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Trust but verify? Voluntary regulation programs in the nonprofit sector

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Abstract
In this article we examine how information problems can cause agency slippages and lead to governance failures in nonprofit organizations. Drawing on the principal–agent literature, we provide a theoretical account of an institutional mechanism, namely, voluntary regulation programs, to mitigate such slippages. These programs seek to impose obligations on their participants regarding internal governance and use of resources. By joining these programs, nonprofit organizations seek to differentiate themselves from nonparticipants and signal to their principals that they are deploying resources as per the organizational mandate. If principals are assured that agency slippages are lower in program participants, they might be more likely to provide the participants with resources to deliver goods and services to their target populations. However, regulatory programs for nonprofit organizations are of variable quality and, in some cases, could be designed to obscure rather than reveal information. We outline an analytical framework to differentiate the credible clubs from the "charity washes." A focus on the institutional architecture of these programs can help to predict their efficacy in reducing agency problems.

Keywords: accountability, nonprofit organization, voluntary program.

Introduction

How might donors trust the claims made by nonprofit organizations (henceforth referred to as "nonprofits") given that they have few means to verify such claims? Recently, Ndengera, a self-described Rwandan nonprofit, made a claim on its now discontinued website (http://www.rwandanorphansfoundation.com) that every 14 seconds, a Rwandan child is orphaned by AIDS. Given the context of the Rwandan genocide, the claim seemed sufficiently credible to encourage donors to support the nonprofit, which was seeking to help such orphans. The claim eventually was found to be false. The nonprofit's office was in fact fictitious; a typical case of the so-called "briefcase" nongovernmental organization (NGO). Indeed, there is some evidence that several fraudulent organizations have sprung up to exploit the easy availability of funds for rebuilding Rwanda. Claudette Umulisa, a

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Rwandan official, notes that "many people and organizations have turned the plight of Rwandans in the last 15 years as a means of making money."[1]

Such accounts are not limited to the developing world. One report estimated that losses due to fraud among US charities could be as high as US$40 billion, or 13 percent of total funds given to US charities each year (Greenlee *et al.* 2007). Across the world, one can find similar instances of nonprofit governance failure (Gibbelman & Gelman 2004; Burger & Owens 2008). Scandals in high profile organizations such as the United Way, The Nature Conservancy, and the Red Cross have focused policy attention on the issue of nonprofit accountability (*The Economist* 2003; Christensen 2004). A prominent US nonprofit scholar notes "The nonprofit sector's claims to exist for the public good are no longer being taken on faith, and more people believe they have a stake in the accountability of nonprofits" (Brody 2002, p. 472). A number of surveys document declining public trust in the nonprofit sector across a range of settings (Salamon 2002; Light 2004). A recent global opinion survey found that in some countries the nonprofit sector is now trusted less than government or business (Edelman 2007).

Nonprofits have reasons to be concerned about such developments. An erosion of faith can lead to lower individual giving and reduced public support for the nonprofit sector (Hansmann 1980; Rose-Ackerman 1996; Bekkers 2003; Steinberg 2006). Some studies suggest that in the US, the costs of these foregone resources may be as much as US$100 billion per year (Bradley *et al.* 2003). Reduced resources may force many nonprofits, including the good ones, to exit the market – a situation that neither the principals nor the nonprofits desire. These dynamics are analogous to the lemon's market described by Akerlof (1970). More broadly, negative press can lead to new regulations that might require nonprofits to divert resources from service delivery to regulatory compliance (Edward & Hulme 1996; Ebrahim 2003; Senate Finance Committee Staff 2004; Panel on the Nonprofit Sector 2007).

Why the increased interest in the issue of nonprofit accountability? Arguably, since the onset of the associational revolution in the 1990s (Salamon 1994) the massive inflow of governmental, private, and foundational funds to nonprofits, coupled with low entry barriers, has dramatically increased the potential for less trustworthy or ethical nonprofits to enter the market.[2] This would not be such a problem if outside principals (donors) were able to differentiate the credible nonprofits from the fake ones but in many cases, principals lack the ability to gather accurate information about nonprofits' internal governance and whether the funded nonprofits are deploying resources in accordance with the organizational mandate. Media coverage about nonprofit scandals makes these principals wonder whether such governance problems are endemic to the nonprofit sector. It is not an exaggeration to say that the negative reputational effects of a few "bad apples" are beginning to undermine the reputation of the sector as a whole.[3]

Nonprofit donors have incentives to reduce the information deficits they face. Because gathering and processing information is seldom without cost, they may seek informational shortcuts. Alternatively, they may impose stringent reporting requirements on the nonprofits they fund. For nonprofits, these are expensive ways to respond to governance problems. Credible nonprofits may be motivated to bear the cost of information provision themselves, and in the process, differentiate themselves from the less credible organizations. In this article we provide a theoretical account of an institutional mechanism, voluntary regulation programs, through which nonprofits seek to mitigate information problems faced by donors. Such programs are increasingly popular across the world. The One World Trust (2009) has recently released an inventory of nonprofit self-regulation initiatives that identifies 309 such efforts globally. These accountability programs offer the opportunity for external actors to base their trust in nonprofits on information that helps to verify nonprofits are working as per their organizational mandate. Such voluntary mechanisms can operate in conjunction with public law and private watchdog agencies to serve the societal goal of bringing more transparency to the charity sector. We recognize, however, that nonprofits may have strategic motivations to initiate or join such programs as a means of protecting charity (market) share or pre-empting increased regulation, even when such regulation might have societal benefits.

We seek to make a broader contribution to the study of governance by extending the previous work on private governance to include the study of voluntary regulation among nonprofits. Governance implies the organization of collective action via rule systems, which has the potential to persist over time. As we see it, sporadic collective action should not be viewed as governance. Collective action is organized by establishing (or adopting existing) rule structures or institutions (North 1990; Ostrom 1990). Arguably, these rule structures need to have some element of intertemporal stability so that they can stabilize expectations of the actors participating, voluntarily or involuntarily, in collective endeavors. To date much of the literature on private governance has focused on collective action among firms; our article brings the study of collective action among nonprofits center stage by examining those features of nonprofit structure that affect the emergence and design of governance institutions.

Furthermore, we focus on voluntary collective action: those endeavors in which either actors participate voluntarily or participation is mandatory but actors are able to provide input to shape their functioning. This input may be exercised through a variety of mechanisms, including "exit" (Hirschman 1970). The scope of our inquiry excludes those institutions in which participation is based on coercion; where participants have virtually no say in program functioning and cannot exit. Having identified a scope condition for our inquiry, we turn to a fundamental question in the study of governance and politics: Why would actors seek to pursue any goal collectively? And why would they subject themselves to rule structures that erode their autonomy? As the massive amount of literature on collective action suggests, such collective endeavors are organized to pursue certain objectives that, arguably, cannot be efficiently pursued by unilateral or uncoordinated action (North 1990; Ostrom 1990). Voluntary regulatory programs are collective endeavors that allow credible nonprofits to collectively signal their commitment to deploy resources as per their organizational mandate. As we will discuss, this signal is more credible when provided collectively rather than unilaterally.

The agency perspective is helpful if one views nonprofits as institutions of collective action.[4] Like firms, nonprofits can be conceptualized as a "nexus of contracts" (Alchian & Demsetz 1972) between nonprofit funders and authorizers (principals) and nonprofit managers (agents) who agree to undertake specific tasks on behalf of these principals. Agency relationships are central to understanding the governance challenges faced by collective endeavors (Berle & Means 1932; Ross 1973; Mitnick 1982). As in other forms of collective action, agency slippages occur when nonprofit managers deploy organizational resources in ways that do not efficiently or appropriately serve the mandate outlined by the funding principals. The policy challenge is to understand why these slippages occur and how they might be corrected. We suggest that under some conditions voluntary programs can be an important mechanism to correct governance failures in the nonprofit sector.

