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Rethinking non-governmental organizations – at the crossroad of economics and civil society

Abstract

RESEARCH OBJECTIVE: The article aims to close the existing knowledge gaps, show why non-governmental organizations are founded and maintained, and elaborate and systematize the existing knowledge through an analysis of the existing subdisciplines within economics, laying the groundwork for the economics of non-governmental organizations.

RESEARCH PROBLEM AND METHODS: The article was written based on a structured literature review with an approach similar to the grounded theory method. The research question is: Why are NGOs founded and what is their *modus operandi*?

PROCESS OF ARGUMENTATION: After determining the research question, literature evidence was collected from a variety of sources, which led to the creation of a theoretical explanatory model. Nevertheless, a deductive, top-down approach has been taken to present the final model in a more comprehensible and transparent way.

RESEARCH RESULTS: Based on the institutional hierarchy of O.E. Williamson and drawing from the theoretical framework of the economics of the public sector and the motives behind the sharing economy, a model was built that explains why NGOs are founded and maintained, thus elucidating the route from social theory (in particular, institutional environments) all the way to undertaking actions to solve a given issue.

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CONCLUSIONS, INNOVATIONS, AND RECOMMENDATIONS:

The article influences and enhances the current state of knowledge regarding non-governmental institutions, including the placement of NGOs in particular disciplines within economics. It also significantly supports researchers doing subsequent studies regarding this area of social science. After further research in the proposed direction, more practical implications may arise in the future, including improvements in the management of NGOs that will facilitate their more efficient operation.

KEYWORDS:

economics of non-governmental organizations, NGOs,
civil society, third sector, globalization

INTRODUCTION

Non-governmental organizations (NGOs) have a substantial impact on the global society. There are millions of NGOs in the world (interestingly, the exact number is unknown, but rough estimates suggest there are up to ten million), including tens of thousands of international NGOs. These organizations, both global and local, employ a fair share of people on the labor market, especially in developed countries; for example, NGOs are responsible for over 10% of employment in the USA (Salamon & Newhouse, 2019) and over 13% in Europe (European Commission, 2017). Additionally, some estimates show that over 850 million people globally volunteer at least once a month, around half of whom do so through an NGO of their choice (United Nations, 2021). However, even considering these numbers, there is relatively little research interest in NGOs and non-profit sector economics; there are also very few consistent theories or models regarding anything connected with NGOs in terms of their management (Lewis, 2001; Osborne, 2013), their ethics and values (Fassin, 2009), or even the sense of existence of these institutions themselves (Reimann, 2005). Furthermore, such organizations are rather elusive in analysis as they usually cannot be objectively labelled as *good* or *bad*; they need to be observed from multiple perspectives at the same time as they cannot be analysed based on, e.g., financial results alone, but factors such as social impact, stakeholder interest and opinion, etc., should also be considered. What is more, NGOs also

differ greatly in distinct countries, cultures, and regions. All these aspects make general (economic or any other) research of such organizations problematic (Osborne, 2013). What is, however, common to most NGOs is that they are *usually* not concerned with profit but with their statutory goals, which are, simply put, aimed at making things *better* in a given NGO's area of specialization with no consideration of a (substantial) profit. The question that naturally comes to mind is *why* people organize and act for stakeholders without expecting to make a profit.

RESEARCH METHODS

Considering the theoretical and methodological problems of NGO research, an approach similar to the grounded theory method is applicable. Observation of NGOs operating globally and locally leads to the research question: *why* are NGOs founded and maintained, i.e., why do people choose to undertake actions in such a market environment? The answer is complex and requires a broad outlook on the issue through an extensive, structural literature review. Deliberations regarding NGOs ought to be focused on various fields of studies in economics: new institutional economics, economics of the public sector, and the sharing economy. These subdisciplines have been proven to create a coherent groundwork for the economics of NGOs as they make it possible to investigate the issue in question through the lens of normative economics, which gives a fuller picture of the case of NGOs and leads to the creation of a theoretical explanatory model.

