



Snapshots

Research Highlights from the Nonprofit Sector Research Fund

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Nonprofits As Contractors for Local Governments Challenges and Benefits

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Results of
groundbreaking survey

When nonprofits contract with local governments, the nonprofits may experience challenges, but they may also gain prestige and funding for programs. Since nonprofits may find that they are distracted from their mission by management challenges and the demands of regulation and oversight, they should carefully weigh both the benefits and the costs of being government contractors.

These are the conclusions of researchers Richard C. Feiock and HeeSoun Jang in their recent report, "The Role of Nonprofit Contractors in the Delivery of Local Services," funded by the Nonprofit Sector Research Fund. Through a groundbreaking survey of nonprofits in twelve metropolitan areas, the researchers examine the types of nonprofit organizations that engage in contracts and describe the costs and challenges they encounter when they produce services for governments. They also studied existing surveys of local governments in order to learn more about how governments choose the contractors they do business with, and the challenges they face in terms of the cost of managing these external contracts.

Are such relationships worth the work? The researchers believe that they are: "Service collaborations have the potential to benefit communities and improve service delivery. They are worth dealing with the challenges of collaborating between two sectors," said Feiock in a recent interview.

A box that summarizes the challenges nonprofits can encounter when they contract with government appears on page 3.

Increased Contracting with Nonprofits for Social Services

Local governments partner with for-profit companies, with government agencies, and with nonprofits to ensure that their communities get the services they need. Such contracting is often seen as a way to replace a monopoly in service provision with the competition of the marketplace (and the benefits of that market).

The researchers identified a range of services that local governments contract with other entities (from any sector) to provide. Such services include "hard" services such as garbage collection, utility service, road maintenance, street construction, vehicle towing, building repair, and ambulance services, as well as "soft" services like mental health services, child care, care for the elderly, homeless shelters, libraries, and cultural and art services. Feiock and

Jang point out that there are important distinctions between contracting hard and soft services: hard services can be purchased in a cost-effective way on the basis of per-unit payment contracts. The harder-to-measure soft services, on the other hand, must be concerned with clients' quality of life as well as effective service delivery.

In order to better understand the decisions that local governments make about contracting with nonprofits, Feiock and Jang compared surveys conducted by the International City/County Management Association (ICMA) in 1992, 1997, and 2002. The surveys documented the percentages and frequency of government contracts with for-profit companies, other government agencies, and nonprofits. While governments contracted with all three sectors for most categories of services, Feiock and Jang did identify some key trends:

- Over the ten years covered by the survey, the researchers found striking increases in the contracting done with nonprofits in order to provide services in areas such as day-care, child welfare, homeless shelters, programs for the elderly, public health, and mental health.
- Governments also continued to contract with nonprofits to provide services in the areas of recreation, parks, libraries, and culture and art; the level of contracting in these areas remained stable over the ten years of the survey. In these areas, the most substantial amount of contracting with nonprofits is for art and culture (41 percent of contracts in this area were with nonprofits).
- On the other hand, for-profit companies maintained or increased their lead as contractors of choice with local government in the areas of residential solid waste collection, street repair, vehicle towing and storage, and legal services.
- Local government tends to contract with government agencies to provide public health programs and mental health programs.

Why Local Governments Choose Nonprofit Contractors

The researchers argue that local governments are likelier to contract with nonprofits to provide soft services and with private companies to provide hard services. There are several key factors at work here:

Nonprofits offer less risk of opportunism. Because for-profit firms have incentives to place profits over service quality, monitoring contracts and ensuring quality can be costly. When local governments contract with nonprofits, these costs are lower because the nonprofit contractors are less likely to be opportunistic. Given the structure of nonprofits' funding and governance, and the character of volunteerism that shapes the nonprofit sector, nonprofits are less risky than private companies when services are hard to measure.

Nonprofits can provide flexibility and cost efficiency. Contracting with nonprofits can allow local government to offer more specialized services to more diverse populations.

Nonprofits can provide services that do not attract private providers. Because they are mission driven, nonprofits respond to service needs and populations regardless of whether there is a profit in doing so. They are also willing to provide soft services, which have a narrower profit margin.

Characteristics of Nonprofit Contractors

Until this study, no one had ever surveyed nonprofits to find out about the relationships between nonprofits and local governments and their contractors. For this part of the study, Feiock and Jang surveyed 1,512 nonprofit organizations in 12 large metropolitan areas in the United States. The researchers specifically wanted to find out how the characteristics of nonprofit organizations and community factors contribute to the decision of the nonprofit to engage in contractual relations with local government.

The researchers found that 53 percent of the surveyed respondents had contracted with local government in the past five years. Echoing the ICMA survey, Feiock and Jang found that nonprofits specializing in some kinds of activities were much likelier than others to fulfill contracts with local government:

- 70 percent of reporting human services nonprofits had fulfilled contracts, as had
- 57 percent of health-related nonprofits,
- 30 percent of education and environmental nonprofits, and
- 22 percent of arts and cultural nonprofits.

The researchers found that nonprofits that contract with local governments may experience some challenges, particularly with management difficulties, uncertainty, and regulations. These issues may also make it hard for nonprofits to provide specialized services. (See the box on page 3 for more details.)

Advantages on Both Sides

While contracting with local government does bring nonprofits some challenges, it also offers nonprofits resources and access to clients.

And on the other side of the relationship, while contracting with nonprofits forces government to give up some control, local government does gain the ability to offer specialized services rather than generic ones. Government can tap the wealth of specialized skills and knowledge that nonprofits have for the specific services that are needed.

Feiock and Jang argue that the costs of contracting are often worthwhile for local government, their nonprofit contractors, and communities.

"The Role of Nonprofit Contractors in the Delivery of Local Services" is available by calling the Aspen Institute Publications office at (410) 820-5338 or by e-mailing publications@aspeninstitute.org.

Characteristics and Challenges of Nonprofits That Contract with Local Government

Little has been known about the nonprofits that contract with government, including their major fields of activity, funding structures, and financial characteristics. Feiock and Jang addressed this gap in the research by surveying more than 1500 urban nonprofits. The researchers found that 53 percent had fulfilled local government contracts within the past five years. Here are a few more details about those nonprofits that have contracted with government:

About the Nonprofits

- 34 percent have revenues of \$1 million or more, while 2.7 percent have total revenue of less than \$25,000 per year. (Health and human service nonprofits have high revenues compared to art and education nonprofits.)
- The median total revenue of nonprofits that contract with local governments is higher than the revenue of nonprofits that do not contract with local government. This may suggest that the financial condition of a nonprofit is crucial in attracting government contracts.
- More than half of those nonprofits surveyed report that they primarily serve low socioeconomic status target groups (70 percent of health organizations and 63 percent of human service organizations, but only 19 percent of art and culture nonprofits).

Challenges of Contracting with Local Government

- 66 percent have seen an increase in demands on their primary services.
- Nearly half make significant efforts to change their management style to outcome-oriented management.
- Nearly one-third have experienced problems that were the result of poor coordination by local government.
- 25 percent report that the turnover of elected officials heightens nonprofits' uncertainty about future expectations and commitments.
- 21 percent report that the turnover of administrative officials causes hardships related to local government's supervision.
- 24 percent say that government regulations and monitoring make it hard to provide specialized service to clients.

Adapted from "The Role of Nonprofit Contractors in the Delivery of Local Services."

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