Two caveats are necessary. First, the principal–agent framework that we employ in this article focuses attention on the role of donors as principals and identifies appropriate governance mechanisms that are consistent with doing what the donor wants. Arguably, nonprofits should also be evaluated in terms of their success in achieving their mission of serving beneficiaries. The reality of resource dependence suggests that donors' preferences often take precedence, and hence our framework differentiates between donors (as principals) and beneficiaries (as customers of the products nonprofits supply). This is not problematic if donors' main concern is that nonprofits serve their beneficiaries; in this case, the preferences of both the donors and the beneficiaries should align. Nevertheless, excessive concerns regarding accountability to donors might lead some nonprofits to neglect their responsibility toward beneficiaries, and beneficiaries might request nonprofit activities that may be viewed unfavorably by donors. Any overall evaluation of voluntary clubs as a policy instrument should take this important factor into account.

Second, our agency perspective may be most applicable to particular types of nonprofit. The nonprofit literature tends to subsume different sorts of nonprofit and NGO under the term "nonprofit." The agency framework may be less useful in the context of nonprofit organizations such as activist groups or NGOs (e.g. Greenpeace), lobbying groups (e.g. National Rifle Association (NRA), American Medical Association (AMA)), community-based self-help clubs (e.g. Putnam *et al.* 1993), and local organizations seeking to supply local public goods or respond to an externality problem (e.g. Ostrom 1990). Our analytical approach is most useful for studying voluntary governance in the context of organizations often labeled "charities," meaning organizations that seek to serve the underprivileged in the local community, nationally, or abroad. Such nonprofits may be more vulnerable to agency slippages due to the information problems we will discuss below.

Agency theory suggests that information problems are the root cause of agency failures. Information asymmetries are particularly acute for nonprofits for three reasons. First, unlike firms where shareholders have claim over profits or the residual, nonprofit principals are not the residual claimants with private incentives to monitor agents' performance. Moreover, nonprofit principals, particularly individual donors, often do not have the resources and expertise to monitor how nonprofits deploy their funds. Thus, monitoring by principals is likely to be undersupplied in the case of nonprofits in relation to for-profits.

Second, these monitoring challenges are accentuated because nonprofits operate in institutional settings that do not necessarily compel them to disclose financial information. The structure of the nonprofit sector provides few mechanisms to ensure that the incentives of nonprofit boards and managers are aligned with those of key stakeholders and resource providers, or that malfeasance – if it occurs – will be detected. Unlike firms, nonprofits are not regularly monitored by financial markets. In the for-profit world, stockholders delegate oversight responsibility to an elected board of directors who have the fiduciary responsibility to observe the behavior and performance of managers in ways to ensure they are acting in line with owner preferences (albeit with varying effectiveness). In addition, commercial firms face some disciplining power from the market for corporate takeovers and an institutional environment (such as the stock market) that requires extensive information provision (Johnson & Prakash 2007). The absence of a merger and acquisitions market in the nonprofit sector further reduces incentives for external actors to ferret out, examine, and interpret financial information about the working of nonprofits (Manne 1965). However, nonprofits do not have clear owners, are less regulated than their for-profit counterparts, and face fewer reporting provisions. While market oversight mechanisms in the for-profit sector are clearly imperfect – as the current economic crisis demonstrates – it is also true that nonprofit managers face far less scrutiny and are less under threat of being sacked if they do not meet the performance expectations of external actors (Ostrower & Stone 2006).

Third, agency challenges for nonprofits are magnified by the nature of their business, an issue much of the nonprofit literature has focused on. Beneficiaries, the consumers of nonprofit goods and services, tend to belong to the vulnerable sections of society. This is particularly true in the context of developing countries. These beneficiaries typically cannot vote with their feet (or dollars), or even voice their disapproval. For them, nonprofits are often the monopoly providers of essential products and services. For example, in Kenya, NGOs run 87 percent of health care clinics and 100 percent of nursing and maternity homes (Government of Kenya, Ministry of Health 2001). Outside principals cannot therefore judge the efficacy of nonprofits in terms of serving the beneficiaries by examining their market share or sales.

To summarize, this article focuses on agency slippages as the key cause of governance failures, and identifies information problems as the permissive condition that allows such agency slippages to occur. We examine the theoretical and policy rationale for voluntary regulation programs as a means of ameliorating agency problems, while recognizing that such voluntary endeavors work in conjunction with (not as a substitute for) governmental regulation.

Beyond the trust hypothesis

So far we have argued that there are theoretical reasons to believe that agency problems in nonprofits are nontrivial, and can arguably be even more pronounced in relation to for-profits given the undersupply of monitoring by principals, consumers, and regulatory institutions (Johnson & Prakash 2007). Furthermore, there is a structural problem rooted in the nature of the nonprofit "product," which compounds the monitoring problem: nonprofits often produce goods whose quality is difficult for both principals and beneficiaries to verify. When product quality is difficult to verify, consumers must make appropriation decisions based on the faith or trust they have in the vendor, simply because they have few means to verify claims about product quality. Market failures often follow, resulting in demands for government intervention to correct these market failures – a classic case of regulatory politics (Wilson 1980). As a response, governments may enact regulations requiring quality testing before products are brought to market, as in the case of food products and pharmaceuticals. The judicial system, via the threat of class action suits, may also serve to deter producers from exploiting information asymmetries. Producers may themselves anticipate that information problems might dissuade potential consumers from purchasing their products. In response, they may decide to offer product or service warranties to assure consumers that they stand by their claims about product quality. Thus, there are a variety of mechanisms to potentially respond to the information problems arising from the nature of the product.

Given the information problems inherent in the products nonprofits supply, why might principals and beneficiaries trust that nonprofits will not opportunistically exploit their information advantages? Hansmann (1980) suggested one way in which nonprofits (as specific types of institutional arrangements) could solve this information problem and enhance trust: the nondistribution constraint. Because nonprofits are prohibited from distributing profits to their "owners," the contention is that this institutional constraint provides credible assurance to beneficiaries and donors alike regarding the nonprofits' good intentions. There are two parts to Hansmann's argument. First, unlike firms, nonprofits do not have legal owners who can legally claim the residual. Second, by law, nonprofits cannot distribute their profits to any entity. Consequently, beneficiaries may assume that nonprofits are less likely to increase profits by engaging in opportunistic behavior; namely, providing a low quality product while claiming (and charging for) a high quality product. Arguably, the nondistribution constraint should also assure outside principals that managers will not deploy resources that are contrary to the organizational mandate – but this argument might not hold in all conditions, requiring nonprofits to engage in additional mechanisms to signal trust.

For Hansmann, the source of consumer or beneficiary distrust stems from the nature of the product or service supplied. Nonprofits often produce "credence" goods or "post experience" goods (Ortmann & Schlesinger 2003; Weimer & Vining 2004) whose quality consumers find difficult to discern not only before consumption but also post consumption.[5] He suggests that the institutional design of nonprofits, namely, the nondistribution constraint, provides a signal of trust that can overcome these product characteristics.[6] Ortmann and Schlesinger (2003) note that Hansmann's "trust hypothesis" is predicated on three assumptions. First, the nondistribution constraint sufficiently restrains opportunistic behavior among nonprofit managers. Second, donors and consumers are able to distinguish nonprofits from for-profits and believe that the nonprofit organizational form is a reliable predictor of organizational behavior. Third, nonprofits are not subjected to "adulteration," meaning the gradual conversion of nonprofits into "for profits in disguise" (Weisbrod 1988). In practice, all three of these conditions are unlikely to hold, as we discuss below.

First, the nondistribution constraint may not fully prevent opportunistic behavior as it provides only a "negative" protection against potential malfeasance rather than providing positive incentives for managerial performance (Ben-Ner & Gui 2003). Even if the nondistribution constraint could curb incentives for cheating, managers might also cheat in ways that do not require the ability to distribute profits. Nonprofit managers might have incentives to use surpluses for personal objectives such as high salaries, perks, or vanity projects such as expanding the organization beyond its optimal size (Oster 1995).[7] Indeed, most scandals plaguing nonprofits pertain to the use of organizational resources for personal gain. Even in the absence of outright fraud, nonprofits may suffer from "goal displacement," goal conflict, or incompetence, whereby they operate according to the preferences of managers and boards (themselves unelected) while paying less attention to the preferences of funders, beneficiaries, and government authorizers (Ortmann & Schlesinger 2003).

