

Managerial Insights for Arts Cultural Organizations: A Review of COQ Theory and its Potential Application

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ABSTRACT

This study explores the potential application of Cost of Quality (COQ) programs to nonprofit Arts and Cultural Organizations (ACOs). At first, we assess the unique nature of ACO nonprofit operations and propose a framework of processes using Deming's model of business operations as a guideline. We identify two typical and distinct activities, "creative" and "administrative" that coalesce at certain phases in the ACO operation cycle. We then examine the scope and complexities of analyzing prevention, appraisal, and failure costs within our framework of ACO operations. Subsequently, we establish different types of costs, "high-yield" and "low-yield" associated with the creative and administrative activities of ACOs. Finally, we suggest that the application of cost of quality can significantly benefit ACOs in improving efficiencies and achieving their missions.

INTRODUCTION

The nonprofit sector comprises organizations with a public service mission or purpose. This sector is growing in importance, accounting for six percent of national income and employing seven percent of the American workforce (Independent Sector, 2002). However, significant challenges are facing the sector. Observers have identified significant sector-wide weaknesses in the areas of operations and management that may be hindering capabilities for improvement. Furthermore, one area within nonprofits may be substantially overlooked in terms of business applications to operation efficiencies: Arts and Cultural Organizations (ACOs). While smaller

than most other parts of the nonprofit sector, the scope of arts and cultural organizations—including museums, heritage centers, orchestras, theaters, zoos, performing arts organizations, and fine arts groups—and their impact is often underestimated. ACOs account for over 25,000 private nonprofit entities in the U.S. (National Center for Charitable Statistics, 2002).

Despite their significance, there has been little emphasis in the academic literature on the application of management techniques to improve operations in ACOs. For example, ACOs have generally been slower to embrace the quality movement, including measurement of costs, value, and quality improvements in comparison to other non-profits such as Hospitals (Holman, Daily & Weisinger, 2003). However, it is becoming increasingly difficult for ACOs to continue on this less than proactive course in terms of managerial improvements. At the same time, the unique and complex nature of ACOs makes it difficult to find answers to their operations and management difficulties. Perhaps, a quality tool, Cost of Quality that serves as a systematic device for review and measurement of opportunities for improvement, could be effectively applied in ACOs. This application seeks to increase a company's profitability by reducing - often substantially - the costs of poor quality. We suggest that valuable insights exist in using the for-profit sector's definition of quality and cost of quality programs to help ACOs accomplish their artistic and cultural missions. Hence one objective of this paper is to develop a model of ACO operations, based on W. Edwards Deming's model of business operations. Revising Deming's flowchart to represent the operations of a typical ACO serves four purposes. First, it shows that these operations can be represented in the same basic cyclical form of any basic industrial organization. Second, it introduces a terminology for the processes inherent in these operations that is appropriate for ACOs, and suggests a set of linkages among these processes. Third, it identifies separate threads of creative and administrative activities that take place simultaneously and merge at key points in the operations cycle. Fourth, it serves as an essential framework for understanding cost of quality issues in ACOs.

BACKGROUND

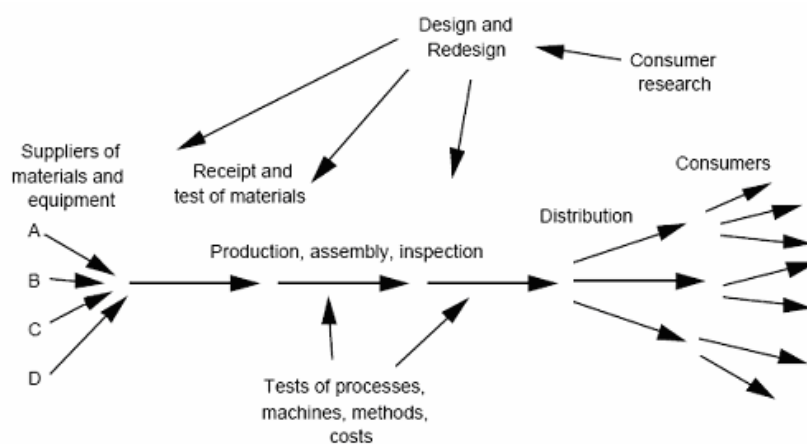
Arts and Cultural Organizations (ACOs):

