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A Deficit Model of Collaborative Governance: Government–Nonprofit Fiscal Relations in the Provision of Child Welfare Services

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ABSTRACT

Much existing scholarship on nonprofit organizations' receipt of government funds appears to assume that there is something highly problematic about this relationship. Although rarely articulated in these studies, the concern about the negative effects of government funding turns on a view of nonprofits that privileges their private character. In this article, rather than examining how public funds constrain private action, we inquire about how government deploys private organizations, via the mechanism of government funding, to secure a public good. Using a case study of the nonprofit child welfare sector in New York State, we theorize a deficit model of collaborative governance in which nonprofits have been deputized by the state to secure children's social rights but do not receive sufficient resources to cover the costs of securing those rights. Then, we connect this theory to organization-level financial management practices that pose challenges to the nonprofits of both survival and service quality. This nonprofit organizational instability concerns the state insofar as it threatens the securing of individuals' social rights.

Much existing scholarship on nonprofit organizations' receipt of government funds appears to assume that there is something highly problematic about this relationship. Government funding undermines the independence of nonprofits (Boris and Stuerle 1999; Guo 2007; Kettner and Martin 1996; Lipsky and Smith 1989; Lynn 2002; O'Regan and Oster 2002; Rushton and Brooks 2007; Saidel and Harlan 1998). Government funding pushes nonprofits to change their approach to client service or staffing (Akingbola 2004; Lipsky and Smith 1989). Government funding creates inefficiencies and increases transaction costs for nonprofits (Gronbjerg 1991, 1993; Kramer

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1994; Lipsky and Smith 1989). Government funding pushes away private donors (Andreoni 1990; Brooks 2000, 2003; Payne 1998; Steinberg 1987).

Although rarely articulated as such in these studies, the concern about the negative effect of government funding turns on a view of nonprofits that privileges their *private* character. Nonprofits are indeed private corporations, with independent Boards of Directors charged with stewarding the organizations' private interests. From the perspective of preserving a nonprofit's private power to determine its activities, the trepidation about how government funding limits that power is appropriate. From a contemporary governance perspective, however, which recognizes that public goods are often coproduced by government and private organizations, we need to consider a wider set of questions about government funding of nonprofits. To state the case in stark terms, we should develop theoretical perspectives that treat the government–nonprofit *relationship* as the object of analysis. Such a perspective rejects the characterization of government and nonprofit organizations as wholly independent entities capable of “government failure” or “market failure.” Instead, it embraces Salamon's (1987, 1995) view that *interdependence* is the default relationship between government and nonprofits, and we should develop theory with this as our foundational assumption.

This view, first presented in Salamon's classic (1987) article, is grounded in the historical reality of the United States, where government has provided consistent financial support to nonprofit organizations for more than 150 years (see also Barrows 1885; New York City Department of Finance Charitable Institutions Division 1904). This long-term financial relationship, as Salamon argues, is motivated by “voluntary failure,”¹ wherein nonprofits offer unique capacities to respond to widely variant community needs but suffer especially from the inability to raise adequate funds, guarantee equitable access to nonprofit services, and perform according to professional standards. Salamon argues that acceptance of government funds allows nonprofits to ameliorate these failures, thereby moving towards coproduction of a set of public goods that more effectively meet community needs in a democratic society. Indeed, recent discussions in public administration increasingly accept that solutions to pressing social needs often rely on collaborative governance (e.g. Andrews and Entwistle 2010; Lecy and Van Slyke 2013).

Public administration scholars also have observed, however, that the nature and complexity of collaborative governance presents government with dilemmas of oversight and accountability. Salamon (1987, 1995) and Kettl (2002) refer to “third-party” government, Milward and Provan (2000) caution about the development of the “hollow state,” and Frederickson and Smith (2003) direct our attention to the “disarticulated state.” These discussions have tended to focus on the impacts of collaborative governance on state power. Equally important for discussions of collaborative governance, however, is how such arrangements affect citizens' claims to state protection. Salamon notes that nonprofit use of government funds shifts the nature of the relationship between nonprofits and their clients: when nonprofits rely only on private

1 More recent scholarship prefers the term “interdependence theory” to “voluntary failure” theory (e.g. Lecy and Van Slyke 2013) when describing the longstanding relationship between government and nonprofits in the United States.

support, “[a]id is provided as a matter of charity, not of right” (Salamon 1987, 41). This specific voluntary failure—Salamon dubs it “philanthropic paternalism” (1987, 41)—is diminished via government support, which allows clients to “establish a claim to [nonprofit] assistance as a right” (Salamon 1987, 42).

The idea of a “social right” is useful for examining the implications of Salamon’s idea that when nonprofits use government funds to assist individuals, nonprofits are not providing charity but rather securing a right of citizenship. Social rights—as distinguished from both civil rights and political rights—are affirmative government guarantees of conditions of well-being for their citizens (Marshall and Bottomore 1992 [1949]). For example, the most generally agreed upon social right is the right to primary education (Marshall and Bottomore 1992 [1949]; UN General Assembly 1948), which is thought to guarantee citizens’ ability both to exercise their civil and political rights, and to pursue individual well-being. In the United States, social rights like public education and public welfare do not appear in the US Constitution but often are guaranteed by state constitutions. Numerous federal and state statutes provide for government intervention into citizen well-being, such as aid to the elderly, children, and the disabled.

In this article, we ask how government’s provision of social rights for citizens is complicated, perhaps compromised, when these rights are secured by private nonprofit organizations using public funds. Whereas the state can properly be considered a guarantor of social rights, can nonprofit organizations also fit this bill? Or are nonprofits fundamentally marked by voluntary failure, and therefore constrained to be only private providers of collective benefits for particularistic groups? Young’s (2007) nonprofit benefits theory offers an important window into these questions. Young proposes that nonprofits produce four different classes of benefits—private, group, public, and trade (2007, 345)—and that different sources of nonprofit income appropriately correspond to these distinct benefits. Social rights, as guarantees of citizenship, are properly considered pure public benefits. It follows that taxpayers should be the sole source of support for social rights. We thus expect that government should fund the total cost of nonprofit provision of social rights.

Does this theoretical expectation hold? If so, then we can be more sanguine about the citizenship implications of collaborative governance. If not, then we need to recognize and respond to the wider issues that government funding of nonprofits raises for polity and society. Our approach to the question of government funding of nonprofits thus takes a different approach than most studies of this topic tend to do. We do not ask: how are nonprofits doing in their quest to serve the particularistic desires of their private constituencies? Instead, we ask: how well is government doing in its effort to guarantee certain social rights when it relies on nonprofits to secure those rights?²

To explore these issues, we provide a case study of the nonprofit child welfare sector in the state of New York. This case has three fundamental characteristics: (a) a statutory mandate for public provision of vulnerable children’s well-being; (b) near-total contracting out of that mandate to private, nonprofit organizations; and (c) a

² We note that the government–nonprofit relationship takes different forms, only some of which involve collaborative provision of social rights. Our theoretical contribution focuses specifically on a social rights-providing form of the government–nonprofit relationship.

Constitutional mandate that the state government regularly inspect nonprofits caring for vulnerable populations, including children, in order to guarantee appropriate provision. Given these conditions, which we might think of as the far end of a continuum of governmental enrolling of nonprofit organizations to secure social rights, how well does collaborative governance realize this goal? And, equally important from a management perspective, what are the relevant mechanisms affecting how well this social right is secured?

We argue that the state's ability to secure the social rights of vulnerable children relies upon private subsidization effectively financed by nonprofit service providers. Our analysis contributes to understanding how public contracting of vital and mandated services happens, how nonprofit providers manage these contracts that may frequently fail to cover total costs, how contract deficits may influence service quality and performance, and thus how this collaborative governance structure may undermine a social right.

