

**Hybrid Organizations and the Diversification of Policy Tools:
The Governance Challenge**

By

**Steven Rathgeb Smith
Nancy Bell Evans Chair in Nonprofit Management
Evans School of Public Affairs
The University of Washington
Box 353055
Seattle, WA 98195
smithsr@u.washington.edu**

Paper to be delivered at the biennial meeting of the Public Management Research Association conference, Tucson, Arizona, 26-27 October 2007.

**Draft:
Do Not Quote
October 2007**

Public-private partnerships, coalitions, networks, and collaborations are an increasingly prominent feature of public and nonprofit management. In general, scholarly attention on partnerships tends to focus on inter-organizational arrangements that can range from very informal relationships among staff in different organizations to formal, binding agreements among organizations such as government contracts with nonprofit organizations and “design-build” agreements between government and large for-profit construction companies. Along this continuum between informal and formal agreements lie a wide variety of possibilities (See Skelcher, 2005; Waddell and Brown, 1997).

This paper focuses on a different aspect of this trend toward partnerships that has not received widespread attention---the increasingly complex intra-organizational relationships between different entities. This trend toward more hybrid organizations is evident in a very diverse array of new organizational entities and relationships: public and nonprofit organizations establishing affiliated foundations; nonprofit low-income housing organizations and community development corporations creating affiliated for-profit partnerships for purposes of building a project and eligibility for government tax credits; nonprofit organizations creating for-profit subsidiaries or affiliated for-profit entities; nonprofit organizations with wholly owned nonprofit management subsidiaries to manage specific projects; and a nonprofit agency that takeovers another nonprofit but the two organizations remain separate entities with distinct, albeit overlapping boards.

This study offers a framework for understanding the governance and policy implications of this shift to hybrid organizations in social policy. The emphasis is on service organizations in the nonprofit sector although examples from the public sector will also be offered. The basic argument is that hybrid organizations represent the impact of diversification of policy tools in the last 25 years and the restructuring of the state under the influence of the “reinventing government” and New Public Management

(NPM) movements. However, hybridization also represents a reaction to NPM and an effort by public and nonprofit managers to solve policy and management dilemmas created sometimes inadvertently by changes in the role of government in financing and providing public services. Indeed, the service fragmentation, diffuseness of mission, lack of transparency, and problems of accountability characteristic of some aspects of NPM as it is implemented can actually be remedied through appropriate uses of hybridization. As a consequence, this study suggests that hybridization and increased complexity of nonprofit and public organizations is likely to continue to grow in the coming years.

Hybrid organizational forms then need to be conceptualized as a strategic management tool as well as a policy tool of government supported programs. Indeed, this study suggests that hybrid forms can actually improve the governance and performance of nonprofit and public organizations, counter to the expectations of many scholars and policymakers who fear that increased complexity reduces accountability and risk making these organizations ungovernable. Indeed, hybridization will increasingly be an asset in the competition for public and private resources in turbulent and uncertain funding environment.

The Emergence of Hybrid Organizations in Social Policy

In the US, the respective roles of the public, nonprofit and for-profit sectors were quite distinct until the 1960s. The public sector was relatively small and operated programs primarily through direct government, through state and local agencies focused on social services and welfare. Nonprofit and for-profit social and health agencies tended to be restricted to a few service categories such as child welfare. Typically, these private agencies depended upon fees from individuals and private donations,

supplemented with occasional payments from government depending upon the service category (Smith and Lipsky, 1993).

These sectoral distinctions and characteristics changed sharply in the 1960s with the growth of government contracting for services. This growth in contracted was initially driven by a desire to expand services quickly to individuals in need of services. In the 1980s and thereafter, contracting continued to increase under the influence of the reinventing government movement and the New Public Management (NPM). Contracting with nonprofit organizations in particular seemed to address two top priorities of policymakers and public managers. First, contracting at least theoretically introduced market competition into the provision of public services, so nonprofit agencies were encouraged to compete for government contracts through formal competitive bidding procedures. Second, contracting with nonprofits offered the opportunity for citizen and community empowerment and participation as well as increasing user involvement in services, the diversity of service delivery, and the responsiveness of publicly funded services to citizen and user concerns.

Contracting thus led to a form of hybrid organizations where nonprofit and for-profit service organizations received public funds. These organizations were also subject to government regulations and performance expectations. But hybrid organizations also grew through the increased utilization of other policy tools. For instance, Congress enacted the Low Income Housing Tax Credit (LIHTC) program in 1986 to promote the building and maintenance of low-income housing. The LIHTC allow eligible private investors to receive a tax credit for investing in low-income housing. Eligible nonprofit (and for-profit) organizations then use the money (which is often combined with other funds) to build housing. In order to take advantage of the LIHTC program, nonprofit housing agencies typically establish limited for-profit partnerships with the majority stake owned by the equity investors and a very small minority stake

owned by the nonprofit. In this sense, the LIHTC requires the creation of hybrid organizations with a main anchor organization and affiliated entities for specialized purposes such as the construction of a low-income housing development. Indeed, many larger housing organizations might have 6 or more limited partnerships, each responsible for the tax credits of a separate project. (Tax credits for historic preservation also have similar qualities.)