Arts and cultural organizations differ from other nonprofits in two important respects. First, they have generally been slower to adopt modern management practices than organizations in other parts of the nonprofit sector. In addition, senior staff members in ACOs have traditionally been trained in the academic discipline of their organization, not in broader management skills (Tolles, 1991). Second, ACOs have for many years been largely able to avoid the difficult but critical issues of accountability, outcomes measurement, and the measurement of value and quality that have caused nonprofit organizations in other fields to re-examine their purposes and practices. But, it may not be possible for arts and cultural organizations to maintain this traditional stance. Outcomes measurement of the type used by the United Way to evaluate and assist the social service agencies they fund is spreading (Hatry et al, 1996). The application of cost of quality for ACOs will be appropriate only when such concepts are adapted to meet their requirements. In particular, nonprofit goals are usually defined in terms of mission rather than money (Light, 1998). In this paper, the connection between mission and operations is made through a model of ACO nonprofit operations based on a model of business operations first suggested by W. Edwards Deming.

A Flowchart of Aco Operations:

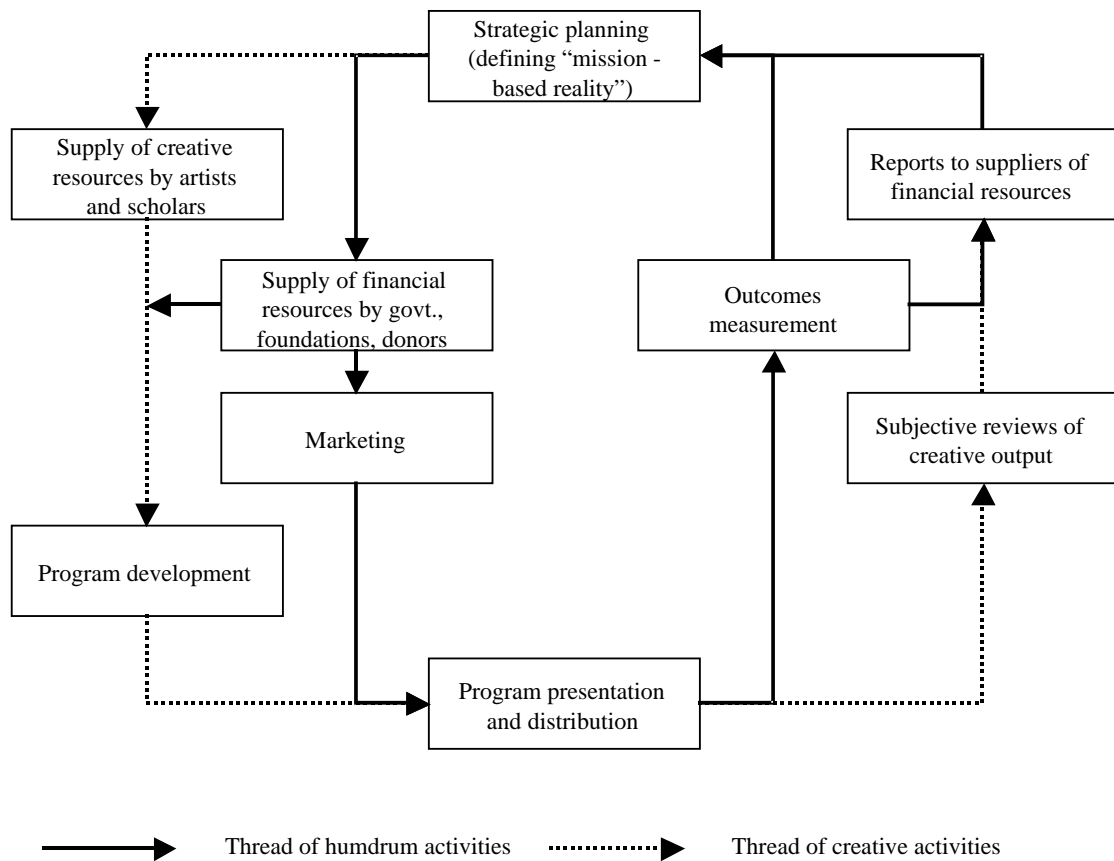
In its most generic form, the operations of an organization can be described in linear terms: Inputs (material, labor, capital, land) → are transformed by processes → to create outputs in the form of products (either goods or services) (for e.g., Tersine, 1985, p. 9). W. Edwards Deming expanded on this traditional framework to illustrate some of his ideas about quality (Deming, 1982, p. 4-5) (See Figure 1).