In the next section, we trace the historical emergence of vulnerable children's social right to state protection. We then theorize a *deficit model of collaborative governance*, in which nonprofits have been deputized by the state to secure a social right, but do not receive sufficient support to cover the costs of securing that right. We further connect this theory to organization-level financial management practices that pose challenges to the nonprofits of both survival and service quality. This nonprofit organizational instability concerns the state insofar as it threatens the securing of individuals' social rights. We then empirically test this theory on a sample of child welfare nonprofits and find support for our deficit model of collaborative governance. We conclude by discussing the implications of our findings for public policy, nonprofit financial management, and the rights of citizens.

FROM CHARITY TO MANDATE: THE EVOLUTION OF CHILDREN'S SOCIAL RIGHTS IN NEW YORK STATE

The question of what to do with dependent and neglected children long has been bound up with the problem of social order (Platt 1969). Such children presented a moral imperative to be cared for, but also inspired a desire to prevent their becoming a danger to society. In New York, these twin concerns proved a constantly evolving project of collaborative governance between private interests and public authorities, pushing ever closer to establishing children's social right to state protection and care. At the same time, the "New York System" of child welfare practice secured a key role for nonprofit organizations in caring for vulnerable children, even as many other states eschewed such public-private collaboration, and leading child welfare advocates disdained the approach (Folks 1911 [1902]; Glenn, Brandt, and Andrews 1947).

The child-saving movement that began in the mid-19th century drew on private philanthropic resources both to assist children directly and to advocate for policy change. Through nonprofit organizations, the child-savers established orphan asylums, placed children in family homes, and lobbied legislators (Glenn, Brandt, and Andrews 1947). In New York, the first step toward establishing children's social rights came in 1875: the Children's Law forbade public authorities from housing dependent children in the local poorhouse (Folks 1911 [1902]). This institution for housing

and controlling public charges—criminals, paupers, the disabled, and the mentally ill (Katz 1996 [1986]; Patterson 1994)—came to be viewed as a threat to children’s well-being, and the state would no longer allow it (Schneider and Deutsch 1941). That same year, the private New York Society for the Prevention of Cruelty to Children (NYSPCC) was permitted to prosecute child abuse and neglect in the courts. New York’s existing laws could support such prosecution, but the state rarely pursued these cases (Folks 1911 [1902]; Hacsı 1995; Letchworth 1893; Myers 2008). Stepping into this void, the private NYSPCC took on this critical function of child protection. In this period, then, New York offered only rudimentary public guarantees of children’s well-being. Nonprofit organizations operating on a voluntary basis provided most of the child protection efforts in the state.

Government did, however, support these nonprofits financially. By 1901, New York City provided about 50% of the revenues for 38 “homes for children” (orphanages for toddlers and older children) and 19 “children’s charities and maternity hospitals” (where newborns and infants received care) (New York City Department of Finance Charitable Institutions Division 1904). State officials recognized that offering public subsidy to already existing nonprofits would prove less costly than setting up free-standing state institutions (Folks 1911 [1902]; New York City Department of Finance Charitable Institutions Division 1904); this is exactly as Salamon (1987) would have predicted the collaborative governance of an emergent social need to be financed.

Importantly, for our discussion of social rights, as the “New York System” of public finance for private charitable institutions developed, the state also included a regulatory component. The State Board of Charities was established by statute in 1867, charged with inspecting public and private charities in receipt of public funds. At the 1894 state Constitutional convention, the Board was elevated to Constitutional status, thereby insulating its regulatory role from statutory repeal (New York State Department of Social Services 1903). Both the statutory and the Constitutional language explicitly targeted state inspection at charitable institutions caring for vulnerable populations: children, the disabled, and prisoners.³ The question of the state’s regulatory powers over private organizations was fiercely debated, especially in cases where the charitable institution did not receive public funds. The 1899 legal case *State Board of Charities v. New York Society for the Prevention of Cruelty to Children* decreed that charities with no public support did not fall under the Board’s regulatory authority (New York State Board of Social Welfare 1930). Child welfare advocates in particular took issue with the decision and led two efforts to amend the state Constitution and establish the Board’s authority over all private charities caring for vulnerable populations. The first effort, in 1915, did not succeed. The second, in 1938, did. The state of New York thus took another key step in establishing the state’s responsibility for guaranteeing dependent children’s well-being, even when their care was provided by a private organization (Galie and Bopst 2012; Schneider and Deutsch 1941).

By the time of this amendment to the state Constitution, child welfare practice had shifted considerably. Most child welfare advocates had turned decisively towards

3 Institutions caring for the fourth major dependent population, the mentally ill, were mandated inspection by a different state entity.

family-based care as far superior to orphanages (Folks 1911 [1902]; Glenn, Brandt, and Andrews 1947), though Catholics maintained that Catholic institutional care was preferable to placing Catholic children in Protestant families (Brown and McKeown 1997; O'Grady 1971 [1931]). At the same time, progressive reformers in New York and other states finally saw victories in their fight to award cash assistance from the state to widowed mothers (Leff 1973). These funds allowed many children to remain at home, rather than be sent to child welfare institutions. In 1935, the federal government weighed in on this issue, creating Aid to Dependent Children as part of the Social Security Act. Thus was the well-being of dependent children essentially equated with state support of families to provide for their children at home (Crenson 2001). At the same time, child welfare institutions continued to serve a need in New York, and public subsidy grew: in 1929, although the number of New York City's "homes for children" had dropped to about 30, on average, these organizations now received about 70% of their revenues from public sources (New York State Board of Social Welfare 1930).

In 1973, New York State passed its first law against child abuse and neglect, requiring all counties to establish procedures for protecting children. In 1974, the federal Child Abuse Prevention and Treatment Act offered states federal funds for child protection, but only if states had child welfare systems in place. More than a century after the passage of the Children's Law, New York's complex collaborative governance of children's social rights combines a public guarantee with a private system of service delivery. Concomitantly, the government share of child welfare provision has risen substantially. In 1970, about 65% of New York City's child welfare nonprofits' budgets came from government (Young and Finch 1977); by the time of our study, that figure had risen to 90%. Providing services through these nonprofit child welfare organizations rather than through public bureaucracies remains a source of considerable savings for the state.⁴

Thus, despite this very significant rise in government support for child welfare nonprofits, we argue that these organizations still operate within the original 19th century fiscal model. Even in the 21st century, when vulnerable children's social rights are well established, we see that government finances only a portion of the total costs of securing those rights. Whereas 19th century child welfare nonprofits were subsidizing an optional (that is, not mandated) public good because of religious and reform instincts, 21st century child welfare providers subsidize a social right established in the Constitution and by statute. Put another way, private nonprofit organizations must

4 For example, one of the major cost savings that New York State government reaps from its current reliance on nonprofit child welfare providers is in employee fringe benefits (health insurance and retirement benefits). While the average ratio of fringe benefits to salaries for New York State government workers is approximately 52%, the average ratio among nonprofit child welfare organizations is only 25% (authors' calculations; child welfare data obtained from the Form 990, and New York State data obtained from Comprehensive Annual Financial Reports). New York State data come from the Statement of Revenues, Expenditures, and Changes in Fund Balance (Deficits) for Governmental Funds for each year from 2006 to 2010. The fringe amounts include the line-items "Pension Contributions" and "Other Fringe Benefits", while the denominator is "Personnel Services." Child welfare data come from the Form 990 Statement of Functional Expenses for 2006-2010. Included fringe items are "Pension Plan Accruals and Contributions," "Other Employee Benefits," and "Payroll Taxes." The denominator measuring payroll includes "Compensation of Current Officers, Directors, and Trustees, and Key Employees," "Compensation Not Included Above, to Disqualified Persons," and "Other Salaries and Wages."

cover a portion of the government's costs of providing child welfare; at the same time, government can use these savings to increase spending in other areas or reduce tax burdens on citizens, effectively financed by child welfare nonprofits.

