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# Managerial nonpecuniary preferences in the market failure theories of nonprofit organisation

Managerial  
nonpecuniary  
preferences

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## Abstract

**Purpose** – Managerial nonpecuniary preferences have been emphasised by the behavioural theories of nonprofit organisation but only weakly related to this organisation's market failure theories. The present paper aims to fill this gap by examining the ways in which the market failure-addressing capacity of nonprofit firms requires recourse to managerial nonpecuniary preferences.

**Design/methodology/approach** – The paper proceeds by examining the ways in which the market failure theories of nonprofit organisation conceptualise this organisation's market failure-addressing mechanism.

**Findings** – It is shown that the market failure theories of nonprofit organisation can be logically complete only if they include an explanation of managerial motivation consisting in the gratification of nonpecuniary preferences.

**Practical/implications** – Nonprofit firms are thereby shown to address market failures in a way different from that of for-profit firms. Specifically, whereas for-profit firms address market failures based on their advantages over market organisation in processing information and aligning incentives, nonprofit firms make the production of goods and services that are undersupplied due to market failures the object of nonprofit managers' nonpecuniary preferences.

**Originality/value** – The economic theory of nonprofit organisation has been traditionally marked by a dichotomy of the market failure theories and behavioural theories, only the latter of which recognised the role of managerial nonpecuniary preferences. By demonstrating that these preferences are crucial to the former theories as well, this paper integrates these two theorising strands and thus deepens the theoretical understanding of the nonprofit sector.

**Keywords** Market system, Strategic alignment, Non-profit organizations

**Paper type** Conceptual paper

## Introduction

More than two decades ago, Hansmann (1987) introduced a distinction between the two types of economic theories of nonprofit organisation. One type is designated as the market failure theories and accordingly explains nonprofit organisation as an institutional device for addressing market failures. The other type is designated as the behavioural theories and is concerned with examining the regularities of economic behaviour of nonprofit firms, placing particular emphasis on the motivation of nonprofit managers and entrepreneurs. As Hansmann (1987, p. 37) himself recognised, these two theorising strands have been disconnected from each other, in the sense that the behaviour of nonprofit firms and the incentives of nonprofit managers have not been seen as importantly determined by these firms' economic role consisting in addressing market failures.



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Since Hansmann made this observation, the economics of nonprofit organisation has progressed significantly, primarily in modelling the behaviour of nonprofit firms by postulating diverse managerial objective functions, such as maximisation of output quantity and quality, maximisation of use of preferred inputs, and realisation of ideology (Steinberg, 2006; Lakdawalla and Philipson, 2006). These objective functions share the assumption that nonprofit managers are interested in things other than profit maximisation, i.e. have nonpecuniary preferences. These preferences' existence has been shown to result in the behaviour of nonprofit firms being different from that of for-profits, particularly in terms of determination of output quantity and quality (Young and Steinberg, 1995; James and Rose-Ackerman, 1986), pricing policies (Steinberg and Weisbrod, 2005; Oster, Gray, and Weinberg, 2003), and labor compensation (Leete, 2006; Ballou and Weisbrod, 2003; Ruhm and Borkoski, 2003; Preston, 1989). Moreover, several empirical studies of revealed objective functions of nonprofit firms confirmed that nonprofit managers at least to some extent strive to maximise service provision rather than their firms' budgets (Brooks, 2005; Steinberg, 1986).

However, this scholarly progress, despite its important achievements, did not entail the substantial narrowing of the gap between the market failure theories and behavioural theories of nonprofit organisation, as the postulated objective functions of nonprofit firms have thus far not borne a systematic relationship to the basic theories of the role of nonprofit organisation in a market economy, such as the theories of Weisbrod (1991), Hansmann (1980), or Ben-Ner (1986). This paper will outline this relationship by exploring the logical linkage between these two types of theories of nonprofit organisation. More specifically, the paper will aim to demonstrate that the realisation of the market failure-addressing role of nonprofit firms requires recourse to nonpecuniary preferences of nonprofit managers.