The other policy tool often accompanying the LIHTC or historic preservation credits are tax-exempt bonds. The use of tax-exempt bonds to support capital projects large nonprofit institutions such as universities and hospitals has a long history but in recent years, the utilization of tax exempt bonds by smaller organizations including community-based housing organizations has accelerated. In general, this bond financing is often crucial to the completion of certain types of large capital projects, so it has tended to encourage greater complexity of organizational structure and more hybrid forms of organizational structures even though a hybrid structure is not necessarily a requirement of bond financing.

Another tax-related policy tool, tax deductions, has also tended to promote greater hybridization. Tax deductions for specific purposes including gifts of cash and property to charitable organizations have been in existence for decades in the US. But the use of tax deductions by individuals and corporations has grown substantially. This growth, in combination with the increase in government support of nonprofit organizations through contracting and grants, has promoted a sharp increase in the number of nonprofit organizations and many longstanding nonprofit organizations have grown substantially. The resultant competition has pushed nonprofit to significantly increase their efforts to raise revenue through a variety of new organizational strategies including for-profit subsidiaries and partnerships and the establishment of affiliated foundations.

In short, the hybridization of organizations reflects the restructuring of the state and then the responses to this restructuring at the local level by individual organizations. Thus, organizations faced with resource challenges seek new opportunities for raising revenue which often entail new and more complicated organizational structures. These strategies are then disseminated widely through professional networks and conferences.

Hybridization also helps solve a problem for public and private funders caused by the implementation of NPM. Contracting for services and the general growth of nonprofit and for-profit agencies tends to produce service fragmentation and inefficiencies in the organization. Public services previously lodged in large public bureaucracies are now decentralized to much smaller local service agencies. But in this devolved service system, agencies often have trouble cooperating on behalf of service users and agencies often lack sufficient resources to invest properly in adequate capacity such as IT, accounting and program evaluation. Indeed, a sizable number of new organizations created in the wake of NPM are arguably unsustainable as organizations because they do not have a viable financial plan once the initial public and private grants expire. As will be detailed in subsequent pages, hybrid organizations are in part an effort to address sustainability concerns among nonprofit service agencies.

Given the multiple reasons for the “hybridization” of local public and nonprofit organizations providing public services, it appears likely that this trend will continue. As a result, the importance of understanding the implications of this shift in organizational structure for nonprofit and public management will grow more imperative.

Conceptualizing Hybrid Organizations

While the trend toward more hybrid organizations is quite evident, research on these organizations is challenged by the many different definitions and interpretations. As noted by Koppell (2003), many scholars have noted the existence of quasi-

governmental organizations that do not fit traditional definitions of government agencies (See Seidman, 1975; Hauck, 1978; Perry and Rainey, 1988; Skelcher, 1998; 2004). This definition of hybrid focuses on governmental organizations and classifies organizations as hybrid if they have a mixed mode of control such as the US Postal Service or Amtrak which receive Congressional appropriations but have boards of directors like a private corporation. Joldersma and Winter (2002) suggest that hybrid organizations are public service organizations that serve government and other types of clients including market-based clients.

Other scholars have conceptualized hybrid organizations differently. Minkoff (2002) studies organizations which combine features of two distinct organizational forms---in her case, national advocacy and service organizations. Thus, she is especially interested in nonprofit organizations that are committed to social change and have a service and advocacy mission. This model of hybridization is related to the work of other scholars of hybrid organizations who focus on organizations with mixed services and missions (Hyde, 1992; D'Aunno, et al., 1991). Another definition of hybrid organizations of relevance to this inquiry is research on nonprofit organizations that have more than one legal category such as a 501 c (3) charitable status as well as a 501 c (4) status for more extensive advocacy efforts. By this definition, nonprofits with an affiliated foundation or a political action committee (PAC) would be considered hybrid organizations.

Despite this lack of consensus on the specific definition of hybrid organization, scholars tend to agree that hybrid organizations contain mixed sectoral, legal, structural, and/or mission-related elements. And following Minkoff (2002), hybridization reflects the adaptive response of organizations at the local level to environmental uncertainty. However, the increased complexity and "hybridity" of public and nonprofit service organizations also reflects the increased complexity of the public sector due to the

impact of NPM and the related reinventing government movement. Nonprofits receive government contracts but they may feel obliged to create affiliated foundations in order to tap community donative support for their activities. Public sector agencies such as the police and parks department want to retain control of their management and finances but they may feel compelled through pressure to be more efficient to look to earned income or donative strategies to support key projects and initiatives.

The focus of this inquiry is on organizations providing public services that become more complex through structural changes to their environment. Thus this research does not include other types of hybrid organizations noted in the literature such as public finance initiatives, multi-party partnerships, and more straightforward examples of government contracting with private agencies. The basic argument of this paper is that the main driver of this increased complexity from the agency's point of view is the competition for resources while minimizing risk. Additional pressure from government and other funders for greater rationalization of the service system is another contributing factor.

