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ABSTRACT

This article addresses the subject of management control, trying to create a performance measurement system for social enterprises, i.e. how to measure success.

Three reference fields for management are analyzed: (1) economic-financial performance, linked to the determination of general performance (profits, value added, etc.) and analytic results (production-cost of services, efficiency indicators, etc.); (2) social effectiveness to measure the quantity and quality of work undertaken and to identify its impact on the intended beneficiaries and the community; (3) institutional legitimacy, verifying conformity with law and mission statement.

In integrating these aspects, we propose a multidimensional controlling framework that is appropriate to the management of a social enterprise.

INTRODUCTION

Management control systems are valuable for orienting the behavior of an organization – both as individuals and as an institution – toward the fulfillment of goals. Predominantly, such control is achieved by means of measurement instruments that are quantitative and quantitative-monetary, with attention also to the increasing importance of qualitative aspects.

When management control concerns a social enterprise (SE)—that is, a social mission-driven organization that trades in goods or services for a social purpose (Borzaga and Defourny, 2001; Nyssens, 2006, Kerlin, 2006)[≠] the related performance measurement systems necessarily assume multiple profiles¹. Actually, an SE should be multi-stakeholder, sustained mostly on earned income and run business that itself accomplishes the social aim through its operation (e.g., integration of disadvantaged people through work; provision of social, community, and environmental services; ethical trading).

Therefore, when referring to an SE as a firm that answers to the community rather than to shareholders (Pearce, 2003), management control becomes instrumental to a vision of general accountability, in the sense of responsibility and the correlated duty of disclosure (Gray, 2001).

Moreover, management control and the related measurement systems are the main instruments that guarantee the availability of data and information for an accountable disclosure. It follows from this that it is appropriate to implement a multidimensional control system over three management-reference fields, in other words, a system that adds consideration of normative-statutory constraints to the traditional double bottom line (Emerson and Twersky, 1996)². These three fields are:

- financial, both for financial statement disclosure and cost-accounting;
- results-based, referable to the concept of (social) effectiveness;
- institutional legitimacy.

Although SEs are established for purposes other than profit (Gui, 1990; Valentinov, 2008), the financial field should not take the entity's legal type into consideration, but rather focus on the activities carried out and therefore on the goods and/or services realized³. Nonetheless, it is important to measure efficiency and profitability in order to verify entrepreneurship as a basic component of assessing overall effectiveness (Ritchie and Kolodinsky, 2003, p. 368). On the one hand, this control will be carried out by means of a financial accounting system (suitably configured) and above all by the preparation of a financial statement designed to furnish the necessary information regarding efficiency and profitability. On the other hand, it requires the institution of a suitable system of cost accounting within the organization, in order to translate the supply-chain into financial values through recording and analyzing the costs associated with products/activities undertaken.

The control focused on results, in contrast, corresponds to an evaluation of social effectiveness. In other words, this control field verifies an SE's capability to answer to the social purpose for which it has been established and managed. It deals with quantitative and qualitative analyses that, besides appraising (physical) inputs and outputs, aims to identify and evaluate benefits to the recipients of outputs, together with the impact on the general well-being. The implementation of these types of measurements also establishes an optimal informational basis for constructing formulae for social reporting (Gray, 1997).

Finally, control regarding compliance with institutional legitimacy is normally reported through:

- checks on institutional coherence (encompassing control of the correspondence among activities undertaken, the results achieved and the goals established in a mission-statement, in the statute of the entity and in the targets set by the board);
- conformity with national and international law.

These fields of measurement and control are obviously broadly interdependent. However, in order to achieve clearness and intelligibility, this article deals with each separately, trying to define the most useful key-indicators within each area and to transform this variety into a unitary control system characterized by a strategic approach (Kaplan, 2001; Somers, 2005).

FINANCIAL PERFORMANCE

Economic and financial performance measurement is used by SEs to check their financial accountability. In this way, management control systems are necessary in order to measure an organization's effort to reach an economic equilibrium – that is, to obtain a normal profit including the average cost of equity-capital (Giannessi, 1960). Unlike other non-profit voluntary organizations or foundations, SEs are first and foremost enterprises and therefore their social goals are to be pursued only by respecting economic and financial efficiency.