This aim becomes particularly relevant in view of the criticisms traditionally levelled against market failure explanations of nonprofit organisations. Two of these criticisms are particularly relevant. First, failure-based theories leave no room for an affirmative and independent role of nonprofit firms. In the words of Lohmann (1992, p. 197), the failure-based economic theories of the nonprofit sector tell far more about what this sector is not than they do about what it is. Managerial nonpecuniary preferences, however, do not have these negative connotations as they directly describe what organisations seek to achieve rather than are prohibited from doing (such as appropriating profit). Second, and perhaps most important, market failure is seen as an insufficient explanation for the existence of the nonprofit sector, since for-profit firms themselves "exist and expand because of failures of contractual arrangements in the marketplace" Krashinsky(1986, p. 114). The second criticism implicates the existence of difference in the ways for-profit and nonprofit firms address market failures. Moreover, the nature of this difference is suggested by the very question this paper will seek to answer: while nonprofit firms address market failure by resorting to gratification of managerial nonpecuniary preferences, the latter preferences must be somehow involved in the process by which market failure is addressed by for-profit firms. Thus, the whole question of integrating the market failure theories and behavioural theories of nonprofit organisation ultimately boils down to explaining the mechanics of the process by which nonprofit firms address market failure, and comparing it to the respective process of for-profit firms.

The nature of the market failure-addressing role of for-profit firms has been well described in the literature. Most importantly, Williamson (1971) showed that for-profit firms address market failure by substituting internal organisation for market exchange, as in some cases internal organisation is more efficient in aligning incentives of economic agents and improving information flows between them. Along similar lines, the market failure-addressing role of nonprofit firms has been supposed to be enabled by their governance instruments such as the nondistribution constraint (in Hansmann's (1980) trustworthiness theory) and the customer control (in Ben-Ner's (1986) customer control theory). Yet, neither of these theories contains explicit references to the role of nonpecuniary preferences that are so prominent in the behavioural theories of nonprofit organisation. Therefore, this paper will analyse the way in which the major theories of nonprofit organisation can be logically supplemented with the explicit account of the role of nonpecuniary preferences.

The paper will proceed as follows. The next section will recapitulate the major market failure theories of nonprofit organisation, paying special attention to the mechanisms by which nonprofit firms address different kinds of market failure. The analysis of these mechanisms will show that they implicitly require recourse to managerial nonpecuniary preferences. The following section will illuminate specific ways in which the concept of managerial nonpecuniary preferences can be integrated into the market failure theories of nonprofit organisation.

### **The market failure-addressing role of nonprofit organisation: received theory**

The failure-based theories of nonprofit organisation explain it in terms of its ability to overcome two types of market failure – those involving public goods, and information asymmetries. Accordingly, the former failure has underlain the public goods theory of nonprofit organisation developed by Weisbrod (1991), while the latter failure has inspired the elaboration of Hansmann's (1980) trustworthiness theory and Ben-Ner's (1986) customer control theory.

The public goods theory argues that governmental provision of public goods cannot be satisfactory to all voters because of diversity of their individual preferences. Some voters will find that the marginal value of the governmentally provided public goods exceeds their marginal cost as reflected in their marginal tax-prices. These voters can resort to creating nonprofit firms as extra-governmental providers of public goods. According to the trustworthiness theory, the nondistribution constraint creates a disincentive for nonprofit firms to exploit their customers or patrons and thus makes them appear "trustworthy". Finally, the customer control theory believes that nonprofit firms can prevent this exploitation by assigning their customers or patrons a more intensive role in these firms' governance (Young, 2001; Morley, 2006). The following subsections build upon the above theories in order to examine the advantages of nonprofit firms permitting them to address the information asymmetry-based and the public goods-based market failures.

#### *The information asymmetry-based market failure*

The case of information asymmetry-based failure is relatively straightforward. The nonprofit organisational form reduces firm managers' opportunistic behaviour by adhering to the nondistribution constraint, whose role lies in dampening the managers'

incentives to exploit the limited ability of consumers to evaluate the quality of products and services produced by nonprofit firms. The nondistribution constraint aligns the incentives of consumers and producers in such a way that incentives for opportunism are weakened. Clearly, the relevant advantage of nonprofit firms in this case is incentive alignment, which is the same as the advantage of for-profit firms in situations involving information asymmetry. Indeed, weakening the nonprofit managers' incentives to take opportunistic advantage of consumers through the nondistribution constraint is conceptually similar to weakening the for-profit managers' incentives to behave opportunistically to each other by means of vertical integration. The basic similarity between nonprofit and for-profit firms is the objective pursued by these firms in aligning incentives – namely, weakening economic agents' incentives for opportunism. The customer control theory Ben-Ner(1986) follows essentially the same incentive alignment logic, as the enhanced customer control changes the incentives of firm managers in such a way as to engage in less opportunistic behaviour toward the customers.