Theoretical Framework

In thinking about the process of organizational change within social service systems, institutional theory provides highly useful insights. In particular, institutional theory suggests that services at the local level tend to be marked by substantial stability, due primarily to the strong social support that exists for institutionalized, taken-for-granted structures. Indeed, organizations derive a substantial measure of their legitimacy from having structures that are deemed to be appropriate by external and internal stakeholders (Meyer and Rowan, 1977; Powell and DiMaggio, 1990; Arndt and Bigelow, 2000). Legitimacy is closely related to structure so for example, nonprofit service are encouraged to have governing boards of directors, certain types of

accounting procedures, and a strong mission focus. In this type of environment, organizations tend to be rewarded for conforming behavior which promotes isomorphism of organizational structure over time (Sosin and Smith, 2007). This pressure for isomorphism can occur through several avenues: government agencies may expect agencies to meet certain programmatic and performance targets; agencies may adopt practices that it will help them win government and private grants; professionals may learn of best practices through conferences and training programs; and consultants may disseminate information on ideal organizational structures (such as the proper division of responsibility between the board and staff.)

Stability in organizational structure can be problematic though. Government officials who support social welfare agencies for example may face pressure to support different types of organizations, producing a mismatch between the preferences of government officials and service agencies receiving government support. At the agency level, organizations may find it difficult to generate promising new programmatic or revenue strategies with their existing structures. Indeed, some agencies may find that the existing structure locks them into a downward spiral of weak boards and executives producing turnover and eroding revenues, which then encourage further organizational decline. This problem is especially severe among younger organizations. Put another way, turbulent environment conditions which create uncertainty for organizations on their future are likely to promote structural innovation (Minkoff, 2002). In the case of the service agencies under study in this paper, this innovation promotes greater complexity and hybridization.

Innovation in organizational structure then may be advantageous to both funders and to agencies depending upon their situation. But organizations may still face the problem that innovation may be risky and discouraged, especially since innovative structures are often counter to prevailing beliefs about the appropriate structure.

Following this logic, one would predict that innovations that offer less risk of delegitimation or revenue loss would be easier to implement than more complicated and drastic innovations. And as suggested by DiMaggio and Powell (1991) and Fligstein (1985), structural innovation is more likely to the extent that other organizations have undertaken similar changes.

Hybridization and Its Different Organizational Forms

Institutional theory then provides a useful frame to understand the evolution of hybrid organizational forms. The intent in this section is to draw upon specific cases of hybridization in social welfare organizations for purposes of developing a more general understanding of the causes of hybridization including different types of hybridization. As the following pages detail, the types of hybrid forms exist along a continuum, from relatively simple straightforward structural changes to complex entities requiring extensive internal and external consultation and intervention.

The Affiliated Foundation. An increasingly common structural change among public and nonprofit organizations is the creation of an affiliated foundation. Typically, this entity is called a foundation but is legally a 501 c (3) charitable organization, rather than a private foundation. The sole purpose of these organizations is usually to raise revenue for the parent organization; the board is controlled at the outset by the parent organization although great variation exists on the specific by-laws and rules governing the board of the foundation.

Initially, these affiliated foundations were mostly confined to very large institutions such as hospitals and universities. The impetus for these foundations was the argument that private donors would be more likely to give money to a foundation than the parent organization, since donors would have greater control over the money and more certainty on the disposition of their donations. Over time, affiliated foundations have

proliferated with many relatively modest sized nonprofit and public agencies creating foundations. In the city of Seattle, for example, affiliated foundations have been established for the following municipal agencies: the police, the school district, the library, and the zoo. Many leading nonprofit institutions including large churches have affiliated foundations.

Thus, these foundations began as a structural innovation by a relative few leading nonprofit institutions who were in a position to raise substantial private donations. Then, these structures were adopted by countless other organizations as the idea was imitated and modeled. A contributing factor was the perception of scarcity and the uncertain environment faced by many nonprofits worried about their financial sustainability in the long run.

Internally, though, this structural change tends to be relatively non-controversial since it does not typically raise complicated questions on mission or governance or nettlesome legal or accounting concerns. The main challenges are structuring the foundation in a way that fits with the resource development goals of the organization. Some organizations may also decide to forego creating a foundation because they are worried about the less direct control that the board and staff of the organization now wield over the funds raised by the foundation.

The foundation does represent a modest increase in the structural complexity of the organization but it also demonstrates the increased complexity of the revenue base of many nonprofit organizations and the sometimes indirect impact of the diversification of policy tools. For example, a local housing organization in Seattle is a quasi-public development authority but it also has an affiliated 501 c (3) organization primarily for fundraising purposes. The housing organizations relies heavily upon tax credits, government grants and contracts and property management fees. But the foundation

helps to raise donations that are subsidized by government and the taxpayers by the tax deductibility of charitable donations.

For-Profit Subsidiaries. Another structural innovation is the creation of for-profit subsidiaries by nonprofit organizations. In the US, for-profit subsidiaries have been common in many hospitals and universities for decades. For instance, universities often own substantial real estate and place these holdings in a separate for-profit entity. Many hospitals have for-profit subsidiaries and long-standing relationships with for-profit entities such as radiology practices or home health agencies. What is new is the growth of for-profit subsidiaries among smaller nonprofit organizations in the social welfare field, many of them who are historically dependent upon government funds. Two examples illustrate the point. The first case is a nonprofit organization providing architectural and design services to organizations serving low income and disadvantaged populations. For many years, the organization was almost entirely funded by government through contracts and grants. But government's support for the organization started to wane and the organization looked for new opportunities to raise revenue. The result was the merger/takeover of a for-profit design firm specializing in child care facilities so that the for-profit became a subsidiary of the nonprofit. The owner of the for-profit firm then became the executive director of the larger nonprofit organization. Over time, the revenues from the for-profit subsidiary have comprised a declining percentage of the overall revenue structure of the agency as the rest of the revenue base has grown through an increase in revenue from fees (which are primarily government funds from other nonprofit social welfare organizations).