Analysis of NGOs on Economic Grounds

NGOs are *usually* not formed to make profit; thus, they cannot be analysed in terms of neo-classical positive economics. NGOs also often have convergent goals with the public sector as the help they provide to their stakeholders is priced below commercial market prices. In this regard, it might even be argued that NGOs – by more efficiently fulfilling their statutory goals, which often converge with



the public sector's missions – somehow replace or will replace the public sector in its actions and reveal its imperfections and deficits in effectiveness. There is, however, no theoretical or empirical proof that such widespread use of NGOs causes the public sector to shrink or become less important in any way; in fact, NGOs in developed countries with the most efficient public sectors are growing in both value and number. NGOs are often not even there to support or complement the public sector; instead, they are sometimes even in direct conflict with the goals of the public sector, as in the case of organizations that monitor the actions of governments. Non-profit organizations rather operate outside of the system to support certain social groups, entities or places that need the representation of the third sector to exist or function in a better way (Grieg-Gran & Wilson, 2007). In view of this, four theories are worth emphasizing. With their roots in new institutional economics, these theories form different perspectives on public sector economic grounds, i.e., public choice theory, competition theory, transaction cost economics and principal-agent theory (Musialik & Musialik, 2013; O'Flynn, 2007). In the case of public sector management, public choice theory implies (in essence, as the approach towards public choice theory might vary, *vide*: Virginia School, Chicago School, Rochester School) that supervisors of particular public sector entities are usually politicians, who in the end will (would) place their own well-being before the public good – either directly or through acting to satisfy their interest groups (who will then vote for them or support them) (Walsh, 1995). This, in turn, often leads to hiring employees (bureaucrats) based on personal preferences rather than actual competencies, which supports growing (ineffective) bureaucracy and leads to wasted or misallocated resources and ultimately to suboptimal solutions for society (Walsh, 1995). Competition theory in the case of New Public Management (NPM) states that governments should seek ways to create competition in as many fields as possible within the public sector (O'Flynn, 2007). This can be achieved through having many small public sector entities following lean management principles (Kadarova & Demecko, 2016) rather than a few (or even just one) big entities that can be perceived in some way as a monopoly or oligopoly (Stoker, 2006; O'Flynn, 2007). When enough entities compete, this should possibly come close to the theoretical situation of perfect

competition, with production costs equal to marginal costs, thus being socially effective (Musialik & Musialik, 2013). Another area of competition in the public sector relates to public tenders, where suppliers compete by offering the best (lowest) price for the best possible quality of supplied goods or services (Urban, 2008). What is important to note is that public sector entities should not simulate open market competition but rather stipulate the use of competition to provide an impulse for better activity (O'Flynn, 2007). In the case of New Public Management, transaction cost economics focus on the fact that, as already discussed, public entities often operate in a highly non-competitive (or even monopolistic) market, do not put enough emphasis on the right allocation of resources, and use an unnecessary and ever-growing amount of bureaucracy. A combination of these factors leads to excessively high transaction costs and, thus, too high operational costs (Williamson, *Public and Private Bureaucracies: A Transaction Cost Economics Perspective*, 1999). Finally, principal-agent (PA) theory is a paradigm on which to reflect when considering both the public sector and NGOs. In general, PA theory discusses market resource allocation considering uncertainty and regarding moral hazard(s) (Grossman & Hart, 1983). This theory deals with the market situation where one entity, the principal, entrusts its actions in a certain field to another entity, the agent. For the sake of PA theory, it is assumed that, despite the delegation (which might be indirect, e.g., elections or a contest) of tasks from the principal to the agent, the principal cannot thoroughly observe the actions of the agent but can observe the results, which also affect the principal. It is also assumed that the result of these actions impacts the amount and share of resources both the principal and the agent will receive because of the undertaken actions (Grossman & Hart, 1983). As a result, it can be assumed that the agent will act in a way that will not be the optimal choice of actions from the principal's point of view, and if the risk of being caught is low, then the agent may resort to actions that are immoral or even directly illegal to maximize their gains. This theory is important, especially in high-income developed countries (or countries aspiring to this status), as it is the framework for creating more complex but more-effective governmental entities (Gauld, 2018); in the case of the public sector, the public (the principal) entrusts a certain degree of decision-making power to the government



(the agent); if the government, for example, is not monitored well enough or if the full details are not disclosed to the public, the risk of being caught is low, which results in corruption motivated by greed or the desire to be reelected (Navot, 2018).