THEORY AND MANAGEMENT CONSEQUENCES OF A DEFICIT MODEL OF COLLABORATIVE GOVERNANCE

Existing literature has hinted at the ways that government support requires nonprofits to subsidize the provision of public goods by raising private funds. For example, Gronbjerg (1991, 1993), Smith and Lipsky (1993), and Kramer (1994) describe cash flow delays that result from the complexities of government contracts. They also hypothesize that nonprofits experience increased costs as the direct result of devoting personnel (both existing and new) to managing those contracts. While these studies recognize the complexities of managing government contracts, we see other financial mechanisms underlying nonprofits' reliance on increased government funding—particularly, when these nonprofits are the sole providers of a social right such as child welfare. For example, differences in government funders' reporting requirements, permissible administrative allowances, and contract requirements increase administrative costs as additional government contracts are acquired by a nonprofit. These administrative differences make achieving economies of scale in contract management difficult. While Boris et al. (2010) find that 65% of New York State nonprofits have four or fewer government contracts, our sample of child welfare providers manages on average 38 separate government contracts from over 20 different public agencies in 2010. This fractured system of funding a social right results in large unfunded transaction costs incurred by the nonprofits hired by governments to secure this right.

Beyond these transaction costs, government contracts also rarely pay for cash flow costs. For example, government delays in payments might result in a nonprofit using a line of credit to cover short-term cash needs, yet the interest charged by lenders is not reimbursable.⁵ Many government contracts also limit the amount of administrative overhead they will fund, insisting instead that the bulk of resources be devoted to direct program expenses. In addition, nonprofits must handle government audits, which use nonprofit resources but are rarely financed by government funds. In fact, given the number of contracts and funders, each with different fiscal reporting periods, many child welfare providers in New York State effectively are audited on a continuous basis year round.

Perhaps most importantly for the case study presented here, government funding frequently limits cost of living adjustments (COLAs) for these contracts. The purpose of COLAs is to reimburse nonprofit providers for increasing costs associated with securing the social right of child welfare, many of which are beyond the control of the nonprofits (such as employee health insurance, food, gasoline and heating oil, among others). Instead, limiting COLAs—and in some instances reducing payment rates already in place—has become a common government budget balancing technique. In New York State, child welfare agencies have received no COLA increases in 5 years,

⁵ In our sample—described in detail later—over 70% of the sample had drawn on their lines of credit.

and Medicaid rates have actually been reduced.⁶ A simple calculation shows how significant COLAs are to a nonprofit. If government reimbursements are frozen for 5 years while economy-wide costs increase only 2% annually (comparable to current inflation rates⁷), the purchasing power of the government reimbursements will have cumulatively fallen more than 10%—leaving the nonprofit to make up the difference. Therefore, while costs incurred by the nonprofit to secure social rights increase, government is able to limit these cost increases to itself by effectively having the nonprofit providers finance these increments themselves. Hence, child welfare providers incur transaction costs because of government contracts, but they also end up financing a portion of the costs of securing a social right. We refer to this financial arrangement as the deficit model of collaborative governance.

We thus make a broad argument that when government fails to cover nonprofits' total costs of securing a social right, it leads to a perverse financial management consequence: the more government funds a nonprofit receives, the more costs the nonprofit must cover on its own in order to secure that right. That is, each additional government dollar a nonprofit receives requires the organization to provide some amount of private funds to cover the deficit resulting from the government funds. These private funds might come from additional donations or from resources that are independent of programmatic output, such as spending accumulated investments, increasing borrowing, or using accumulated reserves. In other words, even after the public has decided that government is to secure some social right—like the protection of children at risk of abuse and neglect—a collaborative governance structure will make that social right subject to and dependent upon private subsidy.

In the case of child welfare, we argue that the contracting process renders the state dependent upon private organizations not only to secure this social right, but also to finance a portion of its cost. This problem is compounded because as government funding to a nonprofit increases, much research finds that private funds via donations decrease (Payne 1998; Steinberg 1987). Further, the use of accumulated reserves and debt for the provision of these services leaves nonprofits exposed to potential fiscal shocks, and such financial vulnerability is related to service quality (Greenlee and Trussel 2000; Keating et al. 2005). Finally, many nonprofits do not even have reserves to draw upon (Blackwood and Pollak 2009; Calabrese 2013), closing off a potential source of private funds for many organizations. Thus, for nonprofits that are effectively deputized by government to secure certain social rights, a high reliance on government funds both makes it difficult to raise the necessary private subsidy to successfully secure the social right, and increases organizational financial vulnerability, thereby placing service quality and continuity in jeopardy.

Because private subsidy appears to be a requirement for nonprofits to provide social rights they have been asked by the state to secure, the nonprofits that survive in this environment will only be those which can in fact obtain sufficient private subsidy via donations, borrowing, or reserves. Alternatively, if nonprofits cannot raise sufficient subsidy, they are likely to attempt to secure the social right by pursuing other financial management strategies. Most obviously, an alternative approach might be

6 See Purcell (2013).

7 The average change in the consumer price index during our study period was 2.25% annually.

for the nonprofit to reduce input costs in an attempt to align the government funds it receives more closely with its total cost; that is, these nonprofit providers reduce the costs of their output—child welfare. One strategy might be to under-invest in organizational infrastructure, such as technology, financial personnel and systems, and other organizational components related to support services. Reducing input costs and investments in organizational support services might solve an immediate financial problem, but this may come at the price of reduced organizational performance (i.e. service quality). Hence, a potential outcome of the deficit model of collaborative governance in child welfare might be a reduction in the quality of child protection, leading to a failure to secure the child's right to be protected.

In what follows, we examine how the deficit model of collaborative governance that is the key to New York's present-day child protection system impacts organizational financial health and child welfare service quality. First, we list several testable hypotheses about the deficit model of collaborative governance. Second, we begin to examine this model using quantitative analyses of child welfare organizations' financial condition and service quality. Third, we use data from our survey of New York child welfare nonprofits to illuminate some of the management strategies that these organizations deploy in the face of their deficit funding relationship with government. We conclude by arguing that when government relies on private actors to secure social rights, and those private organizations chronically fail to secure necessary private subsidies,⁸ what at first glance appears to be a private organization's financial management problem becomes instead a threat to the securing of a social right.

HYPOTHESES

The following testable hypotheses emerge from our deficit model of collaborative governance, as articulated above.

- H1: As the deficit from collaborative governance increases, the nonprofit will increase its private grantseeking to cover costs related to but not funded by government sources, all else equal.
- H2: As the deficit increases, the nonprofit will use up accumulated investments to cover costs related to but not funded by government sources, all else equal.
- H3: As the deficit increases, the nonprofit will increase its indebtedness to cover costs related to but not funded by government sources, all else equal.
- H4: As the deficit increases, the nonprofit will use up reserves to cover costs related to but not funded by government sources, all else equal.
- H5: As the deficit increases, the nonprofit will reduce support services to reduce costs, all else equal.
- H6: As the deficit increases, the nonprofit will experience a decline in its programmatic quality, all else equal.

The first four hypotheses are related to a nonprofit having to finance uncovered costs resulting from the government funding it receives. Hypothesis 5 is related to

⁸ The structural inability to secure private subsidy created by the deficit model propagates one of the key dynamics of voluntary failure: philanthropic insufficiency. We thank one of the anonymous reviewers for this point.

cost reduction efforts by nonprofits seeking to minimize the gap between available resources and spending resulting from this deficit model. We test Hypothesis 6 because these organizational efforts to secure a social right have the potential to erode the fiscal health of the nonprofit, leading to reduced quality of services, or even the failure to secure this right.