The second example is a nonprofit low income housing organization in Seattle which created a for-profit café and catering subsidiary about four years ago. Like the first case, this agency hoped to raise earned income revenue and perhaps elevate its profile in the community by creating a for-profit café with a physical location in downtown

Seattle and a catering business that would service the greater Seattle area. The organization had relied to date almost exclusively on government contracts and tax credit financing as well as modest fee income to support its housing programs. The for-profit subsidiary offered the possibility of a new revenue source at a time when government funding is scarcer.

While environmental uncertainty might be common causal factors in the two cases, other aspects are quite different. The first case represented a takeover of an existing for-profit entity with a closely aligned mission to the parent organization, while the second case represented the creation of an entirely new for-profit entity in a completely different line of business (i.e. food). The latter was very complicated and expensive, requiring the services of many outside consultants and professionals. Further, it was a high-cost venture for an organization whose focus is housing. Not surprisingly, the new for-profit café quickly started to lose large sums of money and the agency decided after a relatively period of time to completely close the for-profit subsidiary, because it was a money-losing venture outside of their major area of expertise.

Limited Partnerships Affiliated with Low-Income Housing Organizations.

Another structural innovation in the delivery of social welfare services is a for-profit limited partnership affiliated with low-income housing agencies. Prior to 1986, low-income housing was built primarily by for-profit developers using grants and contracts. But in 1986, Congress enacted the Low-Income Housing Tax Credit (LIHTC) which offered private investors tax credits for investing in low-income housing construction. Congress appropriates tax credit money every year and then this funding is distributed on a formula basis to the states which then allocate the credits on a competitive basis to worthy projects by nonprofit (and to a much lesser extent for-profit) housing developers. In order for the investors to receive their tax credits, though, the nonprofit agency needs

to establish a for-profit limited partnership to receive the credits. The majority stake is owned by an equity firm which pools the investor money and a fractional interest is held by the nonprofit. At the expiration of the tax credits, the ownership of the project reverts to the nonprofit agency that holds the fractional interest. Typically, a nonprofit agency will create a separate limited partnership for each tax credit deal, since the eligible investors will be different.

This tax credit program (along with a closely related tax credit program for historic preservation) represents the diversification of policy tools and the increased complexity of organizational forms. However, the greater complexity is not immediately apparent from a review of agency annual reports or 990 tax returns because these housing agencies are not required to include the assets of the limited partnerships on their books. As a result, the actual budget size and financial picture of these agencies is often difficult to discern, although a movement does exist among these agencies to create consolidated financial statements which would include the limited partnerships and the parent organization finances in one statement to provide more transparency of operations.

The increased complexity associated with these limited partnerships is different than the other examples noted in this paper since most of these nonprofit housing organizations were completely new organizations that emerged to take advantage of the tax credits and the resultant opportunities to build new housing for disadvantaged people. In this sense, the initial structural innovation in the 1980s was the nonprofit housing organization itself which then was required to create limited partnerships to receive the tax credits. The proliferation of nonprofit housing organizations throughout the country is also due to the diffusion of this innovation through professional networks and the aggressive support of the this type of housing program by large national

organizations including the Ford Foundation, the Local Initiatives Support Corporation (LISC), and the Enterprise Foundation (now called Enterprise Community Partners). Indeed, in a further example of the hybridization of the organizational field in low-income housing, Enterprise Community Partners created a for-profit subsidiary called Enterprise Community Investment to pool tax credits for eligible housing projects.

Wholly Owned Nonprofit Subsidiaries. In the last ten years, the number of nonprofit social welfare organizations has more than doubled. Many of these organizations are small and undercapitalized, creating severe financial sustainability problems. One option for small organizations in trouble is to merge with another, usually larger more stable organization. However, mergers are very difficult to accomplish in the nonprofit sector. Boards of directors want to protect the integrity and mission of their organizations so it is often difficult for boards to resolve differences pertaining to strategic direction and governance. Further, the larger, more stable organization may be understandably reluctant to assume the financial liabilities of a failing organization, especially since a substantial uncertainty may exist on the potential revenue base of the organization since some public and private funders may no longer support a merged entity.

The difficulties of merger though present a serious problem for public and private funders. First, funders are increasingly concerned about the fragmentation of services into many, many different relatively small agencies, creating service coordination and integration difficulties. Second, each of these agencies has an administrative infrastructure to support which is inefficient from a funder's perspective. Third, government may be relying upon small, financially unstable agencies to provide vital public services using government funds; thus, government contract administrators may feel that their clients are vulnerable to service disruptions unless the clients can be moved to a more stable organization. In a sense, all of these factors push away from

the decentralization to community based agencies that characterized the direction of services in the last 15 to 20 years.