From the NGO perspective, it becomes apparent that the motivation of people who engage in the actions of such organizations, i.e., managers, employees and even volunteers, is completely different to that of people from the public or private sector. They are not elected in common elections, and they usually act for the sake of the stakeholders' wellbeing instead of their own (public choice theory). They operate in a highly competitive market as they may face competition from the public sector, the private sector, or even the third sector (competition theory), which makes appropriate resource allocation crucial (transaction cost economics). Finally, while all the actions of such people cannot be observed, such organizations are usually more transparent regarding funding and expenditure, while their layered structure (elevated risk of being caught) and lower potential gains make it less likely for such organizations to be involved in non-ethical practices.

New Institutional Economics

In considering why NGOs operate, the first area to investigate is institutional economics, particularly new institutional economics. This sub-specialty is an ideal starting point for deliberations regarding the economic aspects of NGOs, even though it was marginalized for a long time and placed outside of so-called mainstream economics (Ratajczak, 2011). The very idea of an institution is broad, and they can be defined as "systems of established and embedded social rules that structure social interactions" (Hodgson, 2006). On these grounds, an institution is, for example, the language we speak, the law in any given country or even the rules of publishing in this journal. Institutions are also the beliefs and values of any given society or group, related to historical and cultural aspects, the way disadvantaged people are treated, the way animals and their rights are perceived, the consideration for the environment, etc. Grassroots social movements are the emanation of such beliefs and values (or lack of thereof)

as their goal is to work to change (improve) the state of things of a given group or groups of interest. If such a movement formalizes its existence, it forms an organization (in the case of our interest, an NGO), i.e., a particular case of an institution that involves (a) certain criteria to manifest their scope and to distinguish organization members and non-members; (b) rules of sovereignty regarding who supervises; and (c) predefined chains of command outlining duties and responsibilities in the organization (Hodgson, 2006).

Furthermore, O.E. Williamson created a theoretical framework for socioeconomic research of institutions and proposed that institutions should be analysed on four distinctive levels, where each one changes over a different amount of time (Williamson, *Transaction Cost Economics: How it Works; Where it is Headed*, 1998).

Table 1: Williamson's Institutional Hierarchy

	Level	Frequency (years)	Purpose
L1 – Social Theory	Embeddedness: informal institutions, customs, traditions, norms, religion	100s to 1000s	Often non-calculative; spontaneous
L2 – Economics of Property Rights	Institutional environment: formal rules of the game – esp. property (polity, judiciary, bureaucracy)	10s to 100s	To get a good institutional environment
L3 – Transaction Cost Economics	Governance: “the play of the game” – interactions of institutional actors, esp. contract (aligning governance structures with transactions)	1 to 10	To get good governance structure
L4 – Neo-classical Economics/Agency Theory	Resource allocation and employment (prices and quantities; incentive alignment)	Continuous	To get good marginal conditions

Source: Williamson, 1998.

In such a defined hierarchy, a higher level imposes certain constraints on a lower level, shaping it in its form and scale; a lower level sends feedback to a higher level that may or may not cause a change in a higher level. In this context, we can get a better basis for NGO research – economic or not. On the higher levels, it needs to be specified whether the NGO we want to inspect is one that shapes and influences its business and social surrounding or just “plays the game”, the rules of which have been set by governing bodies. The lower levels



are the baseline for answering questions about the resource allocation and employment that are needed to optimize the functioning costs of the organization. Those are also completely different compared to a for-profit entity.

Certainly, NGOs have an impact on the market environment they function in, both direct and indirect. In such a context, and considering the services they offer, one can argue that they are market participants (market agents) and this thus makes them market institutions. Ignoring the reason for which they are created and analyzing just their operational processes, it can be noticed that they are market institutions that keep externalities contained, constantly look at *competition* from the public and private sector, and make smooth information flow crucial to their functioning (McMillan, 2008). All in all, the aim of NGOs can be defined as achieving collective benefits through social coordination. The subgoals rooted in that aim, which are important from NGOs' point of view, could be thus summarized as (a) the need to lower transaction costs; (b) a reduction of uncertainty in their market activity; (c) monitoring the activity of entities providing the same or similar goods/services; and (d) reducing externalities (internalization) (Owczaruk, 2003; Wojtyna, 2007).