The trust hypothesis also assumes that consumers recognize the implication of the nondistribution constraint. Evidence from the US suggests that citizens have a limited understanding of what the nonprofit form entails (Schlesinger & Gray 2006). Moreover, the way in which ownership form matters will vary across sectors. In particular, consumers may struggle to distinguish fee-based nonprofits from for-profits providing similar services in sectors where both institutional forms are common. In sum, agency problems afflicting nonprofits range from outright fraud to managerial incompetence. Eventually, the scandals caused by these problems are likely to damage the reputations of all nonprofits because they demonstrate that the nondistribution constraint by itself cannot curb agency slippages.

Nonprofits face two types of adulteration challenge that the nondistribution constraint may be insufficient to deal with. Internal agency problems are compounded by the potential for external adulteration: if consumers tend to trust nonprofits, crafty entrepreneurs might enter the sector to exploit this trust. Over time, nonprofits may begin to operate more like for-profits. Positive "selection effects" might help temper this agency conflict; that is, nonprofits might attract disproportionate numbers of ethical, "beyond temptation" managers who will not behave opportunistically. In other words, while for-profits attract instrumentally oriented actors, nonprofits tend to attract normatively oriented individuals. For selection to fully curb opportunism, however, the nondistribution constraint must be a sufficiently strong deterrent that few opportunistically oriented managers will want to run a nonprofit.

While this is an interesting argument, empirical support for such selection effects is thin. Basing trust in nonprofits based on selection effects (in the presence of a nondistribution constraint) leads to other problems. While selection effects might hold in the short term, in the long term, they might encourage adverse selection: unethical managers might seek to enter this sector given that the nonprofit that employs them cannot differentiate between unethical and ethical managers. Self-interested entrepreneurs might choose nonprofit status to weaken the incentives for ex post expropriation and thereby attract charitable donations (Glaeser & Schleifer 2001). This temptation may be even greater in situations such as those in many developing and transition countries where unemployment is high and nonprofit salaries are relatively remunerative, giving individuals an incentive to start a nonprofit as a means of employment rather than as a means to serve the public good (Platteau & Gaspart 2003).

In sum, while the nondistribution constraint and selection effects might lower agency slippages, nonprofits are likely to continue to suffer from high levels of agency problems because of the nature of the products they offer, the external adulteration they face, the lack of institutional oversight that compels them to disclose information, and the lack of a residual claimant whose interests would be protected by the board of directors. Recognizing this issue, we now examine how voluntary programs might be considered as a mechanism for nonprofits to signal their commitment to outside actors to mitigate agency issues.

Agency dilemmas in nonprofit organizations

The discussion so far suggests that the trust issue in nonprofits can be understood, inter alia, as an agency dilemma. An agent is an actor who acts on behalf of a principal (Mitnick 1982). Agency problems arise when agents do not function per the wishes of their principals and instead act in line with their own preferences, which may not align with those of the principals (Berle & Means 1932; Ross 1973; Mitnick 1982; Fama & Jensen 1983; Moe 1984; Wood 1988; McCubbins *et al.* 1989; Waterman & Meier 1998). When agents' preferences diverge from those of their principals, governance failures follow.

Agency is a relational construct involving an agreement between two parties. Although agents respond to contracts offered by principals and agree to work on behalf of principals, agents can also shop around for principals just as principals might shop for agents. Managers regularly move to different firms seeking new principals whom they believe are more supportive of their activities, ideals, or styles of functioning. Similarly, shareholders (the principals) sell stock in one company and buy in others seeking to fund agents/activities who share their ideals (e.g. social investment or ethical funds). Depending on the context, both agents and principals can exercise exit options. At any point in time, nonprofits must assess the costs, benefits, and feasibility of responding to the requirements of current principals versus shopping around for new ones. For charitable organizations, funders are likely to be key principals and the agency perspective provides insight into organizational behavior irrespective of whether the charity was originally established by funders, sprung up and then looked for funders, or changed funders during the course of its organizational existence. In sum, no matter who the principals are and no matter what the causal chain behind the emergence of the nonprofit is, current funders constitute the key principals as per our framework.

Consistent with the principal–agent framework it is important to differentiate beneficiaries (customers, clients, and consumers) from principals and patrons. The former are the consumers of the products (or organizational output) produced by the organization. In the case of charitable organizations, the composition of goods and services produced is not governed by market demand. Principals or patrons may even direct the organization to create products that consumers may not want; that is, misguided principals may force agents to work against the objectives for which they hired the agents in the first place. Principals may also provide contradictory or incoherent directions to agents. The world is full of examples of misguided and incompetent principals. In some situations, the same actor might serve as both the beneficiary and the principal. While there has been a great deal of rhetoric about making nonprofits more "accountable" to their beneficiaries, this rhetoric is rarely matched by actual incentives or mechanisms through which beneficiaries can hold nonprofits to account – thus beneficiaries remain clients or customers of nonprofits rather than becoming principals. Principals and beneficiaries sit at the two different ends of the value chain (or the charity chain in our context).

Agents' preferences and actions may diverge from the wishes of principals for a number of reasons, and the specific reason for agency failure may have implications for the design of institutions to correct it. Agents may act contrary to principals' preferences as a result of intentional design, ignorance, or confusion (Miller 2005), each of which poses a different type of institutional design challenge.

In the case of *strategic* agents exploiting information asymmetries by design, principals have incentives to persuade agents to pay heed to principals' preferences. Both carrots and sticks can be used. Needless to say, agents may require different types and degrees of persuasion. If principals need to invest valuable resources to establish incentive systems, they may undertake a careful cost–benefit analysis to estimate the efficient levels of "supply" of persuasion. After all, valuable resources are expended in establishing and running institutions. In some cases principals may decide to tolerate agency losses simply because it is expensive to establish new institutions. In other cases, principals may create counterproductive incentive systems simply because they fail to get a sense of agents' preferences and how these might be shaped in response to incentives.

Ignorant agents may simply be unaware of the expectations of principals or not know how to convey information about their activities to principals in a useful way. For the ignorant agent, principals need to either improve the supply of information about their preferences or create incentives for agents to actively seek the relevant information from them. But donors themselves may lack the ground-level knowledge that would allow them to clearly specify their expectations, or the vocabulary to effectively communicate them to their agents. The problems are compounded because many of the activities that nonprofits undertake cannot be easily measured. Vague directions from donors can lead to agency losses. In concrete terms, resource providers must clearly communicate to nonprofits their objectives and how they expect nonprofits might function. On the other hand, nonprofits should have incentives to seek clarification if some directives are not clear. Again, the supply of complete information is often impossible; both principals and their agents function in situations of incomplete information. The problem is exacerbated because the supply of new information often imposes nontrivial costs on the principals. As with their dealings with strategic agents, principals need to assess the benefits of supplying new information in relation to potential agency losses. They need to identify whether the problem lies with inadequate supply from them or with the inadequate capacities of the agents to absorb and process the available information. The institutional solutions to both these issues might be different.

For the *confused* or *conflicted* agent receiving conflicting directions from multiple principals whose preferences do not align, there are two institutional approaches to resolving the resulting confusion. The principals can either sort out the issue among themselves or leave it to the agent to prioritize preferences for them. From the principal's perspective, the latter strategy is fraught with problems because agents might be responsive to the dominant principal, or might play off one principal against another. But in order to provide a uniform and cohesive signal, nonprofit principals would need to first solve their own collective action issues and then provide coherent instructions to the agent. One of the principals might assume the role of the lead principal (or be so designated by others) and other principals could follow the lead principal in providing instructions to the agent. Without such coherence, principals as a group will suffer agency losses.