However, nonprofit firms realising the incentive alignment advantage by adhering to the nondistribution constraint necessarily raises the question of entrepreneurial motivation. Indeed, as Hansmann (1987, p. 62) recognises, “one would expect that when the profit motive is eliminated a price is paid in terms of incentives”, e.g. incentives for rapid response to the change of the consumer demand or incentives for the efficient use of production inputs. Yet the problem of incentives is even more fundamental for nonprofit organisation than Hansmann appears to assume. Specifically, the prospect of receiving profit represents a source of motivation for an entrepreneur to undertake a particular activity. This motivation is lost if profit can no longer be appropriated and the nondistribution constraint is perfectly enforced. Moreover, Malani and Posner (2007) have shown that eliminating the profit incentive to shirk on quality does not eliminate other incentives to do so, because the nonprofit organisational form, by itself, simply replaces one non-verifiable condition (quality of the product or service) with another (altruistic motivation of the entrepreneur).

These criticisms of the trustworthiness theory suggest that the ability of nonprofit firms to utilise the nondistribution constraint as an incentive alignment device depends on the presence of an entrepreneurial nonpecuniary motivation that must substitute for the lost motivational role of profit appropriation. The nonpecuniary motivation explains why those stakeholders who derive zero profit from the operation of their nonprofit firms nevertheless remain willing to maintain these firms' operation and do not exercise opportunistic behaviour in forms other than cheating uninformed consumers. This insight follows directly from the fact that individual utility maximisation involves the gratification of preferences that may include preferences for monetary income as well as nonpecuniary preferences. By implication, if the former preferences are not gratified in a particular segment of behaviour, this behaviour must be motivated by gratifying the latter preferences. This implication, however, gives rise to the question regarding what kind of nonpecuniary preferences are operative for enabling nonprofit firms to achieve their incentive alignment advantage in addressing market failure. Evidently, this is the question that is basically unasked by both trustworthiness and consumer control theories of nonprofit organisation, although by not considering it, both of these theories remain incomplete in the sense of failing to produce a sufficient explanation of the motivation of nonprofit firms' stakeholders.

### *The public goods-based market failure*

According to Weisbrod's theory, nonprofit firms are created by individuals whose marginal valuation of the governmentally provided public goods exceeds the marginal tax-prices they pay for the governmental provision. Through nonprofit firms, these individuals expand the production of public goods until these goods' marginal prices and marginal benefits become equal. Weisbrod's theory therefore implies that nonprofit firms produce public goods for the purposes of own consumption by these firms' founders, and this implication reveals an important difference in the market failure-addressing capacity of for-profit and nonprofit firms. Specifically, for-profit firms produce their outputs not because these outputs are desired by their owners as such, but rather because these outputs allow the generation of profit for the owners. By contrast, in the framework of Weisbrod's theory, the founders of nonprofit firms desire these firms' outputs because they consume these outputs, while the owners of for-profit firms do not consume their firms' outputs in any comparable sense. It is precisely because nonprofit firms can produce outputs that are directly desired by their founders that these firms acquire the capacity to compensate the failures of both governments and for-profit firms. The ability of nonprofit firms to produce outputs directly desired by their founders thereby becomes consistent with the notion that the operation of nonprofit firms, to the extent that it is not motivated by monetary gains, must be motivated by the gratification of nonpecuniary preferences. Clearly, in the case of public goods-based market failure, these nonpecuniary preferences consist of utility from consuming the relevant public goods.

Thus, the ways in which nonprofit firms address public goods-based and information asymmetry-based market failures are similar in their reliance on nonpecuniary preferences whose gratification is indispensable, at least on the part of some stakeholders, for the operation of nonprofit firms. This reliance may be more readily seen for the former type of market failure, but it is no less relevant for its latter type, even though it has been relatively deemphasised in Hansmann's theory. The role of nonpecuniary preferences therefore constitutes the basic difference in the market failure-addressing capacity of nonprofit and for-profit firms, a difference that tends to be overlooked in the conception that all organisations represent, in fact, responses to market failures Krashinsky(1986, p. 114). This conception may be true, but it must account for the fact that different organisations address different kinds of market failures in different ways. Thus, the fact that the existence of for-profit firms represents a response to market failure does not necessarily reduce the explanatory value of the market failure theories of nonprofit organisation. On the other hand, however, the identification of peculiar advantages of nonprofit firms in addressing market failure calls for recognising the key difference in the market failure-addressing capacities of nonprofit and for-profit firms, specifically the difference in these firms' reliance on the nonpecuniary preferences of their stakeholders. The next sections will build upon this difference to emphasise the distinctive nature of the market-failure addressing capacity of nonprofit firms.

