting Higher Levels of Nonprofit Engagement in Capacity Building (measured by financial investment)	Is there a statistically significant relationship?	What is the direction of the relationship?	What does this reveal?
Nonprofit Capacity-Building Orientation	Yes	Positive	*Higher levels of capacity-building orientation are predictive of higher levels of engagement in capacity building.*
Other Organizational Characteristics:			
Number of Years Organization in Existence	Yes	Negative	*The age of the organization is negatively related to engagement in capacity building; younger organizational age is predictive of higher levels of engagement.*
Human Services Mission	Yes	Negative	*Mission is related to engagement; being a human service agency is predictive of lower levels of engagement.*
Currently Collaborate with Other Organizations to Deliver Core Programs and Services	Yes	Positive	*Collaboration with other organizations is predictive of higher levels of engagement.*
Had Cash Shortfall in the Past Three Years	Yes	Negative	*Having a cash shortfall is predictive of lower levels of engagement.*
Diversity of Financial Resources	Yes	Positive	*Having a diversity of financial resources is predictive of higher levels of engagement.*
CEO with Advanced Degree	Yes	Positive	*Having a CEO with an advanced degree is predictive of higher levels of engagement.*
Dependence on Government Funding, Dependence on Foundation Funding	Yes	Negative	*Being dependent on government or foundation funding is predictive of lower levels of engagement.*

Note: Statistical significance is at least $p<0.05$.
The model also controlled for a variety of other organizational characteristics, including organizational size and satisfaction level with capacity-building provider types and content areas. Only statistically significant results are presented here.

DISCUSSION

Higher levels of capacity-building orientation are predictive of both higher levels of engagement in capacity building and higher levels of nonprofit organization capacity.

- These findings had the largest and strongest statistical values in both analyses. When an organization has a high level of nonprofit capacity orientation — *a learning orientation involving shared leadership, broad staff participation, evidence-based practices, and organizational policies supportive of capacity-building* — not only is it more likely to direct financial resources toward capacity building, but it is also likely to exhibit higher levels of organization capacity.

Higher levels of engagement in capacity building are predictive of higher levels of nonprofit organization capacity.

- Financial investments in capacity building are predictive of higher levels of organization capacity. This finding reinforces the role of managerial discretion, strategic choice, and continuous improvement in capacity building.

TABLE 2. WHAT FACTORS PREDICT NONPROFIT ORGANIZATION CAPACITY? SUMMARY OF MULTIPLE REGRESSION ANALYSIS, SIGNIFICANT FINDINGS

Factors Predicting Higher Levels of Nonprofit Organization Capacity	Is there a statistically significant relationship?	What is the direction of the relationship?	What does this reveal?
Nonprofit Investment in Capacity Building	Yes	Positive	*Higher levels of capacity-building orientation are predictive of higher levels of organization capacity.*
Nonprofit Capacity-Building Orientation	Yes	Positive	*Having a capacity-building orientation is predictive of higher levels of organization capacity.*
Other Organizational Characteristics:			
Proportion of Staff Participating in Capacity-Building Activities	Yes	Positive	*High staff participation in capacity-building activities is predictive of higher levels of organization capacity.*
Proportion of Board Members Participating in Capacity-Building Activities	Yes	Positive	*High board participation in capacity-building activities is predictive of higher levels of organization capacity.*
Currently Collaborate with Other Organizations to Deliver Core Programs and Services	Yes	Positive	*Collaboration with other organizations is predictive of higher levels of organization capacity.*
Had Cash Shortfall in the Past Three Years	Yes	Negative	*Having a cash shortfall is predictive of lower levels of organization capacity.*
Diversity of Financial Resources	Yes	Positive	*Having a diversity of financial resources is predictive of higher levels of organization capacity.*

Note: Statistical significance is at least $p<0.05$.
The model also controlled for a variety of other organizational characteristics, including organizational size and satisfaction level with capacity-building provider types and content areas. Only statistically significant results are presented here.

Board and staff involvement in capacity building are related to higher levels of nonprofit organization capacity.

- These findings are complementary to the learning organization paradigm that suggests that both leadership and broad staff participation matter.

Certain organizational characteristics relate to levels of engagement in capacity building.

- Both organizational age and human service mission are negatively predictive of engagement in capacity building. This finding warrants additional inquiry. Because neither variable is predictive of higher levels of nonprofit organization capacity, it is not clear that such organizations do not have a need to engage in capacity building. They may have a disincentive to engage in capacity building, but this also is not clear from the existing data.
- Having a CEO with an advanced degree is predictive of engagement in capacity building. This may be a result of specialized training either more closely related to technical dimensions of the organization or an orientation toward learning, both of which would complement nonprofit capacity-building orientation.

Financial characteristics are related to both engagement in capacity building and nonprofit organization capacity.

