Leadership and Economic Theories
of Non-profit Organizations

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Abstract: Economic theories of Nonprofit Organizations (NPOs) have modified standard economic assumptions to explain altruism and nonprofit entrepreneurship but have neglected their dependence on leadership due to the traditional reluctance of economists to consider phenomena associated with preference change. The relevance of Hermalin's (1998) model of leadership by example and Casson's (1991) theory of leadership through moral manipulation are considered within an NPO context where leaders seek to influence stakeholder commitments to the organization's quest. The propositions Elster (1998) advanced with regard to the relationship between the emotions and decision making are then applied in a theory that explains how NPO leaders can develop a culture of hope that maintains the quality control and product differentiation advantages claimed for these organizations. It is argued that policymakers should consider the dependence of NPOs on the quality of leadership when choosing the organisational mechanism for social service delivery.

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Introduction

Few could deny the contribution economists have made to multi-disciplinary research into the role and behavior of nonprofit organizations (NPOs). In a retrospective assessment of the upsurge of interest in this area of research that occurred in the 1980s after the establishment of the Program on Nonprofit Organizations at Yale University, Estelle James (1997, pp. 1-2) has observed that: "This work was heavily dominated by economists and by attention to the role of non-profits in providing services. It had a strong theoretical focus. The authors asked three major inter-related questions: under what conditions do non-profits exist; from which resources do they get their resources and why; and how do they behave differently from for-profits and governments?" The progress economists have made addressing these questions has been all the more notable when one considers that it has typically been necessary for them to "re-examine the psychological and organizational premises of their discipline" (Rose-Ackerman, 1996, p.701) in order to analyze the role and behavior of "noneconomic' institutions such as NPOs.

It should be pointed out, though, that this has presented a greater challenge for economists seeking to explain the supply rather than the demand-side of the "third sector". Demand-side theories such as Weisbrod's (1977) model of NPOs as suppliers of public goods that are undersupplied by governments to heterogenous populations and Hansmann's (1980) model that treats the "non-distribution constraint" of NPOs as a signal that they can be trusted by consumers, donors and government funders not to exploit information asymmetries typically draw from concepts of market and government failure that have been widely applied by economists in analyzing other areas of microeconomic policy. However, for those economists who have shifted their theoretical focus from the "nature of demand" to the "sources of supply" for NPOs (Weisbrod, 1977, p. 677), it would seem that "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 behavior" (Rose-Ackerman, p.701).

Economic theories of the supply-side of NPOs have mainly sought to extend the standard economic framework to understand altruism and nonprofit entrepreneurship. To explain why individuals gift their time, effort and wealth to NPOs when faced with the free-rider problems that arise because these gifts typically have only an insignificant impact on the level of services provided, some economists have resorted to models that relate the psychic benefits individuals derive from such gifts to the "warm glow" of their marginal contributions (Andreoni, 1990) or a "buying-in mentality" reflected in beliefs that "they may feel that they deserve to feel good about the charitable program only if they have made some marginal contribution to it" (Rose-Ackerman, p.713). Other economists have followed Sen (1977) in arguing that such gifts may be motivated by "commitment" rather than "sympathy" where individuals form a "second order metapreference" about what they want their preferences to reveal. Sugden (1984) has plausibly extended this concept of commitment to argue that most people believe that free-riding is morally wrong and therefore feel obliged to give at least as much as those in their reference group. According to Rose-Ackerman (1996, p.714) this model "accords with the facts of charitable giving better than competing theories because it predicts some altruistic activity, but at an inefficiently low level".

Economists have also puzzled over the problem of explaining why entrepreneurs would take on the risk and commit the resources required to found organizations that are subject to a non-distribution constraint that precludes these actors from having any residual claim to surpluses. Young (1983) has studied the screening process that filters various entrepreneurial types whom he characterizes respectively as "professionals", "believers", "searchers", "independents", "conservers", "power-seekers", "controllers", "players" and "income-seekers" into sectors of alternative structural characteristics. He found that the nonprofit sector tended to attract a relatively greater proportion of entrepreneurs who exhibited the characteristics of the first four categories. Similarly, James (1993) has found that the significance of religious and linguistic diversity in explaining the share of nonprofit schools can be attributed not only to the demand for religiously and ethically specialized schools but also to the willingness of committed individuals and religious groups to found them.

Rose-Ackerman (1996) has sought to distill the key findings of this research by positing an "ideological" motivation for nonprofit entrepreneurs, defining this type

of "ideologue" as "a person with strong beliefs about the proper way to provide a particular service" (p.719). She goes on to posit that an NPO that has been founded by such ideological entrepreneurs may have two sources of comparative institutional advantage: what she terms the "quality control advantage" and "the product differentiation advantage".

