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# Voluntary Financial Disclosure to Downward Stakeholders: An Empirical Examination of Chinese Nonprofits

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## ABSTRACT

Downward financial disclosure in the nonprofit sector is little scrutinized in the extant literature where most studies focus on financial disclosure “upward” to regulators, governing bodies, and donors. Analyzing a sample of 311 nonprofits collected in China, this article examines the determinants of nonprofits’ financial disclosure downward to their staff, beneficiaries, and the general public. The authors claim that in addition to the four sets of factors—organizational strategy, capacity, governance, and environment—organizational culture also affects nonprofits’ voluntary financial disclosure. In addition, there are different decision-making patterns of financial disclosure to the three downward stakeholders. While disclosure to staff is associated with strategy and internal governance, disclosure to beneficiaries is associated with internal governance, and disclosure to the general public is associated with strategy, capacity, and organizational culture.

## KEYWORDS

Chinese nonprofit organizations; downward accountability; financial disclosure; nonprofit accountability; nonprofit stakeholders

It has been claimed that the global nonprofit sector is undergoing a “crisis of accountability and transparency” (McGann & Johnstone, 2006, p. 66). As a primary component and means of nonprofit accountability, financial disclosure is often performed either mandatorily or voluntarily in response to this crisis (Brinkerhoff, 2001; Brody, 2004; Keating & Frumkin, 2003). By disclosing financial information to their stakeholders in the forms of annual reports, financial statements, and so forth, nonprofit organizations can demonstrate their accountability to an authority (or authorities) by reducing information asymmetry and signaling readiness for scrutiny (Bushman, Piotroski, & Smith, 2004; Verrecchia, 1983).

Nonprofits navigate relationships with upward and downward stakeholders (Edwards & Hulme, 1996); however, financial disclosure is usually performed to meet accountability demands by their upward stakeholders, such as regulators, governing bodies, and funders. These possess or administer

resources critical to nonprofits including funding, information, and legality, and thus are able to hold nonprofit organizations accountable to them (Ebrahim, 2003; Edwards & Hulme, 1996). Such accountability, facing “up” to existing power relationships, is often referred to as upward accountability (Edwards & Hulme, 1996). By contrast, nonprofit may also perform financial disclosure to their downward stakeholders such as staff, beneficiaries, and the general public, who do not control critical resources and often lack effective means to demand nonprofits’ financial accountability. This accountability to downward stakeholders is termed *downward accountability* (Ebrahim, 2003; Edwards & Hulme, 1996).<sup>1</sup>

Compared to their upward stakeholders, nonprofits nevertheless are less motivated to disclose financial information to their downward stakeholders (Awio, Northcott, & Lawrence, 2011; Christensen & Mohr, 2003). While nonprofits are sometimes required by law to make public their financial reports, little is known about nonprofits’ financial disclosure to their downward stakeholders in a voluntary disclosure environment. However, it is the downward stakeholders that operate nonprofits (employees and volunteers), receive the effects of their action (beneficiaries and affected communities), and thus embody the overall value of the nonprofit sector. Accounting to these stakeholders is critical for increasing their engagement and empowering nonprofits to improve responsiveness and representation of their constituency (Andrews, 2014; Guo & Musso, 2007).

This study explores nonprofits’ voluntary financial disclosure to their downward stakeholders. We extend Saxton and Guo’s (2011) four-factor (specifically, strategy, capacity, governance, and environment) model of nonprofit financial disclosure by adding a fifth factor, organizational culture, and empirically examine whether these five factors affect nonprofits’ financial disclosure to their downward stakeholders when such disclosure is legally voluntary. We further examine whether the five factors affect nonprofits’ downward financial disclosure the same way for different stakeholders, considering that the downward stakeholders have different attributes and different relationships with the organization (Ebrahim, 2003; Mitchell Agle, & Wood, 1997; Najam, 1996).

By analyzing survey data from a sample of 311 Chinese nonprofits, this study finds that a significant proportion of nonprofits do disclose financial information to three downward stakeholder groups, including staff (employees and volunteers), beneficiaries, and the general public, in a legally voluntary environment. However, how the five factors influence voluntary financial disclosure varies among the stakeholder groups, revealing different decision-making patterns for financial disclosure in the nonprofits. The study concludes with implications for practice and future research.

