

**Multi-stakeholder governance,
Self-regulation
and
Independent monitoring
of Nonprofit Organizations**

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A model of ethical self-regulation for the social responsibility of non profit organizations

□ self-regulatory ethical standards

- seen as tools for implementing a model of “extended governance”**
- Settling fiduciary duties owed to stakeholders (mainly, beyond employees, the beneficiaries and donors)**
- by means of written self-regulatory norms and rules of behavior**
- Explicitly stated and agreed by means of social dialog amongst nonprofits and their stakeholders**
- Monitored and verified by nonprofit independent bodies**
- But nevertheless self-enforced and self-imposed by the organizations on they own, without the external enforcement by the law.**

Why collective decision mechanisms fail in providing financial support to the production of welfare goods?

❑ The market fails

- Externalities make inefficient using the price system
- Asymmetries of information and credence goods allow for opportunistic behavior on the part of private firms, that would expropriate the consumer of large part of the value

❑ The government fails

- It is ready to cover just the demand of the median voter

❑ Hence there is a demand for private voluntary provision of welfare goods based on donations

Also nonprofits may fail

- ❑ Incomplete contracts and asymmetry of information give wide discretion to the management
- ❑ The non distribution constraint reduces significantly the incentive to act opportunistically
- ❑ But nevertheless there are many other ways for expropriating the beneficiaries or the donors (i.e. appropriation of a fundraising campaign through exaggerating costs, benefits etc.)
- ❑ The nonprofit risk to be converted in a company for the advantage of the producers

Why the nonprofit does not fail?

- ❑ This may be due to intrinsic motivations of those who are ideologically committed to a “mission”
 - But looking after a “mission” in a particular sector of welfare goods doesn’t make sure that different stakeholders are treated **fairly**
- ❑ The search for reputation (= trust) through iterated exchanges with beneficiaries and donors may correct the tendency to act opportunistically
 - But how does the reputation mechanism work in effect ?

Reputation effects

- ❑ The organization must be able to **signal** a **positive** (even if small) initial **probability** that it is an honest type, that does not abuse his donor/beneficiary ,
 - and it must be able to undertake a commitment to play as if it were such a type
- ❑ It must be **farsighted enough** to have the incentive to follow the commitments
- ❑ Each play must **end** with a couple of actions and payoffs **clearly observable** by the players
 - **each player A must be able to infer whether the organization has acted according a given commitment (a type) i.e. whether “what had to be done has been done”**

The Cognitive fragility of reputation

- To enable the reputation cumulative process, the organisation should **commit** to a **strategy** carried out by a specific **unambiguous** and **verifiable** action
- **BUT** under **incomplete knowledge** and **unforeseen contingencies** contractual commitments are **mute** or **not even specified** (on the unforeseen states)
- Under radical asymmetric information outcomes are **not even observable** and hence it impossible to **verify compliance** with contractual commitments
 - **There is no basis to verify that “what had to be done has been done”**
- These **cognitive gaps** give **NO** basis for reputation

Three roles for ethical self-regulatory norms

- The basic idea is that the nonprofit doesn't fail due to the three basic roles of self-regulatory ethical norms
 - The normative role
 - The cognitive role
 - The motivational role

Normative role: settling fiduciary duties owed to stakeholders

- In order to **trust** a nonprofit organization, stakeholders, donors and voluntaries, employees and local communities must rely on the assumption that their trust will not be abused and they will be treated fairly
- Hence the “corporate governance” model of the nonprofit should reflect a multistakeholder approach based on a principle of fairness (social justice)
- **who runs the organisation (entrepreneurs, directors, managers) undertake responsibilities that range over the fulfilment of **fiduciary duties** towards all the organisation’s stakeholders**

Multiple fiduciary duties are the necessary reference point for nonprofits governance

- **The organization's governance structure is legitimate only if it works as a mediating hierarchy (Blair- Stout 1999)**
- **It must protect each stakeholder from each others opportunism, by balancing their respective claims and interests**
- **Thus a legitimate governance structure should be enlarged to include:**
 - Not only residual rights of control given to the owners or the management delegated to run the firm
 - But also a set of fiduciary duties owed to the non controlling stakeholders, enabling them to beneficiate from fair shares of the surplus carried out by the firm seen as a cooperative venture amongst all the relevant stakeholders.