The first source of advantage may arise because the ideological founders of NPOs may be able to reduce costs without diminishing the quality of services by hiring managers and employees who share their vision. Even where these staff members are high level professionals they "may accept lower levels of pay in return for greater certainty that their efforts are actually helping to achieve their altruistic goals" (Rose-Ackerman, 1996, p.720). There may also be significant savings in the agency costs incurred in monitoring the performance of these committed workers. The organization's vision may also be attractive enough to elicit donations that supplement the payments of clients or government funders. Moreover, if the quality of the service is perceived as being related to who else consumes it, another type of quality control advantage may be achieved if the NPO comes to embody an ideology that precludes it from providing services to "undesirable" clients. It should be pointed out, though, that such cream-skimming may be regarded as a type of "voluntary failure" (Salamon, 1987) by social policymakers concerned with gaps in the coverage of services provided by NPOs.

The second product-differentiation advantage of ideological NPOs arises when customers look to ideologues whose strong views are reflected in a clear service philosophy to alleviate the dissonance they experience from their relatively poorly formed tastes. As Rose-Ackerman (1996, p.721) puts it: "Poorly informed customers or their relatives may want to rely on experts or specialists. However, they may fear exploitation . . . The commitment of the provider to Dewey, Montessori, Freud, or the Roman Catholic Church acts as a signalling device. Customers are buying reified ideology. . . The combination of ideology and nonprofit organizational form may act as a guarantee that neither could provide on its own".

A significant question does, however, seem to be arise with respect to how nonprofit entrepreneurs can sustain and, perhaps, strengthen these two sources of advantage they derive from the ideological foundations of their NPOs. In particular, how are they able to maintain the commitment and support of staff, donors and clients

in the face of the corrosive impact the inevitable accumulation of disappointments (Hirschman, 1982) is likely to have on these commitments?

The central argument of this paper is that this issue can only be addressed if economic theories of the supply-side of NPOs are augmented with an economic theory of leadership. In exploring this argument the paper naturally divides itself into four main sections. It first considers why economists have traditionally neglected the phenomenon of leadership before outlining the key features of leadership models that have been developed by economists who have been careful not to stray too far outside the boundaries of standard economic theory. The paper will then go on to apply some of the main propositions advanced in Elster's (1998) survey article on the nature of emotions and how they influence decision making to both criticize these models and analyze the role hope plays in inducing the stakeholders in a NPO to strive toward the realization of their shared goals. The ways in which an inspirational leader can strengthen the hopes and counter the disappointments of these stakeholders will then be examined before the paper concludes by considering some policy implications of the preceding analysis.

Economics and Leadership

The phenomenon of leadership has been the subject of a considerable body of literature in certain branches of the humanities and the social sciences. Traditions of inquiry into leadership have been particularly prominent in philosophy, politics, anthropology, psychology, sociology and history. Moreover, insights from all these traditions have been integrated into studies of management and organizational behavior that have been of both an academic and popular nature (a particularly comprehensive survey of these studies is provided by Bass, 1990). The link between the performance of NPOs and the quality of their leadership is well recognized in these studies (see Nanus and Dobbs, 1999) as it is the literature on non-profit management. Indeed, the dependence of NPOs on the quality of leadership has been identified as a distinguishing characteristic of these bodies. As Kramer (1987, p.244) has pointed out: " Large or small, most voluntary agencies are unusually dependent on the quality of their executive leadership, and therefore, more subject to idiosyncratic rather than structural factors."

However, despite its general significance and particular importance to the non-profit field, economists appear to have largely neglected the phenomenon of

leadership. The traditional reluctance of economists to examine leadership may have been based on the perception that, in seeking to influence followers, leaders are trying to change their preferences. The study of leadership would therefore seem to be out of bounds to the majority of economists who subscribe to the convention that economic analysis should either (i) take the preferences of individuals as given and not look inside the "black box" within which they are formed and transformed; or (ii) assume that they are stable and explain apparent preference change in terms of adjustments in the shadow prices of inputs in household production functions (Stigler and Becker, 1977).

Hermalin's Model of Leadership by Example

A recent paper by Hermalin (1998) may, however, have shown mainstream economists how they can account for leadership without breaching this convention. Hermalin shows how it is rational for individual members of a team to follow the exemplary levels of effort expended by a leader where this person has superior information about the value of effort devoted to their common activity. Leading by example is thus a mechanism by which leaders convince followers that they are not misleading them. In the absence of this signal, followers will be "predisposed to disregard (the leader's) calls to action" (Hermalin, 1998, p.1189).

Hermalin's model does, however, seem to limit followers to being influenced by the actions and not the words of their leaders. It thus neglects the influence a leader's rhetoric can have on follower's behavior. This neglect is evident in Hermalin's comment that "historical instances of leading by example include Dr. Martin Luther King, Jr. marching at the head of civil rights marches" (p. 1189). Surely King's rhetoric mattered to at least some of his followers. They would have been influenced both by his exemplary actions and the inspirational effect messages such as the famous "I have a dream" speech had on their emotions and behavior.

Casson's Model of Leadership by Moral Manipulation

An economic model that explicitly takes into account the relationship between rhetoric, emotions and behavior was formulated by Mark Casson in his book *The Economics of Business Culture* (1991). The central insight of Casson's theory seems to be that if principal-agent relationships can be transformed into leader-follower ones, then there may be significant scope for reducing agency costs that include both

the negotiating, monitoring and bonding costs involved in establishing a principal-agent agreement and the residual losses that arise from the potential agency failure which remains uncorrected by the agreement. This would seem to suggest that the "quality control advantage" that Rose-Ackerman identified for NPOs would be significantly related to the quality of their leadership.

