

# THE INFLUENCE OF FINANCIAL MANAGEMENT AND GOVERNANCE IN THE PROVISION OF SOCIAL SERVICES IN NON-PROFIT ORGANIZATIONS

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## ABSTRACT

*The financial crises and the pandemic COVID 19 have reinforced the importance of the nonprofit organizations (NPOs) in promoting the social welfare. These institutions face nowadays various challenges related to the new needs required by the populations, and also the deepening of the traditional social problems. In this context, fulfill their social mission implies that NPOs have to take care with their performance and simultaneously maximize the social value generated. The review of the literature allowed to identify factors associated with financial management and governance that may contribute to the definition of the social services offered by NPOs. Thus, in a studied applied to Holy Houses of Mercy in Portugal, this investigation intends to understand the influence of the financial management and the governance on the NPO social services provided. The results obtained show a positive contribution of the finances and the governance on the social services of these institutions, which lead us to conclude that to be more effective in the social services provision, NPOs must emphasize their financial management and governance practices.*

**Keywords:** Social Services, Non-profit Organizations, Holy Houses of Mercy, Financial Management, Governance.

## INTRODUCTION

The importance of Nonprofit Organizations (NPOs) is increasing nowadays in terms of diversity and demand for social services they have to offer to address the social problems, deepened by the pandemic COVID 19, with impact on the wealth and jobs created by the sector. The unfavorable socio-economic context, accompanied by the significant decline of working age population, associated with lower birth rate and higher life expectancy, put in evidence the prominence of the NPOs in fighting poverty and social inequalities (Soares et al., 2012). Their organizations, whose action assumes a strongly assistentialist character, currently face numerous and new challenges of a conjunctural and structural nature, which has forced them to change their paradigm, giving greater importance to the development of strategies that promote their

sustainability, valuing human resources, taking advantage of synergies and economies of scale (Soares et al., 2012).

Concerning the factors that influence the promotion of social services on NPOs, we address the financial management. For these institutions to find a sustainable and stable path, a continuous improvement of their economic performance is increasingly crucial while fulfilling their social mission (Dall'Agnol et al. 2017). According to the same author, these challenges are related to the search for operational sustainability while being dependent on sources of revenue of different natures or origins, such as support from state and private funds.

In addition to this, studies like Garcia (2016) show us that for NPOs to survive and achieve their goals regarding the importance of governance practices. They must use appropriate management tools, including market orientation and the principles of good governance based on the existence of well-defined missions, clear objectives and aligned with the organizational strategy.

Despite the importance of these variables for the management of these organizations, it is through the social services they promote to the community where they operate, that the action of these NPOs gains outside visibility. Thus, financial management and governance practices are aspects to consider when the reflection points to the reasons that influence the social responses that these organizations promote (Bryce, 2017; Santos et al, 2018; Zollo et al., 2019).

Moreover, in the investigation (Oliveira et al, 2021) it was found that to optimize their governance practices, NPOs should pay attention to strategy and human resources management, as the governance is influenced by strategy and human resources management, but also aspects related to strategy determine human resources practices.

Thus, this study focuses on Portuguese NPOs, in the specific case of Holy Houses of Mercies in Portugal, aims to verify the influence of financial management and governance practices in social services promoted by the Holy Houses of Mercy in Portugal.

## LITERATURE REVIEW

Several studies have revealed the growing academic interest in research on strategy, respective instruments and practices in NPOs (Laurett & Ferreira, 2018; Suykens et al., 2019). Several reasons are found for NPOs to adopt elements generally associated with profitable organizations, assuming that the main objective of these changes is to improve the economic and social performance of NPOs (Petitgand, 2018): changes in the external environment of NPOs, the need growing and increasingly competitive of sponsors and patrons (Weerawardena, 2010), more restrictive changes in the legislation in force under which these organizations are governed (Baines et al.2012), the need to be more autonomous in financial terms (Suykens, 2019) and efficient in the management of resources and services (Coelho et al, 2016).

Several authors (Nielsen et al., 2018; Sanderse et al. 2020) have been focusing on the particularities of the NPOs business model's elements, namely its resources, activities, value proposition, costumers, and collaborators. There are several studies in which it is recognized that the instruments and practices usually associated with for-profit organizations must be subject to adjustments and terminology when applied to the non-profit sector (Suykens, 2019). These adjustments should include the recognition that NPOs are more complex than normal companies, namely concerning the relationship with the customer (Anheier & Toepler, 2019) and the fact that NPOs have to respond to multiple stakeholders' needs and interests (Costa & Pesci, 2016). Besides, the complexity of strategic options, which sometimes determine that strategies are

adopted contrary to the social mission, guarantees the organisation's sustainability in the medium and long term (Larsen & Brockington, 2018). Another important aspect is that NPOs aim to achieve social value instead of the “mere” economic value proposed by companies (de Langen, 2018).