It is important to note that, in this case, these subgoals cannot be perceived as some good practice guidance but as core rules without which the existence of any given NGO is pointless. It is hard to imagine a non-profit organization that helps one cause while causing harm to another group at the same time (large externalities), provides services that are delivered well for "free" by a public sector entity, or lacks an element of social coordination.

Economics of the Public Sector and New Public Management

While the first government in human history was created a few thousand years ago, a long time passed until the economics of the public sector was contextualized. Major texts emerged in the 1950s and 1960s regarding conceptual issues important for the economics of the public sector, which can be marked as the beginnings of the subdiscipline (Faccarello & Sturn, 2010). Considering the shift in the thinking of the

global society of highly developed countries and in view of general liberalization and democratization, the flaws of the public sector have become especially apparent, e.g., the monopolization of certain services, ever-growing bureaucracy and the limited responsibility of the people involved in the public sector's operations (Stewart, 1985; Walle, 2003). New Public Management (NPM) has directly pointed out the weaknesses of public sectors where improvement is needed; noteworthy mentions regarding these are:

- Christopher Hood's doctrinal components, which includes issues such as the need for "hands-on professional management" (as well as private-sector styles of management practice), clear standards and measures of performance, emphasis on output controls, a shift to the disaggregation of units in the public sector, the need for greater competition in the public sector, and the need for greater discipline in resource(s) usage (Hood, 1991).
- Kuno Schedler and Isabella Proeller's generic element categories of NPM, which points out objectives for the public sector, such as the delegation of responsibility, the reduction of size and hierarchy, output orientation, efficiency, being closer to private sector financial instruments, involvement of the citizen, gaining legitimacy in service delivery, and more competition (Schedler & Proeller, 2001).

From this perspective, if NGOs are to be analysed as public entities (thus based on a ready framework), one can notice that the former largely and somewhat by design mitigate the aforementioned (potential) flaws typical of the latter, as they reduce the hierarchy, separate political and managerial roles, involve citizens on the grounds of civil society, operate in a competitive environment, and their importance is perceived by the effects of their actions; all this while being relatively efficient. Nonprofits could, in some way, be perceived as a kind of small-scale, *next-level* public sector: very efficient, yet very limited in resources and specialization; functioning on the grounds of public-private partnerships, yet with a lot of independence from the influence of people or entities whose goals are not aligned (or worse) with those of a particular NGO.

Sharing Economy

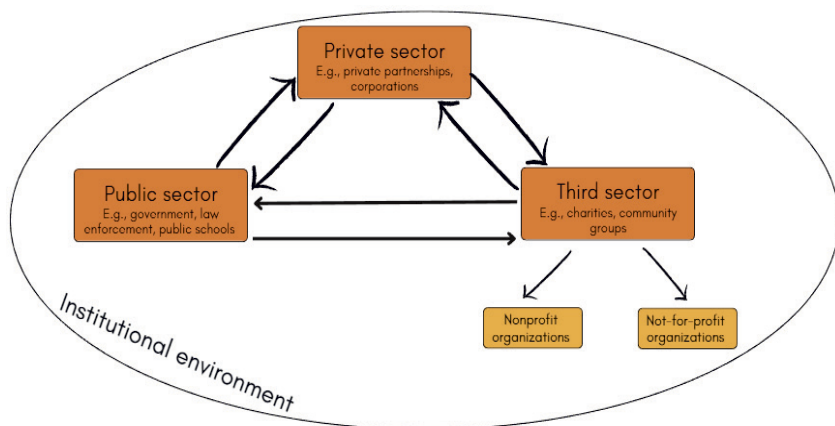
While the sharing of commodities between people (both for-profit and not-for-profit) existed for millennia, the contextualization of the sharing economy became a reality in the late 2000s due to (a) the radical reduction of information costs due to the transformation from the analogue to the digital era, i.e., the ubiquity of the internet (Codagnone & Martens, 2016); and (b) common environmentalism and sustainable development; environmental policies affecting governments, the private sector and modern societies (Heinrichs, *Sharing Economy: A Potential New Pathway to Sustainability*, 2013). There is a good number of research papers regarding how sustainability and the sharing economy intertwine or can be used together to form a better civic society or cause environmental benefits for everyone (Heinrichs, *Sharing Economy: A Potential New Pathway to Sustainability*, 2013; Curtis & Lehner, 2019; Plewnia & Guenther, 2018). Nevertheless, literature evidence that NGOs are in the scope of the sharing economy is rather scarce and seems only to refer to the close connection between NGOs and particular notions that are closely connected with the sharing economy, such as aforementioned sustainability, crowdsourcing, (social) networking, knowledge sharing, local development, etc. (Zbucha et al., 2018). In other words, it has been observed that NGOs share (for free or below market price) commodities and services due to their statutory missions. However, looking from a distinct perspective, the sharing economy can relate to NGOs and explain the motives behind NGOs. Originating from the refugee crisis in 2015, a new and interesting perspective on the matter was formed. While usual thought concerning the sharing economy regarded sharing certain services and/or material resources, it may be argued that sharing a concern about people, events, or ideas, i.e., the *moral dimension* of sharing, is another, equally important dimension of the sharing economy (Kornberger et al., 2018). Researchers dealing with the refugee crisis quoted the local government leaders of Vienna, Austria, who claimed that the grassroots movement devoted to helping the refugees is an instance of the sharing economy, but “not like sharing lodging, as in Airbnb. It is about sharing concern, and help, and hope” (Kornberger et al., 2018). On these grounds, the sharing economy might be broadened to the case of NGO operations around