According to Casson, leaders can reduce the agency failure associated with opportunistic behavior such as shirking or free-riding through either (i) more intensive monitoring of the individual efforts of group members or (ii) more intensive "moral manipulation". The latter involves the use of "moral rhetoric", addressed to the group as a whole. It aims to establish a group norm for moral commitment that indicates the extent to which members can expect to place their trust in one another.

Casson suggests that the utility functions of group members will include emotional components, the parameters of which are susceptible to moral manipulation by the leader. Specifically, the guilt a follower associates with failing to comply with the group norm for moral commitment will be affected by a combination of his or her innate moral sensitivity and the "intensity of manipulation" applied by the leader. It follows that even if the disutility of effort supplies a team member with an incentive to break the group norm against shirking, this person will still comply with it, if the disutility of guilt exceeds disutility of effort.

Casson proposes that there will exist a threshold intensity of manipulation, below which even the most morally sensitive follower does not experience sufficient guilt to make keeping the commitment worthwhile. He suggests, though, that once this threshold is passed, the benefits of raising the intensity of manipulation will be subject to diminishing marginal returns since its impact will be felt more and more by people who have already decided to comply with the group norm and less and less by the remainder of relatively insensitive "hard cases" for whom non-compliance is still an option.

There will be fixed and variable costs to raising the intensity of manipulation. These will depend on the charisma of the leader, the cost of media services and the level of trust in the culture in which the group is imbedded. While these costs will vary between groups it is assumed that each leader will know the marginal cost function which applies to the particular group concerned. Since the leader will also know the shape and position of the declining marginal benefit function this person will be able to set the optimal intensity of manipulation where marginal benefit equals

marginal cost. This optimum will be associated with a particular level of agency failure, the cost to the leader of which, can be added to the total costs of achieving an optimal intensity of manipulation to ascertain whether manipulation is less costly than monitoring.

Casson derives a number of interesting and testable hypotheses from his model. For example, he hypothesizes that monitoring is likely to be favored where leaders lack charisma or face high media costs or where followers are subjected to hazardous or strenuous work in warm climates. Manipulation may, however, become more appropriate where the performance of followers is difficult to measure. In intellectual work or in the "coping" activities associated with the human services provided by many NPOs where work tends to be "unobservable" (Wilson, 1989) the type of morally manipulative leadership described by Casson would seem to be an attractive option.

The central insights of the models formulated by Casson and Hermalin can be combined to account for those situations where a leader has established some moral authority by leading by example. In these situations, followers will not only focus on the leader's actions, as Hermalin suggests; they will also attend to this person's words. Their sensitivity to the leader's rhetoric will give this person some leverage to strengthen and reinforce team norms against shirking.

The NPO Context

Both models focus on the informal leader-follower relationships that can emerge at any level of any type of organization. While these relationships are clearly important within NPOs, it would seem that their performance depends most crucially on the quality of leadership exercised at the top by their presidents, CEOs or executive directors. Moreover, from the perspective of these top leaders, the key relationships they form are not the "vertical" ones they establish with "followers" but the more "horizontal" ones they establish with key stakeholders. Krashinsky (1997, p. 149) points out that the concept of "stakeholders" comes out of the literature on organizational theory where Jones (1995, p.21) defines them as those "people who have interest, claim, or stake in the organization, in what it does, and how well it performs . . . (and) are motivated to participate in an organization if they receive inducements that exceed the value of contributions they are required to make". With regard to NPOs a distinction can be made between "inside stakeholders" who would

include board and staff members and volunteers and "outside stakeholders" including donors, grantmakers, potential allies, the media and other interested players in the business and public sector.

Writers on organizational leadership typically try to distinguish leadership from "management" or "administration" in terms of the future orientation and distinctive activities undertaken by leaders. For example, with reference to NPO leadership, Nanus and Dobbs (1999, pp. 8-9) write: "Leadership should never be confused with the *management* or *administration* of a nonprofit organization. The main responsibility of a manager is to operate and maintain the organization efficiently, ensuring that it provides useful services to clients or the community at the lowest possible cost. The leader, though always cognizant of current operations, is more concerned with building the organization for the future – that is, securing new resources, developing new capacities, positioning the organization to take advantage of emerging opportunities, and adapting to change. Leading and managing are quite different functions. They require two separate mindsets and two different sets of skills. Because managers are chiefly responsible for processes and operations, they are mostly interested in what needs to be done and how it can be accomplished. In contrast the leader is concerned with strategies and direction, with where the organization should be headed and what it can and should be doing in the future. This means that the manager's attention tends to be present oriented, with one eye on costs and the other on performance. The leader cares about these thing as well, but most of his attention tends to be broader and longer term, with one eye on the challenges that lie just over the horizon and the other on the growth potential of the organization" (*original emphasis*).