The upshot of this discussion is that the institutions or rule structures devised by principals to influence the behavior of agents are likely to depend on the expectations of principals about the drivers of agency loss. Given the proliferation of "briefcase" NGOs, the scenario of dealing with strategic agents is quite realistic for resource providers. Furthermore, given that most nonprofits receive funds from multiple sources, the scenario of a *confused* or *conflicted* agent is plausible. Finally, given that in most settings the nonprofit sector is dominated by numerous small-scale, low-capacity organizations, principals also have reason to expect that agents might be *ignorant* both about appropriate management and organizational strategies and about how to convey information about their activities to outsiders. The multiple sources of agency dilemmas suggest that both principals and agents have reason to value signals that produce reliable information about the quality and performance of nonprofit organizations.

Nonprofits might use a variety of mechanisms to signal their intent to minimize agency loss. We focus on how nonprofits seek to *collectively* signal this intent via voluntary accountability programs established by nongovernmental actors. Such programs attempt to signal that nonprofits have improved their internal management systems and operations in ways that cohere with the objectives established by resource providers. We propose conditions under which these programs allow ethical, well-functioning nonprofits to differentiate themselves from less ethical nonprofits that are less likely to join such programs.

Voluntary regulation programs impose obligations on nonprofits that go beyond legal or administrative requirements. By making information about these obligations (and whether nonprofits meet them) available to outside actors, voluntary programs can reduce the information deficits that resource providers face about nonprofits' activities. By joining these programs, nonprofits aim to provide assurance to external principals that they are committed to their mission fulfillment through rules and procedures that minimize administrative overheads, focus spending on agreed-upon projects, and effectively deliver services to the target population. In other words, these programs can provide assurance to the principals that their agents (namely, nonprofits) are functioning as per the principals' objectives in ways that minimize agency losses.

The evidence suggests that such programs are proliferating rapidly. One example is the Standards For Excellence Institute in the US. The Institute has developed charity standards and trains state-level entities to engage in certification, issuing a "seal of approval" for nonprofits to display. Similarly, the Better Business Bureau/Wise Giving Alliance offers nonprofits a "Charity Seal" if they pass accreditation of nonprofit compliance with the standards. The International Council of Fundraising Organizations (ICFO) supports twelve independent agencies running charity certification programs in the US, Canada, and Europe. These voluntary programs are not limited to industrialized countries. Sidel (2003) describes 17 such efforts in Asia and Gugerty (2008) finds 12 in sub-Saharan Africa. Of the 309 programs identified by the One World Trust, approximately half are in developing countries.

It is important to recognize that the voluntary regulation programs our article examines are part of a broader governance context that includes a mix of regulatory tools, including governmental regulations and charity watchdogs. This regulatory environment will affect the emergence and structure of voluntary programs. Moreover, it is possible that some larger institutional donors in fact already have the capacity to monitor their grantees. But even if donors have the ability and resources to monitor, the nonprofit is still left with a multiple principals problem: How to respond to different donor requirements? Indeed, complaints about multiple reporting requirements may be a major motivation for establishing clubs. Furthermore, in anticipation of more cumbersome donor reporting requirements that might straightjacket nonprofits, nonprofits may have strategic incentives to pre-empt such requirements by establishing and/or joining voluntary clubs.

Voluntary regulation clubs as a response to agency dilemmas

In the previous section we suggest that strategic as well as ethical nonprofits have incentives to develop or join voluntary mechanisms – what we characterize as voluntary clubs – that provide a reputational signal to principals. Voluntary clubs may appeal to principals who prefer a reliable signal of quality rather than engaging in expensive monitoring. But nonprofits and their principals may differ on how this signaling is to be accomplished and this may depend, in turn, on the perceptions of principals regarding the most important source of agency losses. Institutional donors might want a specific signal that ensures nonprofit activities are aligned with their specific funding priorities and they may fear that nonprofit agents will be confused or conflicted by the needs of multiple donors. Governments want to ensure that nonprofits are serving charitable purposes that justify their tax exemption, so may fear nonprofit confusion or ignorance. Individual donors are likely to be concerned about adulteration and may therefore desire a simple and straightforward mechanism for identifying worthy organizations for giving to. Nonprofits, on the other hand, would prefer one signal that is credible for multiple stakeholders. How can these competing interests be served? What constitutes a credible signal? What kinds of information must it contain?

Spence's (1973) discussion of labor market signaling is instructive for understanding signaling dynamics. Given that employers lack full information about the quality of potential employees, job applicants have incentives to find signals of quality. Obtaining a college degree is one way of doing so. Because low quality individuals will find it more costly to obtain a college degree than high quality individuals, a college degree serves as a signal of quality, regardless of whether a college education actually improves employee skills or job productivity. The college diploma signal induces a "separating equilibrium" in which "good" and "bad" types are revealed.

Where pre-existing signaling mechanisms do not exist, however, signal seekers, such as nonprofits, need to create new signaling mechanisms via voluntary clubs. To do so, they must ascertain what type of signal induces a separating equilibrium that distinguishes high quality from low quality nonprofits. In other words, what kind of signal establishes sufficient information on reputation? This is an external credibility problem. A second challenge has to do with who will bear the cost of constructing the signal and how the flow of information will be coordinated. These decisions pose an internal collective action challenge.

The institutional design of voluntary clubs must address both the external credibility problem and the internal collective action problem. To create a credible signal the cost of program participation must be sufficiently high that low quality organizations do not participate. If securing admission to college was easy, college degrees would become devalued (indeed, exclusivity is now an important component of many collegiate ranking systems). Thus, the entry barriers associated with qualifying for membership tend to influence the credibility of the voluntary club brand with external actors.

In addition, the club must be able to ensure that participants are actually meeting the program standards. Potential employers would be skeptical of university diplomas if universities did not impose graduation requirements on their students. Universities need to put in place mechanisms to ensure that students acquire the knowledge and skills that they should. Voluntary programs also need some way to assure external principals that participating nonprofits have followed up on their obligations. Below we outline how voluntary clubs seek to accomplish this objective.

The club framework

In economic theory, clubs are rule-based institutions that create benefits which can be shared by members, but which nonmembers are excluded from enjoying (Buchanan 1965; Cornes & Sandler 1996). Clubs thus function to produce and allocate impure public goods; that is, goods that can only be created or enjoyed collectively. Such goods are neither fully private (if they were they could be provided by markets) nor fully public (if they were they it would be impossible to exclude others from enjoying them). Club goods are excludable goods that are nonrival within the club. Excludability means that it is feasible for one actor to exclude others from appropriating the benefits of a good for which the actor has contributed resources. In the case of clubs, nonmembers can be excluded from enjoying the benefits of club membership. Without excludability, other actors have an incentive to "free ride;" that is, to enjoy the good's benefits without contributing to its production, maintenance, or protection (Olson 1965). Rivalry means that if one actor consumes a particular unit of a good, it is no longer available for another actor to consume: if I am eating an apple, then you cannot eat the same apple. Among club members, each participant can enjoy the benefits of club membership without reducing the benefits available to other members. Clubs can therefore be viewed as institutions that provide collective benefits for members. In the case of nonprofit clubs, the good being produced is a reputational signal of nonprofit quality that distinguishes high quality from low quality nonprofits.

Voluntary programs as clubs perform three functions (Prakash & Potoski 2007). First, clubs require members to adopt policies and undertake activities that go beyond what is legally or operationally required of them. These "beyond guidelines" activities and policies are tied to outcomes that nonprofit principals care about. Second, by requiring members to undertake these activities, clubs impose costs on members. These costs help to create the reputational signal for the club. Third, to compensate members for incurring new costs, the club provides benefits. The most important benefit, the benefit of a good reputation or "brand," has characteristics of a club good because all members can benefit from it at any given time, but it is available only to members and cannot be appropriated by nonmembers.