It follows from this that it is necessary for SEs to adopt a double entry accounting system focused on the accrual principles applicable to for-profits and to establish well-constructed financial statements (Torres and Pina, 2003). The purpose of this is to be able to control economic and financial values and to guarantee a true and fair view of the annual accounts in order to assess:

- economic efficiency, not only in terms of the bottom line, but also providing full details of all parts of the income statement;
- the financial situation, considering assets, liabilities and net equity.

More specifically, with regard to the income statement, it will also be appropriate to work out formats that can express the incomes of the various participants in the production process - that is, to use a value added approach in order to disclose revenues, expenses and the final result.

A value added statement uses information from the financial accounts to calculate the value added by an organization through the transformation of externally purchased goods and services (Burchell *et al.*, 1985). It looks beyond income to encompass ownership and includes the wealth created for a wider group of stakeholders (Mook *et al.*, 2003). There are three possible approaches, each of which responds to a different definition of internal and external resources⁴:

- for the accountancy discipline and for professional accountants, value is added by using labor and capital: therefore, internal expenses are labor costs such as wages and employee-benefits, depreciation and investor-earnings, while external expenses are goods and services bought outside the company;
- for social accounting, internal expenses concern the economic flows destined to a wider group of stakeholders, namely human resources (both employees and collaborators), the community (income taxes) and investors (equity or debt) etc.;
- for mutualities such as cooperatives, internal expenses include all payments to the partners and the related network, in accordance with the international cooperative principles (International Co-operative Alliance, 1995).

While it can almost always be observed that organizations making use of the “external” profile of economic-financial analysis - albeit with different degrees of analytic depth - the “inside” profile appears less widely diffused, above all when referred to budgeting ⁵.

For an SE, it is often difficult to plan for the future. The reasons for their substantial incapacity for forward thinking and multi-annual planning and budgeting include dependence on public spending and/or working with projects financed by investors who are pursuing social aims, and sometimes also the lack of markets combined with weak capital structures due to their average small size.

It follows that it is important to track, record and analyze an SE’s activities and income components (and above all costs) at least in the short term. That is to say, it is necessary to identify reasons for the emergence and the variability of revenues and expenses. In operational terms, then, the implementation of this planning and control system will entail a change of form, from natural to destination-based accounting.

The following steps put the above approach into effect:

1. definition of cost-absorbing items: an SE should clearly define its core responsibilities – “responsibility-centers” –to collect and report revenue and cost information by areas of responsibility. This requires that the SE assigns the responsibility-centers in relation to its organizational structure, matching these to specific functions (administration, project-planning, cost-pooling, etc.), activities and/or realized goods and services. In the initial phase, it may be useful for the SE to refer to the financial accounting statement as a basis on which to design its organizational structure;
2. analysis of cost-behaviors and cost-drivers: an SE should seek to apply the principles of objectivity and convenience when allocating costs to responsibility-centers, and should attribute costs on a robust and consistent basis;
3. concrete revenue and cost allocation, as defined in points 1 and 2.

Finally, the economic values (ex-ante or ex-post data) are reclassified according to responsibility-centers. Thus, purchases, services, labor costs, depreciation, etc. need to be distributed within the organizational structure of control.

As outlined, this internal control serves the following purposes:

- development of partial results for assets/services/products, elaborated as synthetic performance accounting expressed as gross margin;
- subsequent evaluations of sectional profitability and efficiency for each input.

Note that the capacity to allocate expenses according to the organizational structure can generate interesting business information.

First, it makes the cost of running certain activities – administration, the purchasing department, the planning department, etc. - evident

Second, it permits the determination of appropriate cost configurations for the "production" of specific goods/services – a home visit, training hours, etc. – in order to assess affordability compared to the revenues.

A better understanding of the costs of production also enables an assessment of the ability to compete with the reference marketplace and, above all, enables participation in public calls for tenders.