These writers go on to examine what they hold to be the six distinctive tasks of non-profit leadership. These are: (a) developing a credible and compelling vision of what they want the NPO to become and securing the commitment of stakeholders to the realization of this shared vision; (b) formulating an effective strategy to provide the overall framework to govern the decisions and actions to be taken by the NPO to realize this vision; (c) acting as an advocate and spokesperson for the NPO and the cause it may be seeking to advance and enlisting external allies in the pursuit of this cause; (d) building relationships with donors and funders to leverage their resources and "maintaining a financial lifeline" (p.192) for the NPO in pursuit of its vision; (e) "empowering and inspiring individuals and helping them learn, grow and realize their

full human potential as they serve the organization's clients and the community" (p.19); and (f) ensuring that the NPO is positioned for the future - a task that "often" involves "introducing a new program or creating strategic alliances with public or private sector partners" and may "sometimes" involve "restructuring the organization or reconfiguring some aspect of service delivery" (p.19).

While other typologies could be devised, the striking feature of this one proposed by Nanus and Dobbs (1999) is that it makes it clear that no nonprofit leader can effectively perform the functions of being a "visionary", "strategist", "politician", "campaigner", "coach" and "change agent" on their own. They need to forge networks with other stakeholders to carry out the tasks that are associated with these functions. Through their interaction with the stakeholders they engage in these networks, the leaders of NPOs will seek to influence the uncompensated, discretionary contributions these actors can be trusted to make. We shall use the term "stakeholder commitments" (SCs) to refer to these contributions. They not only encompass donations and grants but the foregone income or discretionary effort that staff members can be relied upon to commit to the NPO's activities.

We would propose that to accomplish the distinctive tasks of leadership, non-profit leaders need to draw stakeholders into networks within which they can influence their commitment to advance the NPO's "quest". At the very least a stakeholder's commitment to advance such a quest must reflect a willingness to apply a common and coherent strategy in pursuit of the realization of a shared vision. NPO leaders can thus shape the commitments of both insider and outsider stakeholders as they perform the visionary and strategic roles referred to above. In performing their coaching and change agent roles they will, however, mainly try to influence the SCs of insiders as they interact with the board, staff and volunteers to inspire, encourage, enthuse and empower them. On the other hand, to be effective campaigners and advocates, leaders will need to elicit and engage reliable (and increasing) levels of support from an expanding network of outside stakeholders. In performing all these functions, leaders will be essentially seeking to interact with stakeholders to influence the emotions that underlie the commitments they make to advancing the NPO's quest. The perspective from which we will attempt to explain how leaders can influence these emotions will be derived from an approach developed by Jon Elster (1998).

An Elsterian Framework for Analyzing the Effect of the Emotions on Behavior

In a general survey of "emotions and economic theory" Elster (1998) points out that emotions can function as "tiebreakers", enabling agents to make decisions where rational choice theory is indeterminate. He refers to Damasio's (1994) research in neurobiology which finds that patients who have experienced damage to their frontal lobes lose their capacity to make decisions. This is because they cannot perform the basic agenda-setting function of screening issues according to their urgency and significance, since it is the emotions that enable "normal" people to spontaneously react to, and focus their attention on, issues that are urgent and significant.

An Elsterian Critique of Casson's Theory

This perspective on the way the emotions shape decisions leads Elster to reject the notion that emotions can be incorporated as psychic costs and benefits in individual utility functions (along the lines proposed by Casson) in favor of an approach which he sums up as follows:" The role of emotions cannot be reduced to that of shaping the reward parameters for rational choice. It seems very likely that they also affect the ability to make rational choices within those parameters. This dual role of the emotions - shaping choices as well as rewards - has analogues in pain, addictive cravings, and other visceral factors. As in these other cases, the claim is not that the emotions fully determine choice, or that there is no tradeoff between emotional rewards and other rewards. Rather, it is that the tradeoff itself is modified by one of the rewards that is being traded off against the others" (p.73).

From Elster's perspective, Casson's theory of leadership would be flawed since the intention by leaders to induce shame and guilt through manipulative rhetoric is incoherent. He generalizes this concept in the following way: "By an incoherent intention I mean the intention to induce emotion X by behavior that would induce X if it was spontaneous but that induces emotion Y if believed to be motivated by the intention to induce X" (p.58). Thus, for example, if the stakeholders of an NPO come to believe that the leader is trying to manipulate their emotions of shame and guilt, they may become angry and experience a build-up of resentment toward this person that would undermine their willingness to look to him or her for leadership. Moreover, as Elster points out, "although a person with an incoherent intention may try to get around this problem by hiding his motivation, this requires an effort that

should itself be counted as a cost and may in a given case be hard to achieve successfully" (1998, p.58).

If, however, the type of inspirational leadership described by Nanus and Dobbs (1999) is conceived as involving the influence, by leaders, of the emotions of hope possessed by the members of stakeholder networks, then these problems of incoherence will not arise. Stakeholders are unlikely to be angry with a leader when they realize that the rhetoric used by this person is directed toward strengthening the hopes they share with this actor. Moreover, to the extent that the inspirational leaders of NPOs succeed in doing this they will enable their stakeholders to counter the disappointments they experience during the course of their engagement in the networks mobilized by the leader. To account for the inspirational dimension of NPO leadership, it may be helpful, then, to draw from the general conceptual framework formulated by Elster to analyze the nature of hope.