- Organizations with a healthy financial picture, as demonstrated by having a balanced and diverse set of revenue streams, are more likely to engage in capacity building and report higher levels of nonprofit organization capacity.
- Organizations with an unhealthy financial picture, as demonstrated by a financial deficit, are both less likely to engage in capacity building and less likely to report high levels of nonprofit organization capacity.
- The source of funding seems to matter, in some instances. Organizations that are dependent on governmental or foundation funding for more than 25 percent of their revenue reported being less likely to engage in capacity building. This is consistent with qualitative findings in which several CEOs viewed capacity-building expenditures as relating to non-mission related expenses and reported concern about demonstrating inefficiency to governmental funders. This might be indicative of either funder pressure for efficiency as a narrow performance criterion or of nonprofit misconceptions of how to account for capacity-building expenditures that might more accurately relate to programmatic expenditures or performance improvement. Qualitative findings also suggest that organizations that need capacity-building assistance might be unwilling or fearful to reveal this to funders or to seek assistance. In addition, qualitative data suggest that a key barrier to engagement is "limited capacity to build capacity," because many institutional funders are more inclined to fund programmatic expansion rather than capacity-building investments.

Collaboration with other organizations is related to higher levels of both engagement in capacity building and nonprofit organization capacity.

- In the learning organization paradigm, the organization attempts to shape the social, structural, and technological dimensions to increase managerial discretion, broaden staff participation, and gain additional data and information while reducing uncertainty in the environment. Collaboration with other organizations might increase learning through additional technical knowledge obtainment and staff experience.

Implications and Recommendations

This application of and empirical test of learning theory illuminates one clear aspect of how organizations engage in capacity building: by possessing a high level of "capacity-building orientation." Importantly, this capacity-building orientation is highly predictive not only of engagement in capacity building, but more importantly of organization capacity. Based on this study's measurement of the Connolly and York conception of nonprofit organization capacity, nonprofits with a high level of capacity-building orientation are more likely to report high levels of adaptive, leadership, management, and technical capacity.

The learning organization paradigm, and this study, suggest several ways to promote a capacity-building orientation: promote broad-based board and staff development and opportunities for participation; empower employees at various levels in organizations; promote internal policies conducive of evidence-based practices; encourage knowledge acquisition and dissemination; and reward discretionary management strategy that is responsive to external environments, performance improvement drivers, and internal dynamics.

Several additional recommendations emerge:

- **Promote fiscal health.** This study corresponds with other research on nonprofit fiscal health that suggests that a diversity of financial resources is associated with greater managerial discretion, strategic choice, and longer term financial stability. Capacity-building assistance related to financial diversification is advised.
- **Develop avenues for horizontal integration and broad staff participation.** Consistent with learning theory, this study suggests that shared leadership and participation of staff at a variety of levels in the organization is important. The development of middle managers would assist such efforts.
- **Support formal education opportunities for nonprofit personnel.** This study points to the importance of advanced or specialized training for nonprofit CEOs. As the nonprofit sector in Pittsburgh prepares for turnover at the CEO level, it will be important also to consider fostering participation in advanced training for promising new and future nonprofit CEOs.
- **Board participation promotes nonprofit organization capacity.** Also consistent with the learning organization paradigm is the finding that board support of and participation in capacity-building efforts relates to organization capacity.
- **Collaboration among nonprofits can produce organizational capacity.** Although this study does not illuminate precisely how collaboration relates to nonprofit organization capacity, learning theory suggests collaboration might produce stronger knowledge bases, greater information dissemination, and shared-learning among personnel. When capacity-building assistance is provided to promote collaboration, it would be wise to attend also to the development of a capacity-building orientation.
- **Advocate a change in orientation by institutional funders.** This study suggests that it may be important to move beyond narrow efficiency criteria and promote a broader set of performance and improvement criteria.

Similarly, it may be important to moderate the perspectives of some nonprofit CEOs to conceive of, execute, and account for capacity-building activities in ways that complement programmatic goals and extend nonprofit organization capacity.

ACKNOWLEDGEMENTS

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The human services support system of Allegheny County, Pennsylvania, incorporates a complex and concentrated network of services for its economically disadvantaged citizens. In 2004, the Allegheny County Department of Human Services (DHS) served 231,400 people by administering 2,190 contracted services through a network of 384 direct service providers, most being autonomous, nonprofit organizations.[1] Local government relies heavily on nonprofit organizations to address the physical, mental, and emotional health of individual residents, which in turn improves the quality of life for families and communities.

Allegheny County residents consequently enjoy a human service delivery system with great geographical access to a variety of service providers. A network of 384 direct service providers delivering services across five DHS program offices provides choice to individuals. This ample supply of service delivery options enables consumers to select direct service providers in close geographic proximity to their residence, as well as an opportunity to select a provider based upon its particular service delivery approach. That said, this abundance of supply options, while likely attractive to the consumer, entails a cost to government or the funder in its costs to administer contracts with each autonomous, direct service provider.

