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## **Inclusive governance in non-profit organisations**

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## **Inclusive governance in non-profit organisations**

### **Abstract**

The study of private non-profit enterprises that offer general interest services is only at the start. The understanding of existing organisations resists an inclusive, public interest view of governance. This contribution aims at providing a reflection on specific features that non-profit enterprises should have, and outlines four main justifications for including stakeholders in production governance: 1) access to knowledge and other resources, 2) trust creation, 3) internal efficiency, 4) external efficiency. Conclusions elaborate on Hansmann's classic theory of the firm to suggest that governance solutions need to be assessed on the basis of total costs, considering also the lower level of social costs that is created when governance includes relevant stakeholders. Our model highlights that when social costs are high, even an enterprise with costly decisional processes, such as the multi-stakeholder, can be the most efficient solution amongst other possible alternatives.

*“The only form of enduring social organization that is now possible is one in which the new forces of productivity are cooperatively controlled and used in the interest of the effective liberty and the cultural development of the individuals that constitute society. Such a social order cannot be established by an unplanned and external convergence of the actions of separate individuals, each of whom is bent on personal private advantage. This idea is the Achilles heel of early liberalism” (Dewey, 1935, pp. 628).*

## **1. Introduction**

In European countries the social and personal service sector is facing increasing difficulties. The demand and complexity of the services is growing and resources have been shrinking (Cf. OECD, 2014<sup>1</sup>). The problem is especially relevant since social and personal services (e.g. health, education, social housing, libraries, arts) impact, more than other goods and services, on the welfare of communities and of particular groups of stakeholders within them. Most of the personal services can be conceived, in principle, as private goods (since they can be excludable and rivalrous), but they may be regarded, at least in part, as common goods when communities value open and equal access to these services independently of the users' capability to pay, and when they generate community value (Borzaga, 2015). Still, social service provision requires specific consideration, since (differently from other types of commons, such as infrastructural goods) they are offered within territorially-defined communities, they may target specific groups of individuals, or are conceived to support users with personalised needs, exceptional difficulties, risk of social exclusion and scarce ability to pay. Social services are also goods with a marked re-distributive connotation, when for example price discrimination is applied in favour of the weakest categories of beneficiaries, to whom services can be offered gratuitously (Borzaga and Tortia, 2010). Because of these features social services can be considered as “fundamental goods,” a specific type of “common” good, whose production is organised flexibly to provide towards the fundamental needs of distinct categories of users (Borzaga, 2015). At the same time, however, because the effects of fundamental goods transcend their direct users and impact on society more broadly (e.g. by increasing the possibility to engage with production activities, increasing trust, social inclusion, and equality), their provision generates public value and has therefore a distinct general interest relevance.

Because of their public interest implications, the provision of fundamental goods and their governance continue posing a number of questions to scholars, policy makers and practitioners. Differently from goods that are solely private or public, these private common goods are or may be provided alternatively by for-profit corporations, public providers, not-for-profit organisations. Most answers are on variants of public and private systems with the familiar shortcomings associated with each (Weisbrod, 1988). On the one hand, private for profit firms avoid engaging in a low profit sector and tend to supply low quality output whenever services embed complex specialist knowledge and monitoring is imperfect, thus forcing the public sector to eventually grant large incentives to providers. Conventional investor-ownership moreover is argued to affect the destination of surplus and initial investment decisions, not necessarily in the best interests of other stakeholders. For these reasons the sector is argued to require both public policy (e.g. in the form of regulation, monitoring and enforcement) and in many cases the direct provision by public authorities. On the other hand, however, public provision is not always able to capture demand and to satisfy it entirely, since it tends to be casted around the median voter and prescribe uniformity on the services offered (Rose-Ackerman, 1996), but also because of an increasing scarcity of financial resources. Moreover, bureaucracy may cause efficiency problems.

Non-profit organizations have demonstrated to be, and have long been considered an alternative way to respond to these challenges. These organisations have been argued to be able to serve the welfare of users or other stakeholders for three main reasons. The *first* is their aim, which is designed around local societal challenges and production of public value. The *second* is the allocation of property and control rights to stakeholders different from investors. In principle, not-for-profit organisations do not have an incentive to exploit information asymmetries to reward investors at the expenses of other interests. In fact, non-profit firms can allocate property and control rights to a variety of stakeholders, including users (Ben-Ner, 1986; Ben Ner and Van Hoomissen, 1991; Hansmann, 1996; Mori, 2013). The *third* reason is the non-distribution constraint, which allows firms to operate with a public interest remit.

While traditional non-profit organizations were mainly playing an advocacy role (especially in Europe) and were characterized by the non-profit distribution constraint (as in countries with a widespread cooperative tradition), in the last decades new not-for-profit providers have emerged. These are characterized by the commitment to service production, not always with a total profit-distribution constraint. Governance-wise, the organisational configuration is inclusive of different types of stakeholders, and are increasingly denominated social

enterprises. Inclusive governance is the most innovative feature of the new non-profit organisations, which has been underlined since the first contributions, for example in the working definition used by the EMES network, as well as by several European laws. Within EMES, Defourny and Nyssens (2008), in particular, recognise social enterprises:

“... not-for-profit private organizations providing goods or services directly related to their explicit aim to benefit the community. They rely on a collective dynamic involving various types of stakeholders in their governing bodies, they place a high value on their autonomy and they bear economic risks linked to their activity” (Defourny and Nyssens, 2008: 204).

