

Symposium Article

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The Impact of Government Funding on Competition in the Nonprofit Sector: An Integrative Model and Review of Empirical Research

Abstract: Changes in the scope and structure of public sector funding over the past few decades have had significant effects on the organizational environment in which nonprofit organizations operate. This article presents an integrative model within which the empirical literature regarding government funding effects on nonprofits is reviewed. This model conceptualizes the effects as deriving from two discrete forces – supply dynamics that have immediate population-level influences and a set of implementation dynamics that shape competition via organizational effects. This integrated model provides coherence to the literature and supplies a framework for future research.

Keywords: nonprofit competition, government, grants, contracts, privatization

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Over the past few decades, the nonprofit sector has witnessed considerable changes in both financing and market structure (Blackwood, Roeger, and Pettijohn 2012). Government funding has grown to become the second largest revenue source in the sector following fees from private sources. The expansion of Medicaid payments, tax credits, loans, and tax-exempt bonds has completely transformed the financing of the health, housing, and human services subsectors. Over the same period, there has been a drastic increase in the number of nonprofits, and several scholars have directly linked this increase to changes in the amount and form of public funding (Frumkin 2002; Gronbjerg and Salamon

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2012; Smith 2010). Historically, government policies such as tax breaks for donors and the G.I. Bill have played a key role in the growth and expansion of the nonprofit sector (Hall 2005). However, the increasingly direct funding relationship between government agencies and nonprofits, along with the increasing reliance of many nonprofit service delivery organizations on government funding, has led to a situation in which the consequences of government funding practices and priorities have sector-level implications that are not so straightforward. On the one hand, one could conclude from the increase in numbers of nonprofits that government funding has introduced more competition into the nonprofit sector. On the other hand, one could point to the evidence of increased concentration of resources in a few large nonprofits and conclude that the sector has become more monopolized.

The purpose of this article is to move toward a view of government funding implications that take into account the plurality of dimensions of the competitive landscape of the nonprofit sector, as well as to start to give some structure to the mechanisms through which government funding shapes that landscape. Becoming clearer on these dynamics is important both for governments' ability to effectively meet its own objectives with regard to privatization (Hefetz and Warner 2004; Van Slyke 2007) and for gaining a more complete assessment of the social welfare implications of government funding policies and practices.

Although there has been a steady stream of books and articles focused on the changing nonprofit–government relationship, the perspectives have focused mostly on organization-level effects (Boris et al. 2010; Gronbjerg 1993). More recently, however, scholars have started to draw attention to changes in the competitive landscape (Lecy and Van Slyke 2013). At this nascent stage, a framework within which researchers can begin to focus would be helpful to advance this area of study.

A model that can be subjected to rigorous empirical analysis is provided in this paper to lay the groundwork for researchers to hypothesize, test, and offer generalizations about the sector-level effects of government funding. Additionally, the existing body of empirical studies on sector-level effects of government funding is summarized and examined in light of this model to identify gaps and opportunities for future research.

In the remainder of this article, the integrative model is elaborated on and the empirical literature is reviewed within the framework it provides. Figure 1 provides an overview of the model. According to the model there are two types of forces, those associated with dynamics in the supply of government funds and those associated with the practices during the allocation and management of those funds. Both sets of forces are shown to operate through direct and indirect paths to influence competitive dynamics in the sector.