The Forbes Funds commissioned The Hill Group, Inc., to conduct a study of the human service delivery system in Allegheny County to determine if there were opportunities to enhance the system's capacity. Specifically, this study investigates whether there is an opportunity to maintain choice in service delivery, a benefit of the Allegheny County human services system, while creating operating efficiencies and enhancing mission effectiveness.

This study addresses the following questions:

- What is the supply and demand continuum of human services in Allegheny County?
- Is there evidence of equilibrium or disequilibria between human services provided and demand for human services?
- Are there high or low concentrations of service providers geographically clustered around clients or any natural market sheds of human services activities?
- Can geographical concentrations of providers and clients be leveraged for efficiency through various forms of collaboration without compromising choice or delivery of services?
- Would the geographic clustering of human service organizations lead to any cost savings to the public (government or funders) or to nonprofit organizations?

[1] DHS Annual Report, 2004.

This study offers a framework to enable local governments, like DHS, to continue to offer ample choice for consumers while providing opportunities to reduce its administrative costs. It also offers an approach to direct service providers to reduce their administrative costs through collaboration, directed by the services offered and the providers' geographical proximity to each other and their consumers.

Context

- DHS, through five human services program offices, administers a $757.4 million human services budget. This budget is derived from 80 different funding sources, each with separate laws, funding regulations, and reporting requirements.
- The current federal budget is projecting a five percent decrease in human services funding over the next five years. This is driving a subsequent 14 percent reduction at the state level and will place increased pressure on the private and foundation sectors to mitigate these funding gaps.
- Human service organizations are facing some of the most difficult challenges in recent memory. The reduction in government funding, coupled with recent and significant regional job losses, has placed severe pressure on the capacity of nonprofits. The nonprofit sector is continually being asked to accomplish more and more with fewer resources.
- The ability to provide ample choice of direct service providers to consumers of human services is desirable for many obvious reasons, including the ability to stimulate competition and innovation in service delivery. Contracting of services allows the marketplace to reward those providers that deliver. On the other hand, Allegheny County's complex system of contracting carries a burden of high transaction costs in eligibility assessment, program oversight, and compliance reporting.
- Past studies investigating the capacity of nonprofits to provide human services have focused largely on fiscal and organizational capacity, documenting the often incoherent, fragmented nonprofit sector (e.g., Kearns, 2004; Johnson, 2005). Strategic restructuring of nonprofit agencies has been advanced since the late 1990s (LaPiana, 1998).
- The research defining industry clusters serves as the springboard for developing service clusters. According to Michael E. Porter (2000), clusters are geographic concentrations of interconnected service providers in a particular field that compete but also cooperate. Other researchers similarly champion "clusters" as a tool to engage organizations in strategy development and problem solving (Waits, 2000). This report argues that the application of the cluster concept provides the same useful alternative for nonprofits to create synergies, increase productivity, and support economic advantages.

Methodology

The Hill Group used multiple research methods to produce this study. The supply and demand continuum of human services delivery in Allegheny County was studied by using geographic information systems and client and provider databases. Primary data was extracted from a DHS client and provider database.

The researchers also used the *National Nonprofit Research Database (FY 2001)* and the *Guidestar National Nonprofit Database (1998–2003)* to examine financial characteristics of nonprofit human services organizations in Allegheny County. This financial data is derived from Internal Revenue Service filings by the nonprofit organizations.

Also, structured interviews were conducted with representatives from the DHS and numerous nonprofit direct service providers. Dr. John Pierce and Lisa Caldwell of DHS were invaluable for their collaboration and contribution to this study.

Findings

DHS provided services to 231,400 individuals in 2004 through five departments or program offices:

Area Agency on Aging (AAA);

Office of Behavioral Health (OBH);

Office of Children, Youth and Families (CYF);

Office of Community Services (OCS); and

Office of Mental Retardation/Developmental Disabilities (MR/DD)

OBH provided 36 percent of the services (Figure 1).[2]

