

Trust and Performance Management in Non-Profit Organizations

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Abstract

Performance management as a steering instrument is slowly gaining momentum in non-profit organizations. Taking the mixed experience with performance management in the public and non-profit sector into account, the article looks into the potential of trust as a soft factor which could lead to more effective performance management in the non-profit sector. As discussed, trust per se, is for various reasons a factor with high relevance for non-profit organizations. After some terminological remarks on trust as a topic in the organizational and economic literature in general, the article focuses on the relationship between trust and performance management, and looks into the beneficial effects of trust. Furthermore it looks into the directions that the increasing literature on the soft factor “trust” gives us with regard to the design of performance management systems as a steering instrument in the non-profit sector.

Key Words

Performance Management, Trust, Non-profit Organizations

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Introduction

Over the last decade the implementation of performance management within the nonprofit sector has been gradually developed in several identifiable stages. A substantial part of the early literature dealt with performance management either on a process-oriented how-to-do level or on a level that attempts to identify adequate performance indicators. The lines between performance reporting, performance measurement and performance management were blurred. Today at last, the lines between performance reporting and performance management are getting clearer, with the former being an accountability tool and the latter a steering instrument. The popularity of the Balanced Scorecard (Kaplan and Norton, 1992; Kaplan and Norton, 1996), first in the private sector and then also in the nonprofit sector, has done its part to increase the popularity of performance management, at least on a rhetorical level. Strategic management systems are gradually becoming more and more important. Some of the larger non-profit organizations are beginning to implement performance management systems. There is an increasing amount of literature on Balanced Scorecard-based proposals for the non-profit sector. One can already distinguish two generations. The first generation of proposals concentrated on adapting the Balanced Scorecard to the special institutional missions and environment of the non-profit sector. This often led to a downgrading of the financial perspective of the Balanced Scorecard. As a top position a mission/common weal-oriented perspective was often included. The second generation of proposals has been more advanced with respect to distinguishing along the different areas of activities. Furthermore, performance management is today not only promoted as a steering instrument within the non-profit sector but also as a management tool for managing contract relations between the public authorities as principals and non-profit contract partners.

Despite its growing popularity it is very difficult to find examples of successfully implemented performance management systems if one looks beyond the success stories told by Kaplan and Norton (Kaplan and Norton, 1996; Kaplan and Norton, 2001). When reviewing the amount of literature on performance measurement and performance management, one could reach the conclusion that the dysfunctional effects prevail. Sub-optimization, tunnel vision, myopia, measurement fixation, negative gaming, ossification are among the well documented dysfunctional outcome effects (e.g. Smith, 1995; Johnson, 2005; Radnor, 2005). Performance management sometimes looks like another management fad established to give non-profit organizations a more professional appearance.

Much less is written about the conditions under which performance management is successful. There are calls by Halachmi referring to McGregor, to put more emphasis on the human factor in business (McGregor, 1960; Halachmi, 2005: 510). Possible options for improving performance management can be found in the growing influence of the so-called soft elements (Karkatsoulis, Michalopoulos and Moustakou, 2005: 580). This paper will concentrate on the trust factor, which is one of the soft factors.

Trust is becoming more and more important as a factor in the management of human affairs and in inter-personal as well as inter-organizational relations (Dasgupta, 1988; Coleman, 1990; Putnam, 1993; Hosmer, 1995; Richter and Furobotn, 2003). Trust is regarded by some authors as an element that can have a significant impact on the productivity and performance in non-commercial areas of organizations (Wintrobe, 1997: 448; Boukaert, 2002; Karkatsoulis, Michalopoulos and Moustakou, 2005: 580).

To look at trust in the context of performance management may seem odd since performance management is often driven by mistrust. The often unchallenged presumption that better performance is achieved mainly through more control is in line with a set of assumptions which McGregor, as early as 1960, labelled "Theory X" (McGregor, 1960). Looking at the mixed history of control-oriented performance measurement and management initiatives, they cannot be labelled an overwhelming success. Often a control-dominated performance management approach has led to a performance management bureaucracy. A control-based approach requires activities to be clearly defined and demands too much stability and predictability for today's non-profit sector.

This article looks more closely at trust as one of the possible soft factors which could lead to more effective performance management in the non-profit sector. Trust is also a factor that is highly relevant to non-profit organizations, not least because they produce to a large extent goods and services with credence properties.

This paper also addresses the following questions: What is the relationship between trust and performance management? What are the beneficial effects of trust in the context of performance management in non-profit organizations? Also, what directions does the increasing literature on the soft factor "trust" take us in regard to the design of performance management systems as a steering instrument in the non-profit sector?

After a brief overview of the significance of trust for the non-profit sector, a section follows dealing with trust from a terminological perspective. Then the paper looks at the relationship between trust and performance management. It next questions the potential benefits of trust in the context of performance management. Finally it addresses aspects of trust building in the context of performance management. The paper does not address the issue as to whether performance management makes sense at all as a management instrument in the non-profit sector. Instead it concentrates on trust as a moderating variable for performance management. Some of the findings are also valid for other activities where goods and services are provided that are difficult to measure in an objective way.

Trust and Non-Profit Organizations

Trust is an important factor for non-profit organizations. The activities of non-profit organizations are found mainly in the service sector. In comparison to material goods, services are intangible in various degrees, which means that they are difficult to measure and are characterized by a high degree of experience and credence properties (Zeithaml, 1984). In the case of goods and services with credence properties, the quality cannot be evaluated (by a non-expert) even after purchase and use (credence goods). Within the range of activities of non-profit organizations one can find many such services, especially in the areas of social and health services. The service recipient faces an information disadvantage. Non-profit organizations also offer services to recipients who are sometimes not in the position to evaluate the services provided. For example, children are typically not well positioned to judge the quality of day care; frail elderly and mentally handicapped people also may have difficulties in evaluating the objective service quality. Sometimes it is because of the nature of the illness or ailment that recipients have that surrounds the difficulties of evaluating the quality of the service offered. It can even be particularly difficult for experts in the field of personal services to evaluate the quality of services since the service is jointly produced by the service provider and the service recipient. Another type of information asymmetry arises within the field of non-profit services because the service recipient is not always the one who pays for the service provided. The institutions or persons who finance the service are also often not present when the service is provided. They may

therefore look for signals of trustworthiness. The non-distribution constraint of non-profit organizations may serve as such a signal.