In addition, where the market is wholly or partly made up of members/associates, knowledge of production-cost provides an important benchmark for pricing decisions.

Finally, for more complex management activities, it has become possible to draw up sectional accounts to record profitability (cost efficiency), highlighting economic performance and each section's gross margin as part of the total SE's financial statements.

Moreover, a fuller knowledge of the contribution made by individual inputs toward the realization of an activity or a good/service can also give rise to calculations of efficiency (productivity), typically with reference to human resources.

To date, attention has been devoted mainly to ex-post data, focusing on ways to highlight economic performance – economic and social value added – and on the possible adoption of an analytical reporting system capable of detailing functions, goods/services or sectional profitability (activities, projects, etc.).

However, the optimal implementation of a control process requires both the ability to measure data ex-post and also to plan activities ex-ante, in other words, future planning: drawing up a global budget and making forecasts of analytical cost/revenue. The management of an SE needs to have an ability to predict the company's future, representing this in terms of quantity-monetary values.

This emphasis on planning – namely the ability to move beyond the tackling of day-to-day matters, by means of planning decisions and providing a description of tasks – allows management to develop a proactive approach. Planning also means being able to coordinate overall business and verify in advance compliance with the main mission-objectives.

The pursuit of economic balance over time also relies upon proper cash management, the ability to locate and deploy the necessary financial resources. When the market is characterized by the presence of "late payers" – as it tends to be the case for SEs with public-sector clients – the ability to optimize cash flows becomes crucial.

Moreover, while non-profit organizations in general are financed both by fundraising and performance, SEs specifically will tend to acquire only a reduced percentage of their resources without making corresponding commitments. As a result, the issues of cash management, which are very close to those of traditional enterprises, are connected to a dynamic economic and contractual capacity on the side of commissioning, supply relationships and the ability to refer to funding programs devoted to social purposes.

In addition to this, it is important to take into consideration the problem of under-capitalization, because the non distribution constraint hinders the attraction of capital and the creation of a balanced financial structure.

SOCIAL EFFECTIVENESS

Although in recent years increasing attention has been paid to business models that control efficiency and effectiveness and orient SEs to implement the financial measurement systems discussed above, this model of management control necessarily also includes a non-financial results assessment. Effectiveness – seen as the ability to achieve goals and implement strategies while using resources in a socially responsible way – becomes important for assessing an SE's success.

For a profit-driven enterprise, effectiveness-measurement can be summed up by reading the income statement and by benchmarking quantitative data such as profits or returns-on-investment compared with those of competitors.

In contrast, while financial data certainly play an important role for an SE, effectiveness becomes fundamental to meeting the social needs it has been designed to address, thereby pursuing its mission. This is “notoriously intangible and difficult to measure” (Kanter Moss and Summers, 1987, 154).

On one hand, attention to output assessment should try to measure what has been concretely achieved as a result of the SE's activity. On the other hand, it is also necessary to consider to

what degree that activity has contributed to the well-being of the intended beneficiaries and also has contributed to community-wide goals. Moreover, the “social” point of view needs to consider not only the output, but also the sustainability of the entire process (Darby and Jenkins, 2006). That is, it should recognize and include economic, social and environment-related elements regarding the choice and use of external resources.

In other words, a suitable evaluation of a SE’s overall effectiveness could incorporate many diverse key indicators. The performance measurement (UK Voluntary sector research group, 2003; Kendall and Knapp, 2000) should include the following:

- inputs, namely the resources that contribute to the activities undertaken;
- outputs, in terms of both activities realized to achieve the mission and direct and countable goods/services obtained by means of the activities carried out;
- outcomes, the benefits or impact for the intended beneficiaries;
- impact, the consequences for the wider community.