Figure 1. Production viewed as a system (Deming 1982, p. 4).



Similar themes exist between the Deming model and the revised framework for ACOs proposed here. For instance, ACOs operations also seem to flow in a cyclical mode. Each operation/process impacts and is impacted by its adjacent process, thereby suggesting a set of linkages among them. In addition, key entities including suppliers, customers, employees, and operations in the Deming model such as distribution and customer feedback activities also apply here. However, several alterations to Deming’s model are proposed to provide a better fit to the ‘mission-based realities’ of ACOs. The most significant alteration is the identification of strategic planning as the keystone activity of nonprofit operations. In addition, we provide some terminology for the processes inherent in these operations that is appropriate for ACOs. We also identify separate threads of activities - creative and administrative - that take place simultaneously and merge at key points in the ACOs operations cycle (see Figure 2).

Figure 2. Nonprofit operations viewed as a system (after Deming 1982, p. 4)



Suppliers and Customers in ACOs:

Suppliers to arts and cultural organizations fall into three categories: (i) Governments, foundations, and donors who supply funding for a program or activity, and (ii) Scholars and artists who supply creative and artistic inputs, which form the core content of the organization’s programs, and (iii) volunteers who supply essential labor. Customers in arts and cultural organizations include (i) the fee payers who experience programs or who purchase a related tangible product, (ii) groups who experience programs at subsidized prices or at no cost whatsoever, and (iii) the governments, foundations and donors who supply funds either on their own behalf or on the behalf of their stakeholders.

Strategic Planning in ACOs:

Strategic planning is the keystone activity in the operations of arts and cultural organizations and other nonprofits (Bryson, 1996). Activities associated with strategic planning go beyond “design and redesign” activities to include organization-wide changes. Similarly, strategic planning goes

beyond “consumer research” to include an integrated dialog with both internal (staff and boards) and external (consumers and suppliers) stakeholders.

Program Formation/Creation:

The unique nature of arts and cultural organizations determines the development of their programs. For instance, two distinct, but connected goals, “artistic and administrative,” are followed in arts or cultural organizations in order to achieve their overall mission of providing cultural, artistic and entertainment goods and services (Caves, 2000). We suggest that the existence of these two distinctly different functions within a single organization represents the key operational characteristic of nonprofit cultural and arts organizations. The primary administrative activities include fundraising and marketing, while the primary creative or artistic activities comprise assembly of creative resources, program planning and program development. In addition, programs can be viewed from two perspectives; their presentation to consumers is essentially a creative activity, while their distribution to consumers is essentially an administrative activity.

Outcomes measurement:

This key activity brings the creative and administrative threads together. It measures the benefits or results for consumers. The focus is on measuring outcomes for external stakeholders in non-financial terms. It is most appropriately carried out collaboratively by administrative and creative staff. The outcomes measurement results are the primary ingredients for the next round of strategic planning. They are also reported to funders whose reactions represent an additional important ingredient of strategic planning.

A Definition of Quality in ACOs:

As with many other concepts from the for-profit environment, cost of quality cannot be applied without modification to nonprofit ACOs. The initial challenge of such an endeavor is overcoming the belief by some in the field that business applications as COQ are inherently ill-suited to their organizations. A second challenge in applying COQ to ACOs is in the definition of quality. A widely accepted definition of “quality” during the 1970s and 1980s was simplified to read: “Quality is meeting or exceeding customer expectations.” In arts and cultural organizations—and in nonprofits generally—these definitions apply but are inadequate. Customers include (i) the fee payers who experience programs (variously participants, audiences or visitors) or who purchase a related tangible product, (ii) groups who experience programs at subsidized prices or at no cost whatsoever (such as children and low-income audiences), and (iii) the governments, foundations and donors who supply funding and who do so on their own behalf and on the behalf of their own stakeholders. This makes it difficult to pinpoint customer expectations. Furthermore, in artistic and cultural circles, the term “quality” has a long-established meaning referring to a subjective assessment of the degree of excellence of, for example, a piece of art or a musical performance, which may or may not include customer expectations.