By joining a voluntary program, nonprofits agree to incur the costs of adopting and documenting compliance with new governance mechanisms. This signals to principals that nonprofits are serious about tackling agency conflict. Thus, voluntary club membership provides information about practices and management systems that principals cannot observe and therefore helps to mitigate information asymmetries between principals and agents. Club membership also provides assurance to principals that agents are adhering to goals as promised. Principals may also welcome voluntary clubs because they serve to reduce the monitoring and enforcement costs that principals might otherwise face.

Club membership creates two types of benefit for members: branding benefits and private benefits (Prakash & Potoski 2006a). Branding benefits, the central feature of voluntary clubs, accrue to club members only and are a key incentive for joining the club because nonmembers are excluded from enjoying them. Branding benefits bestowed by the club take many forms, including increased goodwill, funding, contracts, or other compensation that members receive from their principals in response to their club membership. These benefits are tied directly to the credibility and strength of the signal produced by club membership. For example, club members often receive a certification that enables them to advertise that they are different from nonmembers by virtue of their club participation. For nonprofits, there are several potential benefits tied to this reputational signal. There is some evidence that donors are willing to reward credible signals of quality with additional funding (Bekkers 2003; Sloan 2009).[8] In addition, in countries where government attitudes toward nonprofits are hostile, such a signal may also help protect an organization from unwanted government interference or scapegoating (Gugerty 2008). In addition to the benefits created through the nonprofit "brand," nonprofit clubs might provide tangible material benefits to participants that also have the characteristics of club goods. For example, club membership or certification might be a prerequisite for tax-exempt status or for receiving government grants or contracts.

Clubs may also create private benefits for participating actors. Individual nonprofits may benefit from organizational learning in the process of certification, or they may find ways to streamline or reduce the costs of other reporting requirements. Compliance procedures may encourage more efficient or effective use of donor or government funds; to the extent that increased effectiveness can be documented, this may in turn lead to both increased funding and higher social benefit. However, nonprofits can appropriate such benefits by establishing accountability systems but not formally joining the club. After all, the obligations imposed by such clubs are often quite straightforward. While the benefits of organizational learning might emerge by participating in a club, they can also be generated and appropriated independent of club membership. Unlike branding benefits, they do not have a collective character to them. Thus private benefits do not constitute the raison d'être for nonprofits to join an accountability club.

If reputational benefits are so important, nonprofits can create them, arguably, by unilateral action. Some of them indeed do, as witnessed by the increased interest in recent years in "branding" among many nonprofits (Bennett & Gabriel 2000; Napoli 2006). Alternatively, nonprofits can hope that the rating agencies will give them superior ratings, which will dispel doubts about their activities. These are certainly lower cost options. Why are signals via clubs more credible than signals by an individual nonprofit? Club membership offers several advantages over unilateral actions for mitigating agency conflict and enhancing reputation with principals. From the principals' perspective, a unilateral declaration by a nonprofit to abide by certain standards is less credible because when individual nonprofits make and enforce their own rules, they can more easily change them. In contrast, clubs are institutionalized systems whose rules are often stable; club membership therefore signals a long-term commitment to curb agency conflict. Furthermore, because clubs can also gain from network effects (Bessen & Saloner 1988) in building reputations, actions taken as part of a club can do more to boost a nonprofit's standing with the principals than the same action taken unilaterally.

The architecture of nonprofit clubs

While clubs seek to signal participants' desire to check agency slippages, their success in doing so might be assessed ex ante by focusing on their institutional design. External principals can be expected to assess the extent to which the club is able to mitigate the internal collective action problems that threaten to undermine the club's ability to control agency slippages. As the club approach suggests, two collective action challenges, both rooted in free riding, are most salient in the context of voluntary programs (Prakash & Potoski 2006a). The first challenge, the recruitment challenge, pertains to a club's capacity to create benefits that are perceived as sufficiently high as well as sufficiently excludable by potential participants to offset the cost of club membership. The excludable nature of these benefits is crucial to prevent free riding. The level of such excludable benefits, and therefore the club's ability to attract participants, depends on the reputation of the club. To solve the recruitment challenge, clubs can seek to develop standards that are stringent enough to demonstrate a credible commitment to mitigating agency conflict, yet are reasonable enough that a minimum number of participants is willing and able to pay the costs of meeting them.

The second challenge involves mitigating another type of free riding; namely, shirking. A club must have the capacity to compel participants to adhere to its rules once they join the club. After all, participants might have incentives to free ride on the club's reputation: one can easily visualize a situation in which some participants join a program and enjoy the benefits of its reputation, but shirk their responsibility to adhere to its standards. Instead of signaling success in curbing agency conflict, widespread shirking becomes a symptom of membership, thereby undermining a club's credibility with principals. If the club strictly monitors behavior and sanctions noncompliance, such shirking can be mitigated. Such clubs are likely to have a higher standing among their principals. Thus, the two attributes, club standards and club monitoring and enforcement, are the key institutional dimensions of voluntary clubs.

Club standards

Club standards establish the requirements for joining the club, thereby outlining the internal rule systems that are expected to curb agency slippages. Given that principals, including donors and governments, often specify reporting and governance guidelines for nonprofits, club standards can be viewed as setting concrete expectations regarding the "beyond guidelines" policies and governance required by the program. In the US, where nonprofits are required to file annual "Form 990" tax reports with the Internal Revenue Service (IRS), club standards may require the public disclosure of full financial statements or require governance structures that go beyond that required for acquiring 501c(3) status. The Evangelical Council for Financial Accountability (ECFA), established in 1979, is perhaps the longest standing accountability club in the US. ECFA standards set out 21 requirements for nonprofit certification, including standards regarding the selection, composition, and operation of the board of directors; rules for disclosure of financial statements and information on spending on specific projects; rules governing fundraising; and rules regarding conflict of interest policies. When voluntary programs are designed to serve nonprofits across a range of sectors, the "extensiveness" of standards, that is, the range of activities covered by the new reporting and governance requirements, may be the most germane measure of standard strength, primarily because it serves as the best proxy for governance costs. Thus the National Standards For Excellence contain 55 standards for evaluation, including the composition and operation of governing boards, human resource management, financial accountability, fundraising practices, and transparency. Although extensive, the standards are relatively broad and generally do not require that nonprofits meet specific targets or adhere to specific practices. In contrast, when nonprofits in a particular subsector face demands from a smaller set of principals, standards may be quite industry specific. The American Association of Museums certification program for example includes more than 100 standards, many of which concern the curation of exhibits and the acquisition of artifacts, as well as other sector-specific issues.

The baseline for evaluating the stringency of such standards must be understood in relation to the specific regulations or donor guidelines that nonprofits face. Ascertaining this baseline is a difficult task given the diversity in the nonprofit sector and the lack of clear reporting guidelines across organizations. The presence of multiple principals complicates the issue if principals vary in their information requirements. It also creates opportunities for clubs to engage in "venue shopping" for venues with the lower baseline guidelines in order to claim high stringency of club standards. These "venues" may pertain to some nebulous sectoral or national level guidelines. Arguably, such inflated claims might eventually be challenged, but nonetheless guidelines may not always be comparable using the same metric. Indeed, there is scope for some ambiguity on this issue that some club sponsors might exploit.

For analytical simplicity, we assume that guidelines established by the dominant funder constitute the baseline against which the stringency (the beyond guidelines element) of the club standards ought to be assessed. For example, this might be the Ford or Gates Foundation in some sectors and the level of government regulation and reporting requirements in others. We expect that nonprofits that are already closer to the standards will incur lower additional costs to join the club. Thus, the expectation is that high quality nonprofits will be more likely to join voluntary programs, potentially increasing the strength of the reputational signal provided by the club. In this way, club standards serve the screening function by potentially screening out the lower quality participants.