Gui has introduced the notion of relational goods. These types of goods arise from relationships that extend beyond the mere exchange of contractible items and can be enjoyed only by participation in a social process (Ben-Ner and Gui 2003: 14). Ben-Ner and Gui are convinced that non-profit organizations, in general, have an advantage over for-profit organizations in creating favourable personal interactions (Ben-Ner and Gui, 2003: 16). The non-distribution constraint may keep in check some conflicts of interest that hinder the development of shared cooperative attitudes. With respect to relational goods, the non-profit form is sometimes essential if a certain degree of trust is to be developed at all. In “mutual” non-profit organizations control is in the hand of stakeholders who have recurrent interactions. Furthermore, participation enhances stakeholders’ emotional involvement and fosters stable and sustainable relationships. In entrepreneurial non-profit organizations the absence of a proper owner may encourage service recipients to feel somewhat like members and not just like customers. According to Ben-Ner and Giu, the non-distribution constraint also helps to create a tendency for better personal relationships among stakeholders even in entrepreneurial non-profit organizations (Ben-Ner and Gui, 2000: 16).

Trust and trustworthiness also play an important role in economic theories explaining the existence of non-profit organizations (for an overview see Anheier and Ben-Ner, 2003; Anheier, 2005: 124). As early as the 1960s, Arrow (1963) had argued that asymmetries in information between the provider and clients in health care might lead to fears that the provider would use this for his/her advantage. Nelson and Krashinsky (Nelson and Krashinsky, 1974) took the argument a bit further by linking it to the existence of non-profit organizations and extending it to the field of social services. It was Hansmann, in the 1980s that explicitly linked the existence of information asymmetries and resulting market failures to an advantage that non-profit organizations may have over for-profit firms. This advantage arises from the non-distribution constraint, which serves, according to the trustworthiness theory, as a proxy-insurance signalling protection from profiteering. For Hansmann (1987: 29) a non-profit:

Arises in situations, in which, owing either to the circumstances under which the service is purchased or consumed or the nature of the service itself, consumers feel unable to evaluate accurately the quality and quantity of the service a firm produces for them. In such circumstances, a for-profit firm has both the incentive and the opportunity to take advantage of customers by providing less service to them than was promised and paid for. A non-profit firm, in contrast, offers consumers the advantage that, owing to the non-distribution constraint, those who control the organizations are constrained in their ability to benefit personally from providing low quality services and thus have less incentive to take advantage of their customers than do the managers of for-profit firms.

Rose-Ackerman (1996: 723) puts her assessment directly in the context of trust:

An organization, that binds itself not to distribute its surplus to owners, may be trusted more by customers and donors unable to judge service quality directly. Non-profits may have a competitive advantage if customers have imperfect information about service quality.

Weisbrod is convinced that the quality of services provided by non-profit organizations exceeds the quality provided by both of for-profit firms and public providers where there is a diverse demand (Weisbrod, 1977: 25). Hansmann in particular notes that the adverse risk consumer will prefer the provisions of a non-profit provider. Krashinsky then combined the reasoning of Hansmann with transaction cost theory (Krashinsky, 1986). According to Krashinsky the non-distribution constraint reduces monitoring costs by the consumers. Ben-Ner and van Hommissen (1993) focus their analysis on non-profit organizations where service recipients decide to produce the services themselves. Trust, with its element of reciprocal beneficial behaviour, is one facet in their arguments for the comparative advantage of the non-profit form.

The trustworthiness theory of Hansmann has not gone unchallenged (for an overview see Ortmann and Schlesinger, 2003). From the perspective of the principal agent theory one can argue that the non-distribution constraint leads to a decrease in the agent's effort. It may result in shirking and consumption on the job. Property rights theory stresses that the dilution of property rights has negative consequences for the efficiency of service delivery. Nevertheless trust-related theories are one of the most prominent approaches used to explain and justify the existence of non-profit organizations. For some authors (e.g. Coleman and Putnam), non-profits also play an important role in the building up of social capital. Trust is a central element of social capital. Putnam is convinced that the greater the level of trust the greater the likelihood of cooperation. For him, networks of civic engagement play an important role in building social capital because they (Putnam, 1993: 173-174):

- increase the potential costs to a defector in any individual transaction,
- foster robust norms of reciprocity,
- facilitate communication and improve the flow of information and
- embody past successes at collaboration, which can serve as a culturally-defined template for future collaborations.

Non-profits are regarded by Coleman as a vital form for experiencing trust-driven relationships outside the family bonds. For Coleman (1990: 304):

... social capital is even less tangible, for it is embodied in the relations among persons. Physical capital and human capital facilitate productive activities, and social capital does so as well. For example a group whose members manifest trustworthiness and place extensive trust in one another will be able to accomplish much more than a comparable group lacking that trustworthiness and trust.

These remarks demonstrate the general relevance of trust in the non-profit context. Nowadays non-profit organizations often have to build up trust in situations where they do not always have a trustworthiness advantage. Service providers, among non-profit organizations in particular, often have to fill a credibility gap. Either they are confronted with allegations that they are not sufficiently business like and therefore inefficient or that they have lost all of their traditional values and are no longer distinguishable from their for-profit competitors, in terms of their behaviour. The erosion of trust particularly affects entrepreneurial non-profit organizations. Contract management, seeking to make formerly implicit elements more explicit, also leads to demands that the intangible parts of the non-profit services be made a bit more tangible and therefore a bit more enforceable. This is in line with a general tendency from a "trust me" to a "show me" culture. Non-profit organizations which predominately focus on being active in civil society are sometimes welcomed, with high hopes by local, national, and international government entities, as strategic partners that - in the long run - are prone to failure in delivering their overambitious

contributions aimed at solving the problems of modern societies. This could be detrimental for trustworthiness, at least in a medium to long term perspective.

Trust in Economic Literature

Trust has been slowly gaining importance in economic literature. Dasgupta, for example, regards trust as a central but heavily neglected element in all business transactions. According to Dasgupta, trust is treated as an underlying fact, present whenever it needs to be called upon, a sort of ever-ready lubricant that permits voluntary participation in production and exchange (Dasgupta, 1988: 49.). The idea of trust as a lubricant is an old one, long ago articulated by Arrow (Arrow, 1975: 23) back in the 1970s. In political science, the idea of trust as a lubricant and social kit for society has been gaining in importance since the 1990s in the discussions of social capital (e. g. Putnam, 1993). Furobotn and Richter stress the contribution of trust as it relates to decreasing transaction costs (Furobotn and Richter, 2003: 64-65).