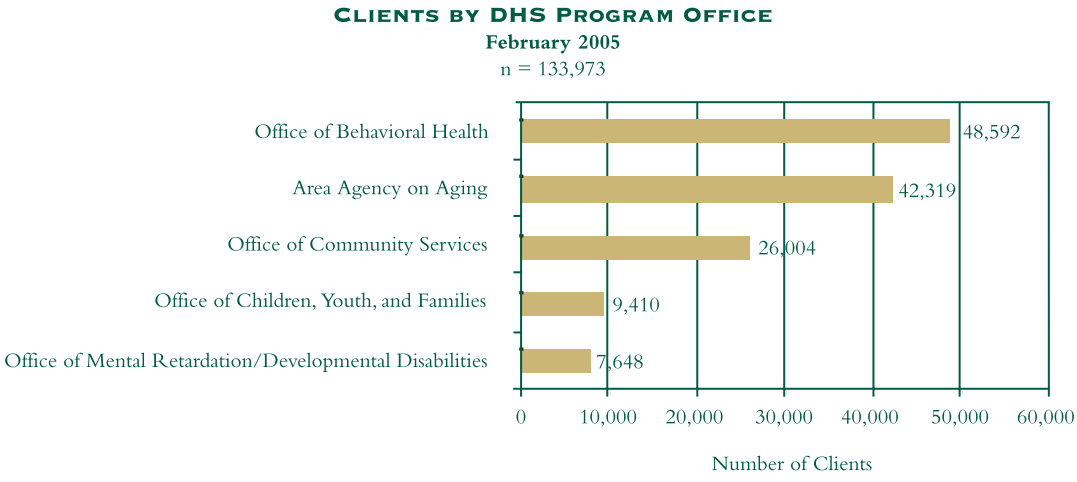
These program offices administered 2,190 contracted services with most delivered through 384 direct service providers, primarily autonomous, nonprofit organizations. At any given time, 70 percent of case-managed individuals are getting help from more than one program office. The most frequent combination of services is mental health and substance abuse. Typical clients for all services are more likely to be female, over the age of 55, and unemployed.

Even though most individuals receiving services require service from more than one program office, local governments, like DHS, are seriously inhibited in providing comprehensive services or a continuum of services. Public funding over the years has been isolated into diagnosis-specific "silos," each with its own set of regulations and eligibility criteria. Funding requirements and regulations make it extremely difficult to provide integrated service to individuals and discourage collaboration between funders and direct service providers.

These funding requirements and eligibility criteria provide a serious challenge not only to local governments or funders of human services, but to direct service providers as well. The administrative costs to administer and fund multiple services

[2] This data, provided by Lisa Caldwell of the DHS, reflects single client contact only. It does not include the clients who access multiple DHS services.

FIGURE 1. CLIENTS SERVED BY DHS DEPARTMENT

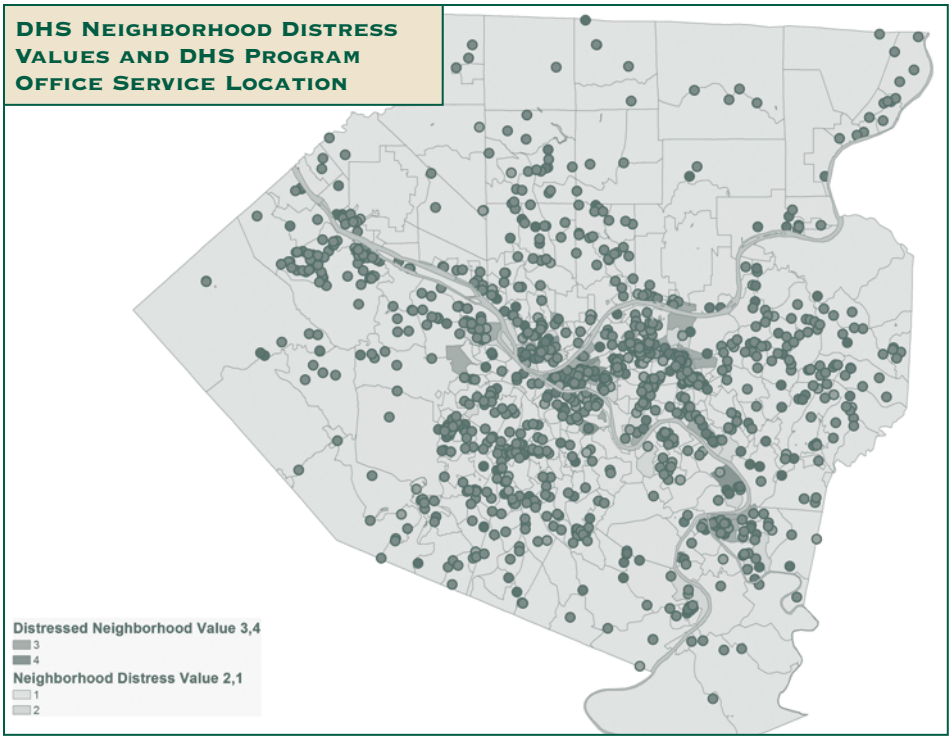


to an individual are obviously significant, particularly due to eligibility assessment and compliance reporting. The administrative costs to direct service providers are high as well due to the same issues.

Location and service density were examined to determine matches between distressed areas, human service provider locations, and services provided (Figure 2). The correlation between human service provider locations and clients in distressed neighborhoods was apparent. Equally telling was the marked evidence of service overlaps. These study findings suggest high concentrations of human service providers and clients in geographic proximity.