The Nature of Hope

Along with "purpose, . . . inspiration, influence, marshaling resources, and effecting change" hope is one of the "common themes" that Nanus and Dobbs (1999, p.6) find in their survey of definitions that they consider to relevant to studies of NPO leadership. The most succinct formulation of the link between hope and leadership is found in the statement, that these writers attribute to Napoleon Bonaparte, that: "A leader is a dealer in hope".

In terms of Elster's (1998) framework, hope would seem to unambiguously qualify as an emotion. He brackets it, along with fear, as an emotion that is "generated by the thought of what may happen" (p.48). To hope is to "savor in advance" (Hirschman, 1985) the realization of some worthwhile future state. In this regard hope can be distinguished from (i) various social emotions like "anger, hatred, guilt, shame, pride, pridefulness, admiration, and liking"; (ii) the "counterfactual emotions" of "regret, rejoicing, disappointment, (and) elation"; (iii) emotions generated by "things that have happened" such as joy and grief; (iv) "emotions triggered by the thought of the possessions of others" like envy, malice, indignation and jealousy; (v) emotions that "do not fall neatly into any category" such as contempt, disgust and romantic love; and (vi) "borderline or controversial cases" which "include surprise, boredom, interest, sexual desire, enjoyment, worry and frustration" (p.48).

Along with these other emotions, hope can be distinguished from non-emotional mental states by six features "cognitive antecedents, intentional objects, physiological arousal, physiological expressions, valence, and action tendencies" (Elster, 1998, p.49). This scheme may be reduced to the proposition that hope is a particular type of action tendency engendered by antecedent beliefs and the investment of emotional energy. This is consistent with the treatment of emotions in psychology since, as Elster (1998) has pointed out: "By and large, psychological studies of the emotions have not focussed on how emotions generate behavior. Instead, they have tried to identify the proximate or ultimate causes of the emotions. To the extent that psychologists are concerned with behavior, it is usually with *action tendencies* rather than with observable actions" (p.47).

The action tendency produced by hope is a readiness to keep striving to advance a particular quest or strengthen a particular relationship in the face of the discomfort or disappointment experienced over the course of the quest or relationship. Snyder (1994) defined hope as "the sum of the willpower and waypower that you have for your goals" (p.5). He proposes that, in the course of striving to achieve the goals they place their hopes in, people need to exercise (i) "willpower" as they draw on their reserves of emotional energy or "determination and commitment", and (ii) "waypower" as they generate one or more effective paths to their realization. They will particularly need to exercise willpower and waypower in the face of opposition or resistance or when the path they are pursuing toward a goal comes to be blocked. From this perspective, hope primarily generates an action tendency toward perseverance.

The action tendencies of hope will be triggered by two core beliefs. The first is the belief that the advancement of a quest or the maintenance and strengthening of a relationship is "neither impossible nor inevitable" (Sutherland, 1989, p.195). This belief does not have to be based on probabilistic calculation. A commitment to a particular quest or relationship is often made under conditions of "bounded uncertainty" such that its consequences cannot be probabilistically calculated - they can only be imagined (Shackle, 1973, p.62). In the case of an NPO, it would seem to be sufficient that its stakeholders believe that they can generate the "waypower" (Snyder, 1994) to move the organization in a specific direction. According to Nanus and Dobbs (1999, p.6) "moving an organization means energizing it, removing

obstacles to progress, making the changes necessary to improve performance, and enabling it to learn and grow."

The second belief is that the advancement of a quest or "reproduction" of a relationship is "worthwhile" or "important" in the sense that it is "worthy of pursuit in a special way incommensurable with other goals we might have" (Taylor, 1985, p.135). The process of placing our hope in certain goals seems to involve an investment or commitment of self to the realization of these goals. Or, to use Hirschman's (1982) terminology, it requires us to form a second order metapreference that committing ourselves to realize these goals expresses the "kind of life I want to live" or the "kind of person I want to become".

In the case of NPOs, Nanus and Dobbs (1999) argue that for stakeholders to hold this belief, they must believe that the organization is moving in "the right direction toward the greater good" (p.6) in the sense that it is advancing "a few steps up to a new higher level of excellence, service and benefit to society". They acknowledge that this concept is easier to recognize than define, but like Hirschman (1982) link it to a process of self-actualization by suggesting that: "As we act out our various roles and participate in community life, especially in nonprofit institutions, we learn what is worth doing and what we have passion for . . . We learn who we are, what we want to do, and how we should invest our own lives to make a difference" (p.39). It would seem that the reification of this type of belief in the form of an ideological NPO is the source of what Rose-Ackerman (1996) calls the "product-differentiation advantage" that accrues to clients who are looking for clear leadership with respect to the type of services they ought to choose.

Hope, however, involves more than a set of beliefs. These beliefs must be expressed with a degree of emotional energy or <u>passion</u> that is reflected in the characteristics of physiological arousal, physiological expression and valence described by Elster (1998). Perhaps the most immediate indicator of passion is a person's level of emotional energy.