If one looks at definitions of trust, it becomes obvious that there is a lack of conceptual clarity (Hosmer, 1996: 380; Luhmann, 2000: 123). Trust is a paradoxical and rich concept which is accompanied by much ambiguity and confusion in the trust literature, as well as in political discussions (Shapiro, 1987: 624; Noteboom, 2005: 55). In everyday use there is often no clear distinction between trust, hope and confidence (Ripperger, 1998). Hosmer's literature review also shows that there is no common understanding of trust in the organizational literature, which tends to focus on different approaches toward trust (Hosmer, 1996: 381-388):

- Trust as an optimistic individual expectation: This approach focuses on the expectations of the trust giver. Trust in this sense has to do with an optimistic expectation about the outcome of an uncertain event. For Gambetta "trust is a particular level of the subjective probability with which an agent assesses that another agent or group of agents will perform a particular action, both before he can monitor such action, and in a context in which it affects his own action" (Gambetta, 1988: 217). Trust is associated with personal vulnerability, because the trust giver would be worse off if the trust receiver acted according to the expectations. Trust is seen as a risky investment which includes the risk of exploitation by the trust receiver. The trust giver does not rely on provisions for safeguarding measures against the opportunistic behaviour of the trust receiver. Trust is based upon past experience and future anticipations. According to Barber, trust has to do with the expectation of a technically competent and morally correct role performance from those associated with the trust giver. If trust is not blind, the possibility of a disappointment of the trust placed is not ignored but processed internally by the trust giver before an optimistic expectation is formed (Luhmann, 2000: 104).
- Trust as an interpersonal relation: Trust is something which is formed in a dyad of dependent interactions and includes a concomitant expectation that the other will reciprocate trust with trust in order to achieve the benefits of mutual cooperation. Trust has something to do with behaviour expectations and aims at improving the quality of cooperation. It relies on reciprocal beneficial behaviour. Morally, trust includes the implicit promise from one person to the other not to do harm (Carter, 1996). Butler and Cantrell link interpersonal trust to integrity (i.e. reputation for honesty and trustworthiness of the parties involved), competence (technical knowledge and interpersonal skills to perform the job), consistency (reliability, predict-

ability and good judgement in handling the situation), loyalty and openness (Butler and Cantrell, 1984).

- Trust and economic transactions: The potential which trust may offer is also claimed to be the basis for economic transactions. The view extends from a concept of trust as a sensible norm which focuses on the transaction cost advantages of trust (e.g. Arrow, 1975; Hill, 1990; Rippberger, 1998; Goebel, 2002; Richter and Furobotn, 2003) to a concept of trust as something which should not be included in the modelling of economic behaviour (e.g. Williamson, 1993). In his earlier publications, Williamson regards trust as something desirable, but chose not to include trust in his modelling, (Williamson 1975) because of the difficulties involved in trying to separate trustworthy and untrustworthy behaviour. In his more recent publications Williamson is more sceptical, as is evident when he states that "trust merely muddies the clear water of calculativeness" (Williamson, 1993: 471).
- Trust and social structure: trust needs to also be examined by a focus on society. Some authors link trust with social capital (e.g. Coleman, 1984; Putnam, 1993) where it is tied to an extensive set of societal expectations on just and fair exchange processes.

In her detailed review of the organizational theory literature on trust, Hosmer identifies the common understandings of the literature (Hosmer, 1990: 390-392):

- Trust is generally expressed as an optimistic expectation on the part of an individual about an event or the behaviour of a person.
- Trust generally occurs under the condition of vulnerability to the interests of the individual and dependence upon the behaviour of other people
- Trust is generally associated with willing, not forced, cooperation and with the benefits, resulting from that cooperation.
- Trust is generally difficult to enforce.
- Trust is generally accompanied by an assumption of an acknowledged or accepted duty to protect the rights and interests of others.

For Hosmer these voluntarily accepted duties clearly go beyond a negative promise not to harm the interests of the other party, but instead aim to provide a positive guarantee that the rights and interests of the other party will be respected in the final outcome (Hosmer, 1996: 392). McLain and Hackman define trust along similar lines as the "belief that a specific other will be able and willing, in a discretionary situation, to act in the trustor's best interest" (McLain and Hackman, 1999: 155). For Noteboom, trust is a four-place predicate: "the trustor (1) trusts the trustee (2) in some aspects of behaviour (3) under some conditions; (4) trust has a variety of sources" (Noteboom, 2005: 36).

Much of the citations so far deal with trust from an individual perspective. According to Luhmann, individual trust is something which will only work in simple social structures. In more complex structures, system trust as a means to manage complexity is also required (Luhmann, 2000). For Luhmann, system trust has much to do with confidence in the functioning of systems and in the belief that systems repetitively generate reliable results in a

trustworthy way (Luhmann, 2000: 90). In contrast to personal trust, system trust is depersonalized and has a complementary relationship to personal trust.

With respect to organizations some authors do not speak of system trust but of organizational trust. On the basis of a literature review on trust and trustworthiness Caldwell and Clapham (Caldwell and Clapham, 2003) have developed a typology which further specifies the elements of interpersonal and organizational trustworthiness:

Table 1: Comparison of Interpersonal and Organizational Trust

Interpersonal trustworthiness factor	Key elements of factor	Organizational trustworthiness elements	Similarities with interpersonal trustworthiness
Ability	skills, competencies, expertise	competence, financial balance, quality assurance	focus on task, excellence and outcomes
Benevolence	benevolence, intentions, “desire to do good”	interactional courtesy, responsibility to inform	demonstrating respect, courtesy, and involvement
Integrity	character, integrity, fairness, credibility	legal compliance, procedural fairness	honors ethical requirements and treats others fairly

Caldwell and Clapham, 2003: 353

The Relationship between Trust and Performance Management

Looking at the relationship between trust and performance management, one can distinguish at least five cases. Two of them are rival and three complementary.