But the push for more centralization is blocked at least in part by the difficulty of agency merger. So, the structural innovation that has emerged is creating an merger, even though two legally separate organizations remain. One recent example illustrates the point. In Seattle, a relatively small social service agency, supported almost entirely with government contracts, was experiencing serious financial and programmatic distress. The agency serves a very disadvantaged homeless population and thus the clients would almost certainly encounter major problems if service was precipitously cut. At the same time, a larger, established agency serving a similar population was scanning their environment for new programmatic and funding opportunities. The city encouraged the larger agency to approach the smaller agency about a merger or takeover. The board of the acquiring agency though was concerned about its financial exposure, especially given the uncertainty surrounding the future of the smaller agency. After a series of discussions, it was decided that the acquiring agency would takeover the smaller agency but that it would remain a legally separate entity. The bylaws of the latter were changed so that the board of directors of the acquiring agency could appoint the board of smaller agency, giving it effective control even though the agency remained legally separate.

This complex arrangement has advantages for all three parties to the transaction. The acquiring agency gains control of the substantial assets and programs of the failing agency while limiting its risk by keeping the agency distinctively separate. The smaller agency is relieved of the daunting legal and financial obligations without having to go through the expensive and complex merger process. It also preserves the identity of the agency, at least in the short-term, so the appearance of continuity is maintained. And

the city, the principal agency funder, gains a more stable agency partner without the disruption and hassle of transferring contracts and clients to a new organization.

A slightly different example of this hybridization of organizational forms illustrates similar themes (as well as the increasingly complex organizational structures and relationships involved in social welfare service delivery). Over ten years, the city of Seattle was given a large tract of land that was previously an Air Force Station. This land included several large building, lakefront property and substantial recreational acreage. As part of the redevelopment of this property, the city made a commitment to build permanent housing for homeless and disadvantaged. Some of this housing was built using tax credits while other housing was be built using other sources of government funding including city tax dollars through a special levy assessment. The housing was developed by a nonprofit housing developer on a project by project basis. Typically these projects were developed through partnerships with social services agency, so for example the housing developer would partner with the Salvation Army to provider supportive services once the housing was built. In addition, a for-profit limited partnership would be created to hold the tax credits. Further, the nonprofit housing developer entered into a management contract with another nonprofit housing organization to manage the projects on an ongoing basis, once the housing was actually built. Operational funding for the housing developer was provided by the city of Seattle which also owned the land, although the buildings and low-income housing were owned by the nonprofit housing developer (and the limited partnership to the extent that the housing was built using tax credits).

Over time, the nonprofit housing developer and the nonprofit management agency became embroiled in an increasingly fractious dispute about appropriate charges and management practices. In addition, the housing developer was very concerned about the sustainability of their own operations, given their relatively small size. As a

result, the developer approached one of the oldest and largest social service agencies in Seattle to essentially take over the management contract and the building and operations of the developer; the housing developer would cease to exist in its previous form and the nonprofit management agency would lose its management contract.

The established nonprofit agency was intrigued by the possibility of assuming the contracts and assets of this housing developer since it offered an income opportunity, at least in the long-run and a way of broadening the service mix and funding and political support of the organization. In the current turbulent funding environment, size has some advantages from a political and funding standpoint.

Yet, this initiative posed unpredictable risks for the agency. Low income housing development and management is a very complex undertaking with a byzantine mix of funding streams and intricate regulations. Also, many agencies are able to assemble enough money for diverse sources including tax credits for construction but it often quite challenging to generate sufficient funds for maintenance and ongoing operations. The financial situation could be further complicated by unexpected future cuts in government funding, especially from city agencies.

The other financial risk is noncompliance by the existing developer and management agency with the strict rules governing tax credits financing. Under federal law, developers can be held liable if tax credit money is used to house individuals who do not meet the eligibility criteria. Indeed, it is possible that serving non-eligible individuals could result in the private investors losing their entire tax credit investment; these investors in turn would seek redress from the developer.

To minimize the risk faced by the acquiring agency, the board of directors decided to create a wholly owned nonprofit subsidiary that would hold the assets and contracts of the nonprofit housing developer. Officially, this subsidiary is called a "Single Member Limited Liability Corporation." So liabilities of this corporation would be limited

to corporation and not extend to the assets of the parent nonprofit organization. The limited liability corporation will keep separate books and be treated as a separate legal entity.

Like the previous example, this new entity and the relationship to the larger parent organization represents a form of centralization since it represents a pull-back from the decentralization that characterized the housing development when it was initially developed 10 years. At that time, an entirely new nonprofit organization was created to develop the housing; now, the city and other government agencies are shifting to greater reliance on larger, more professionalized and stable organizations. In this sense, these examples are part of the shift away from the “disaggregation” tendencies characteristic of public management reform in the last 25 years (See Dunleavy, et al., 2006).

Governance Challenges and Opportunities of Hybridization

These new, more complex organizational structures present important challenges as well as some surprising opportunities for policymakers and managers of nonprofit service organizations. This section addresses the following governance issues: transparency; community and citizen participation; engaging the board and stakeholders in governance; and tool design and implementation.