Collins (1993) has formulated a theory in which emotional energy is "the common denominator in rational social action". According to this writer, people invest varying levels of emotional energy in their social interactions. High levels of emotional energy will be reflected in feelings such as enthusiasm and confidence while low levels are manifested, for example, by apathy and depression. However, in most interactions the emotional energy of individuals is at a "medium level" which

will be unnoticed by both themselves and those with whom they are interacting. Only people with very high or very low levels of emotional energy will pass the attention threshold at which their degree of emotional intensity becomes "empirically visible, both in behavior (especially nonverbal expressions and postures) and in physiology" (p.211). It is suggested that "passion" consists in the high and observable level of emotional energy that can either draw people toward, or repel them away from, interactions in which it is generated by participants.

It would seem, though, that the hope that is invested in a particular quest such as moving an NPO in the "right direction" can be subject to processes of accumulation and depreciation. The problem facing leadership is how to reinforce and strengthen it in the face of disappointments that can accumulate in a way that undermines it. These disappointments can arise from a number of sources. Firstly, the members of a leader-stakeholder network will be exposed to disappointments associated with their quest. Due to their "poverty of imagination" (Hirschman, 1982) they may not imagine all the obstacles to its advancement so that surprising failures and setbacks may be interpreted as disappointments. Secondly, they may experience disappointments associated with belonging to a particular network. These disappointments typically arise when network pressures to conform its norms lead to "preference falsification" (Kuran, 1990) among its members as they over - or - under commit themselves in relation to the degree that they seek to express their hope in the quest. Thirdly, to the extent that individuals internalize group norms and form "second order" "metapreferences" to keep them, they will experience disappointment with themselves when they fail to keep the commitments that are the subject of these norms. These different sources of disappointment can clearly combine and interact with one another in a cumulative process.

This may explain the punctuated equilibrium pattern that has been observed with regard to many types of commitment. Individuals typically sustain their commitments until their disappointments have accumulated above the threshold at which they break these commitments and commit themselves to alternative quests and relationships (Hirschman, 1982). A helpful way of explaining this type of behavior is to treat disappointment as a source of dissonance and leadership as a dissonance reduction mechanism. This approach must now be examined in more detail.

Inspirational Leadership as a Dissonance Reduction Mechanism in NPOs

Elster (1998) rejects a cost-benefit model of the emotions that treats them "as psychic costs and benefits that enter into the utility function on a par with satisfactions derived from material rewards" (p.64) in favor of an approach that views them both as sources of dissonance and as mechanisms of dissonance reduction. The concept of "cognitive dissonance" was popularized by Leon Festinger (1957). It refers to the unpleasant feeling of tension individuals experience when they have to choose between alternative, mutually exclusive courses of action. Once they have committed themselves to a particular course, they will look for cognitions that support it and reduce their feelings of tension or dissonance. A classic example of this is provided by automobile buyers who, after having decided to buy a particular model, mainly read literature that confirms the wisdom of this decision.

According to Elster, dissonance theory is more realistic than the cost-benefit model in that it views individuals as making hard choices "on the basis of *reasons* rather than on the basis of introspections about how they feel" (p.66). It can help explain the "sticky", "punctuated equilibrium", "path dependent" nature of many commitments in respect of which individuals seek for reasons to sustain their commitments until a threshold is reached "when the arguments on the other side become too strong and the rationalization breaks down" so that "a switch in behavior occurs" (p.66). Although Elster points out that "psychologists have not considered emotions as sources of cognitive dissonance and dissonance reduction", he suggests that "there seems to be no reason why emotions could not be sources of dissonance" (p.66). Elster proposes that if emotions can be incorporated into dissonance theory then this could lead to their incorporation into economic theory since a number of economists (such as Akerlof and Dickens 1982; and Rabin 1994) "are now incorporating dissonance theory into their framework" (p.66).

The networks that link leaders with stakeholders provide the context within which their shared hopes can be strengthened through interaction so that the dissonance associated with accumulated disappointments can be reduced. There are two ways in which network interaction can strengthen hope and reduce disappointment. Firstly, such interaction is likely to involve a mutual sharing of reasons for hope. Each member is likely to have his or her own reasons for participating in the network but these will always, to a degree, be implicit, inchoate

and partly articulated. They will therefore look to other members to provide a clearer, more explicit articulation and to buttress their beliefs in the worth and possibility of committing themselves to the advancement of their quest. This will not only strengthen the cohesion of stakeholder networks and facilitate the convergence of their hopes on a shared vision. It may also serve an "evangelistic" function, persuading outsiders of the worth and possibility of committing themselves to a particular NPO and its quest.

While every stakeholder may make some contribution to this process of developing a vision, they may look to one person, the leader, to act as a "final respondent", to have the "final word" in articulating the shared vision of an NPO. To be able to inspire stakeholders with their rhetoric, leaders must occupy the central position in what Charles Taylor (1985) called the "public space" of a network that engages in "a common act of focusing" on the worth and possibility of advancing its quest. Their authority, both formal and informal, will thus vary according to their the capacity to command the attention of stakeholders so that these actors do not just focus on these questions but also on the leader's response to them.