Human services in Allegheny County are densely clustered with mission-similar, direct service providers offering services in close geographic proximity to each other and to clients. "Meals" was chosen as a sample service in this study because financial data was accessible; more than 70 percent of meals are provided through the AAA. Meals provided through the AAA demonstrate horizontal service clustering of direct service providers (Figure 3).

FIGURE 2. OVERLAY OF SERVICE LOCATIONS IN DISTRESSED NEIGHBORHOODS



DEPARTMENT OF HUMAN SERVICES DISTRESS FACTORS

(Anne B. Casey Foundation, 2003)

Poverty level greater than 27.3%

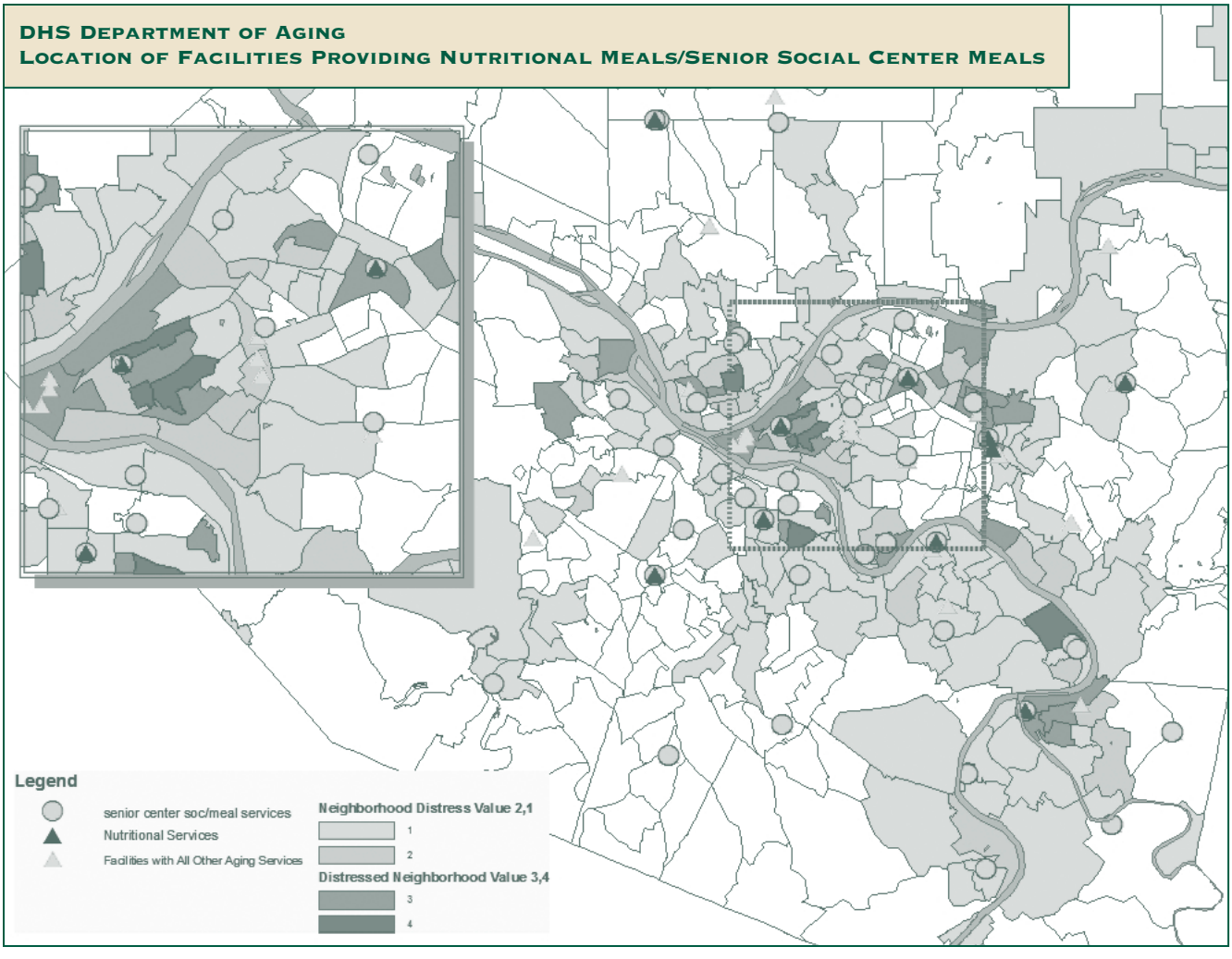
Single female head-of-household level greater than 37%

High school drop-out rate greater than 22.9%

Male unemployment rate greater than 33.9%

Neighborhoods exhibiting at least 3 of 4 factors are considered distressed

FIGURE 3. OVERLAY OF MEAL SERVICE PROVIDERS IN DISTRESSED NEIGHBORHOODS



All symbols ●▲= multiple service providers
Each cluster circle represents approximately a three-mile radius.