- case 1: trust as a substitute for performance management
- case 2: performance management as a substitute for trust
- case 3: performance management as a basis for trust
- case 4: trust as a basis for performance management
- case 5: performance management as a safety device to limit the risk of the trust giver

In the *first case* trust is regarded as an alternative steering element to performance management. Instead of relying on an explicit steering tool, with performance indicators and target agreements, cooperation and relationships are trust based. The principals trust that the agents will perform at their highest ability and in the best interests of the commonwealth. Sometimes the relationship between the external board members and the CEO in non-profits is characterized in such a way. To rely on trust as an implicit steering instrument instead of relying on performance targets in relationships with external funders can often be seen as an approach from the past, when non-profits had a trustworthiness advantage. Decades of New Institutional Economics have raised doubts that such a self denying servant to the common weal exists. Blatant cases of mismanagement and consumption on the job, various forms of voluntary failures (philanthropic inefficiency, philanthropic particularism, philanthropic paternalism, philanthropic amateurism or excessive professionalism, philanthropic accountability gap etc.; see Salamon et. al., 2000) have to some degree

undermined the trust in non-profit service providers. An empirical study by Sargeant and Lee, based on a sample of 566 questionnaires of UK residents (Sargeant and Lee, 2001: 75), shows that the general level of trust of the donors was not high. The increasing amount of quality signals demanded by institutional donors also may serve as an indicator that the trust in non-profits is not so high, without regard to whether it is a service provider or a predominant lobbying-oriented non-profit organization.

In the *second case* an explicit steering by performance management replaces a trust-based cooperation. In the past, when public budgeting and accounting was input-factor-driven and when there were no agreements on expected output or outcomes, the principals trusted that, if enough resources were provided, the best possible outcome would be realized. This was true for relationships within the public sector as well as for relationships between the public sector and non-profits in public private partnerships. In Germany this was previously accompanied by the dominance of an object-financing of non-profit organizations mainly by the public sector. During the last decade a change from a “trust me” to a “show me” culture also had its effect on non-profits. In public-private partnerships, as well as in contract agreements with (public and private) institutional donors, performance agreements play a more and more important role. If a non-profit provider of services for the elderly in Germany wants to get some funding from the social insurance system, three types of contracts are necessary: a service level agreement; a quality agreement; and a finance agreement. Instead of relying implicitly on trust, clear performance expectations are articulated and their fulfilment is monitored on a regular basis.

Performance Management, as a popular management tool, can also be regarded as one approach (among others) for creating trust in the functioning of the non-profit sector (*third case*). The existence of a performance management system as a steering instrument and as a tool for governing the relationship in public-private partnerships may help to create the impression of a modern non-profit organization which is up-to-date with modern management techniques. The implementation of a performance management system may be seen as an instrument which signals competence by conforming to what is regarded as behaviour which is up to a professional management standard. From the perspective of the New Institutionalism, one could argue that such a practice is a form of mimetic isomorphism. According to DiMaggio and Powell, it may be advantageous for organizations to model themselves after other organizations which are regarded as successful in situations where organizational technologies are poorly understood, goals are ambiguous or where the environment creates (symbolic) uncertainty (DiMaggio and Powell, 1991: 69). Such a modelling process is aimed at increasing the legitimacy of the copying organization. The implementation of a performance management system may also be interpreted as an act of coercive isomorphism, especially if it is externally imposed on a non-profit organization. According to DiMaggio and Powell, coercive isomorphism results from both formal and informal pressures which are exerted on organizations by other organizations upon whom they are dependent as well as by cultural expectations that exist in the society within which the organization is supposed to function (DiMaggio and Powell, 1991: 66). Due to the fact that performance management systems are sometimes forced upon non-profits by institutional donors, coercive isomorphism should not be ruled out completely. This line of argument is of course not exclusive to the implementation of performance management systems within the non-profit sector. It is also open to any implementation of management practices which is imposed on or chosen by any organization in reaction to external pressure in attempt to increase its legitimacy.

Whether the existence of a performance management system improves management capability is still an open question. Promoters like Kaplan and Norton, who see their Balanced

Scorecard as a strategic management system, are convinced of the instrumental value of such a tool. To them it is an important step towards better management, irrespective of whether it is implemented in the public or private sector (Kaplan and Norton, 1996). Sceptics would argue that the existence of a performance management system may be seen as a mere ritual of confidence and good faith (Meyer and Rowan, 1991: 58). In that sense, the existence of a performance management system may be a symbolic device aimed at creating confidence that non-profits are operating up to externally expected standards. Following this reasoning one can explain why most of the 20 interviewed non-profit organizations, in a recent empirical study by Greiling, had implemented the four classical Balanced Scorecard perspectives in an unmodified way. Only three out of 20 social service providers had included a mission perspective in their Balanced Scorecard. Performance management also may have an exonerating effect on non-profit boards by providing the impression that they are really in a steering position. In addition, it may help safeguard the autonomy of those whose actions should be guided by performance targets. That will more likely be the case if the indicators leave considerable room for discretionary behaviour. Many services are provided by non-profit organizations (or public service providers) because they are difficult to define, which virtually necessitates a high level of discretion.

Considering the problems that performance management systems face in the nonprofit sector forces us to acknowledge the existence of different relationships between trust and performance management. Trust can also be a necessary basis for performance management (*fourth case*). Performance measurement, as well as performance management, faces many challenges when attempts are made to implement it in the non-profit sector. The following table provides an overview of the central obstacles of performance measurement as identified by Johnson (Johnson, 2005: 11). Although this was formulated originally for the public sector, it is also transferable to the challenges of performance measurement in the non-profit sector, since they face similar evaluation problems and in some areas comparable management challenges as well:

Table 2: Obstacles Associated With the Implementation, Use and Outcome of Performance Measurement

	Obstacles
Implementation	low theoretical or methodological planning competence (“data-driven” implementation) small resources/capacity for development inadequate implementation structures low top-management commitment impatience resistance
Use	lack of relevant statistics and data measurement errors low decision relevance running down of performance indicators proliferation of performance indicators information overload indirect line of responsibility no ownership of performance loyalty to professional norms rather than to management misrepresentation (manipulation of data) “creaming”

Outcomes	suboptimization tunnel vision myopia measure fixation gaming/ratchet effect ossification discrediting of performance indicators
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Johnson, 2005: 11

This list of obstacles suggests that implementing performance management will not be a simple task either because it includes performance measurement. Compared to the challenges of performance measurement, the problems of performance management are likely to be greater, especially if it is combined with a performance-linked pay system. Coming to a consensual agreement about performance objectives, identifying relevant indicators, getting some first hand ideas about the interaction of the performance indicators and limiting the amount of indicators to be integrated into a performance management system are just some of the challenges performance management systems face. Non-profits often have ambiguous, demanding goals and taking into account the size of most non-profits they are often overambitious missions as well. The problem of coming to a joint interpretation of the measurement results and the problem of identifying causalities between two or more indicators are two other crucial challenges of performance management systems. These challenges are even more crucial when performance management systems are implemented in the non-profit sector than would be the case in the private sector. The fact that non-profit organizations are regarded as multiple stakeholder organizations, which lack the discipline of one (financial) bottom line, often makes it difficult to balance conflicting stakeholder demands. Compared to private sector entities of similar size, the number of constituencies a non-profit organization has to take into account is in most cases higher. The absence of a dominant profit motive in combination with the prominence of substantive missions which allow a great variety of interpretation makes such a balancing of diverse stakeholder demands a difficult endeavour, particularly if one takes the governance structures of non-profit organizations into account.