DATA

To examine this deficit model of collaborative governance, we conducted a case study of the child welfare sector in New York State. At the end of fiscal year 2010, some 24,000 New York children were in the care of governments throughout New York State. Approximately 5,000 were in some form of congregate housing (e.g. group homes or other institutional settings), while 19,000 were in non-congregate care (generally, family foster care). About two-thirds of these children were under the age of 13. In New York, when the state determines that a child is experiencing or is at risk of abuse or neglect, government workers will determine whether the child must be removed from the home, or if some other form of intervention is required. Once that decision has been made, however, it is a private, nonprofit organization that delivers services.

Our sample begins with the population of nonprofit organizations that are members of the Council of Family and Child Caring Agencies (COFCCA).⁹ COFCCA is a membership organization representing (at the time of our study) 89 nonprofit organizations that provide the vast majority of child welfare services in the state of New York. Three member organizations were excluded from our study because they operate nationally, and four were excluded because they were large multiservice organizations that operate very small child welfare programs.

Financial Data

We gathered financial data on the 82 remaining COFCCA members from multiple sources. Our primary source of financial data came from audited financial statements for the years 2006 through 2010. The New York State Attorney General's Charities Bureau makes available online the audited financial statements of registered nonprofit organizations. For organizations in our sample that were missing financial statements from the Attorney General's database—due to being exempt from the requirements (for some religiously affiliated organizations or simply due to oversight)—we gathered the audited financial statements directly from the child welfare nonprofits, with the assistance of COFCCA. The audited financial statements were then augmented with information from the organizations' federal Form 990 informational returns. In the case of child welfare nonprofits with multiple corporations, which therefore have multiple Form 990s and audited financial statements, we combined the multiple public financial documents to analyze the organization as a single consolidated entity.

9 COFCCA provided financial support for this study. See [Marwell, Calabrese, and Krauskopf \(2012\)](#).

Survey Data

We augmented the financial data with a survey that was developed in close collaboration with COFCCA. The goal of the survey was to better understand the fiscal management and governance practices within child welfare nonprofits, so as to inform our analyses of the financial data. We administered the survey in either a face-to-face or a telephone interview with each organization's Chief Financial Officer or equivalent.¹⁰ Of the 82 organizations in our sample, 79 participated, for a response rate of 96%. The 110-item survey was designed with a goal of taking 45 min to complete; actual interview durations ranged from 35 to 75 min.¹¹

Performance Data

New York City's child welfare agency, the Administration for Children's Services (ACS), issues performance scorecards to its nonprofit child welfare contractors. Performance is assessed on four criteria, with each one receiving a letter grade between A (the highest) and F (the lowest). The scorecard grades are based on case record reviews and outcome data from existing systems. Importantly, these scorecards were developed in collaboration between ACS and child welfare nonprofits. While the nonprofits have articulated some concerns about using standardized performance measures to assess their services, they recognize the importance of such performance evaluations and believe that these measures actually address the most important aspects of child welfare (Scaglione 2010). As such, these performance measures have important validity properties that are lacking in many evaluations of human service agencies.

The four performance criteria are: safety, permanency, well-being, and foster parent recruitment and support. Safety performance focuses on how well children are protected from abuse and neglect and safely maintained in their own homes whenever possible. Permanency performance focuses on foster care being a short-term placement while a safe, permanent, living situation is found for the child, either with the birth parent(s) when it is safe or, if that is not possible, with relatives, adoptive parents, or kinship guardians who make a permanent commitment to the child. Well-being is a broad performance outcome that involves families being better able to provide for their children's needs and children being provided with services that meet their educational, physical health, and mental health needs. ACS also tracks the ability of child welfare nonprofits to recruit qualified families to provide foster care for children when necessary.

The scorecard evaluations were implemented in 2009, so we gathered 2010 scorecard data on 27 of the 40 New York City child welfare nonprofits in our sample (scorecard data on the remaining 13 New York City organizations were not available because these organizations were not scored by the City). The scorecard data were combined with the financial data (from the survey, audited financial statements, and Form 990s), so that we could link organization finances and service performance. Unfortunately,

¹⁰ Organizations located within New York City generally were interviewed in person, while organizations located outside New York City were interviewed via telephone.

¹¹ All respondents to the survey were guaranteed through a process of informed consent that responses would be kept confidential. Only de-identified data are used publicly.

municipalities outside of New York City do not collect performance data on child welfare nonprofits, nor does New York State. Thus, our empirical analysis of the performance data is performed on a much smaller sample than our other analyses and should be treated only as suggestive.

MODEL

To test this deficit model of collaborative governance for child welfare in New York State, we use the following model:

$$Y_i = \beta_0 + \beta_1 \text{ Deficit Margin}_i + \beta_2 X_i + \varepsilon_i \quad (1)$$

In model 1, Y_i takes various definitions to test our articulated hypotheses, Deficit Margin_i represents the amount of annual spending to secure a social right by organization i that is not financed by government funds, and X_i represents a series of control variables. Our variable Deficit Margin_i operationalizes our articulated theory of government not covering the full costs of securing a social right. Although each child welfare nonprofit might be considering all Y (dependent variables) simultaneously, we estimate each equation separately using ordinary least squares (OLS) regression. Because our models use identical regressors, OLS is more efficient and appropriate.

DEPENDENT VARIABLES

To analyze the relationship between the collaborative governance deficit and private grantseeking (Hypothesis 1), we use the organization's fund raising expenses scaled by total organizational expenses (to address potential size differences between organizations). This variable measures the extent to which the child welfare nonprofit devotes its resources to securing private donations. Data for this variable are obtained from the organizations' audited financial statements.

To analyze whether child welfare nonprofits spend down investments to make up for the deficit model (Hypothesis 2), we construct a measure of an organization's spendable investments. We measure investments in securities (publicly traded and others) using data from the Form 990 (lines 11 and 12 of the balance sheet); for entities not filing the Form 990, we gathered comparable data from their audited financial statements.¹² We subtract the balance in permanently restricted net assets as an estimate of investments unavailable to the organization for spending. We then scale this spendable investment by total expenses, thereby measuring the extent to which these investments could cover organizational spending.

To analyze the relationship between the collaborative governance deficit and debt (Hypothesis 3), we construct a measure of an organization's total liabilities, scaled by total assets. These data are obtained from the audited financial statements and measure the extent to which an organization has used borrowed resources to finance its assets.

12 Four surveyed organizations are not required to file Form 990s because they are religious organizations exempt from filing requirements.

To analyze whether the deficit model and the use of reserves are related (Hypothesis 4), we construct a simple measure of cash at year-end (obtained from the audited financial statements), scaled by total expenses.¹³ This variable measures how long a child welfare nonprofit could maintain spending on current services using its cash on hand.

To measure the relationship between the collaborative governance deficit and organizational support service spending (Hypothesis 5), we construct a measure of organizational spending on management and support as a fraction of total spending (data for which were obtained from the audited financial statements). Management and support costs usually include back office operations such as financial management and accounting, information technology, and other administrative expenses.

We analyze performance (Hypothesis 6) separately.

INDEPENDENT VARIABLE

Our primary independent variable of interest is the ratio of total spending on child welfare services (a social right) that are not financed by governments. Such a variable requires measures of total government funding of each child welfare organization as well as total spending by each agency. We draw these data from the nonprofits' audited financial statements, either directly from operating statements or from the notes to the financial statements that provide data on program service revenues and, most importantly, the source and public nature of these revenues. In New York State, most public funding is provided to child welfare nonprofits through contracts for services, calculated either on a per diem basis (i.e. nonprofits are paid per child per day by government for some particular service) or reimbursed for expenditures (i.e. nonprofits are repaid for expenditures made on programs after vouchers and proof of such payments are provided to the government). We then subtracted total expenses from this government funding data to determine the amount of annual spending not financed by government. To reduce heterogeneity, we scale this measure of deficit margin by total expenses.¹⁴

CONTROL VARIABLES

We include several controls that may be related to our dependent variables. An organization's age has proxied for its stage of growth and reputation (Tinkelman 1999). As such, we include a measure of age—calculated as the years since a child welfare nonprofit was founded and the current fiscal year. We obtained organizational founding data from the Form 990¹⁵; for the few organizations not filing Form 990s, we obtained year of formation data from annual reports publicly available on websites.