These mission-similar, direct service providers have an opportunity to collaborate or share non-mission critical or back-office functions like compliance, accounting, information technology, and human resources, hence horizontal integration.

There are 20 direct service providers offering meal services in the county. Approximately 70 percent of the direct service providers are located in close geographic proximity to each other in one of three service clusters. It appears that clients may have an oversupply of service delivery (or ample choice). If there is an oversupply in some areas, these nonprofit organizations may not be optimizing their capacity to provide services, especially if they are all expending resources on compliance and other non-mission critical support activities. The economic characteristics of this network are as follows:

Horizontal Integration Cluster Characteristics

- 14 of the 20 agencies are in service clusters (70 % of agencies fall into a cluster).
- 70 percent of the contracts administered by DHS fall into one of the three clusters (23 out of the original 33 contracts).
- The total budget of these 20 agencies is $8.0 million for meals.
- 70 percent of the agencies represent a total budget of $5.6 million (or an average budget of $400,000 for each agency).
- If 18 percent, a conservative estimate, (Urban Institute, 2004, cites 20%) of the $5.6 million budget associated with clustered agencies is allocated to DHS administrative costs associated with eligibility assessment, oversight, and compliance reporting, then $1.01 million is allocated to DHS administrative costs with all agencies in these three clusters.
- It is estimated that DHS spends approximately $43,900 per direct service provider on contract administration.

DHS Potential Cost Savings

If the 14 direct service providers, distributed within three service clusters, collaborate or share services with each other in administrative support areas like program compliance, accounting, information technology administration, and human resources, there could be considerable cost savings to DHS and to the collaborating direct service providers.

DHS could save $400,000, or five percent, of the total program budget for this service by reducing the number of contracts administered from 23 to 12. The logic of this scenario is as follows:

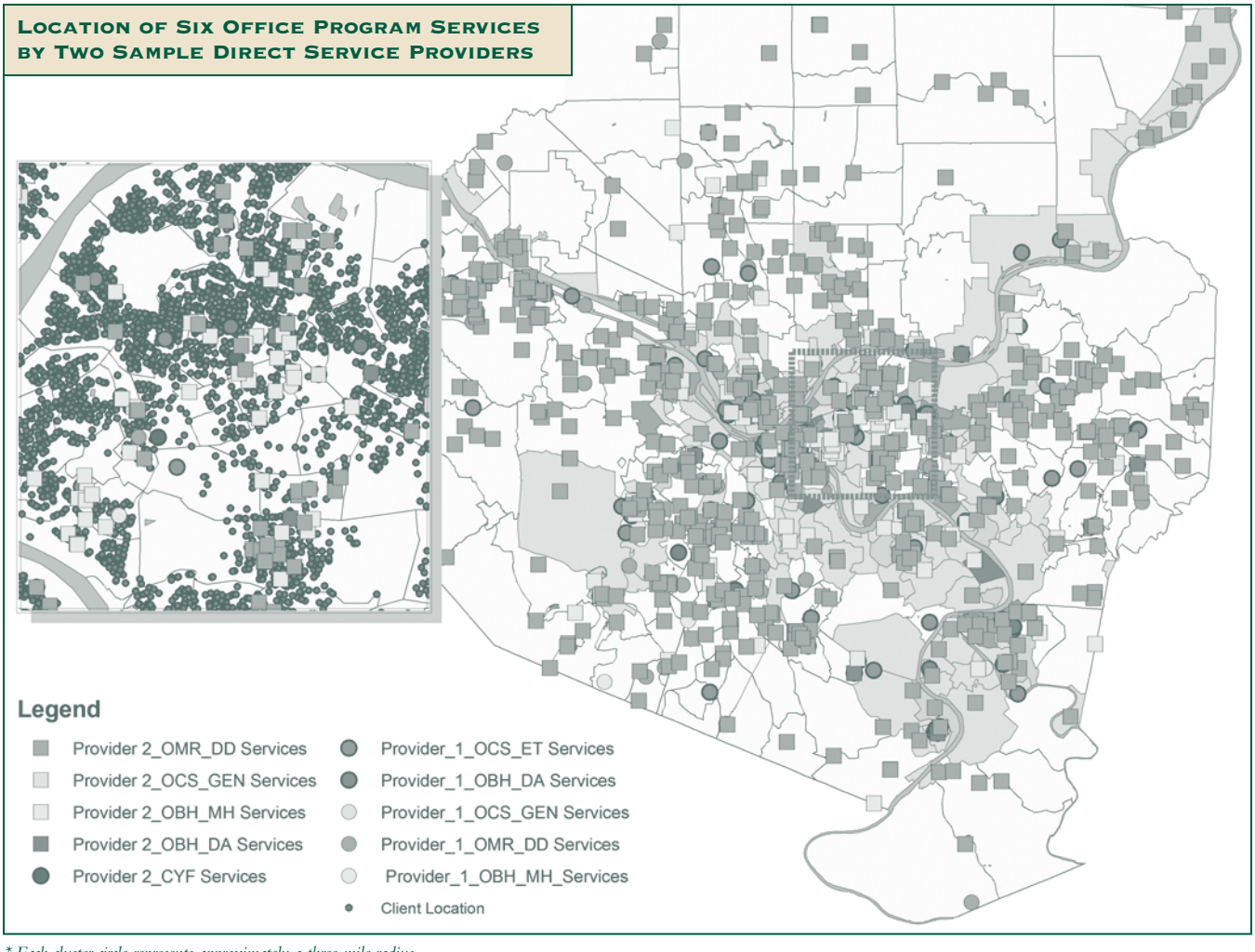
- [(33 original agency contracts – 23 contracts within 3 clusters) + (3 new contracts organized through three service cluster collaborations)] = 13 total contracts
- The 10 original, non-clustered contracts cost approximately $43,900 each to administer.
- If the three new contracts for each of the three service clusters increase by 30 percent due to complexity, then the average administrative cost to DHS of the three service cluster contracts is $57,000.
- Estimated administration cost to DHS after service clustering would be [($43,900 * 10) + ($57,000 * 3)] = $610,000
- DHS savings would be $1,010,000 - $610,000 = $400,000