All organizations must strive for both effectiveness and efficiency. In recent years, the nonprofit sector has focused on ways to achieve high levels of effectiveness (for e.g., Grace & Wendroff, 2001). Yet, in Peter Drucker's terms, efficiency is a "minimum condition for survival" (Drucker, 1993, p. 45). Hence, in our paper we define quality in ACOs in terms of both effectiveness and efficiency.

Cost of Quality in ACOs: Drawing Insights from Service Industry:

All generally accepted quality costs fall into one of four categories; prevention, appraisal, internal and external failure costs (Johnson & Kleiner, 1993). There is some evidence in the literature for successful application of COQ in services. ACOs invariably offer hospitality as part of their service offering—customers who purchase tickets for performances have expectations formed by their experiences gained as customers of for-profits offering a blend of hospitality and experience (see Pine & Gilmore, 1999). Lawrence Carr reports a rare cost of service quality program implementation success story at the US Marketing Group (USMG) at Xerox (Carr, 1992). This program can provide insights that are applicable to nonprofit theaters, healthcare centers and soup kitchens. In addition, numerous publications have advocated the use of COQ in hospitals (Al-Assaf & Schmele, 1993). However, no specifics regarding such applications were found in the literature. However, it must be noted that the complex nature of services makes it challenging to apply COQ. A similar challenge occurs when determining the role of customers in the service delivery. Customers of services may assume two roles-- consumer and producer, while generally in manufacturing the customer is separate from the production process (Youngdahl & Kellogg, 1997). Hence, customer participation in services, and in particular arts and cultural organizations, may make it difficult to even quantify actual quality costs.

It is apparent that a framework for costs of quality that focuses on creating awareness and supports improvement actions would be a significant tool in enhancing effectiveness and efficiency in arts and cultural organizations. While quantifying actual costs may quite tricky, we argue there would be a substantive gain in arts and cultural management and staff by simply examining the categories of COQ. Awareness and examination of what an organization considers to be quality issues in and of itself provides numerous benefits. As stated earlier the artistic nature of ACOs creates a challenge for administrators in seeing the benefits of business techniques; however, a structured review of potential preventative measures and undesirable pitfalls could serve as a source of new information for enhancing performance.

Application of Cost of Quality Framework to ACOs:

This discussion considers each of the quality costs and discusses them in terms of current issues in nonprofit management. Tables I-III offer specific examples of typical quality costs in arts and cultural organizations. These costs are divided into likely "high-yield" and "low-yield" activities. High-yield activities (i) are common, (ii) may be costly, and (iii) are unlikely to be controversial if included in a cost of quality program in arts and cultural organizations. Low-yield activities are similarly common and potentially costly, but are likely to be controversial if implemented. These are most appropriately evaluated using frameworks based on outcomes measurement rather than financial measurement (see tables I-III).

<u>Areas (and activities) of nonprofit capacity building</u>	<u>Prevention cost elements (Gryna, 1999; Harrington, 1987)</u>
1. Aspirations (e.g., developing a mission & vision)	Long-range planning
2. Strategy (planning specific actions & programs)	Learning the expectations of customers. Conducting product evaluations to determine their fit to customer expectations
3. Organizational Skills (developing capabilities in areas such as performance measurement)	Cost of quality system development. Quality audits (that can be compared to outcomes measurement procedures)
4. Human Resources (training)	Planning personnel. Employee training – also several related activities such as the development of the training procedures themselves and the preparation of operations and technical manuals to support and perpetuate new employee skills
5. Systems and Infrastructure (administrative & knowledge management systems)	Quality systems, procedures, and standards. Process planning. Process control & evaluation. Equipment capability analysis