The need for a normative model to set a balance among the stakeholders' interests and corporate fiduciary duties

- “Stakeholder” is *descriptive*: there are many classes of individuals holding a stake in the the firm because of their contributions, or because they are afraid of bearing external social costs

But...

- Stakeholder claims may also be conflicting
- Stakeholder theory needs a normative model in order to say
 - *how* to balance their conflicting claims,
 - how to identify which claims generate rights and fiduciary duties
- Thus an ethical *criterion* is needed to find out a balance that:
 - Can be accepted in advance by all stakeholders as a basis for their fair/efficient cooperation;
 - Be acceptable **from the impartial point of view** of whichever stakeholder

The “social contract” as the criterion for defining the balance amongst fiduciary duties

- A fair and efficient ‘*social contract*’ amongst all the stakeholders is the criterion to balance their different - sometime conflicting – interests, values and claims
- A social contract decides which claims are legitimate basis for recognizing rights and generating fiduciary duties upon who runs the organisation

Cognitive role: giving a base for definite expectations such that reputation effects can play their incentive function

- Against the benchmark of **general principles**, even if **vague**, stakeholders can entertain **expectations** about the firm's behaviour **also when** there are:
 - **unforeseen events** (not completely ex ante describable in details)
 - no **evidence** of company's behaviour
- These entail **rules of behaviours** activated by default reasoning in front of unforeseen situations that can be a **surrogate** for the lacking information about **concrete commitments** over actions
- Allows stakeholders to **fix a parameter** for deciding whether to trust or not to trust the organisation

The logic of self-regulatory norms and standards, operating as a gap filling device

- A) General ethical **principles** (fuzzy sets)
- B) **Precautionary rules** of behaviour /standardised rules of action (default inferences)
- C) Two-way communication and **dialog** in order to reach a **common understanding** about the matching between situations/principles/ and behaviours

(A) General Principles of ethics: gap filling

- Their statements are **abstract** and **universalisable** (**focused on characteristics invariant from situations to situations**)
- Their application does **not** need an ex ante **detailed description** of every situation, but only depends on the recognition of some **abstract characteristics** (**fuzzy pattern recognition**)
- In **no** situation they are **mute**: they cover any situation, foreseen, unforeseen or not even ex ante conceivable

(B) Precautionary rules of behaviour

- **Protocols** of behaviour (procedures) are activated in situations putting at **risk** the conformity to a principle
- Their activation depends on a given level of vagueness (**fuzzy ethical threshold**)
- They are **standardised, observable** and externally **verifiable**
- They are activated by **default reasoning** (the rule is obligatory until contrary proof is given)

(B) ... reasoning by default

- Default reasoning does not ask for a complete knowledge of the case
- You **must** just follow the protocol as far as the **vague belonging** of an event into the domain of a principle exceeds a **given threshold**
- Thus **commitments** can be undertaken even in the face of unforeseen contingencies
- As far as the protocol is implemented, **there is no evidence** that intentional infringement of a principle has occurred

Motivational role: generating intrinsic preferences for compliance with fiduciary duties

- ❑ Reputation, as an instrumental motivation, may allow also sophisticated strategies of abuse of donor's trust (against the beneficiary's interest)
 - For example: Codes of ethics and Social reports used just as window dressing ...
 - Egoistic stakeholders could give in in front of such sophisticated abuse
- ❑ BUT Stakeholders hold multiple reasons to act:
 - selfish/altruistic
 - but also based on deontological conformity with a principle of value

Motivational role (2)

- If organizations
 - announce ethical principles and rules of conduct ,
 - and the appropriate expectations are developed,
- then ideal preferences are activated, so that they go well beyond mere self-seeking behavior
- Stakeholders attach importance to the very fact that the organization complies with its own norms
 - Especially true when organizations undertake a commitment on principles and make promises
- Hence reactions from stakeholders to sophisticated abuse might be much less acquiescent than what could be expected in case they were holding just material “stake”

Intrinsic preference for reciprocal conformity to a principle of justice are at the basis of the very possibility of nonprofit organizations

