The Economics of Stewardship and the Role of the Nonprofit Firm

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In colonial America, care of the indigent poor was often either auctioned off, case by case, to the family that made the lowest bid, or provided in almshouses managed by the lowest bidder (Hall, 2006). If the parsimony of these arrangements is foreign to modern sensibilities, so too is the relinquishment of self determination that accompanied the acceptance of public support. There are situations, however, in which modern charity seems to demand not only the transfer of real resources but also the exercise of judgment as to the allocation of those resources: the care for young orphans, for example, or for the “incompetent” elderly, the heroin addict or the schizophrenic, requires that the caregiver act on behalf of—and not at the behest of—the person cared for. This relationship, in which one agent, the steward, provides material and decision making resources to another agent, the ward, is a relation of stewardship.

The research problem addressed in this paper is the social provision of stewardship in an advanced economy. The research question is this: Given the tools of microeconomic theory, as developed into theories of organizational choice and in particular theories of the nonprofit sector, how can we understand the institutional design of the provision of stewardship, and what is the appropriate role for the nonprofit sector in its provision?

First, the standard model of rational choice is broken down into three requirements for effective self determination, any of which can fail, creating a potential ward. These three basic requirements of self determination are the requirements of effective stewardship. First, effective stewardship requires that the steward have the rationality and the information necessary to be able to make sound judgments on behalf of the ward; call this capacity expertise. Second, the steward must be compelled or otherwise inclined to act on behalf of the ward, that is, to carry out those sound resource allocations on behalf of the ward; call this orientation regard. Third, the steward must have control over resources to allocate on the ward’s behalf; call this rights to property or, simply, resources.

The social problem of stewardship, then, is to construct an institutional framework (regulations, limited property rights, criminal sanctions, etc.) in which stewardship constitutes an effective contractual relationship. Cost-minimizing institutions will have low costs of monitoring expertise and ward-regarding behavior; they will transfer resources to stewards in ways that select into the market for stewards those persons with genuine regard for their charges. Nonprofit firms are often seen as competing with for-profit firms as providers of goods and services; in the case of stewardship, both for-profit firms and nonprofit firms compete with the family. What does a model of “family failure” look like, and can our theories of the role of the nonprofit firm (e.g. Weisbrod 1975; Hansmann 1980; Steinberg 2006) be extended to cover the possibility that the non-profit firm solves the problem of “family failure” in the provision of stewardship? The paper identifies cases in which the market serves to weed out providers who lack expertise, giving market-based institutions such as nonprofit firms an advantage over family provision. The paper also explores the ability to regulate for-profit and nonprofit firms, and the importance of profession-based norms of comportment versus altruism as a motivator for ward-regarding behavior.

Second, I examine the institutional arrangements that deal with the provision of stewardship, cataloguing the use of limited property rights to shape incentives for responsible stewardship. Effective stewardship Foster children are cared for in families but also in group homes, some public and some non-profit. The financial affairs of the incompetent elderly are sometimes
handled by relatives given power of attorney, sometimes by professional financial managers, sometimes by non-expert strangers. The empirical strategy of this paper is fundamental fact-finding, drawing together information on how one large country, the U.S., incentivizes and regulates stewardship.

The key theoretical finding of the paper is that the consideration of stewardship provides an additional rationale for the existence of the nonprofit sector. What the case of stewardship highlights is that families are institutions that provide other-regarding care, including stewardship care, and as such families are institutions that compete with nonprofits in the provision of certain charitable services (as in the examples of care for orphans and foster children). A model of “family failure” points to the costliness of monitoring expertise and other-regarding behavior within the privacy and minimally regulated atmosphere of the home. From this perspective, the nondistribution constraint on the revenues of the nonprofit firm has its well understood effect on promoting trust in the firm’s dedication to its declared mission of other-regarding behavior; further, competition in the market and reputations of long-lived firms provide stronger signals of expertise than can in general be extracted from families.