The value proposition is the heart of the organization and “is defined as the organization’s mission, its programs or bundle of products and services — that create value for its customers, stakeholders and partners and its brand (Sanderse et al., 2020).

### **Financial management of non-profit organizations**

The sustainability of social organizations has been a hotly debated topic in recent years. NPOs must adapt their sustainability to management models that do not forget the nature of promoting social well-being, which is fundamental for the region's sustainable development where each social organization is inserted (Santos et al, 2010).

Effective financial management is as important to the performance of NPOs as it is crucial to the performance of for-profit companies. They are similar, differing essentially in the main objective: to meet socially desirable needs and not to increase shareholder value (Su et al., 2014).

The authors (Strydom & Stephen, (2014) argues that, with NPOs playing a key role in addressing various social challenges, studies on their financial management and sustainability are essential. For these authors, a greater theoretical and empirical understanding of the financial management of NPOs will lead to better efficiency and, consequently, to better services provided.

Some studies (Bryce, 2017; Dall’Agnol et al. 2017) show that the performance of NPOs (which is measured according to the achievement of their objectives) depends on the efficient management of your financial resources. They also show that these organisations' financial fragility will limit the quality and quantity of services provided to people who enjoy them.

The study by Dall’Agnol et al. (2017) indicates that fiscal performance, efficiency in fundraising, and organisations' total assets are positively related to the number of people that organizations can assist in accessing primary education and health. The authors also argues that understanding the relationship between financial management and the performance of NPOs will allow their managers to use financial resources more efficiently, achieving the organization's objectives.

### **Governance of non-profit organizations**

Some authors (Cabral & Bertero, 2016; Bukhari et al., 2014) state that it is essential to implement management methods and practices in NPOs, respecting their specificities and using assessment formats and governance applications adapted to their characteristics, such as the mission, vision, principles and profile of stakeholders.

The author (Garcia, 2016) shows that for NPOs to be able to survive and achieve their goals, they must use appropriate management tools, which include market orientation and the principles of good governance based on the existence of well-defined missions, clear objectives, and aligned with the organizational strategy, which, in turn, underlies the existence of strategic planning and sound financial management.

Organizations that adopt corporate and pluralist governance systems improve their performance and institutional strength, benefiting stakeholders' action as social intermediaries (Taylor, 2015). Governance incorporates codes of ethics and corporate responsibility that, in some way, including the vision and mission of organizations and the quality of results. Successful companies that implement corporate governance items achieve financial stability and sustainability (Saltaji, 2013).

Promoting organisations' sustainability is only possible with effective governance, which allows companies to improve their financial management, enjoy reduced capital costs, and manage to attract interesting customers, suppliers, investors, and partners (Saltaji, 2013). In the current austerity contexts, NPOs must invest in governance practices, which allow them to guarantee their sustainability and achieve their objectives and manage to face the multiple challenges they face daily (Garcia, 2016). The investigation presented by (Taylor, 2015) point us in the direction of being the governance practices the main responsible for the implementation of measures with influence in the financial performance of the organizations.

According to these authors, the GOV has a decisive action on the various areas of the management of organizations, but it is closely linked to the financial aspects. In the case of NPOs, the fulfillment of their missions is done through an effective SOC offer, so the good GOV, in theory, should be related to a good performance at the FIN level, with a view to a good SOC. When referring to financial aspects, we take into account indicators such as knowledge of financial instruments, costs and revenues, best practices, instruments to be used, sources of revenue, associated risks, budget, balance and greeting (Su et al., 2014).

## HYPOTHESIS

- H1 The financial management of non-profit organizations influences positively social service practices.*
- H2a The governance practices of nonprofit organizations influence positively social service practices.*
- H2b The governance practices of non-profit organizations influence positively the social service practices, mediated by financial management.*
- H3 The governance practices of non-profit organizations influence positively the financial management.*

## METHODOLOGY

We performed quantitative research using a questionnaire survey to understand whether Financial Management (FIN) and Governance Practices (GOV) influence the Social Services (SOC) of Non-Profit Organizations (NPOs). We also analysed the influence of Financial Management (FIN) on Governance practices (GOV). We analysed 242 Holy Houses of Mercy, those which were interested in participating in the study, which corresponds to 62,5% of the universe of 387 Holy Houses of Mercy currently in operation in Portugal.

