Non-profit organizations have been key actors in providing welfare services in Iceland. The recent economic crisis in Iceland, described as the most serious since its independence in 1944, will create new and extensive demands for welfare services. In the research it is analysed how non-profit organizations in the welfare sector have responded to the new challenges they face as a result of growing demands and the financial uncertainty following the collapse of the banking system in the fall of 2008 and how the economic situation is expected to influence their roles, operational capability and managerial strategies. Three types of non-profit organizations are analyzed: service provision organizations, mutual support societies and campaigning associations.

The importance of the third sector in providing public and quasi-public goods in a market economy has been well documented. Its existence has been explained by its ability to respond to “demand heterogeneity”, an unmet need for goods not provided by the government (Weisbrod 1977), being trustworthy agents as their incentive is not distributing profit to owners (“nondistribution constraint”, Hansmann 1980) and having an important entrepreneurial role for promoting social value and innovation (Anheier 2005).

In recent decades the third sector has become a more influential actor in public service provision and policy making – not least in welfare services (Smith and Lipsky 1993) in addition to the traditional role as social entrepreneurs and active participants of civil society (Herrington 2006).

Because of this increasingly important role it is a demanding question how the global economic crisis will affect the third sector as it faces shrinking budgets and increasing demands.

The research is based on findings from a national case study the authors are currently conducting. The study is based on qualitative data, both historical documents and semi-structured interviews with six general managers of nonprofit organizations, two of each category discussed in the paper, and six senior officials, three working for the central government in Iceland and three for local governments, all of whom interact with NPOs to some degree. In addition the data are based on documents describing the operation of twelve nonprofit organizations in Iceland (Kristmundsson, Hrafnsdottir 2008).

Prospective changes in the operation of nonprofits were analyzed according to: a) demand for activities offered, measured in changes in the number of users, buyers, clients, members, etc.; b) the operational activities they undertake, measured by the increase or decrease in services, programs, changes in human and financial resources; c) prospective managerial strategies dealing with the changes; and d) relationships with governments (central and local).

The last variable is analyzed according to Young’s taxonomy (2000). Different theoretical frameworks have been used to describe the relations between nonprofits and governments. Young describes three types of relations. According to Young complementary relations reflect collaboration between government and the third sector that carries with it mutual benefits; one party provides necessary resources, the other services or support. Due to nonprofits’ incentives and non-distributional constraints, the negative effects of information asymmetry between government and nonprofits should be minimal when compared to profit-making companies, thus promoting nonprofits as ‘trustworthy’ agents. Supplementary relations reflect
the situation when nonprofits simply are responding to unmet demands for public goods not fulfilled by the government. The important incentive of NPOs of establishing new welfare programs in the early 20th century in Iceland is an example of this type (Kristmundsson 2008). The adversarial relations describe when the two entities can be seen as adversaries in policy-making and provision of public services. A divergence of nonprofits and government is reflected in the former’s attempt to influence the policy-making of the latter. Instead, government tries to regulate its operations and advocacy initiatives.

An essential independent variable in discussing the economic effects on the third sector and its reaction is its primary mission as it reflects its working environment and the nature of activities, resources, and stakeholders, among other factors. Several taxonomies have been used to classify different types of non-profit organizations based on activity, main source of funds and function.

Here is a classification that was originally put forward by Charles Handy (1990) and further elaborated by Mike Hudson (2002). According to the authors nonprofits can be divided into three categories based on their primary mission:

Service provision organizations (e.g. organizations operating nursing homes, youth centers and shelters for the homeless). Mutual support organizations (e.g. Alcoholics Anonymous and other self-help associations). Campaigning organizations (e.g. Amnesty International, environmental associations).

NPOs frequently fall into more than one category, for example it is common that organizations broaden their functional scope as they develop. However, this taxonomy serves the purpose of the analysis, namely to define the basic elements affecting the operational environments of the organizations involved. In the research the characteristics of each type of NPO in Iceland is described and how the economic crisis is expected to influence their operations and their managerial strategies.

The global economic crisis has created new unprecedented challenges for the third sector. Since October 2008 the demand for welfare services provided by NPOs has increased, more or less in relation to the economic situation. There are indications of larger memberships in mutual support groups. The growing interest in social movements in the last year is a result of dissatisfaction with the government that can be expected to last.

The growing demands on all three types of NPOs call for more financial and human resources. In the case of service organizations providing welfare services the largest single revenue source is government payments based on contracts. Historically, NPOs have provided services in several welfare areas based on informal complementary relations. Following the advent of NPM in the 1990s formal contracts primarily with existing service providers were entered into. It is assumed that that governmental funding based on formal contracts will be maintained but revised on the basis of what can be considered essential services. It can be expected that the government will put up for bid new programs dealing with complex social or health problems. The NPOs will instead press for long-term contracts with price index changes. NPOs will move towards a more diverse revenue base. Instead of corporate donations the focus will be more on household contributions, a revenue source that is predicted to be unaffected despite of the crisis. Both because of limited liquid assets and reliable investment options income from investment will be limited. In addition to changes in income strategy other responses will include revision of the existing contingency strategy, efforts to improve the economy of scale and scope, and putting constraints on paid human resources instead of focusing on a volunteer base. The mechanisms of allocation will be used more purposively. As the mutual support organizations rely primarily on volunteers rather than financial resources for their operation, the expected cuts in annual general grants and the substantial increase in their membership will not create serious operational problems. Campaigning organizations experience a similar situation as they rely on membership fees and other household donations and volunteer input. The two types of organizations must lower administrative costs by pooling resources and using service centers. Other types of cooperation with other NPOs can also be expected.