the world. In the end, such organizations are formed, managed, and directed towards sharing a concern despite lower returns (or none whatsoever) in material resources, i.e., financial gains.

The Reasoning Behind NGOs

The role of NGOs is obviously different to that of the public or private (for-profit) sector; while the public sector's goals can be summed up as a rather broad notion of the general public good and wellbeing, the private sector firstly focuses on profit maximization and/or maximizing market share, whereas the third sector (NGOs) focuses on goals specific to particular stakeholders chosen by each of these organizations (Brandsen & Karre, 2011). All these goals are impacted by the institutional environment in which all these organizations function, e.g., laws, culture, history, etc. These sectors also affect and have an impact on the others, influencing subsequent market factors. The relationships are illustrated in Figure 1 below.

Figure 1. Simplified market overview



Source: Own work.

What is important while researching NGOs is the differentiation between nonprofit (sometimes also written *non-profit*) and not-for-profit organizations. While these two terms are often used interchangeably



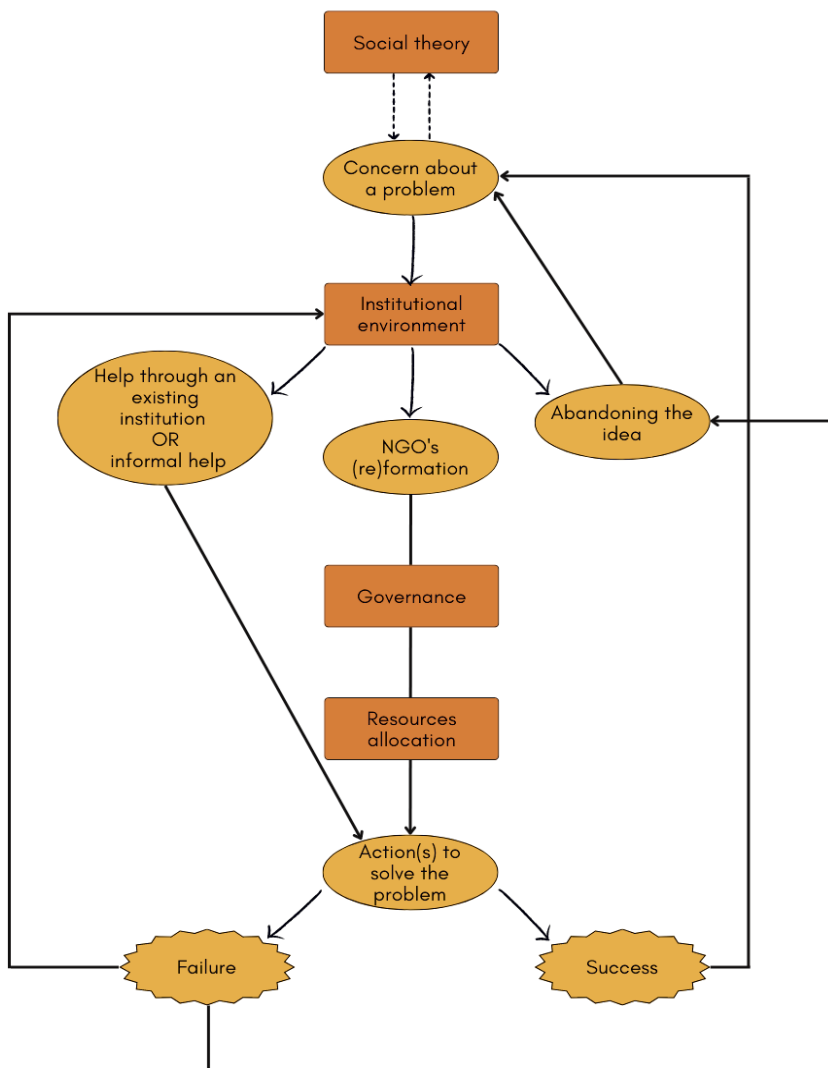
in the literature, for the sake of this article nonprofit organizations should be understood as organizations founded not to attain any profit whatsoever but acting mostly for the good of society unrelated to the members of the organizations, i.e., emphasizing the social purpose of their actions. In other words, such a nonprofit NGO creates some value that extends beyond the organization's framework and is impactful to other stakeholders (Teegen et al., 2004), e.g., legal aid societies, volunteer service organizations, animal shelters and sanctuaries, etc. On the other hand, not-for-profit organizations, while also not created to make profit, are organizations that can be perceived as clubs that chiefly focus on the welfare of their members, i.e., create some value that only the members benefit from (Teegen et al., 2004), e.g., community sports clubs, any clubs for like-minded people, labor unions, etc.

Based on this literature review, in particular the institutional hierarchy of O.E. Williamson, the theoretical framework of the economics of the public sector, and the motives behind the sharing economy, the author of this article built a model that describes the principles of the formation and functioning of NGOs in a modern economy. This model is presented in Figure 2 below.