With regard to inputs, there are several assessment possibilities. Besides a cost-efficiency analysis related to outputs/outcomes, a social-effectiveness perspective has to consider the responsible use of resources, that is, to evaluate the socially responsible behavior of SEs when producing services (or goods). In other words, a sustainable SE should pursue community interest by:

- choosing local suppliers to favor short supply chains;
- choosing socially or environmentally certified suppliers (Sa8000 or other “ethical” certification, Eco-management and audit scheme - Emas, etc.);
- adopting a regime of decent work conditions (safety, health, etc.)

Moreover, there should be maximum disclosure with regard to the chosen governance model. In other words, an assessment of social effectiveness also entails consideration of whether the members of an SE’s board represent shareholders or stakeholders. Board members may be elected because of their expertise in managing assets or because they represent stakeholders and, consequently, when assessing overall social responsibility, it is important to know which governance model is preferable – that of stewardship or democracy (Low, 2006; Cornforth, 2004).

The second approach to non-financial performance measurement uses the analysis of outputs in the narrow sense. This involves highlighting the “physical” product of the activities carried out by a SE, as a valuation (or quantitative accounting) of outputs. Additionally, such information can be analyzed in relation to relative production-costs and ultimately against the income generated, to measure economic efficiency (productivity).

The third key element in a effectiveness control system is the measurement of outcomes. This is distinguished from the analysis of production in quantitative terms by its focus on qualitative results, with the aim of evaluating the “benefits” (positive effects) that flow from activities undertaken to the intended beneficiaries. Outcomes can be measured either as internal (the achievement of a mission and chosen objectives) or as external (client/user satisfaction). For example, this would require the verification of:

- the success of a program of re-insertion (improving the life prospects) of a disadvantaged individual;
- the utility to individuals of a post-university training program, measured in terms of employment outcomes;
- improved mental health at the end of a support program;
- a higher artistic/cultural understanding as a result of social tourism.

In short, this can be defined as the real utility/impact of an operation, above all in terms of its achievement of goals in accordance with the SE’s mission. In these terms, success can also be defined independently of the concrete amount of produced outputs.

Finally, it is interesting to consider the measurement of impacts on the wider community, recognizing the secondary effects that may accompany the work of a SE. Here, effectiveness control focuses on the contribution made by the SE to the creation of social capital and collective well-being, through the identification of parameters by which to measure medium or long-term impacts⁶.

Moreover, there are methodologies that translate such impacts into concrete financial-economic calculations. For example, when a SE's activity pre-empts a need for intervention by the public authorities, this can be defined as a revenue, in that it represents a collective saving to the collective purse. In other words, this approach quantifies impact as "avoided expenditures"

INSTITUTIONAL LEGITIMACY

Institutional legitimacy control involves verifying that the SE has respected its self-imposed "rules" (statute, mission, program of action) and the legal norms applicable to its institutional formula⁷.

The first aspect, namely a verification of institutional coherence, is usually dealt with through mission-accounting, demonstrating that the SE has respected its own mission and constitution. Here it is interesting to note the methodologies which, on the basis of the mission statement, check off itemized points correlating them to sub-objectives, activities carried out and results achieved.

The second aspect of legitimacy concerns the respect for the general and particular legal regimes that govern a SE, specifying the conditions for its creation and functioning (Kerlin, 2006). By way of example, the Italian law regarding social enterprises (D.Lgs. 155/2006) prescribes appropriate procedures for involving staff in relation to the intended subjects of the organization's activities. These regimes require that the SE foresees mechanisms that will be capable of accommodating a multi-stakeholder approach to managing an enterprise, as well as social reporting (Marano, 2006). This approach is also seen in the recent UK law concerning Community Interest Companies (CIC), which requires that obligatory reporting include information regarding modalities for the stakeholders consultation.

SYNTHESIS

The above multiplicity of reference fields implies a final problem: SEs will need to implement a multidimensional management control system. Consequently, their management finds itself called upon to discover means to unite all the three profiles that have been discussed, constructing a map of indicators and instruments for measuring "success".

Returning therefore to our three reference fields – financial performance, social effectiveness and institutional legitimacy – this article concludes that a series of variables can be elaborated as a measurement scheme for concrete implementation. These variables should integrate the various fields of analysis, representing the decided programs and budgets and could be used for ex-post evaluation of what has actually been done by the SE⁸.