Transparency

Hybridization has tended to out-pace by far the current regulatory regime designed to monitor and collect information related to nonprofit organizations. For example, the Internal Revenue Service (IRS) requires nonprofit organizations to annually submit a Form 990 containing detailed financial information. This 990 form is one of the principal tools by which the government and private organizations themselves strive for

organizational transparency. However, the 990 Form has great difficulty capturing the increased complexity of the organizational universe of nonprofits. Thus, the affiliated partnerships of low-income housing organizations are reported separately as is the nonprofit subsidiary mentioned on the previous page. Citizens and regulators would have little idea of the true scope of programs and assets from simply a review of the 990s. Agency annual reports also rarely mention these complex organizational relationships.

The relative lack of transparency may make it more difficult for citizens to understand agency programs and require board members to exercise exceptional effort to learn about organizational governance and the implications of structural changes or innovations on the organization. Overall, government should take steps to enhance the capacity of its regulatory regime to accurately portray the increased complexity of the organizational structure. Nonprofit organizations could also be more pro-active in providing information to the public on their organizations including their affiliations and relevant programmatic and financial information.

Community and Citizen Participation

As a generalization, hybridization is associated with the professionalization of service agencies. First, creating these new organizational structures requires the services of skilled professionals, both internally and externally. The establishment of affiliated foundations is an acknowledgement that a nonprofit or public agency wants to be more aggressive in raising private charitable dollars. This in turn usually leads nonprofits to hire more highly paid, skilled professionals with development experience.

Second, these hybrid structures require the expertise and time of highly paid lawyers and accountants since the rules and regulations governing the structures can be extremely complex, especially since many service organizations rely extensively on

government funding. The need for these skilled professionals also generates an internal demand for more professionalization because the organization needs to put in place systems to oversee these new structures and entities on an ongoing basis (in order to comply with the expectations of the outside professional consultants).

Third, the ability to successfully complete structural innovation is related to resources and professional expertise. These organizations will have an edge in the competition for new contracts and programs. Over time, this edge will produce a modest centralization of services since fewer grass-roots organizations will have contracts; thus, hybridization represents a shift away, albeit incremental, from the devolution to community organizations characteristic of the 1980s and 1990s.

Engaging the Board and External Stakeholders

One prevailing assumption might be that greater complexity and hybridization undermines good governance. In this perspective, the volunteer board members of nonprofit organizations are likely to be at a disadvantage in understanding these new structures, so that the subsidiary or affiliated organization is essentially controlled by a select few, probably the executive director. Further, the opaqueness of some of these structures makes it difficult for even skilled professionals to understand the implications for the organization's governance and programs. Complexity undermines good governance. By implication, this assumption tends to flow from at least some models of nonprofit governance which focus on single modest sized board and its responsibilities.

However, the argument of this paper is that increased complexity can actually improve and enhance the performance and accountability of nonprofit service agencies. The major reason is rooted in the fundamental characteristics of nonprofit organizations. As noted by Hansmann (1980) and Lynn and Smith (2007), nonprofits are essentially "unowned" organizations since they lack owners with a claim to the residual earnings of

the organizations such as for-profit organizations due to the “non-distribution” constraint. The latter legally prevents the board or staff from “profiting” from the earnings of the organization.

But the lack of owners means that nonprofits face serious problems in accountability, governance, and performance attainment because the board and staff lack the same type of incentive to be engaged in performance as for-profit organizations. (Public agencies have political accountability, albeit unevenly implemented and exercised, to legislative and executive branches of government.) These problems of accountability and governance can be especially pronounced in newer nonprofit organizations who are challenged by small boards and staff, undercapitalization, and a lack of strong external connections. Larger nonprofit organizations can also grow substantially even without strong commitment to performance and effective governance.

Given this context, greater complexity can actually improve organizational governance. First, a discussion of a structural innovation usually provokes extensive internal discussion within an organization about mission, purpose, and strategic direction, even within a relatively modest change in structure. For instance, the creation of an affiliated foundation raises important questions related to development, future priorities, operational and capital needs, and staff infrastructure. More complicated innovations such as for-profit or non-profit subsidiaries raise these key questions about the organization’s governance and future even more pointedly.

Second, these structural innovations require, as noted, expert legal and accounting advice. This input involves outside consultants in important matters of governance and performance more profoundly than would otherwise be the case with the ongoing operations of the organization. Indeed, the hours of legal time required to establish a for-profit subsidiary or an affiliated partnership for a low-income housing agency can be very substantial. Depending upon the organizational structure, nonprofit

agencies may also be required to put in place new systems of internal control and monitoring, especially for more complicated partnerships and subsidiaries.

Third, these structural innovations tend to involve a broader group of stakeholders in the organization in new and important relationships that can help improve governance. Affiliated foundations typically have a different set of board members than the board of the parent organization. A different and more intensive involvement characterizes affiliated partnerships with low income housing organizations. These partnerships involve private investment funds and individual investors in a quasi-owner relationship to the parent nonprofit because of the requirements of tax-credits. The involvement of investors forces organizations to pay attention to stringent financial controls, compliance with government regulations, and overall performance.