13 Noncash depreciation expenses are not included in this calculation.

14 We further explored defining our independent variable as Total Government Revenue/Total Expenses. While the empirical results were qualitatively the same as those presented, the interpretation of the current independent variable is more straightforward.

15 Beginning with the Form 990 redesign implemented in 2008, field L on page 1 includes "Year of Formation."

Because organizations with endowments tend to behave differently than those without endowments (Bowman, Tuckman, and Young 2012), we also control for the existence of endowments. Because endowments are not known with certainty from the Form 990s and are not consistently reported in audited financial statements, we use the method recommended by Bowman, Tuckman, and Young (2012) to determine if a child welfare nonprofit is “presumptively endowed.” We measure “presumptive endowment” by first examining invested securities (excluding land and property); we then determine that organizations with investments in excess of annual expenses to have an endowment (in other words, financial investments in excess of annual spending are defined as an organization’s endowment). Given the lack of precision with this measure, we use a simple dummy variable to indicate that a child welfare nonprofit is presumptively endowed.

As is common in the nonprofit finance literature (e.g. Core, Guay, and Verdi 2006; Tinkelman 1999), we also control for organization size. Larger organizations may achieve economies of scale in some operational capacities (such as cash management and banking), have easier access to credit, and may have different levels of financial sophistication. We define size as the natural logarithm of total expenses.

We include as an additional control the number of government contracts an agency manages because Guo and Acar (2005) find that such contracts do alter organizational behavior. This data were gathered from interviews with agency financial managers; unfortunately, the data were only available for 2010, the last year of our panel. We included the variable in levels and natural logs for the 2010 cross-section and results were not significant. Given our limited data on the topic, future research should further explore this topic.

Table 1 includes definitions of all variables. All data were first adjusted for inflation using the consumer price index from the Department of Labor.

RESULTS

Descriptive Statistics

Table 1 also includes the descriptive statistics for the variables used in our analyses. During the 2006–2010 period of analysis, child welfare nonprofits in New York State financed about 11% of total spending from nonpublic sources. These nonprofits only devoted about 1% of spending to fund raising, and less than 12% of spending towards management and other support services. The average child welfare nonprofit has spendable investments of nearly 21% of annual spending; this represents about 75 days of spending—or about 2.5 months. Importantly, only 8% of the sample (or about six organizations) is estimated to have an endowment. These two variables suggest that New York State child welfare nonprofits are not managing large endowments and do not have access to significant accumulated organizational wealth. Cash reserves of less than 7% indicate that the average child welfare nonprofit has about 24 days of cash on hand to cover expenses; this would be enough to cover just one biweekly pay cycle. The average child welfare nonprofit has a total debt ratio of 55%, while the average for the nonprofit sector as a whole is nearly 68%.¹⁶ This means that borrowing financed about 55% of child welfare nonprofits’ assets, with the remaining 45% financed with net assets.

¹⁶ Based on authors’ calculations. Using the National Center for Charitable Statistics Digitized Database—which is a representative sample of the sector—for the years 1998 through 2003.

Table 1
Descriptive Statistics – Financial Characteristics of New York State Nonprofit Child Welfare Organizations

| Variable | Definition | Mean | SD | Minimum | Maximum |
|----------------------|--|----------------|----------------|---------------|---------------|
| Dependent variables | | | | | |
| Fund raising | Total fundraising expenses scaled by total expenses | 1.06% | 1.76% | 0.00% | 13.46% |
| Investments | Total financial investments – permanently restricted net assets scaled by total expenses | 20.82% | 44.53% | 0.00% | 292.35% |
| Reserves | Total cash scaled by total expenses | 6.68% | 7.66% | 0.62% | 49.69% |
| Debt | Total liabilities scaled by total assets | 55.03% | 32.32% | 2.10% | 209.25% |
| Support services | Total management and general expenses scaled by total expenses | 11.63% | 3.78% | 0.28% | 30.06% |
| Independent variable | | | | | |
| Deficit margin | Government funding – total expenses/ total expenses | -11.34% | 12.03% | -60.38% | 0.00% |
| Controls | | | | | |
| Age | Years since organization founded | 85.16 | 52.75 | 3.00 | 204.00 |
| Endowed | Dummy variable, where 1 = financial investments greater than annual expenses | 8.10% | 27.32% | 0.00 | 1.00 |
| Size | Natural log of total expenses | \$16.77 | \$1.15 | \$13.19 | \$19.40 |
| Size (not logged) | Total expenses | \$34.1 million | \$40.9 million | \$0.5 million | \$267 million |

Reflecting the long history of child welfare nonprofits in the state, the average age of organizations in our sample is over 85 years. While there are some newer organizations, 30 are over 100 years old. The average child welfare nonprofit spends more than \$32 million annually. This amount of annual spending makes these child welfare organizations much larger in terms of total expenses than other nonprofit organizations on average.¹⁷

Methodology

We employ several different techniques to estimate the relationship between the deficit model of collaborative governance and child welfare nonprofits' financial management decisions. We first estimate Equation 1 using ordinary least squares regression.¹⁸ Robust standard errors clustered by child welfare organization are used to address potential problems with autocorrelation and heteroskedasticity (Cameron and Trivedi 2010). The explanatory variables are lagged 1 year to mitigate potential endogeneity concerns (Wooldridge 2013). Further, year dummies are included in the models to control for larger policy and economic factors that equally influence the nonprofit agencies, but the results are not presented due to space constraints. Locational fixed effects are also included to control for unobserved factors related to organizational location because urban providers likely face different financial needs than rural providers. For example, urban providers may face greater costs for property—and hence have greater debt—than rural providers; urban providers especially in New York City may have greater proximity to certain donors and have fewer resources devoted to grantseeking. The location fixed effect helps control for these differences. Results of this estimation are included in Table 2, Panel A.

Many of our variables exhibit little change within each organization over the 5 years of our study. This is unsurprising because client populations do not change significantly year to year, and government contracts to child welfare nonprofits are routinely renewed (because the service is required and the government itself has no capacity to deliver the services). Because of this limited variation, we also estimate Equation 1 using the 5-year average of all data. Although lagged variables are not possible, these averages smooth out annual variation and reduce potential noise in our financial variables. Results are included in Table 2, Panel B.¹⁹

17 The average total expenses for all nonprofits between 1998 and 2003 is approximately \$14.1 million based on the Digitized Data. Authors' calculation.

18 We also tested all models using Tobit regressions because the dependent variables are censored. The results were effectively unchanged from those presented.

19 Further robustness checks were employed with similar results but are not presented because of space. For example, estimating Equation 1 with the debt ratio as the dependent variable introduces one potential empirical consideration. Because the debt ratio is necessarily dependent upon the prior year's indicator (because the debt ratio in period t is by definition dependent upon what the ratio was in $t - 1$), we should also include a lagged dependent variable in our estimates. Doing so, however, requires us to estimate the equations using Zellner's (1962) seemingly unrelated regressions (SUR) estimator to allow for the error term of each equation to be potentially simultaneously correlated with the others. Such simultaneity assumes that these organizational changes may occur jointly (e.g. an organization might consider reducing costs as well as spending down investments). This was not a concern in the original estimations because the regressors were identical throughout the estimations, and in those cases, the estimates obtained via SUR are identical to OLS. When we estimate the equation using SUR, the results are qualitatively unchanged: signs and significance on our primary independent variable of interest in any estimates. We also tested a model in which we used 4-year averages of our variables, allowing us to mitigate endogeneity concerns by using lags. The results were again unchanged from those presented.