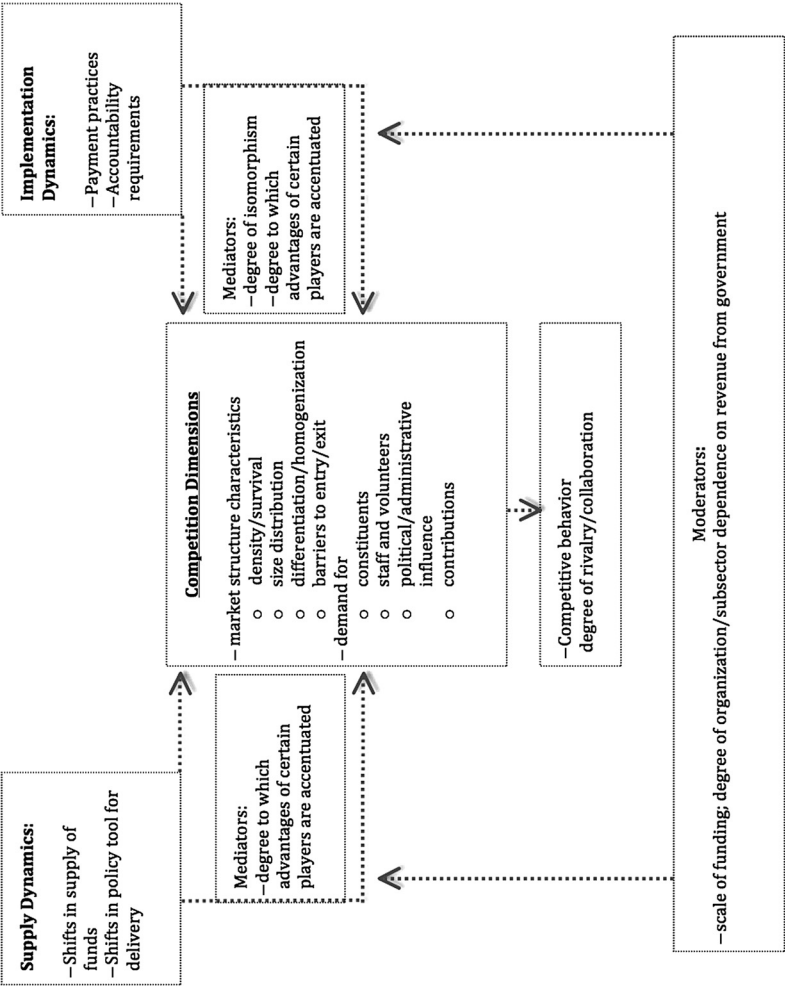


Figure 1: A model of government funding impacts on nonprofit competition

This article does not attempt to name the full array of existing funding pressures nor does it attempt to identify or specify each individual possible causal pathway. Instead, the effects described throughout are offered as examples to demonstrate the validity and theoretical richness of the framework. The paper is concluded with a discussion of implications for future research.

Elements of the model

In the development of the model, illustrated in Figure 1, three requisite qualities were considered important for it to be a viable theoretical model. First, the scope should not be limited to any one type of government funding. The model needs to be relevant to grants and contracts as well as tax credits, bonds, and vouchers. Second, the model must be adaptable across levels of government and international boundaries to accommodate all the variations in funding priorities and practices. Finally, the model has to make space for the dynamic interplay between the actions of organizations and the market conditions that result from those actions. It must be clear that the adaptations that existing organizations make as a result of government actions are also relevant inasmuch as they have consequences at the market level when a significant portion of organizations operating in a market are affected. Ignoring the organization–environment relationship would be to deny the significant developments in organization theory that have brought attention to the environment- and population-level dynamics (Hannan and Freeman 1977; Powell 2007).

The model has at its center different ways of appraising competition in the nonprofit sector. These include structural characteristics of the context in which organizations have to operate along with several of the resources for which organizations compete. Each of these factors could be considered dials that, when turned in either direction, have the effect of either promoting or discouraging competition. First, the elements of market structure include the number and size distribution of organizations, entry/exit conditions, and the extent of differentiation (Oster 1999). According to Oster, competition is expected to be higher in markets where there are several, similarly sized organizations providing substitutable services with low barriers to entry. Second, looking at what nonprofits compete for provides another view on competition. Among other things, nonprofits compete for clients, staff, volunteers, contributions, and influence. The level of demand, and thus the degree of competition for these resources, is prone to variation in response to forces in the organizational environment (Hunt and Morgan 1997). Finally, this model preserves the distinction between competition

as a market characteristic and competition as a set of actions or behavior (Ritchie and Weinberg 2000). This is an important distinction because it allows for causal effects to be directed to changes in the market conditions, where they are more properly attributable, rather than conflating them with measures of how organizations respond to those market conditions. While there is a link between market conditions and competitive behavior, it is worth noting that the type of market structure does not completely determine the degree of rivalry in a market. It is possible that even in competitive markets there may be a fair degree of cooperative behavior. Oster (1995) provides the examples of the coordination of food airlift operations among the relief organizations Save the Children and Oxfam and the sharing of artworks and exhibits between museums to demonstrate this point.