## Literature review

### *Financial disclosure and nonprofit accountability*

Bovens (2007, p. 450) defines accountability as “a relationship between an actor and a forum, in which the actor has an obligation to explain and to justify his or her conduct, the forum can pose questions and pass judgment, and the actor may face consequences.” Financial disclosure serves as a primary component and means of nonprofit accountability as it makes transparent the allocation, disbursement, and utilization of financial resources managed in the organization (Brinkerhoff, 2001; Brody, 2004). Mitigation of information asymmetry thus enables informed stakeholders to hold the organization accountable to laws, rules, regulations, and organizational goals and missions and helps better identify effective and efficient nonprofits.

Ideally, nonprofits should account to all the persons and groups that they are affecting directly or indirectly (Bendell, 2006; O'Dwyer & Unerman, 2010). But in practice, financial disclosure is performed mostly to their upward stakeholders rather than downward stakeholders (Ebrahim, 2003; Keating & Frumkin, 2003; Najam, 1996). There are several reasons for this. First, the upward stakeholders have the authority to impose their request for financial information on nonprofits and demand responsible action as they control resources such as funding, legality, and partnership that are critical to nonprofits' daily operations and their pursuit of mission. Just as claimed by resource dependence theory (McCarthy & Zald, 1977; Pfeffer & Salancik, 2003), to the extent that one group depends upon another for resources, the latter controls the agenda. Second, upward stakeholders have preferential interests in financial disclosure (Kilby, 2006; Mitchell, 2014; Moxham, 2010). Financial reporting serves as a supplement or even an alternative for learning about an organization's activities and outcomes, as it specifically reflects how financial resources are utilized. Donors thus can make informed decisions on how to better use their money (Bushman et al., 2004). Moreover, regulators and governing bodies put primary emphasis on an organization's compliance with financial rules and laws so as to ensure its tax-exempt status and prevent nonprofit managers' fraud (Keating & Frumkin, 2003). Third, sometimes nonprofit managers disclose financial information in order to avoid political cost (e.g., increased scrutiny from regulators) and demonstrate “worthiness” to donors (Hofmann & McSwain, 2013).

In contrast with disclosure to upward stakeholders, nonprofit managers are much less motivated to disclose finances to their downward stakeholders such as staff, beneficiaries, and the general public (Awio et al., 2011; Christensen & Ebrahim, 2006; Ebrahim, 2003). In the first place, depending on the resources managed by nonprofit managers, downward stakeholders lack the means or incentives to scrutinize nonprofit operations as dictated by

resource dependence theory (McCarthy & Zald, 1977; Pfeffer & Salancik, 1978). Second, disclosing finances reduces nonprofit managers' latitude for managing financial resources and decreases their power over the downward stakeholders. As Joshi and Moore (2000, p. 50) argue, "[E]very agency at a position of authority has a strong interest in limiting information, so that they influence community choice." Third, nonprofit managers usually prioritize the demands of financial disclosure from upward stakeholders when their demands are different from or even in conflict with that of downward stakeholders (Andrews, 2014; Kim, 2005).

Despite these disadvantages, however, nonprofit managers may still perform financial disclosure downward to their less privileged stakeholders in order to meet moral obligations, build legitimacy, or foster potential donors. For example, some nonprofit managers may be motivated to disclose financial data downward by the belief that being accountable is the right thing to do for nonprofit organizations (Goodin, 2003; Kilby, 2006). Additionally, nonprofit managers may disclose finances in response to the public's rising desire for nonprofit transparency, and thus increase organizational reputation and attract potential donors by demonstrating such transparency (Shumate & O'Connor, 2010). In addition, sharing financial information helps build trust and engagement in the community and encourages partners' inputs into the partnership to bring about higher performance (LeRoux, 2009; Norman, Avolio, & Luthans, 2010). And finally, the rise of the Internet, especially social media, greatly reduces the cost of sharing information with a variety of stakeholders (Gandía, 2011; Lovejoy & Saxton, 2012; Saxton & Guo, 2011). When not in conflict with patrons' demands and consistent with organizational values, financial disclosure may be conducted toward the downward stakeholders (Andrews, 2014).

To date, studies have empirically examined nonprofits' downward financial disclosure as researchers have been widely concerned about downward accountability in the nonprofit sector (Burger & Owens, 2010; Ebrahim, 2003; O'Dwyer & Unerman, 2010). Nevertheless, research gaps remain in the extant literature.