For analytical clarity, we consider two ideal types of standard: lenient and stringent (Prakash & Potoski 2007). Lenient club standards require marginal effort (above the legal and donor requirements) on the part of potential nonprofits to join the program. They tend to impose new requirements only for a small range of activities. For this reason these are low-cost clubs. For example, the Council on Foundations Statement of Ethical Principles contains only six broad principles: mission, stewardship, accountability and transparency, diversity, responsible governance, and respect. Little elaboration or definition is provided. Similarly, the NGO Code of Conduct in Kenya includes seven broad principles for conduct. Such broad standards are expected to have only a marginal impact on correcting agency slippages. Consequently, while nonprofits might find it easy join a lenient voluntary club, they should also expect small reputational gains by virtue of club membership.

In contrast, stringent club standards impose requirements that are well in excess of the guidelines faced by nonprofits and that cover a wider a range of activities. The advantage of stringent standards is that the club brand is more credible and can serve as a signal of club members' commitment to reducing agency conflict. The downside is that stringent standards impose high costs that nonprofits working on slender budgets may not be able to afford. Thus, honest but modestly endowed nonprofits that are priced out of the voluntary club market may get grouped with less credible nonprofits that are unable to meet the club requirements. For example, the Central Fundraising Bureau (CBF) in the Netherlands provides certification to nonprofits using standards that include more than 60 requirements that extend well beyond any legal requirements in the Netherlands, but the 200 or so members represent a fraction of the total number of charities in the Netherlands. Similarly, the Pakistan Council on Philanthropy provides certification to nonprofits that meet a complicated set of standards and can provide extensive documentation of their compliance with these policies, but to date only approximately 140 of the tens of thousands of nonprofits operating in Pakistan have been certified.

Our sense therefore is that there is no ideal level of club standards and that evaluating the stringency of standards may be context specific. Indeed, we believe that in designing voluntary clubs, sponsors will have to balance competing objectives. Furthermore, given the lack of consensus on appropriate reporting standards for nonprofits, many clubs may emerge with relatively lenient standards, particularly in the early phases of club development. As an example, in the US context a club might require that members make their IRS 990 tax reports and audited financial accounts public, and it may impose certain requirements regarding board governance, such as the number of board members or composition of the board. Such requirements do not go significantly beyond legal requirements, but bundled together and made public by club sponsors, they can serve as a signal of quality. As a club matures, it might slowly ratchet up the stringency of its standards, especially in terms of the extensiveness of the reporting and governance requirements.

Club monitoring and enforcement

The stringency of standards is one component of club credibility. The second component is the extent to which clubs can demonstrate that participating nonprofits are complying with standards. Noncompliance might result from willful shirking or from simple confusion or ignorance. Willful shirking among club members may occur when the goals of nonprofits and club sponsors diverge or because participants are able to exploit information asymmetries between themselves and club sponsors regarding their adherence to club standards. While one can draw these fine distinctions analytically, empirically it is difficult to identify which part of shirking is strategic and therefore willful, and which is due to structural factors beyond the control of the agent (i.e. confusion or ignorance). We anticipate that voluntary clubs will seek to curb both willful and structural shirking, with particular emphasis on the former.

One perspective suggests that nonprofits may not be subject to the same shirking problems as firms because of the centrality of principled beliefs or values to their actions (Keck & Sikkink 1998); because of normative sociological pressures for behavior (March & Olson 1989; Rees 1997); or because the actions of managers are more trustworthy as they face a nondistribution constraint (Hansmann 1980). This is akin to the selection argument discussed above. Such normative beliefs and pressures could potentially mitigate shirking, but it is not clear if they will be sufficiently credible to outside stakeholders. As we noted at the outset, increasing pressure on nonprofits to demonstrate "accountability" and "results" suggest that these normative tendencies are not perceived as sufficiently strong by many stakeholders. In the absence of credible normative pressures, nonprofits, like firms and bureaucracies, will need some kind of enforcement mechanism. Monitoring and reporting requirements in clubs attempt to enhance the credibility of the club signal by providing information about adherence to standards. Furthermore, while a reduction in such information asymmetries may mitigate agency conflicts, clubs may also need to incorporate an explicit sanctioning mechanism to further enhance the credibility of compliance.

What are the elements of effective and credible monitoring and enforcement systems? The club approach identifies three components: disclosure requirements, verification requirements, and sanctioning (Prakash & Potoski 2006a). Clubs can use disclosure or transparency requirements that require nonprofits to provide and make public particular information. Clubs could also require that participants produce documents and certify compliance. The certification could be first party (self-certification), second party (peer certification), or third party (independent agent). Once verification and certification mechanisms have been established, clubs face the question of how to handle cases of noncompliance. The threat of sanctions can indicate that club sponsors are serious about ensuring the club's credibility. At the same time, club sponsors may not want to acquire a reputation of being harsh and adversarial. They may want to promote organizational learning, especially if shirking is rooted in structural causes. Learning will be better facilitated if participating nonprofits are willing and able to report mistakes. In clubs sponsored by nonprofits themselves, there may be a fear that public sanctions will identify "bad apples" that weaken the reputation of the sector as a whole. In addition, club sponsors may arguably have a greater impact if they retain nonprofits with imperfect compliance in the club because they can retain leverage over these nonprofits' policies.

Enforcement mechanisms may run the gamut from weak to strong: the weakest enforcement is asking club members to pledge their adherence to the code without actual verification or certification. The Council on Foundations asks only that its members pledge adherence to the statement of ethical principles. Stronger enforcement might involve some form of self or peer verification or certification, with the very strongest clubs relying on third party certification. For example, the American Association of Museums certification requires the use of third-party certifiers retained at the individual museum's expense. Likewise the Pakistan Council on Philanthropy Seal is awarded after a process involving extensive documentation and an on-site evaluation by a team that includes independent evaluators. Clubs may also provide mechanisms by which complaints about members can be brought to the certifying organization. Thus the NGO Council in Kenya compensates in part for its lenient standards through the development of a complaints process with adjudicating powers. Clubs may also make public the names of those organizations that do not provide required information or are found to be noncompliant, or they may be removed from the club.

The strength of voluntary accountability clubs among nonprofits is thus comprised of two features: standards and enforcement. The strength of clubs can be seen as a continuum from very weak to quite strong, depending on the mix of standards and enforcement employed. Drawing on the club literature (Prakash & Potoski 2006a), Table 1 lays out an analytical typology for nonprofit clubs.

The reduction in agency conflict is expected to be smallest in clubs with lenient standards and weak swords; such clubs are analogous to "fire alarms" (McCubbins *et al.* 1989) because their monitoring mechanisms typically rely on complaints rather than institutionalized reporting. These are low-cost clubs that may be able to attract a large number of participants but are likely to create only marginal branding benefits for

Table 1 Analytical typology of nonprofit voluntary clubs

	Weak monitoring and enforcement	Strong monitoring and enforcement
Lenient club standards	Costs: Low joining cost Benefits: Marginal branding benefits Principals' assessment: Marginal reduction in agency loss	Costs: Medium joining cost Benefits: Moderate branding benefits Principals' assessment: Moderate reduction in agency loss
Stringent club standards	Costs: Medium joining cost Benefits: Moderate branding benefits Principals' assessment: Moderate reduction in agency loss	Costs: High joining cost Benefits: High branding benefits Principals' assessment: Significant reduction in agency loss

Adapted from Prakash and Potoski (2006a).

participants because they are likely to be able to identify only extreme cases of malfeasance. Such clubs typically have standards that are aspirational in nature and include only minimal monitoring mechanisms.

Agency slippages will be lower in clubs that feature stringent standards and significant enforcement, such as third-party certification mechanisms. Such clubs are more likely to distinguish high quality nonprofits from lower quality organizations because such clubs will be too costly for lower quality organizations to join. In this way, stronger clubs help to allay principals' concerns about nonprofit governance and effectiveness. Because of their greater signaling and branding power, principals are also more likely to reward participants in these clubs with higher levels of funding or greater discretion.