On both sides of the model are sets of forces arising from government funding policies and practices that are shown to have both direct and indirect effects on competition in the nonprofit sector. The separation of these two types of forces is of great significance in this model. The idea is to show that government funding effects on competition can come from two pathways, either they are population-level effects that occur as a consequence of changes in supply or they are effects that stem from the accumulation of adaptive changes that fund recipients make in response to funding requirements. Distinguishing between the population-level and organization-level effects that have population-level consequences is a primary task when it comes to sorting through the range of government funding effects. Further description of each pathway is provided below.

Supply dynamics

In the contemporary model of social policy implementation, nonprofit organizations play a critical role in public service delivery and, in turn, government plays a central role in meeting the financial needs of nonprofit service delivery organizations. A consequence of this interpenetration of government and nonprofit is that government now has considerable influence over conditions in nonprofit markets. Changes in government funding policies are consequential to the overall demand for nonprofit services, which, in turn, can impact the size of the nonprofit. Further, the types of funding mechanisms used by government can have profound implications on the size distribution of organizations and costs of entry into nonprofit markets. These are dynamics that have implications for the entire population of organizations in markets where government funded is consequential.

The general trend from the 1960s to the present is one of government-fueled growth, particularly among service delivery organizations (Salamon 2012).

Politically determined fluctuations in funding have had the effect of encouraging more organizations to enter the market and motivating growth of existing organizations during times of expansion or, likewise, causing organizations to exit or cut back services during periods of contraction. Smith (2010, 143) documented these dynamics and noted that government contracting “essentially created an entirely new set of agencies that previously did not exist.”

Expansion of the use of other policy tools from direct grants to contracts to vouchers to loan guarantees to tax credits to tax-exempt bonds has also been a driver of growth and restructuring of nonprofit markets across a variety of sub-sectors. Salamon (2012, 25) estimated that the amount of funds distributed in tax expenditures, direct loans, and loan guarantees alone increased two-fold in the 20-year period from 1990 to 2010, making just those three funding sources, “almost equivalent to the \$500 billion in total direct government support to nonprofits.” Additionally, the growth of quasi-vouchers like Medicaid to finance human services, which is a tool that shifts funding so that it is tied to the client rather than the agency, changes the way that nonprofit agencies compete for clients. It also impacts the pool and type of organizations with whom nonprofit organizations compete as for-profit firms, attracted by the increased demand generated by vouchers, enter markets once dominated by nonprofit organizations (Lipsky and Smith 1989). Additionally, the intricacies of the reimbursement process for Medicaid funding and the cost-structure limitations of managed care systems can be daunting barriers to organizations that have previously provided services under different funding mechanisms or those wanting to enter the market.

These supply dynamics are also shown in the model to have indirect effects on competition by perpetuating the advantages of certain types of organizations. This is particularly salient to the effects that certain policy tools can have on resource concentration. The case of tax-exempt bonds vs tax exemptions provides a useful illustration of this point. Large organizations, who have the advantage of assets and technical skill, are more likely to receive tax-exempt bonds giving them greater access to resources as opposed to other nonprofit subsidies, like tax exemptions, which are distributed equally across the sector.

Implementation dynamics

Heightened requirements for fiscal and programmatic accountability arising from government contracting have had significant impacts on the management and governance of service delivery organizations (Ferris 1993). Government agencies regularly exercise a heavy hand in determining what types of services

will be provided, how much those services will cost, what qualifications are required of those providing the services, and who can be served. They also engage in payment practices, like making payments late or failing to cover the full cost of services, which significantly impact the day-to-day operations of recipient organizations (Boris et al. 2010). Because service delivery nonprofits have grown so dependent on government the effects of these funding practices and accountability requirements are both widespread and profound (Smith and Gronbjerg 2006). To the extent that these demands shape nonprofit structure and practice in significant numbers, they can shift population characteristics in ways that have important consequences for nonprofit competition. In daycare services, for example, requirements to have certain licenses or accreditation or a certain number of teachers with master's degrees as a condition of eligibility for contracts or vouchers can increase barriers to entry and increase nonprofit demand for qualified teachers.