First, previous studies on downward financial disclosure focused primarily on the general public (Saxton, Kuo, & Ho, 2012), and gave little attention to disclosure to staff (volunteers and employees) and beneficiaries (Awio et al., 2011). Although all the three groups are on the less privileged side, the public, staff, and beneficiaries actually have different stakeholder attributes. According to stakeholder theory (Mitchell et al., 1997), the degree to which managers give priority to one stakeholder's claim over others (in their words, *stakeholder salience*) is based on three stakeholder attributes: (1) the stakeholder's power to influence the organization; (2) the legitimacy of the stakeholder's relationship with the organization; and (3) the urgency of the

stakeholder's claim on the organization. In the case of financial disclosure, staff, beneficiaries, and the public have different attribute patterns concerning power, legitimacy, and urgency. For example, staff members have relatively high power, high legitimacy, and even high urgency compared to the other two stakeholders as they run the organization's daily routines, deliver services to beneficiaries, and conduct communications with external stakeholders. On the other hand, beneficiaries have high legitimacy and urgency but low power as they need nonprofit services. Finally, the public has relatively high power, sometimes high urgency, and low legitimacy as they affect the external environment to which the nonprofit is subject. Given these differences, nonprofit managers may assign different levels of salience to these stakeholders and treat them differently in terms of financial disclosure.

Second, few studies examined financial disclosure in the context in which financial disclosure is completely voluntary. While some studies examined voluntary financial disclosure to the public primarily in the form of web disclosure (and supposedly also to staff and beneficiaries) (e.g., Behn, DeVries, & Lin, 2010; Calabrese, 2011; Gandía, 2011; Rodríguez, Pérez, & Godoy, 2012; Saxton & Guo, 2011), such disclosure nevertheless occurred in countries where nonprofits' financial information are required by legislators to be accessible for the public on request. Given that some nonprofits subject to mandatory disclosure still tend to hide or misreport financial information (e.g., Christensen & Mohr, 2003; Hofmann & McSwain, 2013), it may be doubtful whether they will conduct financial disclosure at all when there is no regulation on downward disclosure.

Third, the nonprofits researched in previous financial disclosure studies were primarily professional nonprofits, which often have legal responsibility to disclose financial information on request. Grassroots nonprofits such as volunteer-operated associations were often excluded in those studies (Behn et al., 2010; Hofmann & McSwain, 2013; Kitching, 2009). However, grassroots nonprofits, which are often unregistered, have few staff, and little funding, constitute the majority of the nonprofit sector, and should be included in accountability literature.

In response to these limitations in previous studies, our study explores nonprofits' voluntary financial disclosure particularly to the three downward stakeholder groups, including staff, beneficiaries, and the general public. We use Saxton and Guo's (2011) model of nonprofit accountability as a starting point but propose an extended model as presented below.

### ***Determinants of downward financial disclosure***

In their study of American community foundations, Saxton and Guo (2011) developed a four-factor model to explain the level of web-based information

disclosure. This model proves valid in analyzing nonprofits' decision on financial disclosure, as shown in Saxton et al.'s (2012) study of nonprofit medical institutions in Taiwan. We thus adapt and extend the model to determine what accounts for nonprofits' financial disclosure to their downward stakeholders in the context of China.

According to Saxton and Guo (2011), four factors affect financial disclosure in nonprofits: strategy, capacity, governance, and environment. First, a nonprofit performs information disclosure based on the organizational strategy for meeting its mission. Second, an organization's capacity, specifically financial and technological resources, influences disclosure practice, given that performing disclosure entails substantial costs. Third, an organization's internal governance affects financial disclosure as it is "essential for ensuring that organizational resources and capacities are properly used and that strategies are properly implemented" (Saxton et al., 2012, p. 1056). Fourth, the environment in which the organization operates influences resource availability, mission development, and strategy building, and thus also relates to information disclosure.

In addition to the four factors identified by Saxton and Guo (2011), however, we propose that voluntary financial disclosure also derives from another important factor: *organizational culture*. Scott and Marshall (2009) define organizational culture as the values, norms, and patterns of action that characterize social relationships within a formal organization. In particular, organizational culture is "neither an organizational attribute nor an individual attribute; rather, it is a system of shared orientations to organizational attributes, a 'consensus of perceptions' regarding organizational stimuli" (McNeil, 1979, p. 76). Bate (1984) claims that organizational culture shapes an organization's response to change and problem resolution. In the nonprofit sector, organizational culture has an especially important influence on organizational behavior because nonprofits are mission-driven (Payton & Moody, 2008), serve highly diverse needs unmet by the government and businesses, and earn legitimacy largely from their distinctive values such as solidarity and voluntarism (Atack, 1999). According to Laratta (2011), nonprofits generally tend toward a "caring climate" in which the primary concern is the well-being of the community at large so that nonprofits should do what is right for the public.