Social enterprises have spread over the last decade, receiving attention from scholars and policy makers alike, as indicated by Europe’s recent Social Business Initiative (2011-2014), as well as by the European research scenario, which advocates the need for research that addresses “the development of new forms of organisations and interactions to respond to societal challenges” as a response to community needs (NET4SOCIETY, 2014: 21). Consistently with the first definition outlined above, the Social Business Initiative identifies the foundational elements of the social enterprise which support the production of public value (EESC, 2012). This work summarises these elements along three characteristics: 1) the social objective, 2) limited profit distribution, and 3) inclusive governance, participation and co-decision (i.e. of workers, users, members).

This paper focuses on “inclusive governance,” that is the last of the three features of social enterprises highlighted above. The reason for concentrating on this element is that governance forms that include multiple stakeholders, and are participated by stakeholders (e.g. users, employees, volunteers, suppliers and contractors, public sector organisations, families, other community constituencies, donors and investors) underpin and facilitate also the other two characteristics (i.e. limited profit distribution and having a social objective). It is quite striking, however, that inclusive governance remains largely unattended by scholars of social enterprises. The modalities of stakeholders’ participation and its effects are often taken for granted and have not been fully researched to date: it still remains unclear: why inclusive governance is needed, what are its advantages, and how it can be realised in practice (in terms of structures, rules, practices).

Whilst initial studies are being developed on the third issue (the structural features of inclusive governance, Cf. Borzaga and Depedri, 2014), on the first two instances there has been no attention paid to whether and how governance arrangements in social enterprises contribute

to the creation of public value, assessed in terms of: 1) specific outcomes generated on stakeholders (considered, for example, in terms of service innovation, improved wellbeing and social inclusion for weaker groups of individuals, savings in public welfare expenditures), 2) broader effects on the community as creation of public value (for example in terms of creation of income equality, social inclusion, social capital, democratic skills and civic engagement, environmental regeneration and safety, criminality rates). Rather, governance studies tend to emphasise how stakeholder inclusion in the governance of the organisation increases ownership costs (Hansmann, 1996; Birchall, 2014).

Differently, this work *conceptualises and hypothesises positive outcomes and public value creation as a function of the inclusion of multiple interests in the strategic decision-making functions of the social enterprise, which is typically defined (albeit not exclusively) by its governance structure and praxis*. The paper proceeds by outlining four main justifications for the inclusion of stakeholders in production governance, namely: 1) access to knowledge and other resources, 2) trust creation, 3) internal efficiency, 4) external efficiency. The paper concludes by elaborating on Hansmann's classic theory of the firm to provide a justification for inclusive governance which considers external efficiency, besides ownership and contractual costs, and reinforcing also knowledge creation and trust amongst the elements that determine internal efficiency.

## **2. Governance: A Critical Perspective**

Governance refers to the structures and processes that define the strategic choices of an organization, the direction and monitoring of activities. Studying governance in social enterprises means to recognise who is responsible for the identification of societal needs, for the design of services, for surplus distribution, or for defining the inter-organisational division of labour along the value chain of service provision. These choices have clear implications for community prosperity and for the welfare of each stakeholder specifically (Gereffi, 1994; Cowling and Sugden, 1998; Kaplinsky, 2000; Cornforth, 2012; Sacchetti and Sugden, 2009).

In the case of social and personal services, the interaction between demand and supply unfolds into a complex interchange between a variety of stakeholders with different roles and experience, albeit potentially accomodable interests. To illustrate, in many of the health and social-related services, the main stakeholders are those who, for diverse reasons, have a disadvantage. Users or patients are clearly those individuals whose life quality is directly

affected by the nature of the service offered. Close bonds, family members and intimate friends, are the next most proximate level of stakeholders, since their life experience is immediately interconnected with the one of the user. Furthermore, the nature of activities involves other constituencies that operate at community level. These can be involved in the production of services whilst, on the other hand, demanding the service. Here we find schools, doctors and their practices, city councils, and other profit or non-profit organisations that participate with various roles into the design or delivery of health-related services.

This broad range of interests and the variety of resources that conflates into the production of value added put the theory of shareholder primacy under strain. According to scholarly literature, in firms owned by shareholders, managers have the fiduciary duty to maximise the interests of the latter. This has been typically identified with revenue maximisation and distribution to shareholders. However, if the fiduciary duty were to be extended to other stakeholders, managers could justify offering lower service rates to beneficiaries, allocate resources to the development of inclusive practices towards users and workers, or invest in co-producing innovative services jointly with private or public sector clients and suppliers. Pursuing these goals would not have to be necessarily functional to the maximisation of shareholders' interests. Given managers' duties, the perspective needs to encompass a change in the controlling function of the organisation. More generally this work argues that, in order for managers to respond to a wider set of interests, the design of the governing bodies of the organisation needs to allow for stakeholders partaking in the strategic control of the firm. In this case, the fiduciary duty of managers is extended beyond mono-stakeholder ownership and strategic interdependencies must be explicitly recognised (Fulton et al., 2015).