The distinguishing characteristic of the implementation dynamics in the model is that they function through changes made by organizations to attract or comply with government funds. In aggregate, these organizational adaptations have implications at the scale of the population of organizations operating in nonprofit markets and are then consequential to nonprofit competition. Isomorphism plays an important role in the link between organization changes and competition effects.

Organizations that receive government funds, especially those with high dependence, will conform to the requirements and expectations of the funding agency. This allows them to successfully gain legitimacy and the resources needed to survive. Other organizations, even those who may not receive government funds, are also impacted inasmuch as the requirements from the funding agency become institutionalized and generally accepted. Institutional theory assumes that organizations regularly monitor environmental conditions in order to maintain a close fit with organizations in their domain (DiMaggio and Powell 1991). Even those organizations that are not fund recipients will eventually adopt the required practices to be more aligned with the changing institutional environment. Otherwise, the organization may lose its competitive edge or come to be viewed as an inappropriate or undesirable participant in its market niche (Singh, Tucker, and House 1986). The more corporate style of management in human services, which has led to organizations having larger and more professionalized boards, greater emphasis on lean management and a flexible workforce, is a contemporary example of these isomorphic pressures. These types of pressures to conform to government mandated practices could impact competition in the sector by increasing the homogenization of services. While this might serve government's service delivery goals, it reduces the

distinct character and competitive advantages of different providers and puts organizations in more direct competition with each other.

The set of implementation dynamics – like the supply dynamics described earlier – is also mediated by the accentuation of organization advantage. A recent Urban Institute study of government contracting practices shows that large organizations have an advantage in obtaining grants and contracts (Pettijohn, Boris, and Farrell 2014). To the extent that payment practices and accountability requirements like cost sharing and matching requirements and limits on administrative expenses are more easily accommodated by larger organizations that have greater access to other fee or philanthropic sources of income, then government funding could lead to greater resource concentration in the sector. Likewise, creaming effects that could result from the use of performance-based contracts can impact the competition among nonprofits for clients who have the greatest possibility for meeting their outcomes (Smith 2010).

Moderators

The moderators in the model point to the fact that although some funding sources may be prevalent, they may be unimportant in their market impact if the amount of money involved is small. For example, it is not expected that the \$30,000 supplied through an award competition to target innovative nonprofits in New York City would create the same market-level impacts as the \$53 million in annual contracts for welfare-to-work employment contracts (Desai, Garabedian, and Snyder 2012). The moderators emphasize the importance of scale in order to produce population-level effects.

Review of empirical research against the model

Method of the literature review

A literature search was conducted to identify empirical academic articles on the topic of government funding to the nonprofit sector published since 1970. The search process was conducted in the summer of 2013. The search spanned academic databases (Public Administration Abstracts, PAIS International, Scopus, JSTOR, EconLit, Sociological Abstracts, Google Scholar), publisher collections (Sage Journals Online, SpringerLink, Emerald Insight, Wiley Interscience, Elsevier's Scirius), and the references of found articles. A range of keywords

were used, including government grants, government contracting, social service contracting, government vouchers, government funding, public sector funding, government tools, public private partnerships, third party government, devolution, government by proxy, and crowding in and crowding out.

Only those articles that contained empirical analyses of government funding and were published in peer-reviewed journals and books were selected from the literature. Theoretical studies were not reviewed. Additionally, articles that focused only on the determinants of government funding allocation – who received government funding – and not the consequences of receiving government funds were excluded. The literature testing the crowding in/crowding out hypotheses, which is relevant because it is focused on the supply of government funds, was sifted through and only those studies that paid attention to how the market conditions or populations of organizations respond to government funding were considered relevant. Most studies of the crowding in/crowding out hypotheses focus on resultant changes in the supply of other funding sources but make no connection to what happens to nonprofit demand for those resources or how these dynamics shape nonprofit markets. After the exclusions, there were 24 articles that were compared against the model, with 20 of those articles finding a place on the model.

Research overview

The general observation following the comparison of the research studies with the model is that only a few studies directly test effects at the population level and the majority of those focus on the category of nonprofit density and survival. This is an unexpected finding, but it raises the issue that competition, at this point, is being narrowly defined in nonprofit research, if given attention at all.