### **The role of nonpecuniary preferences**

This section examines specific ways in which managerial nonpecuniary preferences contribute to overcoming the market failures described above. It proceeds by outlining the general role of these preferences in the market failure-addressing process in



nonprofit firms and analysing the implications of this argument for the major market failure theories of nonprofit organisation.

*The general argument*

The preceding subsection has demonstrated that the basic models of the role of nonprofit firms, such as the theories of Weisbrod (1991), Hansmann (1980), and Ben-Ner (1986), do require recourse to the concept of nonpecuniary preferences if they are to explain how nonprofit firms address market failure. It is only natural to use these nonpecuniary preferences as the basis for assuming a particular nature of managerial utility maximisation practiced in nonprofit firms. On this basis, it must be hypothesised that those goods and services that are produced in suboptimal amounts by for-profit firms due to market failure are produced by nonprofit firms because this production gratifies the nonpecuniary preferences of nonprofit firms' management.

In fact, the effect of market failure consists of disabling the usual profit motivation to induce the production of goods and services desired by consumers. As a consequence, the production of these goods and services requires a different motivational justification, which is provided by including the process of production and/or its outcomes directly into the utility functions of those who manage the production. This inclusion can be interpreted as recourse to self-sufficiency in a situation where market exchange is prevented by market failure. Indeed, if economic actors cannot gratify some of their preferences by relying on for-profit firms, they can only do so by own engagement in an activity directly aimed at gratifying these preferences. This activity will be motivated not by monetary gain, but by its own intrinsic value. It is precisely this absence of monetary motivation that makes the preferences in question "nonpecuniary". Clearly, this way of addressing market failure is quite different from the way this task is performed by for-profit firms, which address market failure by utilising their information processing and incentive alignment advantages over market organisation (as argued by Williamson (1971)). In a sense, for-profit firms address market failure by facilitating market exchange, while nonprofit firms do so by replacing exchange with self-sufficiency in view of the severity of the market failures involved.

Now, the logical gap between the economic theories of the role of nonprofit firms and the theories of their behaviour can be filled by analysing the way the former theories implicitly invoke gratification of managerial nonpecuniary preferences. This can be done by applying the proposed understanding of the market failure-addressing capacity of nonprofit firms to different economic theories of the role of nonprofit organisation in a market economy.

*Application to major economic theories of nonprofit organisation*

It is probable that Weisbrod's (1991) theory, which envisages nonprofit firms as extra-governmental providers of public goods, allows for the most straightforward application. Indeed, since nonprofit firms are created by individuals seeking to produce public goods for their own consumption, organising and managing these firms enables these individuals to gratify their consumption preferences for the public goods in question. Similar reasoning can also be applied to Ben-Ner's consumer control theory of nonprofit organisation. According to this theory, consumers (or donors) assume an important role in the governance of nonprofit firms in order to eliminate information

asymmetries that prevent the production of high quality products or specific products particularly desired by consumers. Thus, by participating in the governance of nonprofit firms, consumers get the chance to gratify their consumption preferences for these products which would not be produced otherwise. Hence, the relevant managerial nonpecuniary preferences in this case are the preferences for consuming the above products.

The case of Hansmann's trustworthiness theory is more controversial. As the preceding subsection made clear, this theory needs to be supplemented with an explanation of why the nondistribution constraint does not destroy the motivation to undertake any entrepreneurial activities at all, and that this explanation must have something to do with gratifying nonpecuniary preferences. Yet, in contrast to the theories of Weisbrod and Ben-Ner, Hansmann's theory does not require those managing the production to be interested in directly consuming the production outputs. Thereby this theory evidently locates the relevant nonpecuniary preferences in enjoying the process, rather than the outputs, of production. Economists have devised a number of conceptualisations of such nonpecuniary preferences, including utility from practicing commitment, sympathy, reciprocity, or receiving private benefits such as prestige and pride (Rose-Ackerman, 1996, p. 714). These explanations can be generalised to represent a set of requirements as to the nature of utility functions of those managing the production in nonprofit firms. Consequently, the applicability of Hansmann's theory must be limited only to those cases when these requirements are sufficiently observed, i.e. when utility functions of relevant stakeholders of nonprofit firms contain the abovementioned nonpecuniary preferences.