Increasing the diversity of those who have access to strategic control does not solve the problem of good governance, however. Managerial behaviour has always represented a challenge for scholars, and has largely dominated managerial and economic theory, which has identified solutions in terms of board and regulators' control over managers' actions (Birchall, 2014). For the principal-agent theory, good governance requires the existence of monetary incentives and processes that ensure the liability of management to the main patron of the company (Cf Gregory-Smith and Main, 2015 for discussion). "Governance failure," in this sense, puts emphasis on reactive measures in the face of opportunism and corruption, greed and short-terminism (OECD, 2004). Complementary, as Cornforth (2003) and Reid (2014) observe, managerial hegemony theory addresses the problem in terms of the power asymmetry



between the management and the board, in terms of uneven distribution of access to information, accountability, specific skills and expertise.

These considerations have been applied mostly to managers and workers, with the aim of aligning individual actions with the interests of the organisation, whether this is for-profit or not-for-profit (Cf. Schleifer and Vishny, 1997). Using the same approach, Cornforth (2004), Spear, (2004), and Birchall (2013) have framed the problem of governance in cooperative organisations.

The same problem of asymmetries and opportunistic behaviour, suggests a different stand on governance. Building on the strategic failure approach developed by Cowling, Sugden, and colleagues (Cf. Cowling and Sugden, 1998 amongst others), we observe that besides bounded cognition and information asymmetries, the problem of “public value deficit” lays in the concentration of strategic decision-making power and control with a single stakeholder (Sacchetti and Sugden, 2010). What follows is a failure of production governance to recognise multiple needs in production choices.

One could argue that the problem of marginalisation of multiple stakeholders could be, in part, addressed via the contractual system, when markets are competitive and contract law is well defined. For example, contracts can be written with the public sector for the design and supply of services, with creditors when activities are funded through debt, with workers and volunteers, and with service users. From transaction cost theory, however, we know that writing complete contracts can be costly or even impossible in the case of large asymmetries, risk and uncertainty, because of the hazards that the opportunism of decision-makers would create to users, workers, suppliers, creditors, and investors (Williamson, 1988; Heath, 2011). Transaction cost theory suggests that hierarchical bureaucracy is the solution when contracts cannot be specified satisfactorily. However, this theory suggests also that control over decision-making should be given to one stakeholder only, generally the one who bears is more penalised by market failure (Hansmann, 1988). The inclusion of multiple stakeholders is not considered, since heterogeneity of interests would harm internal efficiency. So, albeit transaction cost theory recognises that inclusion in governance is the solution to contract incompleteness and information asymmetries, it does not justify the presence of multiple stakeholders. In other words, internal efficiency is obtained by means of the exclusive control of one stakeholder, whilst other interests are safeguarded by means of contracts.

However, a complete analysis of governance failure exceeds the transaction cost sphere. In the absence of inclusive governance, perfecting market contracts (in a context of uncertainty and

power asymmetry), the reduction of information asymmetries and opportunism (reached by some degree of contract-based cooperation), or improved cognitive abilities of decision makers (reached by means of more effective use of information) do not lead necessarily to the recognition and empowerment of multiple and collective needs. In other words, *improvements in contracts, incentives, information and cognitive skills are not sufficient conditions to solve deficits in stakeholder welfare and public value creation.*

Rather, *there is a problem in the structure and method used to formulate decisions.* Mono-stakeholder control, as a governance solution, and command-and-control as the method of interaction cause a deficit of participation, knowledge, trust and efficiency in decision-making. To consider these aspects, decisions need to be formulated by including those affected and their interests. This is not the norm when governance forms include only one stakeholder. An explanation comes from Cowling and Sugden (1998), for whom *decision-makers, whether managers or patrons, do not minimise costs (as assumed by transaction cost theory), but maximise their own interest, whatever that is.* With exclusive decision-making power, “opportunistic” decisions may incur even though the excluded parties are aware of it and share the same information and understanding, i.e. even if there is not an information asymmetry problem or a managerial hegemony problem. Our take of opportunism is related to the exclusion of others’ interests from decision-making. In this case, *the decision maker acts opportunistically when, informed about multiple needs and possible solutions, s/he still prefers to act exclusively, i.e. despite the interests of others* (Sacchetti, 2015). Even from a transaction cost approach this is plausible, since with the decision-making power asymmetry, those excluded from governance cannot sanction the decision maker, even if they wanted (they could walk away, but for many social and health services this may not be an option). This holds when stakeholders do not have access, or the capability to access, proper alternative responses to their needs.