The majority of the studies focused on the implementation dynamics side of the model, but they rarely specified any particular payment practice or accountability requirements. Across all the studies, government funding was mostly specified as the dollar amount of government funding or a dichotomous variable indicating whether or not an organization had received government funding. The policy tools coverage was limited. The tools included were grants, contracts, and welfare waivers. Below, the studies are categorized by supply dynamics and implementation dynamics, and their contribution to understanding competition effects, broadly defined, is discussed in further detail. Table 1 provides a summary of the categorization of the research studies and compares their findings against the hypotheses that would be expected in the model based on the discussion in the previous section.

Table 1: Effects of government funding on nonprofit competition

	Supply dynamics	Implementation dynamics
Density/Survival	H: Positive Relationship *Lecy and Van Slyke (2013) *Luksetich (2008) *Salamon and Anheier (1998) *Twombly (2003) *Hager, Galaskiewicz, and Larson (2004) *Matsunaga and Yamauchi (2004)	H: Negative Relationship
Size distribution	H: Positive Relationship (Indirect) ~Hager, Galaskiewicz, and Larson (2004) *Twombly (2003)	H: Positive Relationship (Indirect)
Product differentiation	H: Increase homogenization *Stater (2010)	H: Increase homogenization (Indirect) ~Vanderwoerd (2004)
Entry/Exit	H: Increase Barriers	H: Increase Barriers
Demand for constituents	H: Increase Demand	H: Increase Demand
Demand for Staff and volunteers	H: increase Demand	H: Increase Demand *Gronbjerg (1993) *Guo (2007) *O'Regan and Oster (2002) *Stone (1996) ~Stone, Hager, and Griffin (2001))
Demand for Contributions	H: Decrease Demand *Andreoni and Payne (2011) ^Thornton (2014)	H: Increase Demand
Demand for Political influence	H: Increase Demand	H: Increase Demand *Mosley (2011; 2012) ^Chaves, Stephens, and Galaskiewicz (2004))
Competitive behavior/ Collaboration	H: Increase Competition ~Jang and Feiock (2007)	H: Increase Competition

Notes: * findings consistent with hypothesized direction; ~findings counter to hypothesized direction; ^mixed results.

Supply dynamics

Density

A number of empirical studies give support to interdependence theory (Salamon and Anheier 1998), which expects increases in government funding to lead to higher nonprofit density as a function of the partnership between government and nonprofits. Salamon and Anheier find that countries where public welfare spending is higher also have larger nonprofit sectors while countries that are dependent on private support have less dense nonprofit sectors. The results from Luksetich (2008) and Matsunaga and Yamauchi (2004) support this finding in the U.S. context. Luksetich (2008) drew on a national sample of nonprofits in 50 states over 14 years and simultaneously estimated the effect of government spending on nonprofit density and the size of the nonprofit sector on government spending and found that both are positively related. Lecy and Van Slyke (2013) test the density hypothesis specifically among human services organizations in the United States. They found in a national sample that increases in government grants increase density.

Organization survival

Twombly (2003) hypothesized from a population ecology perspective that changes in policy initiatives such as welfare reform would affect the patterns of births and deaths in the human services sector and that increased density would create barriers to entry. He examined experimentation with AFDC waivers across 53 metropolitan regions and found that entry of human service providers in metro regions increased as AFDC waivers were introduced but that deaths were not significantly affected. Additionally, his results provide support for the indirect effects described in the conceptual model related to large organization advantage. He found that smaller and younger nonprofits were significantly more likely than larger and older nonprofits to fail after changes in welfare funding. Although Hager, Galaskiewicz, and Larson's (2004) results run counter to this expected result. They found that the receipt of government funding equalized the survival rate between large and small nonprofits.

Demand for contributions

The research by Andreoni and Payne (2011) showed that organizations that receive government grants tend to reduce their fundraising efforts. This finding

made significant contributions to the crowding out theory and demonstrates how government funding reduces demand for contributions. Thornton (2014) extends this line of inquiry and takes advantage of grant type specifications in Federal Assistance Award Data System (FAADS). He found that program and block grants decrease fundraising activity while condition grants increase fundraising activity.