Fourth, nonprofit and for-profit subsidiaries often involve much higher level of financial and programmatic risk for a nonprofit organization. Thus, the board is forced to engage in monitoring the finances and programs of the agency (and the subsidiary in particular) more rigorously than would otherwise be the case. Because of the higher level of risk, subsidiary operations require (or at least strongly encourage), boards to constantly ask if the subsidiary operations fit within mission of the organization and is the program worth the financial risk. For example, the housing developer with the for-profit café closed it after an extensive internal discussion of the finances, core mission and values of the organization.

To be sure, organizations undertaking structural innovation are likely have a better, more professionalized management than other organizations since even considering an affiliated partnership or foundation requires resources and commitment of top management to even further professionalization. Failing organizations do not start new subsidiaries: they lack the external support and they are unlikely to have the internal resources necessary to launch these types of innovations.

Moreover, larger more stable organizations are more likely to have advisory committees and ad hoc committees for specialized purposes. For example, a large nonprofit social welfare organization might create a community advisory board or a specialized fundraising committee. To this extent, many organizations are trying to broaden their political and community support by creating structures outside the existing board structure.

Hybridization and the Design and Implementation of Policy Tools

The cases discussed in this paper underscore the close inter-relationship between the diversification of policy tools and the increased complexity of organizational forms. Tax credits for low-income housing require nonprofit organizations to establish affiliated partnerships. The growing reliance on tax deductions has prompted nonprofit and public agencies to create affiliated foundations. Bond money and contracts have encouraged the proliferation of new agencies; but over time, government and private funders have also been pushed to create alternative structures to coordinate these services.

Put another way, the New Public Management (NPM) and the reinventing government movement encouraged tool diversification through contracting, vouchers, earned income, and tax credits, producing greater complexity in organizational structure as a direct consequence (i.e. affiliated partnerships for low income housing) and an as indirect consequence (e.g. the two nonprofit subsidiary cases).

The interaction between tool diversification and organizational form raises questions about tool design and implementation. An important assumption of the research on tool design is the distinctiveness of different types of tools such as contracting and tax credits, especially in terms of their effects on individual and organizational recipients. For example, contracting at least conceptually is regarded as

a more market oriented policy tool than direct government. Tax credits are a more indirect form of policy implementation than contracting because they depend upon private entities to exercise them (See Salamon, 2002).

Yet, hybridization tends to undermine the distinctive characteristics of specific policy tools. Low-income housing organizations essentially rely upon tax credits, contracts, bonds, private donations, and subsidized loans. So the behavior of the organization as a whole is not easily characterized by reference to specific policy tools since funding is typically pooled to build specific projects; the limited partnerships are an organizational vehicle that permits this pooling of funds using tax credits. The nonprofit subsidiary cases illustrate the difficulties encountered by smaller community based organization in an increasingly competitive funding environment. By essentially taking over the smaller organizations, these parent agencies extracted certain commitments from funders that minimize the extent to which these organizations have to formally compete for the contracts. Indeed, the expectation is that the acquiring agency will continue to receive the contracts subject to the attainment of specific programmatic and financial objectives.

Hybridization then calls attention to organization structure which has receive far less attention in the literature on policy tools. Successful projects using tax credits and other policy tools need the appropriate organizational structures which allow the organization to meet legal and accounting requirements as well as respond with nimbleness to a rapidly changing environment. Similarly, nonprofit subsidiaries need to be designed in a way that balances the increased risk of these ventures with transparency and flexibility in responding to new funding and political circumstances.

Further, the ability of hybrid organizations to successfully manage complex revenue streams and projects will increasingly be a condition of receiving many of the policy tools associated with the New Public Management including contracts, tax credits,

bonds, and vouchers. Hybridity is becoming a marker for the successful adaptation of an organization to a turbulent environment.

Conclusion

Hybridization is directly related to the widely discussed shift to network governance (Goldsmith and Eggers, 2006). Often, structural innovations representing examples of hybridization are initially started through network relationships. Frequently, though, the emphasis in this network governance literature is on inter-organizational relationships such as public-private partnerships, government contracting with private organizations, and multi-party collaborations. The examples of hybridization noted in this paper represent an important, increasingly common development that needs greater attention. But these different types of hybridization are indicative of the internal restructuring of organizations that seeks to capitalize and strengthen the external networks of the relationships of the organization. Two examples illustrate the point. First, affiliated foundations are an implicit acknowledgement that the generation of private donations from private individuals and corporation are more likely through a specialized foundation that focuses on these partnerships. Second, the takeover of the low-income housing organization by the larger diversified social service organization was justified in part by the potential for growth of government contracts and private donations in support of low-income housing development and maintenance.

Put another way, structural innovation is a strategy to support the intensification and strengthening of external networks that may in turn lead to additional resources through contracts, tax credits, grants, and donations. These resources may flow directly from the new entity or they may be generated more indirectly. For instance, the city of Seattle was quite supportive of the takeover of the two agencies by the larger more

stable agencies, since it solved an urgent problem for them. The resultant goodwill may be helpful for these agencies on other matters including other contracts and grants.

Hybridization, in short, has potentially substantial value to nonprofit agencies and many of their key stakeholders. Thus, hybridization is likely to continue to increase in scope and variation. It will spread through professional networks that encourage agencies to consider hybridization as a strategic option for agencies. And, agencies will opportunistically respond to new initiatives as public and private funders adapt themselves to a changing funding and political environment for public services.