Table I. Relationship between capacity building activities and prevention costs

Activity	Comments
<u>“High-yield” activities</u>	These are activities that (i) are common, (ii) may be costly, and (iii) are unlikely to be controversial if included in a cost of quality program in arts and cultural organizations.
Reviews that ensure consistency with strategic plan	Strategic planning represents a form of “resource leverage” (as defined by Hamel & Prahalad, 1993). As such, proposed activities that are inconsistent with the strategic plan are not only wasteful on their face, but also represent a missed opportunity for leveraging scarce resources.
Formative evaluation of exhibits	Formative evaluation ensures that a planned exhibit will achieve the objectives that its curators intend. It is useful to quantify the effort put into this activity in financial terms (but not so the value of the scholarly or artistic conclusions reached as part of this process).
Customer perception and/or satisfaction auditing (see Johns & Clark, 1993)	This represents a specific example of assessing the needs and requirements of customers and the extent to which these needs and requirements are being met by an arts or cultural organization.
Time spent reviewing & proofing contract documents (such as artifact loan agreements and planned gift agreements) or inspecting printed fundraising & marketing materials for typographic errors	These are examples of a typical “white collar” quality appraisal cost (see Harrington, 1987, p. 103-122). The financial consequences of allowing errors to remain can be usefully calculated either over the short-term (the need for redrafting) or the long-run (lost gifts and donations).
Financial audit	This is another typical “white collar” quality appraisal cost with both significant short-term and substantial long-term financial consequences if it is not undertaken promptly by qualified personnel.
Travel to other organizations to review potential new productions or traveling exhibits	This is a necessary expense to ensure that a production or exhibit is suitable for the venue but the same result might be accomplished at less cost, for example, through the use of video and/or videoconferencing
<u>“Low-yield” activities</u>	These are activities that are common, may be costly, but are likely to be controversial if included in a cost of quality program in arts and cultural organizations
Selection of artistic repertoire or exhibit themes	For-profit businesses will calculate the likely financial consequences of deciding to bring a particular product to market. The same financial calculation could theoretically be made by an arts or cultural organization. To do so, however, is unhelpful since these decisions are most appropriately made with reference to its mission.
Dress rehearsals	These meet the definition of appraisal costs, but determining their scope through a cost of quality calculation is similarly unhelpful since these decisions are most appropriately made with reference to criteria of artistic quality.

Table II. Examples of appraisal costs in arts and cultural organizations

Activities	Comments
<u>“High-yield” activities</u>	These are activities that (i) are common, (ii) may be expensive, and (iii) are unlikely to be controversial if included in a cost of quality program in arts and cultural organizations
Non-value-added activities	Activities that do not advance strategic goals of the organization
Costs of recruiting new volunteers to fill gaps left by excessive turnover	Results from a failure to meet the expectations or requirements of existing volunteers.
Cost of reprinting fundraising and marketing materials found to contain typographic errors. Returned and undelivered fundraising and marketing mail due to faulty address information	Typical “white collar” quality costs.
Extension of benefits beyond expiration date in order to satisfy complaints of disgruntled member	In a large nonprofit the financial consequences of actions such as this can add up quickly.
Abandonment of program during planning stages	Programs that necessitate such action are likely developed by staff engaged in creative activities without reference to the organization’s strategic plan. Although the decision will almost certainly be controversial, it is “high-yield” because of the likely impact on the organization.
Scrap and rework due to theatrical set or exhibit design changes or process failures	This is the classic “scrap and rework” definition in the cost of quality literature.
Repairs to an interactive exhibit that is used by visitors in unintended ways	The cost of these repairs is a consequence of failing to meet the needs of the exhibit visitor. Many possible problems will be avoided by effective formative evaluation (see Table 2).
Lost ticket sales due to sub-optimal marketing expenditure	This quality cost should be calculated in order to improve a nonprofit organization’s marketing operations. Note the need to accurately diagnose the root cause of the problem.
<u>“Low-yield” activities</u>	These are activities that are common, may be expensive, but are likely to be controversial if included in a cost of quality program in arts and cultural organizations
Replacement of cast member who does not meet artistic expectations of casting director	The quality costs of this situation could be calculated, but the casting director is less likely to be motivated to avoid making the same mistake by a calculation of the financial-cost of the situation than of his/her own understanding of its non-financial consequences.
Loss of artifacts from a museum through theft or accident	The cost of this process error (either a flaw in security or safety training) can be calculated. The museum will be more motivated to improve their processes by the scholarly and or artistic value of the artifact than the cost of replacement and investigation.