There are, however, no grounds to suppose that these nonpecuniary preferences must emerge in every case that there occurs an information asymmetry-based market failure. This means that information asymmetries in evaluating product quality must not always lead to the emergence of nonprofit firms. This point is clearly made by James and Rose-Ackerman (1986), who observe that information asymmetries are substantial, for example, in the used car market, yet nonprofit firms do not arise to correct that market failure.

According to James (1987), an important general class of nonpecuniary preferences that motivates the creation of nonprofit firms in many countries of the world consists of realising particular ideologies, that represents a variety of commitment in the abovementioned classification of Rose-Ackerman (1996, p. 714). In her criticism of Hansmann's theory, James emphasises the importance of ideological entrepreneurship to the exclusion of any implications of higher trustworthiness of nonprofit firms due to the nondistribution constraint. A more balanced approach, though, would be to admit that, in a general case, information asymmetries and ideological preferences exist independently of each other. In those cases when the occurrence of information asymmetries is accompanied by the existence of the relevant nonpecuniary preferences, nonprofit firms can really be created by ideological entrepreneurs in order to economise on the cost of monitoring the poorly-observable quality of goods and services. This can be particularly true in nonprofit firms that seek to promote various kinds of public benefit, relating, e.g. to health care, social development, education, research, or culture, for the reason that ideological preferences often take the form of specific subjective conceptualisations of the nature of public benefit. By contrast, in those cases when information asymmetries occur in transactions



involving a weaker appeal to ideologies and other kinds of relevant nonpecuniary preferences, nonprofit firms do not arise because entrepreneurial motivation is not secured, that can be observed, e.g. in the used car market.

In still other cases, significant information asymmetries may not occur, but the relevant nonpecuniary preferences, such as ideologies, nevertheless exist. It is this set of cases that forms the empirical base of James' ideological entrepreneurship theory of nonprofit organisation[1]. According to this theory, the nonprofit firm is chosen because the main objective of particular activities is not compatible with profit-maximising behaviour, as is the case with, e.g. maximising religious faith or religious adherents (Ballou, 2005). In these cases, the trustworthiness function of the nondistribution constraint is indeed irrelevant as a rationale for the choice of the nonprofit organisational form.

Importantly, the ideological entrepreneurship theory of nonprofit organisation does not represent a market failure theory, because there are no grounds for associating the existence of ideological, and more generally, nonpecuniary preferences with the occurrence of market failures. Yet this theory explains nonprofit organisation in terms of nonpecuniary preferences, which have been shown in the preceding discussion to represent important, albeit underemphasised, categories of market failure theories as well. Thus, a comparison of these two types of theoretical rationalisation of nonprofit organisation reveals the twofold role that nonpecuniary preferences play in its operation. On the one hand, according to the market failure theories, nonpecuniary preferences constitute a means whereby nonprofit organisation addresses market failure. Specifically, market failure can be partially corrected if the production of goods and services which are produced in suboptimal amounts by for-profit firms as a result of market failure becomes the object of direct nonpecuniary preferences of some stakeholders. On the other hand, according to the ideological entrepreneurship theory, nonpecuniary preferences may constitute an end in itself rather than a means of addressing market failures. As an end in itself, nonpecuniary preferences do not need the occurrence of market failure in order to be gratified through nonprofit organisation.

Given this subtle dialectic of the means-ends relationship in the economic role of nonpecuniary preferences in the operation of nonprofit firms, it is not surprising that market failure theories of nonprofit organisation have been accused of providing an overly negative view of it. For while market failure theorists have been correct in pointing out that nonprofit organisation can address market failure, they have underemphasised the crucial role of nonpecuniary preferences in securing the sufficient motivation to exercise entrepreneurial activities under the nondistribution constraint. This shortcoming has stood in the way of an appreciation of the inherent complementarity of the means and the ends dimensions of nonpecuniary preferences, and has thereby prevented an understanding that these preferences play both independent and instrumental roles in the operation of nonprofit firms.