Consider medical doctors. Doctors represent the scientific community which holds the necessary knowledge to prevent, diagnose and cure illnesses. They use this knowledge to control the health expenditures on behalf of the public sector. Patients are subject to the doctors’ care and judgement since the decision-making power, information asymmetry and understanding is usually large. Doctors are therefore in a position to eventually use that asymmetry to their own advantage even at the detriment of patients (e.g. by not dedicating the required attention to each patient). In the case of health and personal services, the exploitation of information and power asymmetries would directly affect specific stakeholders, and cause a failure to produce public value. For example, it may prolong recovery times or make some

patients chronic because not involved, it may cause hazard to patients, distrust in the medical community, the persistence of social exclusion for patients and carers, and inequality at societal level.

Likewise, the providing organisation (public sector, or a health-related enterprise) could behave opportunistically towards doctors and patients, by not providing the required conditions that are necessary to offer quality healthcare, for example by incentivising doctors to control expenditures for prevention, diagnosis and care despite implications for the patients. Whoever is the provider, exclusive governance fails to achieve socially desired ends.

### **3. Multi-stakeholder solutions**

*In response, this work defines inclusion as a form of governance by which the strategic direction and control of the firm are exerted by a plurality of stakeholders who share aims and values, whether such functions are held through ownership or by other coordination mechanisms, as long as they are recognised in the statutory rules of the firm and implemented (empowerment).*

In this work, multi-stakeholdership is considered as a specific type of inclusive governance, which is gaining considerable diffusion. Consider, for example, recent multi-stakeholder cooperatives that provide social and personal services in Italy. These are owned and/or controlled by a variety of patrons (such as workers, public bodies, volunteers, suppliers, users). Using original survey data (ICSI Database, 2007), Borzaga et al. (2011) have undertaken an effort to map the governance status of these organisations. They evidence that nearly 80 percent of enterprises providing personal, social and work integration services feature some form of multiple stakeholder involvement.<sup>ii</sup> Sacchetti and Tortia (2014), consistently, show cases in which a dynamic and inclusive approach to the governance of social enterprises capitalise on the resources of multiple patrons at different levels, by involving them as member owners (e.g. disadvantaged workers and volunteers) or by including them in the board of directors (e.g. public administration, job centres, client and supplier organisations, parent associations).

The inclusion of stakeholders is a challenging process for organisations, which requires, amongst other things, re-thinking the distribution of organisational resources, and the decision-making process. Multi-stakeholdership (in the membership and/or in the board) historically emerges from an evolving “percorso” during which the enterprise interprets community unmet needs, contextual changes (e.g. in service demand, in the legal framework),

or stakeholders' changing preferences on engagement and participation, and creates the organisational conditions for the inclusion of each emerging stakeholder (for example, the inclusion of workers with disabilities as members may require the introduction of a psychologist within the organisation and the reformulation of human resource strategies). As a result, a *gradually* growing network of stakeholders gains voice in the definition socio-economic activities and creates space to stakeholders and community interests (Borzaga and Ianes, 2011; Sacchetti and Tortia, 2014; Borzaga and Depedri, 2014;)

In other cases, multi-stakeholdership is the product of a more formal institutional framework, or a mix of the two, i.e. when the law reflects successful organisational experiences. In fact, similar organisations in different countries follow the principles of a mixed membership approach because required by law. For example, the French law on SCIC (Société Coopérative d'Intérêt Collectif) provides for three types of members being represented in the board: workers and beneficiaries, plus a third category to be nominated. In some cases, public administration or private for-profit organisations can also be members of a social enterprise, e.g. in France and in Spain.

But why inclusive governance, in the form of multi-stakeholdership, has emerged? And what can be the main justification for including more than one interested party in the governing bodies of the organisation?

#### **4. Inclusion, access to knowledge and other resources**

A first justification revolves around knowledge. In existing experiences, governance solutions that include multiple stakeholders aim at providing fundamental services in a novel way with respect to standard public sector provision. The presence of these inclusive governance solutions suggests that failure is not exclusively generated by the behaviour of managers, directors, and regulators. Rather, it may be generated by a failure in *acknowledging* the interaction amongst the interests and experiences of a diversity of stakeholders. Despite being excluded and marginalised by prevailing governance forms, each and every stakeholder has the potential to contribute to the definition of needs and modalities by bringing its own experience and perspective into the process of choice (Cf. Dewey, 1927). This consideration is even more pertinent in the context of social and health services.

An inclusive account of governance helps to *acknowledge (to know)* the nature of the needs to be addressed, their diversity, and the complexity of the interactions between actors who demand and supply the service, the resources that each actor can deploy, thus reducing the public value deficit (Sacchetti, 2015). For example, within the encompassing stakeholder category defined as “the patient” we find multiple needs, interests, and power where resources have to be allocated amongst the prevention, diagnosis and cure of different illnesses. This is true also for other types of stakeholders, such as investors in investor-owned firms, workers in worker cooperatives or consumers in consumer cooperatives. There are, in other words, multiple interests also in so-called mono-stakeholder organisations, to which our analysis also applies.

Together with each and every actor’s specific and contextual knowledge, inclusive governance recovers other related immaterial resources, such as actors’ social capital, pro-social motivation and creativity. This function of governance is different from that of contracts, which are not suitable to capture the non-monetary and unselfish elements of stakeholder participation, i.e. contracts do not reward for the use of resources and motivations that cannot be monetised.

