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Managerial rewards and the behavior of for-profit, governmental, and nonprofit organizations: evidence from the hospital industry

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Abstract

Studies of mixed industries frequently focus on differential behavior between for-profit and either nonprofit or governmental producers. Substantially less is known about differences among governmental, religious nonprofit, and secular nonprofit organizations. We examine the compensation of hospital CEOs to assess the extent to which these three organizational forms pursue similar objectives. Compensation levels, the use of salaries versus bonuses as proxies for weak versus strong incentives, and the criteria organizations use to determine bonuses are analyzed. We conclude that the CEO incentive contracts at religious nonprofit, secular nonprofit, and governmental hospitals imply substantive differences in the behavior of these organizations.

Keywords: Nonprofit; Comparative institutional form; Organization behavior; Incentives

JEL classification: L2; L3

1. Introduction

The role of different forms of institutions has been fundamental to economics since at least the days of Adam Smith. The choice between relying on private

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markets and on government continues to concern both economics and public policy debates. The debate has increasingly been expanded to encompass the option of relying on a third form of institution, private nonprofit organizations. In recent decades, as the nonprofit sector's share of gross domestic product has increased while the public sector share declined (US Census Bureau, 1999), it has become increasingly important to understand both the forces that affect the choice among organizational forms and the efficiency consequences of these choices.

Research on mixed industries—examples of which include hospitals, nursing homes, colleges, day care centers, and museums—has focused heavily on the distinction between for-profit firms and organizations that are subject to a 'nondistribution constraint,' which prohibits organizations from distributing profits to their managers, trustees, or owners. It is important to note that such a constraint does *not* prohibit organizations from actually earning positive profits. Two common ownership types—religious private nonprofit and secular private nonprofit—are both legally bound by an explicitly stated nondistribution constraint. Governmental organizations, while not legally subject to the same nondistribution constraint as are private nonprofits, are subject to political and legal constraints that also effectively constrain governmental organizations from distributing their profits. Thus, the religious nonprofit, secular nonprofit, and governmental institutional forms are all constrained with respect to the distribution of their profits, and, as a consequence, studies that rely on nondistribution constraints to explain differences in organization behavior cannot account for any systematic differences that may exist among these forms.

While there are many industries in which one or more of the three types of these distribution-constrained organizations are present, typically along with for-profit firms, relatively little is known about whether and how these various forms of organization differ in their behavior and outputs and, hence, the degree to which they are substitutes. Such information would be useful in assessing how the presence of multiple organizational forms influences consumer welfare. Additionally, better knowledge of differences (or similarities) in behavior across religious nonprofit, secular nonprofit, and governmental organizational forms would contribute to the development of a more general model of the mixed industry that is capable of explaining the presence and distribution of multiple organizational forms.[2]

By examining the structure of executive compensation in one large mixed

[2]Our focus on four types of organization—for-profit, religious nonprofit, secular nonprofit, and governmental—is admittedly arbitrary. After all, we could have examined an even finer disaggregation that separates, for example, rural 'district hospitals' from other governmental hospitals. We have focused on these four types because (1) existing economic literature commonly distinguishes between public and private organizations and, increasingly, between for-profit and nonprofit organizations; and (2) we believe that it makes sense to begin with a fairly coarse disaggregation of organizational forms, allowing any measured differences to inform the direction that more detailed future studies should take.