The proposed model shows how social theory, e.g., culture, religion, customs, etc., affects what is and may be a problem, an issue that requires action, i.e., some occurrences and events may be completely normal in one community yet be a sign of a bigger problem in another. Sharing concern about a problem starts within this theory and is the catalyst that is processed by an institutional environment that consists of, among others, the market composition and competition, laws, and bureaucracy. The institutional environment thus presents a certain degree of a hindrance to the concern-sharing process. If such hindrance is too big a barrier, the idea of helping is abandoned until concern arises regarding another problem. If the institutional environment does not pose too many problems (or even provides some incentives), actions are taken to solve the problem, depending on factors such as available resources and personality traits, resulting in helping through an existing institution (note that it does not necessarily have to be an organization), autonomously (i.e., informal helping/volunteering) or by forming an NGO. Actions taken either result in success, which eventually leads to concern regarding another problem; alternatively,

these actions might fail, which causes a revision of the entire process on the grounds of the institutional environment.

Figure 2: NGO formation model



Source: Own work.

Eventually, if an NGO is created, it must go through processes of governance, which consist of management, setting the direction

of actions, the process of finding needed resources, forming internal regulations, accountability, etc. Then, available resources are allocated (assigned) in a way the organization perceives as correct to solve a chosen issue. These processes, and the actions taken, result in either solving a particular problem or failing to solve it. If these actions are successful, the organization can move on to observing and solving another problem. In the case of failure, it can either abandon the idea of helping altogether or go back to the institutional environment level to search for another approach to the same problem, e.g., searching for another source of revenue, reforming the NGO structure, or helping through other available means instead.