Linking performance indicators with compensation schemes, discussed by Kaplan and Norton (Kaplan and Norton, 1996), can be regarded as a special challenge in situations where the measurement is not easy. The evaluation problems that most non-profit services face usually lead to noisy measures which may leave much room for window-dressing. Street-wise self-interested agents will also develop a notoriously high ability to play fast and loose with the indicators (Jacobides and Croson, 2001: 208). The problems in finding an appropriate monitoring system and in choosing the right indicators are multiplied by problems of uncertainty and ambiguity. The types of services examined by basic principal agent models refer to activities where the output is easily observable and measurable in an objective way. In real life, however, most of these activities do not meet such straight forward requirements (Prendergast, 1999). There are many nonprofit services where the output is not easy to measure. It is frequently quite difficult to define what constitutes a politically desirable outcome or even what the outputs of the non-profit services are. The definition of the most desirable output or outcome is often a highly political choice. Decades of experience with programme evaluation, with its myriad of problems regarding output and outcome measurement, show that it is highly likely that one will have to rely on proxy indicators. Linking incentives to outputs which are not easily measurable can invite dysfunctional behavioural responses. Taking into account that a non-profit service provision (like a provision by public entities) may be preferred because the quality of the services cannot be fully specified ex ante, and in some cases often not ex post, it becomes

obvious that it is fiction to believe that a non-profit service providers will only meet a high rate of objective output or outcome indicators if it simply tries hard enough.

As suggested by Holmstrom and Milgrom with regard to multi-tasking activities, it is not helpful to reward an easily measurable subset of activities (Holmstrom and Milgrom, 1991). Complex jobs, like many non-profit services performed, often include easily measurable and not so easily measurable activities. In cases where only a subjective performance evaluation is possible, the principal agent theory predicts that the agents are likely to waste valuable resources by currying favours with the principal (Prendergast, 1999: 9). Also, the problem of gaming arises (for various types see Radnor, 2005). In non-profits such gaming is often driven by good intentions. The whitewashed picture of performance reports may be regarded by the employees as a legitimate device in order to secure the financial basis of non-profit services in the interest of needy clients. From the perspective of an individual non-profit this may be rational, but for the total number of non-profits operating in a particular field it leads to an inflation of performance standards.

Jacobides and Croson argue that performance measurement (used as a generic term) may even contribute to agency loss where measurement imperfections, unobserved multitasking, casual ambiguity and latent economics of continuation prevail. Such losses can occur, whenever the insistence on monitoring destroys value by creating organizational dysfunctions (in the form of the productivity paradox, perverse learning and pyrrhic victory) (Jacobides and Croson, 2001: 212). A productivity paradox occurs if significant incentive incongruence between the principal and the agent exists and the adopted indicators are either inappropriate or monitoring is so expensive (and socially wasteful) that any social efficiency gains are offset. In situations where perverse learning occurs inefficient measures are implemented and the agent has room to beat the numbers without making any extra effort on behalf of the principal. In the case of a pyrrhic victory the present costs of implementing a new information system offsets future productivity gains. To assume that all non-profit agents are not driven by self interest but are driven because the non-distribution constraint prevents the distribution of the net earnings of the organization to individuals (members, officers, directors, or trustees) who exercise control over it, is naive.

All of the above mentioned obstacles or challenges make it clear that performance management will be a steering instrument in need of improvement when implemented in the non-profit sector. It seems highly unlikely that all of the problems can be eliminated. It is more likely that performance management systems in the non-profit sector and in the private sector as well, will only cover parts of the steering spectrum. Therefore, there is a need for additional factors to be applied. Trust could be one such additional factor since it could function as an implicit coordination mechanism. In that sense trust can be regarded as a measure to complement an explicit steering by indicators. Trust and a trust-based organizational culture could be an option which limits the necessity of explicit performance indicator-based steering and which could also contribute to limiting dysfunctional effects of performance management. In that sense a certain amount of trust and trustworthiness acts as a basis upon which to implement a performance management system. Without a certain level of trust the dysfunctional effects could easily exceed the potential positive effects of performance management.

The *fifth case* is closely linked to the second and fourth case. In this case, performance indicators may act as a safety device to limit the risk of the trust giver. Since trust can be seen as a risky investment on the part of the trust giver. The rational trust giver evaluates how risky the decision is before providing trust. This includes expectations about the consequences if the trustee does not act according to the expectations of the trustor. If trust is

not granted unconditionally, a rational trust giver bases his decision to trust on the calculation of the risk involved in the fact that the other side might exploit the vulnerability by acting in an opportunistic way. The trust giver may decide that there are risks he or she is not prepared to take. The trust giver therefore may seek out complementary measures. One option may be to enter into a performance indicator-based contractual agreement with the trust receiver. Implicit and explicit instruments are, in this case, used as complementary procedures. Such an explicit indicator-based performance contract could be targeted at limiting the foreseeable risk of the trust giver and may be the basis for an optimistic expectation formed by the trust giver. Trust, if not blind, to some extent demands control measures in order to limit the disappointment quota by the trust giver. If the trust receiver can be convinced to agree to explicit monitoring by the trust giver, this may be a step towards fostering the trustworthiness by the trust giver in the future. The readiness of the trust receiver to agree to some explicit monitoring measures in itself may be a signal of trustworthiness. As already mentioned, trust is something which is formed in a dyad of dependent interactions. The performance indicator-based safety net may act as a step towards improving the quality of cooperation. Monitoring the explicit performance indicators may also act as a measure that permits regular examination, at least on a symbolic level, as to whether a continuation of trust is still a reasonable expectation. Such symbolic control may contribute to the maintenance of a trust-based relationship. The line of reasoning in the fifth case is applicable to the use of performance measurement in all sectors.