Implications for future research

Our article speaks to the broader collective action literature that recognizes that information asymmetries between transacting actors can lead to market failures (Akerlof 1970) as well as government failures (North 1990). We suggest that information problems also create governance failures in the nonprofit sector, an issue that has received inadequate theoretical and policy scrutiny. This lack of attention to information problems has impeded the evolution of a broader accountability research program examining common sources of governance failures in the for-profit, nonprofit, and governmental sectors.

To systematically examine the source and consequences of information problems, we suggest viewing nonprofits as a "nexus of contracts" between principals–donors and nonprofits. If we do this, agency issues are a key component of the challenges to nonprofit accountability and governance. This article offers an analytical account of how nonprofit voluntary clubs seek to respond to this challenge.

Our approach to the study of nonprofit accountability and governance raises a number of interesting questions for further research. We highlight four themes in particular. First, how might one assess the relative importance of voluntary programs in the overall governance mix? Second, in what domains and regulatory contexts, and in what types of nonprofit, are accountability problems most accentuated? Third, in what domains are voluntary nonprofit programs likely to emerge? Fourth, who initiates or sponsors voluntary programs and with what consequences for club reputation?

How important are voluntary programs in relation to other forms of governance? While governmental regulations provide the baseline for any regulatory activity, the abilities of governments to enforce their own regulations vary considerably. Rating agencies or charity watchdogs that seek to assess the organizational parameters of nonprofits are a relatively new phenomenon. Furthermore, such raters are more established in developed countries in which literacy levels are high and donors can access rating information at low cost. Even in those settings, however, the percentage of nonprofits that are rated remains relatively low. One of the largest charity rating organizations in the US, Charity Navigator, currently evaluates roughly 5,400 of the more than 1.5 million charities that are legally required to file tax documents with the federal government. Moreover, the basis for rating is limited to financial information. In many nonprofit arenas, third-party ratings systems, fundraising and other ratios that measure overhead and fundraising expenditures as a percentage of revenues, are quite common, in spite of the belief that comparison of such ratios across organizations is problematic (Nonprofit Overhead Project 2004; Bowman 2006; Spzer & Prakash 2009).

An important indicator of the importance or salience of any regulatory instrument is its pervasiveness. While governmental regulations tend to be ubiquitous, rating agencies are relatively few (two dozen at most) and their evaluations typically cover only a small number of nonprofits and employ a relatively small number of standards. For example, the Charity Navigator monitors only 5,400 of the more than 1.5 million charities in the US, rating them largely on their financial health. The Better Business Bureau/ Wise Giving Allowance provided reports on 1,100 charities in 2007. In most countries, such charity evaluators do not even exist. In contrast, voluntary regulations have proliferated across continents: the One World Trust (2009) has recently released a comprehensive database identifying more than 300 initiatives worldwide. We speculate that voluntary initiatives would be most useful for two types of organization: nonprofits in developing countries, and organizations that rely on big donors for their funding. The latter is important because voluntary programs can be tailored to meet specific expectations of key funders. Charity watchdogs are likely to be more popular in developed countries where the literacy levels are higher; where donations by citizens are an important source of revenue; and for membership-based organizations that rely on a large roster of donors.

Voluntary regulation programs are likely to emerge where accountability problems are most accentuated. In what contexts and in what types of nonprofit will this be the case? As we noted previously, all institutions – markets, governments, and nonprofits – are susceptible. A typical reaction to market failure is to invoke government intervention. Similarly, a typical reaction to government failure is to bring the market back in via privatization and deregulation. Decisions about the most appropriate course of action, unfortunately, tend to get caught in partisan crossfire. The issue of nonprofit failure, thankfully, has not yet been wrapped up in ideological debates. Thus an important theme for empirical research is to identify sectors or areas where nonprofit accountability problems are most accentuated. We have suggested this will be the case in situations where information problems between principals and nonprofits are most severe; entry into the nonprofit sector is easy; public law for the regulation of nonprofits is weak; no dominant principal sets the sectoral guidelines; or nonprofit beneficiaries do not have the ability to exercise voice or exit. We believe a careful empirical examination of the varying incidences of agency failures is needed given the rather substantial volume of funds flowing through these actors.

Following this issue, future research needs to explore the conditions under which nonprofit clubs emerge. A demand-side explanation would suggest that such clubs are likely to emerge where the accountability issues are the most severe: if there is demand for new institutions, clubs will emerge. Indeed, the political economy literature suggests that signaling programs such as voluntary clubs are likely to emerge where nonprofit behavior and the quality of nonprofits' products are hardest to observe. Permissive conditions for this include situations in which customers and producers are separated by large distances (Prakash & Potoski 2006b; Terlaak & King 2006), transactions are not repeated, or goods and services are idiosyncratic or quality is difficult to judge or verify (Potoski & Prakash 2009b). This is the case when nonprofits are charged to supply "credence" or post experience goods whose quality is difficult to verify. Voluntary regulation may also emerge when nonprofits operate in jurisdictions in which the public law governing nonprofits is weak and therefore "bad apples" face fewer barriers to entry.

However, such demand-side explanations ignore the costs of organizing collective action. Some actors must have incentives and abilities to set up clubs and then induce nonprofits to join them. What would motivate actors to do so? In the environmental policy field, trade associations and governmental agencies (surprisingly enough) have played an important role in sponsoring clubs for the for-profit sector. Given the lack of a regulatory actor with exclusive jurisdiction for its field and an interest in policy innovation (such as the US Environmental Protection Agency [EPA] for the environmental field), we do not expect to observe large numbers of government-sponsored nonprofit voluntary programs. In contrast, given the impact of public scandals on nonprofit reputation and fundraising, nonprofit industry associations with a clear stake in maintaining the reputation of the industry are likely to emerge as program sponsors. We expect that most nonprofit clubs will be sponsored by nonprofit associations, especially the ones in which a few big or prominent nonprofits have an important role; we expect emergence to be more likely where such entities already exist.

Emergence might also differ by nonprofit type. There is substantial heterogeneity even among charity-driven nonprofits, leading to different intensities of accountability problems. Nonprofits can be differentiated in a stylized way as one of four types: institutionally funded (e.g. foundations, corporations, governments), membership-based (e.g. faith-based organizations), contract-based (e.g. USAID contractors), and fee-based (e.g. some hospitals and educational institutions). Are all of these nonprofit types equally susceptible to agency problems? We focus on two issues: multiple principals and monitoring impeded by collective action. Multiple principles may hold divergent preferences regarding how nonprofits ought to be functioning. Nonprofits might get conflicting directions, and in some cases, strategic agents may be able to play off one principal against another. Alternatively, even if the preferences of the multiple principals do not diverge, principals may want to free ride on the monitoring efforts of others, given that monitoring is expensive. Thus collective action problems afflicting multiple principals with similar preferences might create opportunities for agency slippages. Future research could explore how agency problems might differ across the nonprofit types identified above. Consider the potential for agency problems in membership-based organizations in relation to contract-based nonprofits. While the former have multiple principals with similar preferences, these principals might face collective action issues in the organization and supply of monitoring. The latter might have fewer principals but with divergent preferences. So there is a tradeoff between preference homogeneity with collective action problems on the one hand, and preference heterogeneity and conflicting demands on nonprofits on the other hand.

One could argue that among all nonprofit types, agency issues should be least salient in fee-based nonprofits, as they rely on customers (as opposed to patrons and authorizers) as key sources of funding. Such nonprofits might also function in contested markets alongside for-profit or governmental nonprofits (e.g. health care or K-12 education). This is because much of the information problems that voluntary regulatory systems seek to solve arise because the funders, patrons, and authorizers cannot (or do not) monitor whether the nonprofit is functioning as they desire. When customers provide much of the revenue, they can vote with their feet. Thus, principals can get clear feedback if the nonprofit is providing products appropriate for the target audience.