Differentiation/homogenization

Stater (2010) examined how government funding impacts nonprofit heterogeneity, which she defines as having a more equal number of nonprofit organizations working in each mission field present in a community to represent the degree to which multiple interests are represented in the sector. Theoretical perspectives on the expected relationship are unclear. Stater's results showed that nonprofit heterogeneity was reduced with increases in government funding.

Implementation dynamics

The majority of research activity on the effects of government funding on the nonprofit sector focuses on the organization-level effects. These studies examine changes to governance structure, administrative complexity, professionalization, advocacy activities, and secularization of religious organizations. None of the studies make explicit connections to nonprofit competition or attempt to measure their effects at the population level. The approach taken here was to map these studies onto the conceptual model if it was likely that their effects could, in aggregate, have population-level impacts on competition. Those that were not considered to have accumulative were those focused on changes to financial management (Calabrese 2012; Hughes and Luksetich 2004), issue definition (Nikolic and Koontz 2008), and performance (Sandfort, Selden, and Sowa 2008).

Demand for staff and volunteers

Evidence suggests that organizations that receive government contracts were more likely to change their staff composition to include more technical expertise (Gronbjerg 1993) and more corporate board members (Guo 2007; Hodge and Piccolo 2005; O'Regan and Oster 2002; Stone 1996). Stone, Hager, and Griffin's

(2001) results, however, suggest that government may not be the main driver of these effects. Nonetheless, the increased demand for staff and board members with specific skills can increase competitive pressures.

Demand for political/administrative influence

Additionally, changes in government funding can make competition for political/administrative influence more competitive since nonprofit leaders will try to influence legislators and administrators to keep funding their policy area. The results from the research on government funding effects on advocacy are mixed (Chaves, Stephens, and Galaskiewicz 2004) or positive (Mosley 2011,2012) and depend to a great extent on how advocacy is defined in the model.

Differentiation/homogenization

Results from Vanderwoerd's (2004) study of secularization of faith-based organizations provide evidence against the hypothesis that government funding accountability requirements promote homogenization.

Competitive behavior

Finally, Jang and Feiock (2007) who were interested in testing whether collaborative behavior by nonprofits depends on the financial incentives provided by funders found that organizations that receive government funding collaborate more than their privately funded counterparts.

Future research

The model developed in this study provides a useful framework for organizing the current body of empirical research and identifying gaps. Although the number of studies has grown over the past decade as scholars have started to bring population ecology perspectives into nonprofit sector research, several gaps were exposed that present rich opportunities for future research. First, more research is needed that expressly connects organizational effects to population dynamics. The model provides specific pathways through isomorphism and large organization advantage for scholars to explore. Research like the type done by

Galaskiewicz and Bielefeld (1998) that examine organizational changes within the context of their niches over time would be useful in making these connections. Second, the existing research is limited in its ability to speak to the wide range of policy tools used to finance nonprofit delivery of public services. Thornton's (2014) research exemplified how results differ when more attention is given to distinctions in the type of funding. He was able to get more granular data on grant type from the (FAADS) data, which makes a limited set of details available to researchers. This points to the need for greater access to disaggregated government funding data at the local, state, and federal levels. Third, Table 1 makes it clear that a sizeable portion of the hypothesized effects have not received any attention at all. More research on those untouched categories would be beneficial toward improving the model and further developing theory in this area. Finally, the link between a competitive market structure and competitive behavior warrants further research to understand how population-level dynamics play out in organizations' internal management and in their relationship with each other. Ritchie and Weinberg's (2000) three distinct styles of competitive behavior in nonprofit organizations – combative competition, collegial competition, and alternative competition – provides a useful starting place.

Conclusions

Government, with its dominance as a funding source and facility for exercising its power in its relations with nonprofit fund recipients, has the ability to affect the conditions for competition in the nonprofit sector. The task undertaken in this article has been to organize the perspectives on this relationship into a conceptual model and analyze the relevant body of empirical research to construct the beginnings of a coherent research agenda around this topic.

It is important both to government and to nonprofits to seek policy options that support the vitality of the nonprofit sector. To inform the design and implementation of policy, we need to understand something of the dynamics by which government shapes the structure of the nonprofit sector. Clearly, there is a lot more research to be done in this knowledge area. The hope is that this model and review stimulates scholarly interest and progress.

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