The key rhetorical role of an inspirational leader does not essentially arise from the social division of knowledge produced by asymmetric information as Hermalin (1998) suggests. Inspirational leaders do not necessarily have to have superior knowledge to their followers. Their relationships with them may thus be distinguished from those that are clearly based on asymmetric information such as teacher-pupil, adviser-client or doctor-patient relationships. These leaders may be in a position to gain access to and process more information than other stakeholders but, in exercising inspirational leadership, they are not simply attempting to change their behavior by supplying them with information they do not have. Inspirational leadership more essentially involves a process of influence through what (Kelman, 1958) calls "internalization" - the amplification and clarification of shared values and beliefs. As Bennis and Nanus (1985, p.96) have found in their studies of leadership, inspirational leaders were "rarely . . . the one who conceived the vision". They tended, more often, to have been "the one who chose the image from those available at the moment, articulated it, gave it form and legitimacy, and focussed attention on it".

A second way in which the leaders of NPOs can strengthen the hopes and counter the disappointments experienced by stakeholders is by engaging them in

interactions that enhance their emotional energy or passion of its members. As Nanus and Dobbs (1999, p. 150) have observed: "A leader's passion for the possibilities of a nonprofit organization ignites the social energy needed to attain the vision. When it is widely shared, passion elevates the spirit of the board and staff members, helps them sustain optimism and hope for the future, and builds commitment and enthusiasm for the collective effort. Passion is most effective as an energizing force when the leader's words are accompanied by actions that exemplify and reinforce the spirit of the organization".

Collins (1993) has proposed that this type of passion can be both a product of, and a resource that can be invested in, what he calls "interaction rituals" (IRs). This "emotional energy" will reach its peak at the climax of a "successful" IR in which the participating group's focus of attention and common emotional mood go through a short term cycle of increase and mutual stimulation until a point of emotional satiation is reached. The interaction will leave each participant with an "energetic afterglow" that "gradually decreases over time" so that individuals have an incentive to reinvest their emotional energy in subsequent interactions. It may therefore accumulate across IRs so that "an individual may build up a long-term fund of confidence and enthusiasm by repeated participation in successful IRs" (p.212). It is this fund, this reserve of "willpower and waypower", that can be drawn on by the members of a team to counter the emotional component of the dissonance they experienced as a result of disappointments and to sustain their "action tendencies" to persist in striving to advance their quest.

To the degree that the leaders of NPOs can successfully establish a culture of shared passion within their organizations and the stakeholder networks that form around them, they will maintain the "quality control advantages" associated with ideological NPOs (Rose-Ackerman, 1996) by sustaining their capacity to save the costs involved in monitoring internal stakeholders and leverage in resources from external stakeholders. To develop this type of culture, leaders will have to structure stakeholder interactions so that they pass the thresholds of "physical density" and "boundedness" that are necessary for their success. The threshold of physical density is passed when at least two persons are close enough for a sufficient period of time to ensure that they can be moved by one another's passion. The threshold of boundedness may be passed when there is an expressive dimension to group

interaction so that participants are expected to identify themselves as committed stakeholders by expressing a passion for advancing the NPO's quest.

A person who does not have this passion will find it more difficult to interact with other network members than Kuran's (1990) theory of preference falsification seems to suggest. It will be hard to "keep up an act", continuously "fooling" other members about their lack of passionate intensity and even if they succeed in this falsifying strategy, they will derive no satisfaction from a sense of belonging to this network. A culture of passion can therefore function as a selection mechanism screening out those participants who do not believe the quest to be worthy of their passion and drawing into the network those people who are willing to commit themselves passionately to it in the hope that it will prove worthy of this commitment. The boundedness of the group may be enhanced over time by the selective effect of this culture.

Leaders may ensure that these thresholds of density and boundedness are passed by structuring their interaction with stakeholders into a number of levels descending in status from the "inner circle" who the leader chooses to interact directly with. Access to this level of interaction will be limited to those stakeholders in whom the leader has placed the highest level of trust. This trust will be based not just on the skills and resources which these followers can deploy in performing the tasks allocated to them, but also on the passion which they express in seeking ways to advance the leader's quest. Nanus and Dobbs (1999, p.151) describe the way in which a new NPO leader sought to revitalize this type culture through relocation: "When the board agreed to relocate the nonprofit to another part of the country, the new leader used the move as a symbolic declaration of the organization's reinvention. He knew that only those staffers who shared his passion for the organization's work would be willing to uproot themselves and relocate. He sparked excitement and dedication in his new staff and gave the organization a whole new sense of purpose and commitment."

Leaders can thus shape the development of an NPO's culture by setting the terms according to which followers compete for access to their inner circle. Moreover they can influence the passion that is generated in this circle and which filters down the organization by enhancing the commonality of focus and emotional mood that is stimulated by IRs. Bennis and Nanus's (1985) conception of leaders as "managers of meaning" would seem to be pertinent in this regard. Leaders direct network

member's attention to the point and significance of their actions and interactions and they narrow their evaluation of this point and significance to a simple consideration of whether these activities are moving the quest in the direction intended by the leader. Leaders may be able to create a common focus among their followers through the intensity of their own passion to advance the quest. As Bennis and Nanus have observed, "these intense personalities do not have to coerce people to pay attention. They are so intent on what they are doing that like a child, completely absorbed with creating a sandbox, they draw others in" (p. 28). A large proportion of effective leader's signals must comprise signals of their attention to the advancement of their quest since, as Peters and Austin found, "it's a matter of the quantity of attention paid to the matter at hand rather than the quality, odd as that statement may sound" (1985, p. 270).