In parallel, because inclusive governance offers an environment where actors can directly influence decision-making, stakeholders will be keener to input material resources, such as voluntary work, membership fees, donations that they would not otherwise deploy in other sectors. Inclusive governance, therefore, facilitate recovering resources that management can then apply to support the needs and solutions identified by the governing bodies.

The effectiveness of inclusive governance to highlight and acquire material and immaterial resources provides also an indication of the capability of the organisation to identify needs and opportunities, and develop desirable solutions. It also gives an indication of the legitimacy that the non-profit organisation has and of its capacity to generate value for specific stakeholders and for society more generally (Moore, 2003; Moore and Hartley, 2008).

## **5. Inclusion and Trust**

The second justification for inclusive governance is its trust-enabling function. Economic literature suggests that the non-distribution constraint makes firms to operate with a public interest remit. Stakeholders, accordingly, would trust that the non-profit organisation produces

public value because there are no incentives to fail stakeholders, and the community overall, in order to reward capital (Ben-Ner, 1986; Rose-Ackerman, 1996). The non-distribution constraint holds, in this sense, a legitimisation function. But, as Hansmann (1996) notices, this is a “rude protection device.” Our inclusive governance approach suggests that, even in the presence of a non-distribution constraint, the controlling stakeholder can still use the decision-making power asymmetry to pursue its own interest to the detriment of others, and fail to produce public value. For example, managers’ and workers’ interests can be pursued to the detriment of users when surplus is reduced by means of unjustified higher salaries rather than, for instance, lower prices for those in need. Or, vice versa, emphasis can be placed on some users’ welfare to the detriment of other groups of users or of the interests of workers.

Rather than relying exclusively on limits to surplus distribution, trust is at the heart of the direct involvement of stakeholders in the organisation’s governance (Cf. also Fairbairn et al., 2015). Specifically when talking social enterprise, trust is based – at least initially – on shared participatory and solidaristic values. These specific values are credible since they are embedded in the inclusive governance structure and cooperative praxis of the organisation. To illustrate, constitutionally, inclusive and pro-social values are recognised by the statutory rules of the organisation. Organisationally, they are embodied in the composition of the membership and of the board. Finally, operationally these features imply high standards of decision-making by discussion, cooperation, procedural and relational fairness amongst stakeholders (Borzaga and Tortia, 2015; Leventhal, 1980; Sacchetti and Tortia, 2013; Tyler and Blader, 2000). With procedural and relational fairness, stakeholders’ voice is enabled not only by pro-social principles, formal structures and distribution of control rights, but also empowered by a culture of communication and engagement (Sacchetti and Tortia, 2013). These features have been argued to build on and, at the same time, foster trust, as well as actors’ motivation to take part and cooperate amongst each other (Ostrom 2010; Deci and Ryan, 2008). From this angle, and consistently with Bradach and Eccles (1989), Möllering (2002), and Borzaga and Tortia (2015), cooperation amongst stakeholders is based on the shared belief or trust that the values of the organisation are implemented by each and every actor through the enabling role of inclusive governance and consistent organisational solutions. These do not exclude managerial control or contract-based coordination, but attach to these two mechanisms an auxiliary role.

## **6. Inclusion and Internal Efficiency**

For transaction cost theory, coordination amongst multiple and potentially conflicting interests requires the costly design of incentives, monitoring and control mechanisms. More trust equals more transparency, less opportunistic behaviours, and less need for bureaucratic control (Cf. Möllering, 2002 for a discussion). However, in line with Borzaga and Tortia, (2015), Thompson (2015) and Valentinov (2004), the argument is that the quality of the public value produced through the provision of fundamental goods is related to a “deeper level of cooperation” than the one achieved through market contracts and managerial hierarchies. We have further argued that deep-level cooperation can be achieved through the knowledge and trust-enabling function of inclusive governance arrangements.

Deeper cooperation requires the inclusion of stakeholders in governance, whereby conflicts are resolved because each actor has the power to present instances, trusting that such instances would be acknowledged and considered in the light of wider and more general interests than those represented by each single stakeholder (Dewey, 1963). Building on an organisational context that expresses participatory and pro-social values that selects in large part pro-social actors, each actor is less likely to behave selfishly, or to use its decision-making power to pursue exclusive advantages. With inclusive governance, cooperation is based on enabling governance rules and relational elements mostly, leaving to managerial control a complementary but more marginal coordination role. It is the prevalence of deep-level cooperation, in fact, that reduces the need for command-and-control and lowers coordination costs (Aoki, 1984; Borzaga and Tortia, 2015; Fitzroy and Kraft, 1986; Putterman, 1984; Sacchetti and Sugden, 2003; Thomson, 2015).