What is also important to note after the analysis of the model is that the described process is very streamlined and efficient as it is stripped of the flaws typical of the public sector and/or the private sector. NGOs (both nonprofit and not-for-profit) have to function in a competitive environment, being responsible for limited resources (making it crucial to allocate them well) and being managed by a person (persons) whose interest is aligned with the organization, i.e., solving the observed issues. NGOs are also closely monitored by both the public sector (which is responsible for revenue streams and/or tax credits, reliefs, and exemptions) and the public itself, who will not support an organization they do not perceive as credible. This way, it may be argued that NGOs sign an informal (or even formal in a variety of situations) social contract to undertake their statutory missions well. At the same time, NGOs do not have to be concerned with the maximization of profit and/or market share; they have different revenue streams than are typical of for-profit entities and their goal is to (keep on trying to) solve chosen problems for as long as resources last.

CONCLUSIONS AND RECOMMENDATIONS

The role of NGOs in the modern economy is undeniable as such organizations are crucial for supporting their stakeholders, who are disadvantaged in a variety of ways. NGOs and the people involved in them are also often the “first line of defense” during any kind of humanitarian crisis. The results presented in the article are coherent

with advances in normative economics, yet NGOs still need more anchor points in economic science. The presented literature review along with intertwined pieces of knowledge within the subdisciplines of economics are intended to be a starting point for subsequent ponderings about NGOs and the third sector. In the scope of this article and through the constructed model, a new perspective has been formed on NGO research and aspects of NGOs' decision-making. Previous perspectives on NGOs within the framework of new institutional economics perceived such organizations as "transitional institutions" that contribute to shaping the evolving dynamics in civil society and the public and private sectors (Cameron, 2010). The approach proposed in this article regarding NGOs has been changed and broadened by the theoretical foundations of public sector economics. Pigeonholing NGOs as partners of the public sector should be avoided; such organizations should be perceived more as partners of civic society that may operate in contradiction to the interests of the public sector (government). While a similar viewpoint has been presented regarding the least-developed countries and developing countries (Dorman, 2001; Copestake & Wellard, 1993), such viewpoint is not as common regarding modern economies. In the author's opinion, NGOs should be perceived as the sheer emanation of a society's need to become a formalized institution, i.e., an organization that is more immune to the weaknesses of the public sector, such as those regarding public choice theory, competition theory, transaction cost economics and principal-agent theory. What is also innovative in the proposed approach is the presented connection between NGOs and the sharing economy. In its current state, the sharing economy focuses on the more *material* side of sharing and perceives NGOs either as yet another market entity that may be able to share some commodity (service), or more as an "additional stakeholder" (Hossain, 2020; Richardson, 2015). This approach, as it stands, is incomplete as NGOs appear to be primary actors in the sharing process as they *share* something different with the society, i.e., affection and concern. In the author's opinion, the literature approach should be refined to widely accommodate the concept of sharing immaterial (and often hard to measure) resources as there is almost no trace of such an approach in the subject literature (Kornberger *et al.*, 2018; Hossain, 2020; Poniatowska-Jaksch & Sobiecki, 2016).



According to the author, what requires subsequent research attention in the first place is the matter of the *effective* management of NGOs. While the positive relationship between strategic human resources management and the performance of a commercial organization has been extensively studied and proven in the literature at length, it is far more complex in the case of NGOs as such management involves issues such as a lack of meaningful formal contracts, different goals (and means to achieve them) of NGOs compared to strictly commercial entities, the scarcity of resources and the constant need for employees/volunteers' time and their will to act, the unclear stance of human resource frameworks on volunteers (can a volunteer become a more *professional* volunteer?) or internationalization due to a different social theory behind every person involved (Bartram et al., 2017). While scarce evidence suggests that the inclusion of ethical practices and effective leadership in the management of an NGO would help with the retention and motivation of employees and volunteers (Bartram et al., 2017; Akingbola, 2006), there is still far from any consensus. Issues other than management that also require further research include questions regarding detailed aspects of NGOs, i.e., the institutional environment, governance, and the resource allocation of NGOs on the grounds of economics. Overall, the author believes that the presented perspective is an ideal starting point for future research regarding NGOs. The topic of NGOs on the grounds of economics is of an evolving nature and still requires a reasonable amount of further research, which is essential for the development of the third sector in national economies.

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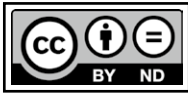
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