Agency Potential Cost Savings

Each direct service provider collaborating within a horizontal service cluster could save approximately $840,000, or 15 percent, of their total budget. The logic of this scenario is as follows:

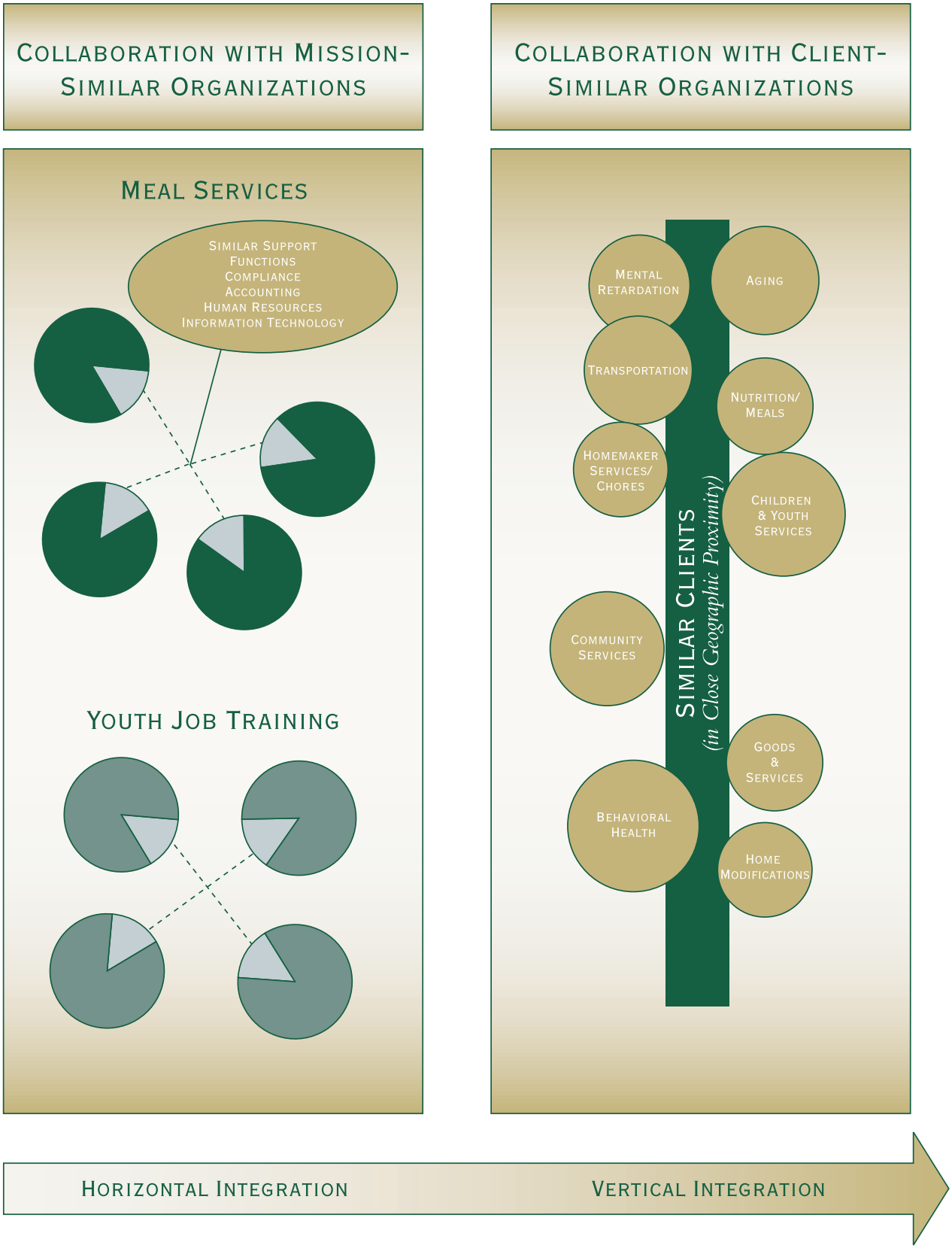
- In general, 20 percent of a human service agency's budget is allocated to non-program-related activities (Urban Institute, 2004)
- Eleven percent of an agency's total budget is allocated to compliance activities (Lara-Cinisomo, 2005)
- Conservatively, at least three percent of an agency's budget can be allocated to accounting and information technology administration and at least four percent can be allocated to human resources activities.
- If 70 percent of the compliance activities could be reduced through collaboration, then 7.4 percent of an agency's budget can be reduced.
- If we take an eight percent budget reduction for compliance activities and seven percent for accounting, information technology, and human resources, there is an opportunity to save 15 percent from an agency's budget through collaboration.
- Estimated savings to collaborating agencies savings would be ($5.6 million * 0.15) = $840,000.