### Conclusions

In a review paper on the development of the economic theory of nonprofit organisation, Susan Rose-Ackerman (1996, p. 701) has noted that "altruism and nonprofit entrepreneurship cannot be understood within the standard economic framework. Theoretical progress requires a richer conception of individual utility functions and a base in cognitive psychology that incorporates the power of ideas and emotions in motivating behaviour". Arguably, it is the insufficiency of the "standard economic

framework” in explaining nonprofit organisation that has caused a major division in the theoretical rationalisation of the nonprofit sector’s existence. On the one hand, there have been continuing attempts to accommodate nonprofit organisation into the standard framework (in the form of various market failure theories); on the other hand, a certain sense of frustration with these attempts has motivated recourse to the less standard concepts of altruism and ideological entrepreneurship. Yet, as the current paper has demonstrated, this division is more specious than it is genuine. The “standard” and “non-standard” economic approaches explaining nonprofit organisation do have a common basis, which consists of recognising the key role of nonpecuniary preferences in motivating the behaviour of nonprofit firms’ stakeholders. While, the standard market failure theories of nonprofit organisation have been developed primarily without resorting to the concept of nonpecuniary preferences, this concept becomes indispensable for explaining the “mechanics” of the process whereby nonprofit firms address market failure.

Indeed, whereas the advantages of for-profit firms that permit them to address market failure consist of their ability to reduce the cost of processing and communicating information, as well as to discourage opportunistic behaviour, these advantages are significantly less relevant for nonprofit firms. By contrast, an examination of the major market failure theories of nonprofit organisation has revealed that nonprofit firms address market failure by making the process and/or the outputs of particular production activities an object of direct preference of those who manage this production. Two things are noteworthy regarding this finding. First, nonprofit firms address market failure in a manner that is significantly different from that which is characteristic of for-profit firms; this implies that a market failure approach to explaining nonprofit organisation does not ignore the institutional identity of nonprofit firms, as compared with for-profit firms that also address market failure, but rather address it differently. Second, while gratifying nonpecuniary preferences represents an instrument for addressing market failure, market failures and nonpecuniary preferences exist basically independent of each other. This implies that overcoming some market failures does not require gratifying nonpecuniary preferences, that is the case with market failures addressed by for-profit firms. Moreover, some nonpecuniary preferences do not require the occurrence of market failure in order to come into existence. It is these nonpecuniary preferences that remain unexplained in the market failure theories and are summarised under the rubrics of ideologies, social values, mission-drivenness, and other concepts that underlie the positive self-understanding of the nonprofit sector. The market failure theories become thereby consistent with the fact that nonprofit firms can exist for reasons other than market failure.

At the same time, emphasising the importance of nonpecuniary preferences does not require denying the ability of the nondistribution constraint to reduce the opportunism of nonprofit firms’ stakeholders as suggested by Hansmann’s trustworthiness theory. Once the role of nonpecuniary preferences in motivating the behaviour of at least some of these stakeholders is recognised, one may legitimately ask whether nonprofit firms have any characteristics comparable to the information processing and incentive alignment advantages of for-profit firms. In the incentive alignment respect, nonprofit firms may indeed succeed in precluding some undesirable behaviours through the nondistribution constraint, as noted by Ben-Ner and Gui (2003, p. 7). This effect, however, appears to be applicable primarily to extrinsically motivated behaviour, while the importance of

nonpecuniary preferences indicates an increased relevance of intrinsic motivation in nonprofit firms. The incentive alignment issue in nonprofit firms thereby concerns not only weakening undesirable extrinsic motivation, but also maintaining and strengthening the desirable intrinsic motivation – an issue that has thus far attracted relatively little research. In the information processing respect, nonprofit firms evidently play a role in reducing the information cost associated with gratifying specific nonpecuniary preferences, particularly through informing the general public about opportunities to gratify particular preferences through involvement in particular nonprofit firms. In a sense, this role is comparable to the role of for-profit firms in economising on transaction cost in its Coase (1937) understanding. Yet this version of transaction cost-economising has not yet gained much currency in the theoretical economic investigations of the nonprofit sector. An appreciation of the information processing and incentive alignment role of nonprofit organisation, however, is crucial for understanding the institutional context within which nonprofit firms provide the gratification of nonpecuniary preferences. More research along the suggested lines is therefore necessary.

#### Note

1. In relying on this set of cases to bring to light the irrelevance of the trustworthiness theory, James apparently assumes away the above-mentioned possibility of the coexistence of information asymmetries and ideological preferences. She does not, however, make efforts to justify this implicit assumption.

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