The data were collected in person, between November 2018 and December 2019, through the application of questionnaires, within the scope of audits carried out through the program "Misericórdias - Gestão Sustentável" of the Union of Portuguese Mercies. For this purpose, managers, technicians and workers from these institutions were surveyed. The data were collected through a questionnaire survey and allowed an investigation of a quantitative nature by estimating a structural model using the SPSS/SEM-AMOS 27 data analysis technique.

The estimated measurement model is composed of three main constructs: Financial Management (FIN), Governance Practices (GOV) and Social Services (SOC). The FIN and GOV constructs are composed of 8 variables. The SOC construct is composed of 10.

To understand what variables used in the questionnaire had an efficient factorial load of explaining the reality studied, we performed an exploratory factorial analysis to understand the number of factors and their explanatory capacity.

In this study, to analyse and identify the component loading, an EFA was performed, which enabled the extraction of the Principal Components Method (PCM) factors. In the analysis, we considered only values whose factors were  $\geq 1$ , which resulted in a KMO=0.895 and a correlation matrix of three factors, which explain 81.18% of the variance. The factor that explains the vast majority of the variance is Factor 1 with 38.71%, followed by Factor 2 with 27.79% and finally Factor 3 with 14.68%.

After performing the EFA, we found that some items had loadings below 0.5, which were removed when we estimated the final model using Confirmatory Factor Analysis (CFA). Items removed were GOV1 with factorial 0.431, GOV 2 with 0.339, GOV3 with 0.223, GOV4 with 0.356 and finally GOV5 with 0.443. According to the literature, these items cannot be used to estimate the measure confirmatory factorial analysis model.

## RESULTS

To check whether the measurement model was statistically valid and significant, we analysed the measurement model's loadings and errors that characterise this study. The proposed model's estimation was performed through the use of the de structural equation model (SEM) and SPSS/AMOS 27 software. The final model was tested according to the literature to test the validity and reliability of the measures. Several research hypotheses were tested to determine the meaning of each path's loadings and coefficients.

According to the literature, we estimated a model composed of three constructs named Social Services (SOC), Financial Management (FIN) and Governance Practices (GOV). To verify the constructs' reliability, we calculated the Cronbach's Alpha ( $\alpha$ ) that there is an excellent total internal consistency ( $\alpha = 0.886$ ) for the sample of 242 respondents. The internal consistency for all items that make up the model is demonstrated by Cronbach's Alpha ( $\alpha$ ) higher than 0.8, revealing validity and internal and explanatory reliability.

To perform the CFA, two models were tested, one with all the variables corresponding to the three constructs under analysis and another removing the variables whose factor loadings were lower than 0.5.

Final research model allowed to validate that FIN influences ( $\beta = -0.237$ ;  $p < 0.05$ ) and GOV of ( $\beta = 0.482$ ;  $p < 0.001$ ) in the SOC of the NPOs under study. We also tested if GOV influences FIN, but our results reveal non statistically significance ( $\beta = 0.089$ ;  $p > 0.05$ ). Finally, we tested if GOV influences SOC mediated by FIN of ( $\beta = 0.114$ ;  $p > 0.05$ ). This indirect effect tested had no statistical influence. After analysing the hypotheses tested in the measurement model, we found that only H1 and H2a were validated. The hypotheses H2b and H3 formulated was not validated in the final model.

The structural model results indicate that FIN and GOV's dimensions have a direct, positive and statistically significant influence on SOC, supporting the research hypotheses formulated (H1, H2a). The research hypotheses formulated (H2b and H3) did not significantly affect the model.

## DISCUSSION

Analyzing the influence of the FIN and GOV dimensions on the SOC, we find that both dimensions have a strong impact on the availability of the SOC of the institutions under study, which confirms the H1 and H2a. It was impossible to determine an indirect relationship between GOV and SOC, mediated by FIN, nor a direct relationship between GOV and FIN, which demonstrates that hypotheses H2b and H3 are not supported.

In this way, we move first to the analysis of H1 confirmation. We advanced the study with the assumption that there would be an influence of FIN in the SOC. It was possible to ascertain that these influencing factors could be grouped into eight sub-dimensions of FIN (knowledge of costs and revenues; financial practices; effectiveness of financial instruments; knowledge of financing sources; financial risk; financial balance; budget; and budget effectiveness). It is important to analyze each of this sub-dimensions relevance and composition in the performance of the SOC.