Table III. Examples of error (failure) costs in arts and cultural organizations

Prevention Costs and “Capacity Building”

As proposed in a recent study by McKinsey & Co., the key to organizational success in the nonprofit sector is effective capacity building (Venture Philanthropy Partners, 2001). This requires investment (i.e. incurring additional costs) in seven areas that they refer to as: Aspirations, Strategy, Organizational Skills, Human Resources, Systems and Infrastructure, Organizational Structure, and Culture. For all nonprofit organizations, there is an optimal level of investment in these seven areas. Prevention costs are best viewed in the same terms. There are many similarities in the types of tasks that McKinsey & Co. identify as components of capacity-building activities and the tasks that are considered part of conventional prevention cost activities. Within the framework presented in Figure 2, Aspirations and Strategy possess many of the characteristics of prevention activities. Rather than preventing specific errors from occurring, however, strategic planning ensures that creative activities contribute to—rather than detract from—an organization’s effectiveness as defined by its mission.

Appraisal Costs, Organizational Culture, and Organizational Structure in Nonprofits:

Recognition by a nonprofit organization of the existence of appraisal costs admits the possibility of errors that result in poor quality costs to the organization. Many costs that would be considered to be part of appraisal activities from a quality cost perspective are considered by nonprofits as “overhead”- costs that are not assignable to specific programs but which maintain the organization as a whole. These costs are incurred through activities on both the humdrum and creative threads of an organization’s operations. Humdrum appraisal costs comprise customer satisfaction and financial audits, contract reviews, and evaluation of exhibits among others, while creative appraisal costs include selection of artistic repertoire and dress rehearsals. These appraisal activities are incurred in almost all phases of non-profit operations (see figure 2). To elucidate, evaluation of existing or potential exhibits must be done prior to or during Program Development phase of nonprofit operation cycle. Similarly, inspection of fundraising and marketing materials, and contract documents are predominant activities during Financial Supply and Marketing phases.

The concept that the cost of quality increases the longer it remains undetected is key for understanding appraisal costs. Harrington, for example, reports a Hewlett-Packard study revealing that a defective resistor costs 2 cents if discarded before use, \$10 if detected during board assembly, and hundreds of dollars if only detected by the customer (Harrington, 1987, p. 20). A key goal in investing in appraisal activities, therefore, is to identify errors as soon as possible after they are made. This goal is facilitated by flat organizational structures that allow for rapid communication vertically through the organization so that errors are reported upwards and their solutions reported downward with minimum delays. Decentralized decision-making and internal collaboration can short-circuit the reporting process. It may also help identify errors and develop solutions to quality problems more rapidly and with greater sensitivity to the specific nature of the problem and the solutions available.

Cost of quality programs seek to identify activities (costs) that do not contribute to the accomplishment of the mission and to reallocate them to activities that do. As such, they

represent an almost archetypical tool for ACOs to identify and eliminate non-value adding activities. As in the case of service businesses, and in contrast to typical manufacturing settings, quality problems in nonprofit organizations are less likely to be defined and recognized by quantitative and statistical methods than by employees who actively participate in the management of their own work processes.

Error Costs in Arts and Culture Service Offerings:

The similarities between nonprofit organizations and service businesses have particular significance for issues associated with error (or failure) costs. It is useful, therefore, to examine in more detail the character of the services offered by arts and culture organizations. Most services share four basic characteristics that also define many aspects of the work product of nonprofits (Gronroos, 1990, p. 29).

First, services are, at least to some extent, produced and consumed simultaneously. As a result, it is sometimes difficult and ultimately unproductive to distinguish internal and external error costs in arts and cultural organizations. (In this paper, therefore, this distinction is not made). This characteristic limits the opportunities for identifying and correcting errors before they reach the customer. Relatively more expensive external errors occur, therefore, instead of less expensive internal errors.

Second, services are activities or a series of activities rather than things. This pair of characteristics defines all the creative programming of arts and cultural organizations, as well as supporting events such as those designed for fundraising. The traditional theatrical adage, "It will be all right on the night," not only expresses wishful thinking but also highlights the inability to guarantee in advance the quality that will be achieved in a performance.

Third, services are generally intangible. Fourth, the customer participates in the production process that creates the service at least to some extent. "Failure to meet customer requirements and needs" is an underlying error cost that may be expressed in many ways (Gryna, 1999, p.8.4-6). As reflected in the feedback loop of the Deming flowchart, information from customers is essential to accurately assess these requirements and needs. Yet Parasuraman, Zeithaml and Berry have pointed out that this intangibility makes it difficult for customers to determine whether their requirements and needs have been met or not (Parasuraman, Zeithaml, & Berry, 1985, p. 42). Their participation in the creation of the service complicates this determination even further. As a result, there will be greater variability in the scale of quality problems reported by individual customers and, therefore, greater inter-customer variability in the cost to the organization of remedying these problems.