Benefits

As far as the benefits that trust offers are concerned, Noteboom identifies extrinsic and intrinsic values of trust. According to Noteboom, the intrinsic value of trust lies in the improvement of personal wellbeing or quality of life (Noteboom, 2005: 36) whereas the extrinsic value of trust lies in the fact that it enables transactions to occur (between persons, network partners, organisations) with lower transaction costs than in the case of mistrust-governed relationships. Trust is regarded as a crucial coordination and control mechanism and as an essential feature of successful relationships (Borgen, 2001: 210). Trust does not only reduce transaction costs; but it also acts as a basis for stabilizing the expectations of the parties involved (Kubon-Gilke and Sturmer and Held, 2005: 8).

The reduction of transaction costs is something that is high on the agenda of those writers who address the economic consequences of trust. If one implements a performance management system, one will face design, implementation and monitoring costs. The design process in itself is resource consuming. Indicators have to be identified, a business model developed and questions as to if and how the indicators are to be linked with an incentive system have to be addressed. Taking into account the obstacles that performance management encounters in the non-profit sector, the design process of the performance management system faces key challenges, such as coming to a consensus about the strategic priorities or the most relevant indicators. Irrespective of the sector in which a performance management system is implemented, it is plausible to assume that the more airtight the performance management system is supposed to be against all forms of creative gaming by those who should be steered by the performance management system, the higher the design costs. The design costs are lower if the performance management system is not overburdened by too many performance indicators introduced in order to monitor the agent closely. Taking into account the identification problems of suitable and measurable indicators in the non-profit sector, the difficulties of designing an airtight system are probably even greater than in the private sector.

Implementing a performance management system is also resource consuming. A lot of energy and resources are spent on communication processes (convincing staff members of the necessity of performance management system and explaining the business model to them) that are linked to the performance management system. In addition to communication costs, resources are likely to be devoted to diminishing resistance. These are likely to be lower if a performance management system is implemented in an organization where the relationships are based on trust. Resistance is likely to be high if the performance indicators are linked to a performance-related pay system. While this linkage may encourage special efforts by the employees it may also invite all types of gaming. Given that performance management faces many evaluation problems and that many input-output-outcome relations in the non-profit sector are unclear, it is likely that a lot of energy will be spent in heated discussions over the benefits and shortfalls of the proposed performance indicators. Taking into account the fact that some services are provided by the non-profit sector (or the public sector) because they have elements that are not easily quantifiable, it is likely that choosing indicators which may serve as incentives for better performance will be a difficult task.

A performance management system is only complete if there is regular evaluation of the achieved results. Irrespective of the sector, monitoring costs are high if the monitoring system is attempting to detect all types of fraudulent behaviour of those being monitored. Taking into account the number of evaluation problems in the non-profit sector, this is an insuperable task. Looking at trust from the perspective of the principal and agent, trust decreases the monitoring costs on the principal's side. Embedding performance management in a trust-based environment may also have the positive effect that transparency is imposed internally rather than externally in the self interest of the reporting entity. Therefore, the number of obligatory reporting indicators can be reduced. In turn this reduces transaction costs. It is easier to implement true and fair accountability in environments where transparency is high on the agenda and where it is unnecessary to hide failures than is the case in environments where mistrust reigns. In the latter environments externally imposed minimum reporting obligations frequently lead to the embellishing of performance reports and to the hiding of information from the reporting entity by any means available. Trust may also reduce the need for heavy-handed third party control (Borgen, 2001: 211). Furthermore, formal contract obligations can be expensive to enforce, especially in fields where performance and under-performance are difficult to measure. In a trust-driven environment the agent probably will not spend as much time trying to find shortcuts for meeting externally imposed performance targets. On the agent's side, a trust-based relationship necessitates fewer reporting obligations to the principal and greater autonomy and flexibility in fulfilling the required tasks than is the case in a relationship which is governed by mistrust. In general, it is quite often assumed that paid employees of non-profit organizations evaluate their autonomy highly and are willing to accept lower wages and fringe benefits because their work contributes to a good cause (e.g. Anheier 2005). In addition, there will be a pay off if performance evaluation is seen not as a system which closely monitors the performance of staff members, but rather as a system that predominantly evaluates the organizational performance and organizational learning.

Irrespective of the sector involved, McLain and Hackman (McLain and Hackman, 1999: 154) regard trust in general as a mechanism for risk reduction. According to them, when compared to other risk reduction elements, trust has several advantages (McLain and Hackman, 1999: 157-158): first, trust requires less specification and management than the distribution of rewards and punishments by explicit contracts. For McLain and Hackman trust is a force that decision makers can use to manage ambiguity and future risks. Second, trust is also fundamental to relationships and decision making in organizations because it is

impossible to formulate behavioural expectations for all structural contingencies in advance. Third, trust appears to be a factor that, if reciprocated, strengthens relationships over time and is not consumed, like other forms of capital, in the process. The supply of trust increases rather than decreases with use, but if it is not used, trust can be depleted (Borgen, 2001: 210). Trust may therefore be regarded as a remedy for reducing the perceived risk and ambiguity of a decision or process. If we recall that ambiguity and problems of identifying appropriate performance indicators are especially likely in the non-profit sector, trust may play a significant role in a functional performance management system.

McLain and Hackman are convinced that on a personal level, especially in the case of ambiguous organizational decisions, the value of trust will increase and trust will *reduce employee stress*, because it is a resource for managing risk, dispersing complexity and dealing with the unfamiliar, with the help of others (McLain and Hackman, 1999: 165). The presence of trust may also encourage members of an organization to share power and control. Therefore it facilitates the implementation of organizational and personal goals through processes like delegation. Furthermore, trust encourages the *sharing of information and participation* in task complexity which in turn is essential for cooperation and for group effectiveness (McLain and Hackman, 1999: 171). In a trust-based culture, the information advantages of the agent are not viewed as a disadvantage but rather as a necessity in a highly specialized process of production (Goebel, 2002: 127). The principal thus benefits from the information advantage of the agent who is the specialist for the required task. The principal does not use his energy in designing overburdening monitoring systems. Therefore agency costs decrease.