Thus, regarding cost and revenue knowledge, the first FIN dimension under analysis, it was possible to verify the existence of a set of relevant indicators with a strong impact on the institution's SOC. As they prove to be decisive for this influence, among the variables under study, it is important to highlight the following indicators of this sub-dimension: the knowledge of costs, namely, knowledge of the real costs of each valence, knowledge of the degree of effectiveness of budget management, and knowledge of the degree of effectiveness of budget management concerning each of the entity's valences.

The second sub-dimension of FIN found to be relevant to the performance of SOC was composed of a set of indicators related to good financial practices. In this regard, it is important to highlight the following indicators: the regular monitoring of the value of structural costs, the regular renegotiation of prices for the services used by the entity and the products purchased, regular banking activity with at least three different entities, carrying out analyzes regular to budget execution, at least quarterly, the exercise of a qualitative analysis of budget execution, the accounting processing carried out internally by adequately trained personnel, the adoption of a proficient system and the preparation and monitoring of treasury plans.

A third sub-dimension of FIN, on which the SOC's performance will depend, is the effectiveness of financial instruments. In this regard, it is important to highlight the importance of the entity's use of a management control panel such as Tableaux de Bord or Balanced Scorecard.

The fourth sub-dimension of FIN is related to the knowledge of the sources of financing. In this sense, indicators stand out that reveal whether the entity knows the alternatives available for obtaining financing and if the figure of the individual/company that finances an investment is used and sees its name linked to it.

A fifth sub-dimension of FIN, with influence on SOC performance, concerns financial risk, which is composed of indicators such as the largest financier being responsible for more than 25% of the entity's current funds, if the patrons have a degree of loyalty to the member of the fundraising team superior to that of the entity and if the revenues that come from the state represent more than 50% of those of the global exploration budget.

The sixth sub-dimension of FIN, found in the present study, is related to financial balance. In order to determine the existence of this financial balance, which is important for the performance of SOCs in these institutions, it is important to consider the following indicators: If in the last three years, current resources have been sufficient to cover the costs inherent in a good

pursuit of the mission, if the expectations for the next three years are that the current resources will be sufficient to cover the costs inherent to a good pursuit of the mission, if the entity has negotiated and available debt capacity, if the entity has any area of intervention that generates financial surpluses and that can be allocated to the mission's financing and, finally, if the entity uses some form of self-production that represents more than 5% of the annual budget.

The seventh sub-dimension of FIN with an impact on SOC performance is the budget. For a budget that aims to promote the performance of the SOC, it is necessary to verify indicators such as the existence, in the entity, human resources with training in the budget area, the periodic realization of a budget of the entity's activities, the entity must consider the budget as a useful management tool, the fact that it includes a projected income and that the entity's goals are compatible or consistent with its financial resources.

The last sub-dimension of FIN found to be relevant to the performance of SOC is budgetary effectiveness. It is important to consider a set of indicators that reveal the prevalence of this effectiveness. The indicators focus on verifying whether there has been revenue growth over the past few years, whether corrective actions are taken by the entity when there are deviations from the budget, whether there is a reasonable degree of effectiveness of the entity's overall budget management, whether there is a reasonable degree of budgetary management effectiveness of each of the entity's strengths, if the entity performs a correct analysis of budgetary execution, if the entity performs budgetary execution analysis, at least, quarterly, finally, if the entity has any software for budget management.

After analysing the results that allow us to confirm H1, we focus our attention on the results related to H2a validation. Regarding the strong impact found by GOV in the SOC, with a direct positive influence on the structural model studied, which in turn confirms H2a, it is important to mention that such findings are in line with the literature considered for the present study.

From the analysis carried out, it was found that the GOV, as an influencer of the SOC in this type of institutions, is composed of a set of practices that can also be grouped, once again, in the form of subdimensions. For the present study, it was possible to determine a set of 3 sub-dimensions (community relations, communication and marketing, and quality and innovation). Thus, it is important to analyse each of these GOV subdimensions' relevance and composition in the performance of SOC in these institutions.

The first sub-dimension of the GOV found in the present study is composed of a set of indicators related to the relations that the institution maintains with the community.

The second sub-dimension of GOV that directly influences the SOC is communication and marketing.

Finally, the third sub-dimension of the GOV with direct impact of the SOC is comprised of indicators related to quality and innovation,

After finding the results that confirm H1 and H2a and identifying the components that characterize and compose FIN and GOV with a strong influence on the SOC of the institutions under study, it is now possible to realize that there is no statistically significant relationship between GOV and SOC, mediated by FIN, which leads to a non-confirmation of advanced H2b in the present study.