FIGURE 4. OVERLAY OF MULTIPLE MISSION-DISSIMILAR DIRECT SERVICE PROVIDERS IN DISTRESSED NEIGHBORHOODS



** Each cluster circle represents approximately a three-mile radius.*

FIGURE 5. SERVICE INTEGRATION MODEL



In this example, the system savings would be $1.2 million or 15 percent of the overall $8.0 million budget. This excess supply, or high number of agencies and contracts with DHS to provide similar services, provides excess administrative cost to DHS. This geographic clustering of supply and demand creates an opportunity to look to the delivery system to improve system capacity. If one were to project this scenario across the entire DHS budget of $757.4 million, a 15 percent savings across the human services system could mitigate federal and state budget reductions and maintain the current level of service providers and choice to the client.

The next example illustrates a current network of multiple, direct service providers offering mission-dissimilar services, located around like clients within geographic clusters (Figure 4). In this scenario, direct service providers are clustered in close geographic proximity, almost vertically stacked around their clients. In this example, mission-dissimilar service providers have the opportunity to collaborate or share non-mission critical or back-office functions like compliance, accounting, information technology, and human resources, hence vertical integration.

In this example, we examine two service providers, each with multiple locations (2,142 locations, combined) and each with six distinct services. The combined budget for these two sample providers is $33.6 million. Approximately 60 percent of the locations fall into discrete geographic clusters. If we apply the logic from horizontal integration, cost savings at the agency level are 15 percent of total agency budget. In this example, these two sample agencies might save in excess of $5 million through collaboration via service clustering.

Recommendations

The reality of current economic conditions should prompt human service funders to consider adopting the Service Integration Model (Figure 5) that provides a mechanism for nonprofit agencies to take steps to collaborate and share non-mission critical services and functions. This will reduce high administrative transaction costs of funders, primarily the government, in administering service contracts, and it provides an opportunity for nonprofits to reduce their administrative and operating costs significantly.

The Service Integration Model suggests that collaboration between nonprofits might be facilitated by their proximity. It is easier to share, communicate, and collaborate with one's neighbor than with an organization separated by distance. The model provides a progression of collaboration. The easiest way to improve system and organizational efficiency, while not impacting mission delivery, is through the collaboration or sharing of non-mission critical or back-office functions.

In horizontal integration, mission-similar organizations in geographic proximity collaborate or share non-mission critical functions like compliance, accounting, information technology, and human resources. The final progression in the model is for organizations in close geographic proximity to organize around their clients (a customer-focused approach). In this progression, organizations that share similar clients, although they may have dissimilar missions, can collaborate on non-mission critical functions.

As natural or logical opportunities for clustering services emerge, future efforts should consider the dynamics of clustering. Maskell (2005) proposes a framework to examine clusters. Maskell's unified approach connects the work of Marshall's "Industrial district" (i.e., externalities), Porter's competitive cluster growth framework, and territorial perspective (i.e., the GREMI approach) (Maskell, 2005, 2004). Maskell builds upon the single dimension of financial efficiency by proposing the economic and social benefits, diseconomies of cluster saturation, intra-cluster synergies, and the life cycle of clusters. The implication is that DHS and funders embrace clustering as an on-going process rather than as a re-structuring event.

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