While recognizing that control systems need to be designed to reflect the specificity of a particular SE – following its characteristics and information and monitoring needs – it is nonetheless useful to spell out the following proposal for a synthesis of the key information. The indicators given correspond to the performance measures that this analysis has judged significant, and can be determined both programmatically and definitively, so as to enable an effective explication of the control process.

The SE's management should point out the following aspects:

1. for the economic-financial field
 - the income statement, demonstrating economic equilibrium, at least in terms of break even;
 - economic and social added value, demonstrating the equitable remuneration of stakeholders involved in the production process;
 - the cash flow generated and thus the capacity of the SE to maintain a financial equilibrium compatible with its marketplace and with its particular investment and development strategies;
 - the incidence of production-costs on revenues, also compared with other market players (for-profit, public, non-profit);
 - the cost of activities/projects and goods/services, providing quantitative data on the basis of which prices are fixed and tenders for public calls submitted;
2. for the social effectiveness field
 - evaluation of the sustainability of resources and production methods (environmental and social);
 - output in terms of "physical" results: the number of services, actions etc.;
 - outcome-indicators on the basis of concrete actions and in relation to external benchmarks;
 - evaluation of economic and social impact;
3. for the legitimacy field
 - institutional coherence, thus the coherence of activities with the stated mission;
 - compliance with general and particular laws applicable;
 - compliance with secondary norms;

Moreover, in matching these three dimensions, it could be useful to obtain further integrated measures:

4. for the economic-financial and social effectiveness field
 - productivity of inputs (labor costs for services rendered, etc.)
5. for the economic-financial and legitimacy fields
 - compliance with the non-distribution constraint
6. for the social effectiveness and legitimacy fields
 - correspondence between achieved results (revenues, outcomes, impact) and the SE's stated mission;
 - the involvement of workers and users/beneficiaries in decision-taking.

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¹ Although this article explores a framework for objective evaluation, it is important to state that performance measurement can be largely subjective (Herman and Renz, 1997). SEs and non-profit firms in general have multiple constituencies (stakeholders) that may differ in how they evaluate effectiveness. Consequently, organizational effectiveness is not a single reality but a more complicated matter of differing interests and expectations.

² “A non-profit organisation has several bottom lines because no price mechanisms are in place that can aggregate the interests of clients, staff, volunteers and other stakeholders that can match costs to profits, supply to demand and goals to actual achievements.” (Anheier H. K., 2000, p. 6).

³ In certain countries, SEs pursue their aims by adopting for-profit legal vehicles in order to be free to produce revenue by running commercial activities. In this way, they can obtain moral legitimacy in strongly market-oriented cultures (Dart, 2004).

⁴ The income equation $Revenues - Expenses = Income$, becomes $Revenues - External Expenses = Income + Internal Expenses = Value Added$. The point is to decide where to fix the boundaries of internal and external costs.

⁵ Not least, the collection of internal data for management control plays no part in fulfilling accounting regulations – civil and fiscal – and therefore is adopted only on a voluntary basis.

⁶ The amplitude of the relevant parameters obviously makes it difficult to identify effects as owing to the work of an SE. Among the best references available are the indicators recorded by the alternative wealth calculation methods, such as the Genuine Progress Indicator (GPI) and the Happy Planet Index (HPI).

⁷ See the following examples of SE regulations: *La société à finalité sociale* in Belgium (1995), *l'impresa sociale in Italy* (2005-2006), UK Community interest companies (2004), *la Société Coopérative d'Intérêt Collectif SCIC* in France (2001).

⁸ Management's efforts to realize the integration of the various measurement indicators and instruments leads to an integrated control-framework. This is a means to avoid the difficulties that arise from an excessive variety of commitments and objectives, or, as Drucker affirms, the lack of a traditional bottom line (“What is the bottom line when there is no ‘bottom line?’”). See P. DRUCKER, *Managing the non-profit organization: practices and principle*, Harper Collins, New York, 1990, p. 107.