Arguably, structural innovation represents a “third way” in the adaptation of organizations to public sector reform (See Christensen and Laegreid, 2001). The last 25 years witnessed a push for more market oriented reforms including greatly expanded use of contracts, competitive tendering, and tax credits. The ensuing problems of service fragmentation and sustainability have not however led to efforts to return to public sector delivery. Instead, the problems faced by public and private organizations are too complex and intertwined, and the tools of government action are much more diverse. Structural innovation among public and nonprofit agencies is a strategy to cope with this more complex environment. While certain strategies such as affiliated foundations appear likely to continue to proliferate through imitation, other organizational changes will continue to be adaptations to specific circumstances and problems, producing wide variation in organizational structure.

And consistent with this point, the implications of hybridization on citizen participation and representative governance may not be entirely negative. Devolution and privatization in the US in the 1980s and 1990s entailed a pronounced shift to community based nonprofit organizations and greater involvement of market mechanisms including tax credits and contracts in public service delivery. But the resultant hybridization need not necessarily lead to a reduction in good governance or

community involvement in service delivery. Indeed, structural innovation can actually widen the network of stakeholders with an ongoing investment in organizational performance and effectiveness. Additional attention and research on these hybrid forms will further aid the design and implementation of these structural innovations in a way that enhances governance and service quality.

References

- Arndt, Margarete and Barbara Bigelow. 2000. "Presenting Structural Innovation in an Institutional Environment: Hospitals' Use of Impression Management," *Administrative Science Quarterly* (September):
- Christensen, Tom and Per Laegreid. Eds. 2001. *New Public Management : the Transformation of Ideas and Practice*. Aldershot : Ashgate.
- D'Aunno, Thomas, Robert Sutton, and Richard Price. 1991. "Isomorphism and External Support in Conflicting Institutional Environments: A Study of Drug Abuse Treatment Centers," *Academy of Management Journal*, 34: 636-661.
- Dunleavy, et al. 2005. "New Public Management Is Dead---Long Live Digital Era Governance," *Journal of Public Administration Research and Theory*, 16: 467-494.
- Fligstein, Neil. 1985. "The Spread of the Multidivisional Form Among Large Firms, 1919-1979," *American Sociological Review*, 50, 3 (June): 377-391.
- Goldsmith, Stephen and William Eggers. 2006. *Governing By Network*. Washington, DC: Brookings.
- Hansmann, Henry. 1980. "The Theory of the Nonprofit Enterprise," *Yale Law Journal*.
- Hyde, Cheryl. 1992. "The Ideational System of Social Movement Agencies: An Examination of Feminist Health Centers," in Y. Hasenfeld, *Human Service Organizations*. Newbury Park, CA: Sage.
- Joldersma, Cisca and Vijco Winter. 2002. Strategic Management in Hybrid Organizations," *Public Management Review*, 4, 1 (March): 83-100.
- Koppell , Jonathan G. S. 2003. *The politics of quasi-government : hybrid organizations and the dynamics of bureaucratic control*. Cambridge ; New York : Cambridge University Press, 2003.
- Lynn, Laurence E., Jr. and Steven Rathgeb Smith. 2007. *The Performance Challenge in Nonprofit Organizations*. Unpublished draft.
- Meyer, John W. and Brian Rowan. 1977. "Institutionalized Organizations: Formal Structure as Myth and Ceremony," *American Journal of Sociology*, 83, 2 (September): 340-363.
- Minkoff, Debra. 2002. "The Emergence of Hybrid Organizational Forms: Combining Identity Based Service Provision and Political Action," *Nonprofit and Voluntary Sector Quarterly*, 31: 377-401.
- Perry, James and Hal G. Rainey. 1988. "The Public-Private Distinction in Organizational Theory," *Academy of Management Review*, 13: 182-201.
- Powell, Walter W. and Paul DiMaggio. Eds. 1991. *The New institutionalism in Organizational Analysis*. Chicago: University of Chicago Press.

Salamon, Lester, ed. 2002. *The Tools of Government*. New York: Oxford University Press.

Seidman, Harold. 1975. "Government-Sponsored Enterprise in the United States," in Bruce L. R. Smith, ed. *The New Political Economy: The Public Use of the Private Sector*. New York: John Wiley and Sons.

Skelcher, Chris. 1998. *The Appointed State: Quasi-Government Organisations and Democracy*. Buckingham: Open University Press.

Skelcher, Chris. 2005. "Public-Private Partnerships and Hybridity," in *The Oxford Handbook of Public Management*, ed. by Ewan Ferlie, Laurence E. Lynn, Jr. and Christopher Pollitt. New York: Oxford University Press. pp. 347-370.

Smith, Steven Rathgeb and Michael Lipsky. 1993. *Nonprofits for Hire: The Welfare State in the Age of Contracting*. Cambridge, MA: Harvard University Press.

Sosin, Michael, Steven Rathgeb Smith, Lucy Jordan and Timothy Hilton. 2007. "Temporary Crises and Policy Change: The Case of State Substance Abuse Systems," unpublished paper.

Waddell, Steve, and L. David Brown. 1997. [Fostering Intersectoral Partnering: A Guide to Promoting Cooperation Among Government, Business, and Civil Society Actors](#). IDR Report. 13 (3).