Another beneficial effect of trust may arise in the context of organizational learning. This is especially important in a mistrust and blame-driven management culture where a lot of energy is spent by the parties keeping their backyards clear and assigning the causes for failure either to someone else within the organization or to extra organizational factors. An open-minded analysis of areas for improvement is more likely to occur in an organization with a trust-based culture. A no-blame culture enhances an open-minded identification of areas for improvement, which is a first step towards organizational learning. If the analysis of failures is already blurred and the diagnosis is unclear, it is difficult to identify the right counter responses. Organizational learning may also have benefits if the search for improvements is a joint endeavour. There may be positive impacts on the quality of the proposals made as well as on the overall acceptance and the authority to implement the measures identified. Some improvements are only possible in and through mutual co-operation. Organizational learning and trust are elements that have a positive effect on one another as building and maintaining trust requires an environment of shared problem solving. Repeated success in trust-based problem solving greatly strengthens trust between the parties involved (McLain and Hackman, 1999: 162).

On the structural level McLain and Hackman also regard trust as a force supporting an adaptive organizational structure. Trust in their view is more flexible, adaptive and generally applicable than frameworks that are enforced by formal policies and procedures (McLain and Hackman, 1999: 171).

Trust-Building

Taking into account all the beneficial effects of trust in the context of performance measurement, this section discusses what directions the increasing literature on the soft factor “trust” suggests with regards to the design of performance management systems as a steer-

ing instrument in the non-profit sector. For analytical reasons one has to distinguish at least three levels of trust-building in the context of performance management. First, a performance management system runs more smoothly as a steering instrument if the relationship between the parties is based on trust. Second, the performance management system itself must fulfil certain requirements in order to be considered trustworthy. Third, the performance management system may be an approach which is central to any effort to build system trust. On all three levels, trust is something to be built and maintained. The act of trusting can be regarded as a temporal phenomenon since it is based on experiences, interactions and perceptions of others, of organizations and of institutions over time (Caldwell and Clapham, 2003: 351).

On the individual level trust can be seen as a specific investment by the trust giver in the expectation of a positive reaction by the trust receiver. For the trust giver trust can be seen as a risky investment which she/he is only willing to make if the chances of keeping that trust are higher than 50%. Trust may be regarded as an attitude which reflects the willingness to assume a risk and relinquish control in the hope of receiving a desired benefit (Caldwell and Clapham, 2004: 351.). The propensity to trust is influenced by one's inherent orientation towards trusting, by habit, by stable belief and by one's history of positive experiences (McLain and Hackman, 1999: 165). In the past, trust has been one of the central steering mechanisms found in non-profit organizations. Nowadays, however, the service providing non-profit organizations often have to fill a credibility gap. The necessary introduction of management techniques and procedures, in non-profit organizations, is often accompanied by intensive discussion by the paid staff and volunteers who fear commercialization and an erosion of trustworthiness.

Trust, being something that is difficult to enforce, cannot easily be installed. Trust building takes time. Furthermore, there are dimensions of trust which are often totally beyond control. Noteboom, for example, regards trust in the form of empathy or identification as two foundations of trust that cannot be engineered (Noteboom, 2005: 41). The formation of an optimistic expectation of the trust giver requires an informational basis. According to Noteboom, there are various necessary options which are not only valid for the non-profit sector. Trust may be something which can gradually replace control measures. Over time and when the trustee has proven to be reliable, trust may even come to replace explicit control measures. In this case, the basis of trust is the past trustworthy behaviour and the past performance. For Noteboom, one problem with that approach is that the implemented control measures may be better designed to control opportunism and in themselves signal distrust. Trust building at first should overcome distrust and "when a relationship starts on such a footing, it may be difficult to turn around to a trust-based relationship" (Noteboom, 2005: 48). Another basis for forming an optimistic trust expectation could be the expected future behaviour and performance. In that case the reputation of the trustee would provide a possible basis for the trust-building. As already noted non-profit organizations were traditionally regarded as trustworthy. The reputation of being trustworthy is something a trust receiver may not want to compromise, for example, in order to keep things simple and to maintain a certain amount of autonomy. Irrespective of the sector, a good reputation is a must for all providers of credence goods.

Trust-building could furthermore be achieved by starting with small steps that limit the risk and expand vulnerability as trust grows. It could even be rational to start more ambitiously with bigger steps as long as they balance mutual interdependence so that untrustworthy behaviour can be immediately responded to (Noteboom, 2005: 49). For Barber trust also has to do with the expectation that the performance of a role is technically as well as morally correct (Barber, 1983).

Recalling the discussion on trust as interpersonal relation and factors like integrity, that is the reputation for honesty and trustfulness of the parties involved, it is clear that competence in the form of technical know how and interpersonal skills to perform the required job, consistency (reliability, predictability and good judgement in handling the situation), loyalty and openness are also important factors for personal trust building (Butler and Cantrell, 1984). One drawback is that these factors can only be partially influenced. Trust, once obtained, does not always continue to exist. It is more reasonable to assume that the trust giver re-examines his/her optimistic expectation at regular intervals. The behaviour of the trust receiver in critical or potentially conflicting situations is vital for prolonging trust or for a change from trust to mistrust. If the trust receiver, in such situations, aims for his short-term benefit, trust may easily be withdrawn. On the other hand, if the trust receiver opts for a trustworthy behaviour, trust will deepen. As already discussed above, interpersonal trust may act as the basis for implementing a performance management system. Interpersonal trust lowers the transaction costs and makes the implementation of a performance management system easier, especially in a sector where the operational problems of a performance management system will be high.

Trust and trustworthiness are also linked with the culture of an organization. Many of the factors for interpersonal trust refer to value positions and basic attitudes. In that context, Sydow advocated a trust-sensitive management. Irrespective of the sector where it is applied, this form of management considers the way decisions, forms of contracting, monitoring, communication, events, procedures, forms of punishments and rewards effect the development of trust (Sydow, 2000: 54; Noteboom, 2005: 47).