We further suggest that agency problems might be accentuated in organizations that provide subsidized or free services to (sometimes distant) beneficiaries on behalf of donors or governments. Unlike fee-based nonprofits, where consumers can vote with their dollars and often with their voice, when goods and services are subsidized or provided for free and no alternatives for provision exist, consumers are beneficiaries of the largesse of nonprofits. They therefore do not have the authority to exercise voice and can seldom exercise exit.

Future research should focus on the issue of club sponsorship. Who sponsors nonprofit clubs, why, and with what consequences for the reputation of the club? In market settings featuring asymmetric information, entrepreneurs are likely to enter the market in order to sell information about suppliers to willing buyers. The profit motive provides the incentive for intermediaries to bear the costs of information gathering and dissemination. Among nonprofits, however, most voluntary clubs are developed by entities that are themselves nonprofit (Ortmann & Svítková 2007; Gugerty 2009). What motivates these sponsors, and what benefits do they reap from club sponsorship?

Given the impact of public scandals on nonprofit reputation and fundraising, voluntary clubs are likely to be initiated by nonprofit industry associations with a clear stake in maintaining the reputation of the industry.[9] Clubs could also emerge in response to external threats to the sector, such as the threat of increased government regulation; in this case we might expect that nonprofit associations would be likely sponsors as they seek to protect their members from regulatory demands. In the examples we note above, both the Council on Foundations and the Kenyan NGO Council standards are association-sponsored standards that emerged, in part, in response to regulatory threats. Similarly, in the United States the Independent Sector has developed a weak club in which nonprofits can sign on to a code of ethics developed by the association. Signatories are posted to the Independent Sector's website. The association's accountability initiatives over the past five years have been in large part a response to initiatives by Congress to increase the regulation of the nonprofit sector (Independent Sector 2007).

The literature on self-regulation and voluntary clubs among firms suggests that programs sponsored by industry associations might be perceived as weaker than those sponsored by independent agencies (Darnall *et al.* 2009). This may be due to the tension that exists in these associations between membership recruitment and club sponsorship. When club sponsors are membership associations, sponsors may find it difficult to restrict club entry, diluting the signaling capabilities of the club. Self-regulatory collective clubs may also have weaker incentives to expose fraud or noncompliance because there is ambiguity in how stakeholders will interpret such exposure (Nunez 2007). If exposure of wrong-doing is seen as a sign of vigilance, principals may reward members for participation, but if it is seen instead as a sign of widespread fraud among all participants, exposure may have negative consequences for members. Self-regulating organizations may therefore choose a much more lax enforcement regime than principals would prefer (DeMarzo *et al.* 2005). Thus the overall expectation is that self-regulatory clubs will be weaker than those sponsored by independent agencies. The demand for independent sponsorship might arise when principals, particularly donors or government, desire signals with stronger separating properties that favor third-party systems, as the reputation and survival of those intermediaries depends on the production of quality information (Ortmann & Svítková 2007). Thus the Pakistan Council on Philanthropy third-party certification program emerged in part from the desire of large donors (especially among the Pakistani diaspora) to be able to vet and support legitimate organizations (Sidel 2003).

When more than one principal makes accountability demands on a nonprofit, competing demands may lead to a broadening or watering down of standards to meet the needs of these multiple principals if their accountability demands do not align. In nonprofit sectors in which organizations are particularly reliant on individual donors and the perceptions of the public for fundraising, club sponsors will be particularly concerned with finding clear and accessible signals of quality that are easily understood by the public at large. This may come in the form of a "seal of approval" or other symbolic gesture. Thus the CBF certification in the Netherlands focuses extensively on standards regarding fundraising. CBF and accredited nonprofits publicize the seal because fundraising from individuals is an important source of revenue in the Netherlands (Bekkers 2003). Alternatively, multiple clubs may emerge in the same policy domain to meet the needs of different principals, and clubs may even compete for members. In such cases it is unclear whether clubs will partition or segment the market amongst themselves, or whether nonprofits might join multiple clubs to serve the needs of multiple principals – and with what effect on club effectiveness.

Finally, as we noted earlier, voluntary regulation programs emerge in the shadow of the state, often in response to changes in existing nonprofit regulatory arrangements. An important question for future research is how national styles of regulation affect the emergence of voluntary programs and shape the ultimate form they take. In the UK, which has favored a negotiated "compact" agreement between the government and the nonprofit sector, voluntary programs have not emerged. In contrast, there is a surprising number of voluntary regulation initiatives in Africa. These initiatives appear to emerge in part because of the relatively distrustful historical relationship between nonprofits and governments on the continent that often results in heavy-handed regulation (Gugerty 2008).

As our discussion suggests, the topic of nonprofit accountability is in a nascent stage and many interesting questions need to be examined. We have offered one perspective to explore this vast issue. Given that nonprofit clubs are of variable quality and barriers to institutional entry in this field are quite low, both policymakers and scholars require an analytical framework to ex ante differentiate the credible clubs from the "charity washes." We suggest that a focus on the institutional architecture of voluntary programs can help in verifying claims about the efficacy of the club in reducing agency problems. We hope our article will generate dialogue and criticism, and move the broader accountability research program forward.

Notes

1 See http://allafrica.com/stories/200906040002.html; see also http://www.afrika.no/noop/page.php?p=Detailed/18383&print=1.

2 In this article we use the terms "accountability" and "governance" interchangeably. On accountability, see Grant and Keohane (2005) and the 2002 special issue (issue 3[1]) of the *Chicago Journal of International Law*.

3 For a lack of systematic longitudinal data on trust in nonprofits, we assume that nonprofit voluntary programs have emerged in response to trust deficits. While they also embody the desire of strategic nonprofits to differentiate themselves from the bad nonprofits, this strategic behavior is predicated on information problems at the donors' end. In the for-profit sector, there is some evidence to suggest that voluntary programs, especially the ones sponsored by industry associations, have emerged in response to growing public concerns regarding the industry; as in the emergence of the Responsible Care program in the chemical industry in the

wake of Union Carbide's 1984 Bhopal disaster (Rees 1997; Prakash 2000). We also recognize that while public concerns may motivate the emergence of a specific institutional form, this institution may persist even after the problem is no longer salient.

4 Institutionalist scholars have conceptualized voluntary regulation as communitarian regulation with a focus on group behavior instead of on the individual. As an instrument of social control, in the for-profit sector, such communitarian regulation tends to emerge at the level of industry (Gunningham & Rees 1997), a phenomenon that holds for the nonprofit sector as well.

5 Consumers of goods and services with experience characteristics face high costs of quality detection prior to consumption. Quality is ascertained only after purchase and consumption. Consumers of credence goods face both high pre- and post-consumption costs of ascertaining product or service quality. Even after consumption, consumers of credence goods are not sure of the quality of product purchased and consumed. Thus is the case when donors "purchase" international charitable activities such as "community development:" even after services are provided, determining the quality of community development provided by a nonprofit is not straightforward.

6 In Hansmann's (2003) view, this signal of trustworthiness is particularly important for "donative" nonprofits that derive a significant portion of their revenue from donations. He argues that in sectors now characterized by a mix of for-profit and nonprofit agencies, such as health care, the continued existence of many nonprofits may be the result of institutional "lag." Even organizations that might prefer to operate as for-profits adopt nonprofit status because governments tend to regulate nonprofits less.

7 Hansmann's formulation has another problem: he implicitly assumed that managers and shareholders have identical preferences (or, shareholders can monitor managers at low transaction costs). In reality, preference divergence is a major problem facing for-profit actors as well. It is fair to say that agency conflicts are present with or without the nondistributional constraint.

8 Voluntary clubs arguably also produce positive externalities for society that flow from the effective use of funds provided by the principals. These externalities might include building social capital, providing citizens with civic experience (Putnam *et al.* 1993), and providing goods and services that are underprovided by markets and government (Weisbrod 1988). However, these social externalities, by their very nature, are not captured by participating nonprofits and therefore cannot serve to draw nonprofits to clubs.

9 See Rees' (1997) work on the development of communitarian regulation in the for-profit sector.

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