The first and fourth characteristics of services have been described here as factors that complicate cost of quality programs. With respect to the need to assess customer requirement and needs, the simultaneous production and consumption of their programs may facilitate the collection and rapid use of customer feedback to improve the quality of future service encounters and, perhaps, even the current encounter. Yet, as discussed earlier, nonprofit organizations have many different types of customers. The various categories of funders, without whom most programs would not happen, are invariably not able to provide such immediate feedback. Cost

of quality, along with outcomes measurement, together provides the framework for a dialog between arts or cultural organizations and their funders as current programs are wound down and new ones planned. Since error costs are inevitable, such a dialog should ensure a judicious selection of operational activities in which error costs are targeted for reduction. For example, a poorly executed performance clearly has cost implications, but couching the failure in financial terms is unlikely to result in an organization-wide commitment to improvement. On the other hand, the consequences of errors in humdrum activities such as marketing and other administrative tasks can usefully be measured in financial terms.

CONCLUSION

Money has always been a sore subject for nonprofit organizations and their employees. Not only is there never enough of it, but it is also difficult to combine the for-profit sector's money-based strategies with the nonprofits' mission-based strategies. Yet, Brinckerhoff's memorable phrase, "No Money, No Mission" seems particularly relevant for evaluating quality costs in nonprofits (Brinckerhoff, 2000, p. 172).

Cost of quality does not appear, at first glance, to be a particularly useful tool for ACO it managers, and the literature suggests that none have implemented formal, sustained cost of quality programs. The reasons for this, as described in this paper, are obvious. Yet this paper has demonstrated that there is a role for cost of quality in the arsenal of tools of managers seeking not only to "do the right thing" but also to "do things right." Cost of quality and outcomes measurement are best viewed as potential complementary programs in an ACO nonprofit organization.

The flowchart of ACO processes described in this paper offers a way of understanding the parallel tracks of creative and administrative activities at the different stages in a cycle of operations that begins and ends with strategic planning. It is recommended that nonprofit managers interested in cost of quality create an operations flowchart of their own organization's activities—or use some other explicit framework for analyzing these activities—as a first step in their review of the concept. The approach taken here is a process perspective wherein activities are mapped over time. This seems most useful for arts and cultural organizations whose activities—presenting a string of unique performances or programs—most closely resemble "job shop" processes as understood in the operations management field. It is likely, however, that a more useful approach for nonprofits whose activities more closely resemble "continuous flow" processes will be to map processes without reference to time as a key variable.

ACO managers have a range of implementation options. At one end of the range, managers could use informal procedures to minimize costs. The key conceptual role of the customer in quality frameworks provides a stable reference point against which to judge activities and costs. At the other end of the range, managers might wish to formally adopt an outcomes measurement into a larger strategic framework of organizational performance. Cost of quality concepts do not dictate how programs are to be implemented. Rather, a key lesson for ACOs and nonprofit managers to learn is that cost of quality is only a framework of ideas. There is no reason why these ideas cannot be implemented in large for-profit manufacturing operations and in small

nonprofit arts and cultural organizations. The processes that are developed by the managers in these contexts will have few outward similarities, but will share the same goals and objectives.

Cost of quality releases funds from wasteful processes for use in activities that accomplish a nonprofit organization's mission. Managers must recognize in advance that in any organization—for-profit or nonprofit—whose cost structure is dominated by labor costs, quality cost savings result in underutilized employees. In for-profit businesses, therefore, personnel reductions are likely to play a major role in reducing the cost of quality. Although not supported by empirical evidence, it is possible that this scenario would play out differently in a nonprofit organization: Employees affected in this way would be reassigned to enhance its mission-oriented value chain. For example, employees previously doing unnecessary clerical work in support of programs might be reassigned to undertake research for the fundraising office. Changes such as these can be considered as “high-yield.” Their likely impact is significant, but their potential for creating conflict between the groups creative and administrative employees in an organization are minimal.

REFERENCES

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