This would be equivalent to saying, for example, that SOC could be benefited or harmed in their activities due to the GOV's capacity to implement initiatives, projects or strategies for attracting financial assets that would be decisive for the implementation of new social responses or that contribute to strengthening existing social responses. The non-confirmation of this

scenario indicates that this context of dependence or an indirect relationship does not exist. Thus, it is possible to understand how decisive the public support and financing programs are, which do not depend on the direct action of the GOV. As they are of regular nature and reach these institutions in the form of subsidies or guaranteed funds, on a regular basis, and that allow SOC to remain over time, regardless of the GOV's greater or lesser efforts to raise funds of a financial nature to increase the social services it promotes.

It is also now possible to notice no statistically significant relationship between GOV and FIN, which leads to the non-confirmation of advanced H3 in the present study.

Thus, even though the GOV directly influences the SOC, in the sub-dimensions previously presented and that allow H2a to be confirmed, the same cannot be said when trying to understand if there is a relationship between this and the FIN, with the final SOC or not, so hypotheses H2b and H3 are not confirmed.

### **CONCLUSIONS, LIMITATIONS AND FUTURE RESEARCH FORMULAE**

Despite these NPOs belonging to the third sector or the social sector and not to the public or private sector, in many of the social services they provide, they end up replacing the public sector, which, recognizing this action by the Holy Houses of Mercy, establishes protocols, where through a financial contribution, these NPOs ensure the provision of a set of social services, considered important for the communities. These protocols are not dependent on a more or less proactive or assertive action by the GOV. However, if the fundamental precepts are fulfilled by the NPOs, they will remain indefinitely. What the non-confirmation of this hypothesis tells us, therefore, is that this context promotes an adaptation by the GOV of these NPOS to the financial resources destined to social responses and that there is no more acute action in the search for more or other sources of revenue that would allow the SOC to be added, on which they would be dependent.

With the non-confirmation of H3, we realize that even if the financial resources are not destined for the SOC, but for other areas of management of these NPOs, such as wealth management, supply, human resources, technology, communication or marketing, still do not depend on the action of the GOV. Once again, also the non-confirmation of this hypothesis leads us to an action of conformity and lack of proactivity of the GOV, which, by not implementing initiatives, projects or strategies that serve to attract financial resources, must be dependent on the sources of revenue that they take for granted and guaranteed, coming from the public sector. This financial dependency, which had been made clear previously, regarding the way in which the SOCs are not influenced by the GOV action, is now even more clear, since also the other management areas of these NPOs, do not benefit from the demand action bigger, better or different sources of financing from the GOV.

The results obtained allow future studies that focus on the sustainability of NPOs in the medium and long term, without thereby deviating from their missions or from offering social responses. Thus, these results may serve to launch future studies that may focus on the analysis of the relationship between the GOV and the FIN of these institutions, namely, on the efforts that can be implemented at the level of initiatives such as: applications for programs or projects, tax breaks, crowdfunding, recruiting supporters of causes, establishing partnerships, implementing commercial activities, implementation of strategies for relational marketing, organization of events, fundraising non-financial resources for specific purposes, profitability of assets or endowment initiatives.



A greater theoretical reflection, through the deepening of studies on the impact of this diversification of strategies at the FIN level, will make it possible to understand whether the level of GOV of these NPOs is the possibility of better performing their role well.

This case study focuses on one type of NPOs, the Portuguese Mercies. As such, the traditional limitations of this typology apply, such as the non-possibility of generalizing the results to other types of organizations or sectors of activity.

The determination of the influences of the variables under study in these organisations' social services does not invalidate that there are no other dimensions of management that may also be relevant. As suggestions for future work, it is suggested to investigate the possible influence of strategy, human resources, technologies and systems and information, communication and marketing, supply management, heritage management, knowledge management, or other management areas of these or other non-profit sector institutions, considered for this type of studies.

It is also recommended to carry out studies that analyze the impact of the implementation of concrete measures that go against the promotion of good financial and governance practices, with a view to increasing the performance of social services of these NPOs.

It is also recommended to carry out longitudinal studies, which allow us to understand the evolution of the relationship between the variables analyzed in the present study, namely after leaving the economic and social context caused by the pandemic Covid19.

Finally, it is suggested to extend this type of study to other NPOs such as cooperatives, mutual societies, charities and local development.

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