Where the focus is on trust building in a performance management system, the literature on trust, which mainly deals with interpersonal trust, does not offer much guidance. Elements like integrity, honesty and empathy are linked with interpersonal relationships and not with organizations. Aspects like reliability and competence are more easily transferable. A management tool commands trust if it is in itself trustworthy. When implementing a performance management system, questions may arise concerning the purpose of such an instrument. Those supposedly being coordinated by the instruments of performance management suffer from the fear of being controlled by it. A similar kind of resistance against both management by objectives and individual target agreements can be found across the sectors. In the latter case, target agreements were not welcomed with enthusiasm by the employees. This shows that the introduction of a performance management system needs a careful but decisive communication effort in order to make the purposes of such an instrument clear and to reduce cognitive and emotional mistrust assumptions. Trust is probably only generated if those who should be steered by the performance management system believe that the system is not specially targeted at supervising them. A second critical phase is the process of coming to an agreement about the indicators to be included. It is necessary to implement a transparent process targeted at arriving at a common and shared understanding of the expectations regarding the outcome of the performance management system. Shared expectations are not only necessary at the level of the general purpose of the management system but also on matters regarding the tasks assigned to individuals and teams. The tasks assigned to individuals or teams must also be in line with the competences and capabilities required. Furthermore, it is necessary to implement a consensual system that describes how to deal with conflicting issues and how to implement organizational learning.

Another issue that needs attention is determining when and how the performance management system is to be linked with a performance-related incentive system. It is normally

very difficult to link the latter with the former in the non-profit sector. Even if the output and outcome could be clearly observed, problems exist regarding the identification of any clear cause-and-effect relationships between the observed output/outcome and the actions of individuals or teams. An alternative way of linking the performance results to financial rewards could be to link them with personal development targets or organizational development goals.

Creating trust in a performance management system requires not only good implementation management but also a trustworthy performance. This trustworthiness will only be generated in response to past experiences. Looking at both the fears of those who should be steered by a performance management system and the reputation of performance management, it is unlikely that a performance management system will receive substantial support in advance.

In some parts of the non-profit sector the initial conditions for trust-building are not good because performance management often tends to have a strong focus on control, at least in the perception of some employees. Non-profits do not have a long tradition of using management tools like management by objectives, which contributes to mistrust. Furthermore, in Germany performance management was sometimes introduced in non-profit organizations in combination with a reduction in public subsidies for non-profits. Performance related pay schemes were sometimes constructed in such a way that even the high performer had to accept a salary decrease. This did not make performance management a popular instrument in an area where emotional defences against performance management regularly exists.

On a third level, performance management may be an instrument for building organizational trust. Its potential for creating the impression that the non-profit organization is up to date with modern management practices was already addressed in the previous section. Taking the criteria of Caldwell and Clapham on organizational trustworthiness into account, a performance management system could address all three aspects of the ability dimension. Furthermore, as a communication system it has a link with the responsibility to inform and may include standards of procedural fairness.

Whether or not the implementation of a performance management system simultaneously leads to building system trust depends not only on the performance of the system and the attitudes of the internal stakeholders towards performance management, but also on the view that central external stakeholders have of performance management. Do they see it as a potent remedy for modernizing the non-profit sector or does the erosion of trust in the trustworthiness of non-profits prevent the strategic stakeholders from having any positive expectation at all?

Summary and Directions for Further Research

Trust is one of the soft factors which are slowly gaining more and more importance in the search for more effective performance management tools in the non-profit sector. Trust and trustworthiness in general, have always played an important role in the non-profit sector. Non-profits offer goods with credence qualities and also produce relational goods and goods with positive external effects. The greater trustworthiness -- in comparison with their private competitors -- due to the non-distribution constraint is one of the guiding aspects of supply-side approaches which explain the existence of nonprofit organizations. Demand-side approaches also refer explicitly to trust as an important factor.

A look at the economic literature shows that trust has been slowly gaining importance. However, definitions of trust illustrate a lack of conceptual clarity. Trust is a paradoxical and rich concept which is accompanied by much ambiguity and confusion. Common definitions of trust addressed by the organizational literature include: trust as an optimistic individual expectation, trust in interpersonal relationships, trust as the basis for economic transactions and trust in the context of social capital. Trust can be regarded as a concept that is rich but complex and difficult to engineer. Besides personal or individual trust in more complex social structures, system trust or organizational trust needs to be analysed.

With respect to the first research questions five cases were differentiated. Case one referred to situations where trust as an implicit steering instrument is solely used. Case two described situations where an explicit steering by performance indicators had substituted the former trust based relationships. The complementary relationship was addressed by this paper in three variations: performance management as a basis for system trust, trust as the basis for performance management and performance management as a safety device within trust-governed relationships.

Recalling the second research question it can be stated that a performance management system embedded in a trusting management culture produces many benefits. Where transaction costs are concerned, the design, implementation and evaluation costs decline. Furthermore, trust is a non-specific risk reduction mechanism and a remedy for ambiguous situations. Beneficial effects also arise in the context of complex problem-solving and organizational learning. With respect to trust-building (third research question), there are at least three distinct levels. There is the interpersonal level, which implies that the relationship of the principal and agent contains a certain amount of trust. Second, trust-building is also necessary with respect to the instrumental level. Last but not least, a performance management system can be defined as a means for increasing trust in the capability of non-profit organizations and therefore as an instrument for improving system trust. The latter is only possible if performance management is regarded as a useful instrument by important external stakeholders.

This paper mainly addressed the issue that trust could be a beneficial factor in the context of performance management in the non-profit sector. Some of the aspects addressed herein are also applicable to other sectors. However, much more research is needed, especially when looking at how to move from mistrust-driven relationships to formerly trust-governed relationships in a field where theoretical reasoning as well as the behaviour of a few actors have partly eroded the belief that non-profit service providers are always acting with the best intentions and that intrinsic motivations still play an important role.

The general literature on trust has also shown that trust-building requires time. Elements of the non-profit sector have lost a lot of their original trustworthiness. In particular, the entrepreneurial non-profit organizations, which operate in competitive markets, sometimes face a serious problem of mistrust. Either they are regarded as inefficient or they are confronted with the allegation that they are distinguishable from their for-profit competitor in their behaviour. Faced with such allegations it can be expected to take quite some time to build up trust again. Today many non-profit organizations have to prove that they are trustworthy. According to Luhmann, in situations of mistrust more information is needed for creating trust than in situations where mutual trust exists. At the same time the amount of information which is regarded as reliable is smaller in mistrust situations than in situations of trust. (Luhmann, 2000).

Today there are no clear concepts as to what could be the most relevant basis for trust-building in the context of non-profit management. Good Governance, high reliability and good service quality may be among the relevant factors. To be as businesslike as the for-profit sector and to copy their behaviour patterns has proven in the past decade not always to be the most successful option. In addition, is an open question as to who and what could act as a mediator in order to help to speed up the process of trust-building.

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