## **7. Inclusion and External Efficiency**

The main feature of the inclusive governance approach is that stakeholders and society at large can benefit of the outcomes and public value created by a cooperative approach to the use of resources. Measurement literature has defined the outcome of a non-profit organization as the “state of the target population or the social condition that a program is supposed to have changed” (Rossi, Lipsey, and Freeman, 2004, 204; Cf. also Lee and Nowell 2015 for a review of performance measurement categories). The focus is on changes in the behavioural and environmental conditions that the social enterprise, through its activities, has contributed to

generate on specific groups (Bagnoli and Megali, 2011). In parallel, public value scholars such as Hills and Sullivan (2006) have operationalised non-profit organisations' broader effects on society in terms of quality of life, well-being, and happiness; social capital, social cohesion and inclusion; safety and security; equality, deprivation, and social exclusion; promotion of democracy and civic engagement (Lee and Nowell, 2015).

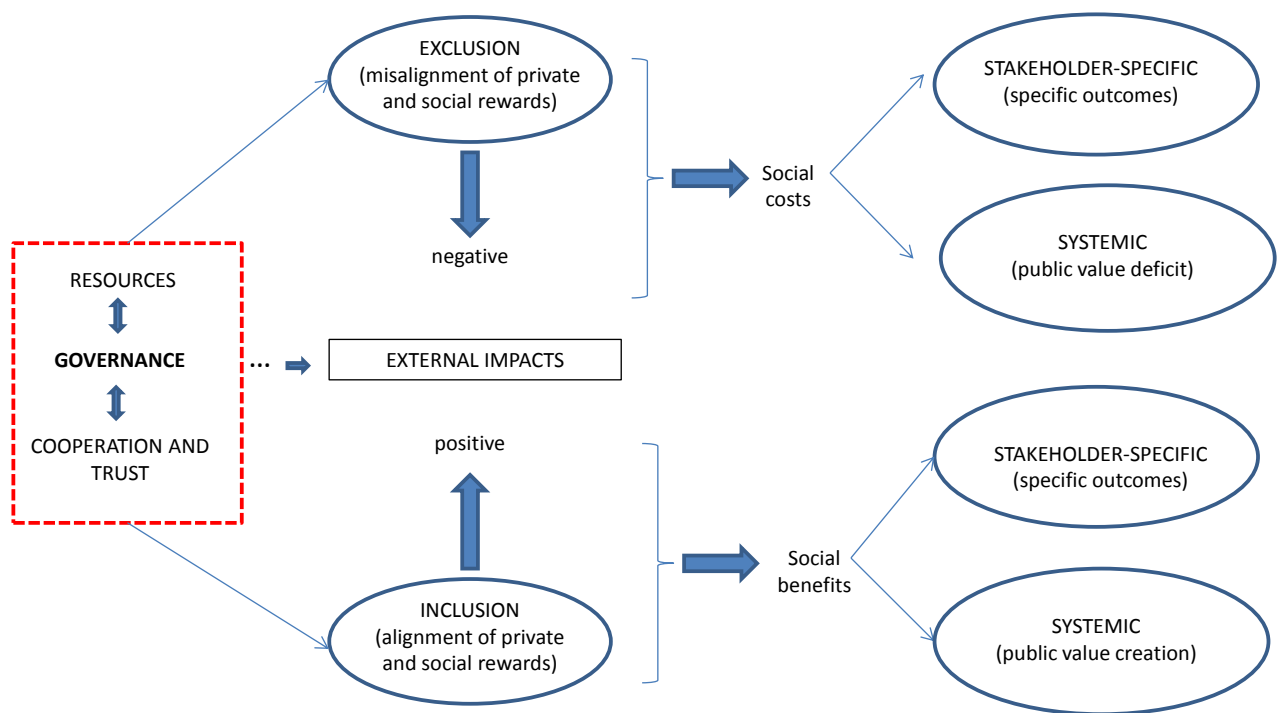
Conversely, when exclusive interests prevail, even despite those of others, exclusive governance creates a deficit in the capacity of communities to generate public value and meet socio-economic needs (Sacchetti and Sugden, 2010). In the case of health and personal services, exclusion produces both stakeholder-specific effects, such as insufficient, excessively standard and parcelled services, persistence of problems affecting the weakest groups, fragmentation of service production and labour functions, and systemic effects across society. Systemically, restricted access to decision-making, to connections, and to opportunities for civic engagement creates a barrier to social integration, to the diffusion of trust, cooperation and democratic attitudes across society as a whole public, thus reinforcing the public value deficit (Dewey, 1927; Hirschmann, 2002; Sacchetti et al., 2009). More generally, excluding all but one stakeholder, as a governance system and as a method of decision-making, contributes to accentuate the incoherence between community needs and those expressed by the production system, furthering the distance between production choices and community development objectives (Mori, 2014; Sacchetti, 2015; Sacchetti and Sugden, 2010; Sugden and Wilson, 2002).<sup>iii</sup>

The analysis considers *two types of interacting "public" impacts: on specific groups (specific effects or outcomes); generalisable to the entire community (systemic effects or public value)*. Whilst specific effects (or outcomes) are excludable, systemic effects (or public value) are non-excludable effects of production governance and processes. Albeit no specific effect is totally isolated, and each and every choice interacts to some extent with other interests, specific effects are those that fall, mainly, on specific groups.

The interconnections between governance and public impacts are illustrated in Figure 1 (where the dots between governance and impacts allude to the organisation of production across the value chain, analysed in Borzaga and Sacchetti, 2015).