Table 2
Relationship Between Government Revenue on New York State Nonprofit Child Welfare Providers

| | DV = Fund Raising (1) | DV = Investments (2) | DV = Debt (3) | DV = Reserves (4) | DV = Support Services (5) |
|------------------------|--------------------------|-------------------------|--------------------|----------------------|------------------------------|
| Panel A | | | | | |
| Deficit margin | -0.087*** (0.017) | -0.597*** (0.159) | 0.528*** (0.220) | -0.165* (0.098) | -0.100*** (0.035) |
| Age | 0.000 (0.000) | 0.001*** (0.000) | -0.001 (0.001) | -0.000 (0.000) | 0.000 (0.000) |
| Endowed | -0.005 (0.005) | 1.315*** (0.181) | -0.330*** (0.713) | 0.019 (0.023) | 0.004 (0.012) |
| Size | -0.003* (0.002) | 0.020 (0.019) | 0.048 (0.030) | -0.008 (0.007) | -0.006 (0.005) |
| Constant | -0.394 (0.764) | 20.991 (18.535) | -29.949** (13.632) | -1.957 (4.359) | -0.253 (1.536) |
| Time effect? | Yes | Yes | Yes | Yes | Yes |
| Location fixed effect? | Yes | Yes | Yes | Yes | Yes |
| F-test | 5.02*** | 20.14*** | 11.11*** | 1.82 | 2.88** |
| R ² | 43.42% | 80.15% | 28.92% | 10.93% | 17.87% |
| N | 316 | 316 | 316 | 316 | 316 |
| Panel B | | | | | |
| Deficit margin | -0.102*** (0.128) | -0.812*** (0.198) | 0.642*** (0.292) | -0.184*** (0.069) | -0.118*** (0.034) |
| Age | 0.000 (0.000) | 0.002*** (0.04) | -0.001* (0.001) | -0.000 (0.007) | 0.000 (0.000) |
| Endowed | -0.013** (0.006) | 1.487*** (0.102) | -0.356** (0.150) | 0.021 (0.035) | -0.000 (0.156) |
| Size | -0.003* (0.001) | -0.001 (0.020) | 0.060** (0.029) | -0.011 (0.07) | -0.007 (0.003) |
| Constant | 0.042*** (0.021) | -0.140 (0.329) | -0.273 (0.485) | 0.231** (0.114) | 0.213*** (0.056) |
| Time effect? | No | No | No | No | No |
| Location fixed effect? | No | No | No | No | No |
| F-test | 18.41*** | 82.24*** | 5.51*** | 3.43** | 4.76*** |
| R ² | 49.87% | 81.84% | 23.21% | 23.21% | 16.17% |
| N | 79 | 79 | 79 | 79 | 79 |

Note: Panel A reports robust SEs clustered by nonprofit organization. All variables are lagged 1 year. Panel B uses the average value over the 5-year panel for each nonprofit organization. * $p < .10$, ** $p < .05$, *** $p < .01$.

Empirical Results

Contrary to expectations, as the deficit margin from government funding increases, spending on grantseeking actually declines (Hypothesis 1). This result is consistent in both specifications (Column 1) and is statistically significant at the 1% level. The results suggest that a 10% increase in the deficit margin from government funding (e.g. from 10% to 11%) decreases fundraising expenses between 9% and 10%, all else equal. Economic studies of the “crowding out” of private contributions by government funding generally find a negative relationship. Our analysis suggests a potential alternative interpretation unexplored in that literature: rather than organizations reducing their grantseeking because the need to fundraise is diminished as a result of government funding, child welfare nonprofits may reduce grantseeking simply as a cost saving measure necessitated by this collaborative governance deficit. In other words, while child welfare nonprofits *need* to seek private funds, they are (on average) unable to fund these efforts because of government underfinancing. Almost pathologically, the deficit model of collaborative governance requires private funding to secure a social right, yet child welfare nonprofits are unable to seek this private funding because expenses must be reallocated to secure the social right at the expense of seeking private funds. Therefore, although the empirical results may appear at first blush to run counter to our theoretical consideration about the deficit model, the results presented in Column 1 of Table 2 may in fact support it and may also inform ongoing analyses about the relationship between charitable donations and government funding of nonprofit organizations in general.

The results in Column 2 related to spending down investments (Hypothesis 2) are consistent with expectations. Both specifications find a negative and statistically significant relationship between investments and the deficit model, suggesting an association between child welfare nonprofits’ investment holdings and the deficit model of collaborative governance. These results suggest, as hypothesized, that nonprofits effectively use up their investments—which are limited in size on average—to cover deficits resulting from government funding that fails to cover the full cost of securing a social right.

Column 3 displays the results for the analyses examining the relationship between child welfare nonprofits assuming greater debt and the deficit model of collaborative governance (Hypothesis 3). The results consistently show a positive and significant relationship, as expected. One potential critique of the results is that stable government revenue makes it easier for child welfare nonprofits to secure debt and is not necessarily a result of the nonprofit needing to borrow for routine operations. The mean operating margin during the 2006–2010 period is -1.23% , which indicates that the average child welfare nonprofit in New York State is spending more on operations than it brings in. Further, the median operating margin (not reported) is 0% , meaning the child welfare nonprofit in the middle of the distribution is simply breaking even (with revenues equal to expenses) during the 2006–2010 period. Such negative and nonexistent margins increase the need for debt, as nonprofits need resources to meet obligations or finance asset acquisition, and profits are unavailable to cover these costs.

Most telling, however, is that the average financial debt ratio (i.e. debt that is traditionally secured by an asset or revenue stream and borrowed from a financial

institution) for child welfare nonprofits is only 19%, while the ratio of other unsecured debt (such as accounts payable—i.e. borrowings brought about through trade credit, not paying vendors, delayed salary payments, etc.) is 36%. Further, the financial debt ratio was unchanged during the 2006–2010 period, while the total debt ratio increased from 52% to 59%. This means that the increase in debt is attributable entirely to non-financial/unsecured debt stemming from not paying bills that are related to operating (noncapital) purposes (e.g. to vendors and employees), or at least extending the time to pay them.

The results in Column 4 analyzing the relationship between the reserves of child welfare nonprofits and the deficit model of collaborative governance (Hypothesis 4) are generally supported. These results support the notion that nonprofits will use reserves to subsidize the securing of a social right. Although the model in Panel A is not statistically significant ($F = 1.82$), the results in Panel B indicate that a 10% increase in the deficit margin leads to an approximate decline of 18% of reserves (all else equal). We believe the results in Panel B are the best results for this dependent variable because cash (the numerator in our reserves variable) can be affected by other management decisions—such as issuing or paying back debt, selling or purchasing other assets, etc. For example, a nonprofit with a low cash balance might borrow money from a bank or sell some asset (such as property) to generate additional cash; alternatively, a nonprofit with a significant cash balance might pay down debt or invest in other assets. As such, cash reserves are codetermined with other financial variables. The results in Panel B are likely the most independent of such simultaneous decisions (due to multiyear averaging).²⁰ The results support the theory that for nonprofits to secure this social right, private resources are required.

The results in Column 5 related to support services (Hypothesis 5) are consistent with our expectations that child welfare nonprofits will reduce overhead to save costs. While some might argue this is a positive development because it shifts spending from “overhead” to direct services, it is increasingly understood that starving organization overhead means depriving organizations of adequate management, technology, systems, and fiscal infrastructure that might make a nonprofit more effective in its service delivery (e.g. [Bedsworth, Gregory, and Howard 2008](#); [Chikoto and Neely 2014](#); [Wing and Hager 2004](#)).

Overall, the results are largely consistent with our expectations about the relationship between the deficit model of collaborative governance and nonprofits needing to use private resources—from investments, reserves, debt, and cost savings—to secure social rights that have been ceded to them by government. In fact, the results contrary to expectations (Column 1, related to increased grantseeking) actually are consistent with the overall theory of the deficit model of collaborative governance: child welfare nonprofits appear unable to finance the private fundraising necessary to pay the costs of securing a social right that are not covered by government.