Attention is not, however, just signalled by the expenditure of effort by leaders. It is also signalled through language. As Berger (1989) has pointed out, attention is a scarce resource and language plays a key role in its deployment. He follows Taylor (1985) in highlighting the inextricable link between language and the evocation of "subject-referring" emotions. These clearly include hope and disappointment since, along with "our sense of shame, of dignity, of guilt, or pride, our feelings of admiration and contempt or moral obligation, of remorse, of unworthiness and self-hatred (and less frequently) of self-acceptance" (Taylor, 1985, p.59), they can only be experienced if a certain "import" or significance is ascribed to the situations that give rise to them. This constitutes more than a subjective reaction to an objective situation since as Taylor puts it, "to ascribe an import is to make a judgment about the way things are which cannot be reduced to the way we feel about them" (p.54). Taylor stresses that subject-referring emotions have to incorporate a degree of articulation in order to open a person to the imports involved. To recognize that these emotions are bound up with a process of articulation, is to recognize that, at any time, they will be, at least partly, constituted by their latest articulation and that further articulation may change the valence of the emotions being experienced.

It would seem then that the inspirational dimension of leadership cannot be explained without taking into account the impact of the leader's rhetoric on emotions of hope and disappointment. It should nevertheless also be borne in mind that the expressive power of the leader's words, their capacity to express and evoke these subject-referring emotions will depend, at least partly, on the extent to which they are

validated by exemplary action. As Kelley (1972, pp. 52-3) has pointed out: "There is as realistic an economy in the realm of meanings as in commodities, but the currency is different. In both cases, it obtains its value from the guarantees that undergird it: what has been invested in it, what backs it up. In the realm of meaning that backing, that guarantee or validation, is a personal and social earnestness shown in the investment by real people of time, money, effort, reputation and self in the meaning and movements which bears it."

To satisfactorily address the central question of how leaders influence the commitments made by the actors who look to them for leadership, economists would seemingly have to combine Hermalin's insights into leading by example with an explanation of the inspirational effect of leader rhetoric along the lines suggested in this section. While these two types of influence would be empirically difficult to separate, their analytical distinction would characterize that which the broader literature on leadership has long made between the "charismatic" and "inspirational" dimensions of this phenomenon (Downton, 1973; Howell, 1988). The policy implications of NPO's being dependent on the quality of leadership in both these dimensions must now be considered by way of conclusion to this paper.

Conclusion

The economics of NPOs should be of considerable interest to policymakers since it seeks to provide a framework to help them address an important issue in social policy: namely; to what extent should government rely on NPOs, as opposed to for-profit firms or government agencies, to deliver social services. As Salamon (1987) has pointed out, this issue often arises in a situation where NPO's have pioneered the provision of a particular type of service. He argues that government intervention in this situation should only occur where the social costs of "voluntary failure" due to "philanthropic insufficiency", "philanthropic particularism", "philanthropic paternalism" and "philanthropic amateurism" exceed the transaction costs involved in mobilizing governmental responses to shortages of collective goods that "tend to be much higher than the costs of mobilizing voluntary action" since "for government to act, substantial segments of the public must be informed, laws must be written, majorities must be assembled, and programs must be put into operation" (p.39). Other economic theories of NPOs have emphasized the need to also take into account

the advantages produced by some generic features of the form these organizations tend to take. The non-distribution constraints and ideological purposes that typify NPOs may thus help mitigate the problems of informational asymmetry and monitoring worker effort and service quality that arise with other institutional forms.

This paper has sought to show that these purported advantages of NPOS may be seen as less generic and more dependent on the quality of their executive leadership when economic theories of NPOs are augmented to take into account the role leaders can play in shaping a culture of hope within these organizations and their stakeholder networks. Indeed when it is considered that NPOs are typically subject to neither the same market pressures to produce efficiently as for-profit firms with contestable ownership and management nor to the controls designed to make government agencies accountable for their probity and effectiveness, it would seem that variations in the quality of NPO leadership could give rise to a relatively greater diversity in the quality of service and overall performance of these organizations. This suggests that government support for, engagement with and intervention in the "Third Sector" should be based on a pragmatic, case by case, assessment of the reliability of the actual NPOs concerned rather than an *a priori* presumption for or against dealing with this sector. A possible model for government relationships with this sector may be suggested by that which shapes the Blair government's relationship with local authorities in the United Kingdom. Recognizing the wide diversity in the quality of leadership and organizational effectiveness of these bodies, this government has established a system of peer review of council management through the "Beacon Council Scheme" that provides special privileges to those authorities that are judged to have provided "excellent services" and that have shared their expertise with other councils (Brooks, 2000, p.399). Through a similar policy of rewarding excellence and the dissemination of information about best practice in the nonprofit sector, the government could signal its appreciation of the crucial role leadership plays in securing the advantages that are often associated with its involvement in the provision of social services.

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