**Figure 1 - Public impacts**



Of the two types of effects (specific and systemic), political economists focus mainly on systemic effects. These, as mentioned, are deficits in public value which essentially refer to market externalities: “uncompensated interdependencies” due to the absence of markets, which can produce social benefits or social costs (Cornes and Sandler, 1996).

Cowling and Sugden (1994), differently, identify societal costs with the “strategic failure” of exclusive production governance. Consistently with their concerns, Meade (1979) centres his definition of externalities on the exclusion of the affected parties from the decisions that led to the external economy or diseconomy.<sup>iv</sup> This interpretation of externalities explains their existence by pointing at the exclusion of stakeholders’ interests (rather than to the absence of markets). The approach allows also to position effects which cannot be monetised, since the focus is on the nature of decision-making rather than on the entity of the external effect (which is rather a consequence of governance structure and processes). The crucial point of this interpretation is that negative public impacts (on specific stakeholders and communities) are due to a governance failure rather than to a market failure. In the first type of failure exclusion is purposeful, since it is the governance level that prevents inclusion and desired impacts. In the latter, conversely, exclusion and its impacts are due to the absence of markets and therefore conceived as involuntary.

## 8. Extending Hansmann

Following Hansmann's argument, the prevailing economic approach to governance supports the view that trying to pursue the interests of multiple patrons makes the firm less efficient, for example with respect to mono-stakeholder competitors (Hansmann, 1996; Birchall, 2014). The inclusion of multiple interests, in particular, may generate conflict over the distribution of the value added or over other strategic decisions. Business ethicists arguing in favour of multifiduciary stakeholder theory (whereby different stakeholder interests are pursued by the board of directors) have been contested on the grounds provided by Hansmann's theory (Heath, 2011).

In explaining the ownership of enterprises, Hansmann's law states that the efficient allocation of property rights occurs by minimising total costs: those related to ownership (CP) and those associated with the use of market contracting (CC). Given these costs, according to Hansmann, the ownership of the firm goes to the stakeholder who minimises the sum of the costs of market contracting (CC) and the costs of ownership (CP):

$$CP_j + \sum_{i=1}^{n-1} CC_i$$

Differently, when stakeholders have heterogeneous interests, Hansmann's model predicts that property costs rise, since the alignment of aims requires greater coordination and monitoring. It follows, in Hansmann's model, one patron can have a representation and a decision-making role in the board of directors, whilst all other stakeholders are coordinated via contracts. Albeit Hansmann does not consider multi-stakeholdership, his perspective would suggest that multi-stakeholder ownership is extraordinary costly and therefore economically not sustainable. The costs derived from the exclusion of stakeholders are not considered.

This claim, however, needs to be re-assessed in light of the public value deficits and specific negative effects produced by exclusive governance. We have argued that decision makers maximise their own interests, which may not coincide with minimisation of total costs, including those produced on excluded stakeholders and society. In the presence of decision-making power asymmetries, then, governance fails to identify needs, resources, and answers. Without including the interested stakeholders, therefore, an array of social costs are generated. On the contrary, including stakeholders implies governance innovation so that costs are recognised in their entirety. The governance structure changes and with it the distribution of resources, decision-making power, and outcomes. In non-profit organisations, governance

changes which increase inclusiveness aim at creating positive outcomes, public value, and to avoid the production of social costs. The historical evolution towards multi-stakeholdership can be taken as an indicator of the relevance of the social costs in the calculation of total costs. Moreover, against Hansmann's claim for homogeneity, successful experiences shows the potential marginality of ownership costs with diverse stakeholders. We have explained this with the central role of inclusive and pro-social values embedded in governance rules and trust-based cooperative practices, which allow the use of resources that otherwise would not be utilised. We have also noticed that the interests of external stakeholders cannot be entirely captured by contracts. Albeit contracts can partly compensate for exclusion, we have argued that some of the costs of exclusion are of non-monetary nature, and cannot be captured through contracts. Some others are of more general nature, they touch upon society as a whole and exceed specific stakeholders. Contracts, therefore, are applied to stakeholders for which immaterial elements can be recovered otherwise, or when such elements are not relevant.

Following these considerations, the costs of exclusion can be regarded as greater than zero. Therefore, we advance Hansmann's model by adding the costs associated with exclusion. Whilst price and quantity-related inefficiencies caused by ex-ante and ex-post market power are typically included among contractual costs (CC), the costs of exclusion (CE) derive from the exclusion of stakeholders from decision-making whose utility cannot be captured through contracts (specific and systemic effects, as in Figure 1). We assume that in order to maximise their own utility collectively (cooperative outcomes and public value), stakeholders must consider total costs, i.e. the sum of contractual costs, ownership costs and costs of exclusion.