Furthermore, the presented results are conservative because they only include the member nonprofits that were in operation during the time of the study in 2010. Seven of New York’s child welfare nonprofits went out of business in the 5 years before the

²⁰ Multiyear averaging reduces these potential issues because averaging reduces the effect of these periodic increases or decreases.

study began, primarily due to financial issues. If the study had been able to include these organizations, the results would be even more pronounced. Although comprehensive financial information on these organizations is not available, we did analyze the Form 990 information of these seven nonprofits. Limiting the analysis to data from the same time period, the out-of-business nonprofits unsurprisingly performed significantly worse than survivors. For example, the operating margin of the out-of-business organizations was -61% (compared to -1% for the surviving nonprofits), the total margin of the out-of-business nonprofits was -29% (compared to -0.2% for surviving nonprofits), and the debt ratio of the out-of-business nonprofits was 139% (compared to 55% for surviving nonprofits).

These results demonstrate that although government delegates the social rights of vulnerable children to nonprofit organizations and provides those nonprofits with very substantial public financial support, the nonprofits effectively are required to augment public funds with private resources (internal reserves, debt, cost-cutting, or some combination) as a means to sustain programmatic output over time. More than 20 years since Gronbjerg (1991, 169) observed that “[p]rivate funding – and the nonprofit agencies themselves – in effect subsidize the public sector,” our empirical results find a similar relationship. Child welfare nonprofits deliver a social right, but to do so must privately subsidize the government funds allocated to secure that right.

Results from our survey of nonprofit child welfare organizations in New York State support the foregoing financial analysis. Ninety-five percent of respondent organizations reported receiving a government contract that fails to pay the full cost of providing the contracted services. Eighty-six percent of respondents stated that they use their private fundraising to offset the deficits their government contracts create. In addition, 83% report that they cut program costs to make up the deficits of government contracts. Even while taking these measures, 69% of the organizations in our sample stated that they simply run these programs at a deficit; presumably, they are hoping they will be able to raise necessary private funds eventually and are loathe to cut off their needy clients. Finally, the organizational impact of running chronic program deficits is both widespread and widely acknowledged among New York’s child welfare nonprofits: 67% report they anticipate a year-end organizational deficit that can only be made up with private fundraising.

Economic theories about privatization and contracting suggest that organizations weigh the costs and benefits of a particular funding stream before bidding on it. As the data above indicate, however, nonprofits generally know that the contracts they are seeking require private subsidization. No child welfare nonprofit in the State operates without public money as a significant portion of its budget. When surveyed, nearly 80% of our sample answered that they have never rejected a government contract because it did not cover its total costs. For the 20% that did, one-half rejected such a contract only once. The implication is that 90% of child welfare nonprofits have either never rejected a contract because of inadequate reimbursement or rejected such a contract only once. Our survey data thus suggest that nonprofits submit to the deficit model of collaborative governance relatively voluntarily. While the present analysis cannot provide a definitive answer for why nonprofits make this choice, our theory offers a potential explanation: the collaborative provision of social rights is a form of *social* contract whose underlying logic goes beyond the cost-benefit rationale of

a purely *economic* contract decision. Managers of child welfare nonprofits could not walk away from this arrangement without violating their most basic organizational values; neither would government managers brook such desertion of their mandate to secure vulnerable children's social rights. Such decisions might be made, however, in other forms of government–nonprofit relationships, where nonprofit services did not rise to the level of social rights. Future analysis should more deeply analyze this question and explore these different relationships.

Performance Measurement Analysis

Our empirical results in [Table 2](#) strongly suggest that this deficit model of collaborative governance erodes the financial condition of child welfare nonprofits. We next seek to analyze whether this decline in fiscal health influences child welfare service quality. If this reduction in fiscal health leads to worse service provision and outcomes, then the deficit model of collaborative governance that we have articulated may be undercutting the social right itself. Further, at the very least, reduced fiscal health suggests that weak nonprofits with limited ability to respond to any shock are tasked with securing social rights. To address this question, we analyzed the New York City performance scorecard for 27 child welfare nonprofits.²¹

Because we only had data for 2010, we averaged the financial data for the years prior to 2010 to smooth out indicators over time. We grouped the nonprofits by whether they had earned a high performance grade—measured as either an “A” or a “B”—or a low performance grade—measured as a “C,” “D,” or “F.” We then calculated difference of means *t*-tests to determine if these two groups had statistically significant financial characteristics. The analysis is presented in [Table 3](#).

[Table 3](#) suggests that child welfare nonprofits with greater investments and with greater reserves perform better on several measures (permanency and well-being). Rather than organizations devoting all resources to current service provision (i.e. child welfare services in the current fiscal year only), these results suggest that child welfare nonprofits able to put some resources aside for the future may be able to provide better services. Obviously, such resources can be drawn upon during times of fiscal stress, and future children benefit as a result. Interestingly, government funds rarely allow for service providers to earn surpluses that can be invested or held in reserve for the future; [Table 3](#) would provide limited information that questions such policies, as the findings here suggest some service quality might be eroded by such limits.

Another interesting suggestion from [Table 3](#) is that it questions the conventional wisdom that society's interest is best served by having nonprofits devote increasing shares of spending to direct services rather than to overhead that supports these direct services. [Table 3](#) indicates that child welfare nonprofits with higher overhead rates have better safety performance and well-being measures; hence, this is a small and limited finding that suggests that starving these organizations' infrastructure can lead to less desired outcomes for society. Debt and outcomes are unrelated in this limited

21 As noted earlier, 13 New York City providers had no performance scorecard data, and neither New York State nor other counties had a comparable performance evaluation system in place during our study period. Hence, we are unable to analyze the performance of those child welfare providers outside of New York City.

Table 3
Differences in Means of Financial Characteristics Between High and Low Performance Measures in New York City Child Welfare Providers

| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
|---|-------------------------|------------------------|-----------------------------|----------------------------|-----------------------------|----------------------------|-------------------------------------|-------------------------------------|
| | High Safety Performance | Low Safety Performance | High Permanency Performance | Low Permanency Performance | High Well-Being Performance | Low Well-Being Performance | High Foster Recruitment Performance | High Foster Recruitment Performance |
| Fund raising | 1.30% | 0.95% | 1.21% | 0.95% | 1.68% | 0.70% | 0.99% | 1.04% |
| Difference in means (<i>t</i> -test) | -0.36% (-0.63) | | -0.26% (-0.50) | | -0.97% (-2.07**) | | 0.05% (-0.09) | |
| Investments | 40.02% | 19.70% | 45.07% | 15.44% | 53.48% | 9.59% | 19.72% | 25.50% |
| Difference in means (<i>t</i> -test) | -20.32% (-0.86) | | -29.63% (-1.41*) | | -43.89% (-2.28**) | | 5.78% (0.24) | |
| Debt | 68.90% | 61.60% | 56.14% | 66.20% | 56.80% | 66.43% | 56.36% | 65.18% |
| Difference in means (<i>t</i> -test) | -7.30% (-0.52) | | 10.06% (0.79) | | 9.63% (0.78) | | 8.82% (0.63) | |
| Reserves | 5.24% | 4.22% | 6.07% | 3.77% | 6.10% | 3.62% | 3.73% | 4.65% |
| Difference in means (<i>t</i> -test) | -1.02% (-0.65) | | -2.30% (-1.68*) | | -2.48% (-1.89**) | | 0.91% (0.58) | |
| Support services | 13.74% | 10.40% | 12.21% | 10.69% | 12.36% | 10.53% | 9.89% | 11.50% |
| Difference in means (<i>t</i> -test) | -3.34% (-2.47**) | | -1.52% (-1.13) | | -1.83% (-1.43*) | | 1.61% (1.09) | |
| Number of agencies in each performance measure category | 6 | 21 | 8 | 19 | 9 | 18 | 6 | 21 |

Note: "Difference in means" is the difference between the average financial characteristics of agencies in each performance group. Values in parenthesis indicate the *t*-test values determining whether this difference in means between the high- and low-performing organizations is statistically significant or not. Analysis only includes 27 New York City child welfare providers graded by the New York City Administration for Children's Services. See Table 1 for definitions of variables.

p* < .10. *p* < .05.

analysis. This finding may result from debt having both positive and negative potential: positive because it allows nonprofits to expand and finance capital that is necessary for providing social services, but negative because debt also locks up spending on debt service—and too much debt can threaten the operations of a nonprofit. However, the other measures are associated with better performance.