□ three conditions must be fulfilled

1) Members agree on a constitution of the organization reflecting a principle of justice (the social contract) that balances the claims of different stakeholders

2) Their preferences depend not just on the material payoff but also on

- **how much each individual contributes in carrying out the principle of justice given what he expect about the compliance of the other members**
- **how much each individual expect that other member will reciprocally carry out the principle given what they expect about himself**

Intrinsic preference (2)

- 3) **Each of them must hold the expectation that other participant will in fact reciprocate conformity with the principle, i.e. will do their best (or nearly so) in contributing to carry out the constitutional principle**
- When these assumption are fulfilled the preference of members will incorporate a motivational factor that may **counterbalance** their material interest – which could push them to act opportunistically with respect to the beneficiary or other stakeholders (donors)
- Hence overall utility of the organization's members drives them to comply with commitments respecting stakeholders fiduciary duties**

How do ethical norms affect intrinsic preference?

- Having agreed on a norm as the constitutions of the organization, a shared principle is assumed working as the parameter for assessing reciprocal conformity
- Conditional, and reciprocal conformity are new motivational component introduced into the preference system of the organization's members
- But were the expectations of reciprocity come from?
- The same fact of the agreements offers a basis for developing these expectations
- In fact, we observe that people asked to agree on a principle under a veil of ignorance are driven to believe that anyone who has also agreed, until proof of the contrary, will also carry out the agreement, even if this is not in his best interest
- This is a good starting point for developing the expectations functional to reciprocal conformity,
- **But it is not enough** for assuming full fledged expectations allowing for conformist preferences

The basic complementarity of intrinsic motivation and self-regulatory norm aimed to reputation

- **Intrinsic motivations and standardized codes of ethics, systems of governance and accountability are not opposed, but complementary**
- By observing the organization to conform to a code of ethics (coherent with its constitutional principle) members support the belief of a generalized conformity to ideology
- Hence they expect members to conform with the constitutional principles
- Thus within the organization are formed those beliefs that support conformist motivations and spontaneous compliance

Civil society independent monitoring institutions as the essential support to the ethical self-regulation of nonprofits

- The next step in the process of self-regulation is the emergence of middle-level social bodies able to promote social dialogue such that (ID for example)
 - A broad consensus on ethical self-regulatory standards is created ,
 - independent verification of compliance with those standards (by means of appropriate monitoring and certification methods) is promoted ,
 - lower level watch dogs are activates

Why a need for multi-stakeholder civil society bodies of the

- Public statements of standards are needed to define a common benchmark against which different organizations may be compared
- Stakeholders may not possess the relevant information or the relevant reference criteria and knowledge to judge the organization's behaviour and communications
- There is an obvious **risk of collusion** between audit agencies and the organisations that these same agencies subject to their scrutiny,
- Monitoring organisations should be designed so that incentives against collusion and conflicts of interest are put in practice

Two basic feature for a collusion-proof design of the multi-stakeholder bodies

■ ***Multi-stakeholdership:***

- ❑ need to ensure that parochial interests do not take over the monitoring institutions - i.e. that they are not captured by vested interests
- ❑ Appropriate design in the distribution of decision rights and weights held by every category of participants, can help in preventing collusion.
- ❑ The idea is simply resorting to the well known constitutional mechanism of '**checks and balances**' among conflicting interests,
- ❑ So that parochial interests are reciprocally constrained, freeing the institution from their control

Two basic feature (2)

■ *Independence.*

- Multi-stakeholdership in itself is not enough
- institutions for social dialog risk to be turned into arenas of constant negotiation where those with the greatest bargaining power prevail or symmetric veto powers are able to drive them in dead-locks
- Is required adequate **autonomy** and **independence** of an ethical/scientific **infrastructure**, able to ensure independent assessments which satisfy requirements of impartiality and competence.

Summing up

- Self-regulation can be facilitated by the creation of middle-level civil society institutions endowed with
 - competence,
 - moral authority and independence,
 - seen as widely representative of the interests at stake
- This would also lead to strengthening those intermediate social bodies that underpin a modern economic democracy and a democratic society in general