Given a number of stakeholders,  $N$ , who interact (directly or indirectly, informally or on a contractual basis) with the organisation, governance choices regarding the inclusion of stakeholders (IS) into the governance structure considers property costs (CP), contractual costs (CC), and the negative external impacts produced or costs of exclusion (CE). We suggest that the choice of whether to include new stakeholders (IS) needs considering CP, CC and CE together.

$$\sum_{i=1}^n (CP_i + CC_i + CE_i)$$

Property costs (CP) are dynamic in our model, and change with the number of stakeholders included. The inclusion of one more stakeholder implies an increase in CP and a change in the

distribution of resources and outcomes, which lowers the costs of exclusion (CE). At the same time, contractual costs (CC) decrease since coordination with newly involved stakeholders does not occur through contracts anymore. In order for CE to be zero, contracts should remain in place only with those stakeholders whose utility is satisfied exclusively through the market mechanism, a possibility which transaction cost theory regards as not possible.

The most efficient firm, for this model, is one for which total costs are the lowest. The model is therefore useful to compare multiple governance solutions on the basis of the total level of costs generated. Following this construct, Hansmann's model would be a specific solution that can be applied only when CE are very low.

## **9. Conclusions**

The study of inclusive governance (and multi-stakeholder social enterprises in particular) is only at the start. Entrepreneurial choices which have emerged spontaneously, as well as the first legal frameworks approved in this direction, lack an adequate theoretical support. The debate itself requires development, as the existing understanding of organisations and their aims resist an inclusive, public interest view of enterprise. This contribution has aimed at enriching the thin theoretical reflections on inclusive governance and multi-stakeholdership in fundamental services, providing examples from a context where they have already appeared, i.e. that of health and personal services.

Social costs, in our model, are not a transitory feature of conventional market organisations or of the public sector but an intrinsic consequence of governance failures caused by exclusive processes determined by mono-stakeholder approaches to governance (see also Borzaga and Tortia, 2005; Zamagni, 2005). In order to reduce social costs, it is therefore necessary to act on governance structures and decision-making, moving away from conventional mono-stakeholder forms (whether the organisation is privately or publicly owned) towards inclusive organisations based on a mix of coordination mechanisms - inclusion and cooperation, control, contracts - but where the prevailing mechanism is the first. It follows that inclusive governance and cooperation do not have a transitional character but represent specific solutions which recognise the complexity and richness of public interests and of production structures, with the aim of addressing multiple welfare aspects. Consistently, the duty of managers is to discover stakeholders and support governance innovations that engage multiple actors in the governing

bodies, since stakeholders' interests can be taken into account if, in the first place, they are not anonymous and if they are not removed from the strategic choices.

The key insight of this work is that, differently from major interpretations, property costs should be considered in conjunction with a more comprehensive range of costs, such as the social costs that emerge when the supply of social and personal services is insufficient or when the identification of aims and means is not shared amongst stakeholders. Our model highlights that when social costs derived from exclusion are high, an organisation with costly decisional processes, such as the multi-stakeholder, can be (and often is) the most efficient solution amongst other possible alternatives. The answer we indicate to the public value deficits and persistence of social costs is to design sustainable inclusive governance solutions that are consistent with cooperation and shared decision-making power, aimed at reducing the negative impacts whilst augmenting the positive ones. Making these interactions explicit is bound to generate new ways of integrating the knowledge, resources and needs coming from multiple actors. In other words, inclusive governance is more likely to fulfil stakeholder-specific and societal needs.

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<sup>i</sup> "In Europe, health spending continued to fall in 2012 in Greece, Italy, Portugal and Spain, as well as in the Czech Republic and Hungary. In Greece, health spending in real terms was 25% lower in 2012 than in 2009, primarily driven by cuts in public spending." (OECD, 2014: <http://www.oecd.org/newsroom/health-spending-starts-to-rise-but-remains-weak-in-europe.htm>. Accessed 8 May 2015)

<sup>ii</sup> Specifically, one out of three social enterprises (34 percent) are multi-stakeholder (albeit, as the authors notice, users are included in the membership in one out of 10 social enterprises only), 29 percent are hybrid organisations with multiple membership but with a single stakeholder (workers) represented in the board of directors, 16 percent have a dual stakeholdership (including workers and volunteers), whilst the remaining 21 percent are mono-stakeholder (workers) social enterprises. Borzaga and Depedri (2015) have further noticed that users (i.e. disadvantaged workers) are members in the majority of social cooperatives that provide work integration services (across sectors, e.g. environmental maintenance, manufacturing), whilst the remaining cooperatives (typically providing health assistance and educational services) tend not to involve users (ibid.). These findings also show that the membership of other organisational types (e.g. public administration units) is unusual. Rather, what is rising is the involvement in the membership of other social cooperatives (with whom, we would say, a commonality of values, practices and aims exists).

<sup>iii</sup> Social capital scholars have argued that communities with poor levels of cooperation generate also less material wealth and, overall, are less prosperous (Putnam, 2000). This is because exclusion and isolation negatively affect diffused trust, social cohesion, equality and, ultimately, the human life experience (thus generating non-monetary, systemic negative impacts).

<sup>iv</sup> "An external economy (diseconomy) is an event which confers an appreciable benefit (inflicts an appreciable damage) on some person or persons who were not fully consenting parties in reaching the decision or decisions which led directly or indirectly to the event in question" (Meade, 1979, pp. 15).