Overall, this analysis of the relationship between service quality and financial characteristics suggests that the financial condition of social service providers is relevant for providing better quality services. Further, in the case of child welfare nonprofits in New York State, better financial condition is associated with a more robust securing of a social right.

An Alternative Hypothesis

Here, we consider an alternative hypothesis not articulated until now. A common critique leveled at nonprofit organizations in general is that they lack the management skills required to successfully steward their finances (e.g. [Peterburgsky 2012](#)). In other words, while nonprofit managers may have “good hearts,” they lack the business knowledge to successfully operate an organization. This hypothesis would suggest that the fiscal indicators really do not reflect the deficit model of collaborative governance, but rather ineffectual management skills that are allegedly endemic to the sector.

Results of our survey data, however, challenge this portrait of the bumbling nonprofit financial manager. As shown in [Table 4](#), New York’s nonprofit child welfare organizations report overwhelming adherence to best practices in a set of five key financial management and governance tasks. Over 90% have Board committees that

Table 4
Child Welfare Nonprofits’ Financial Practices ($N = 79$)

| | |
|---|-----|
| Board committee charged with budget and financial oversight | 91% |
| Frequency of this committee’s meeting | |
| Monthly | 32% |
| Every other month | 18% |
| Quarterly | 39% |
| Annually | 9% |
| Other | 2% |
| N/A | 9% |
| Frequency of financial variance reports to staff | |
| Annually | 3% |
| Quarterly | 20% |
| Monthly | 71% |
| Never | 6% |
| Length of time for variance reports to be delivered | |
| 1 month or less | 69% |
| Between 1 and 2 months | 15% |
| Within 2 months: | 12% |
| Other | 4% |
| Nonprofits with cash flow projection model | 78% |

oversee organizational finances, and 90% of these committees meet at least quarterly (nearly half meet more frequently). Again, over 90% of our sample issue regular financial variance reports, a key tool of financial management that compares actual organizational expenses to budgeted expenses. Nearly, three-quarters of the organizations issue these reports on a monthly basis, and nearly all produce them at least quarterly. Finally, almost 80% of child welfare nonprofits use cash flow projection models, a basic tool designed to help organizations prevent budgetary shortfalls, such as the inability to meet payroll. In other words, the organizations in our study give little indication that the deficits engendered by their government contracts can be traced to poor financial management alone.

DISCUSSION AND CONCLUSION

Many studies of government support of nonprofit organizations focus on the ways that government funding alters the private character of nonprofits, for example by pushing nonprofits to align their activities with government mandates or requiring nonprofits to submit to government oversight. In this study, we ask a different question: how is government's guarantee of citizens' social rights complicated when these rights are secured by private nonprofit organizations using public funds? Because social rights are pure public benefits (Young 2007), taxpayers should be the source of financial support for securing social rights. Here, we argue that in the case of child welfare in New York State, nonprofit service providers must subsidize the provision of children's social rights because government funding fails to cover the full cost, given the State's choice of a coproduction provision mechanism. This deficit model of collaborative governance indicates that private subsidization—through private contributions, the use of debt, spending down investments and reserves, and lowering overhead costs—is necessary for the State to secure the social rights of vulnerable children. Further, we find evidence that this deficit model weakens the fiscal health of the nonprofit service providers and may erode the quality of the services rendered to children.

Prior research (Gronbjerg 1991; Kramer 1994; Smith and Lipsky 1993) has documented that government funding creates significant transaction costs for nonprofits in terms of personnel required to manage contracts and delays in waiting for contracts to be paid (see also Boris et al. 2010). Gronbjerg (1991) has even proposed the argument that nonprofits subsidize government. Our study builds on this earlier important work by examining a wider range of potential mechanisms by which nonprofits subsidize the provision of public goods, empirically linking the provision of subsidy to the erosion of nonprofit fiscal health, and providing suggestive evidence of an association between fiscal health and service quality. Each of these aspects of our study supports our theoretical contention that collaborative governance arrangements to secure public goods threaten government's ability to discharge its responsibility to citizens. This is particularly the case when the public good constitutes a social right, as in the case of child welfare.

One important contribution of this study is to provide empirical descriptions of what nonprofit subsidization of government means for nonprofit organizational fiscal capacity and health. Our evidence suggests that the deficit model of collaborative governance leads nonprofit managers to limit their fundraising capacity, spend

down accumulated investments and reserves, and reduce overhead costs. Perhaps most importantly, we find preliminary evidence that these practices and their associated negative fiscal outcomes may lead to worse service performance. The deficit model for child welfare services thus undermines nonprofits' organizational infrastructure and imperils their ability both to provide quality services, and, potentially, to survive.

In New York State, government and the nonprofit child welfare sector are mutually dependent. Child welfare nonprofits operate primarily with government funds. Yet without these nonprofit organizations, New York would be unable to carry out its Constitutional and statutory mandates to support vulnerable children. The capacity to do so simply does not exist within government. From a management perspective, however, this collaborative governance arrangement appears to require the private subsidy of children's social right to protection by the state. Although we recognize the case study nature of our research, results from a recent study by [Boris and colleagues \(2010\)](#) indicates that our findings likely generalize to other sectors and states. That study found that 68% of surveyed human service nonprofits reported that governments not fully funding the costs of contracted services presented significant management issues for them.

Recent scholarship by [Mosley \(2012\)](#) highlights that social service providers almost universally advocate to maintain funding streams from government agencies. Importantly, [Mosley \(2012\)](#) finds that nonprofit staffs were more concerned with maintaining existing or securing new government contracts rather than advocating for specific details about contract requirements. The New York child welfare case indicates that these contract requirements may be critical and can even cost the nonprofit resources if full costs are not paid. Taking our study and Mosley's together, the results suggest that service providers may need to use their advocacy experience to help reshape the deficit model of collaborative governance currently in place. This might include pursuing altered funding models, predetermined COLA increases that are not subject to annual budgetary appropriations but are instead automatic, and administrative cost allowances that will permit nonprofits to invest not only in higher quality programs but also in crucial organizational infrastructure. This will become even more important as persistent government budgetary stress potentially leads public officials to seek even more savings from nonprofit providers.

Our study has some limitations. Although child protection is a social right, many of the services that government contracts with nonprofits to provide do not rise to the level of a social right. Services like afterschool programs, senior centers, immigrant incorporation initiatives, arts education, and other types of efforts to which government may contribute have a status akin to that of child welfare at the end of the 19th century. That is, nonprofit organizations acting in these areas may receive some assistance from government, but the provision of the service is voluntary, the benefits are not "public" in nature ([Young 2007](#)), and thus private organizations should expect to contribute some percentage of the cost of providing the service. Indeed, if a particular nonprofit service is far from being a social right, nonprofit managers should be much more cautious about entering into government contracts that operate on the deficit model of collaborative governance. By making the government–nonprofit *relationship* the object of empirical analysis, future research could explore which types of services we should expect to see in different funding relationships with government and how

widespread is the deficit model of collaborative governance we discuss here. A second limitation clearly concerns the relationship between the financial management effects of the deficit model and the question of service quality. The analysis of service quality we present here is only suggestive, and future research should examine this question in more depth.

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