In addition, previous studies have indicated the association of organizational culture with downward accountability. For example, Kilby (2006) finds that the three types of values—temporal values, terminal values, and organizational values—are related to the forms and levels of engaging beneficiaries in Indian nonprofits. Andrews (2014) claims that the value of being accountable to organizational mission contributes to downward accountability practices in Mexican nonprofits. In a comparative study of



British and Japanese nonprofit organizations, Laratta (2011) argues that executive directors' ethical considerations predict their willingness of being accountable to beneficiaries. Generally, while these studies indicated the prominence of organizational culture in accountability practice, specifically how organizational culture influences downward financial disclosure remains unclear in the literature.

Based on the previous discussion, we argue that all five factors—strategy, capacity, governance, environment, and organizational culture—should be included when explaining nonprofits' financial disclosure to their downward stakeholders.

### **Strategy**

By disclosing financial information, nonprofits have strategic incentives to demonstrate their performance, increase legitimacy, and enhance reputation to their constituencies (Ebrahim, 2003; Gugerty, 2009; Hale, 2013). We examine two strategy factors that may affect nonprofits' financial disclosure: legal status and functional type.

Legal status influences financial disclosure as it determines a nonprofit's legitimacy to the government. Nonprofits that are registered with the government have little legitimacy concerns about disclosing organizational information. However, doing so for an unregistered nonprofit may expose it to the stigma or even government punishment of being an illegal organization. Also, some nonprofits, especially grassroots nonprofits, may prefer to remain unregistered to preserve their autonomy by hiding themselves from the attention of the government and the public (Jensen & Meisenbach, 2015). We thus hypothesize:

H1a: A nonprofit organization is less likely to disclose financial information downward if it is unregistered.

Another strategy factor is a nonprofit organization's functional type, which classifies nonprofit activities roughly into two categories: service provision such as shelter, education, health care, and expression such as cultural development and policy advocacy (Frumkin, 2005). Generally, the tangible outcomes like products and services provided by social service organizations are more likely to be noticed and appreciated by constituencies than the progress in public awareness, knowledge, or public policy that are produced by expressive organizations. This popularity of social service provision can encourage financial disclosure. For example, in their study of 300 largest nonprofits in the United States, Behn et al. (2010) find that a nonprofit is more likely to disseminate its financial statements if it has no lobbying expenses. Therefore, we expect that:

H1b: A social service nonprofit organization is more likely to disclose financial information downward than is an expressive nonprofit organization.



## Capacity

An organization's capacity to undertake strategically driven initiatives may also influence financial disclosure. Here we examine two capacity factors: organizational size and utilization of the Internet.

Organizational size is a consistently important capacity factor. According to Luoma and Goodstein (1999), as an organization grows in size, it attracts greater attention from different stakeholders such as government, media, donors, and the general public, and thus is more likely to be held accountable by its stakeholders. Saxton and Guo (2011) and Nie, Liu, and Cheng (2016) find similar results in that nonprofits' asset size is positively associated with their online disclosure level. Moreover, Gordon, Fischer, Malone, and Tower (2002) find that a nonprofit with more gross assets discloses financial information to a higher extent. We thus posit:

H2a: The larger size a nonprofit organization has, the more likely it discloses financial information downward.

Utilization of the Internet has revolutionized the operations of modern organizations. In the nonprofit sector, Internet-based instruments, websites, and social media have been widely applied to disseminate information, build community, and mobilize resources (Lovejoy & Saxton, 2012). With respect to accountability, a growing number of nonprofits prefer to disclose their performance and financial information online and engage stakeholders via social media (Dumont, 2013; Gandía, 2011; Saxton, Guo, & Brown, 2007). Admittedly, use of the Internet requires technological capacity (e.g., Internet equipment and staff members with related skills) for communicating with stakeholders, which has received inadequate attention in the nonprofit sector (Hackler & Saxton, 2007). We thus expect:

H2b: The more utilization of the Internet a nonprofit organization has in public communication, the more likely it discloses financial information downward.

## Governance

The relationship between organizational governance and accountability in nonprofits has been emphasized in recent years (Enjolras, 2009; Stone & Ostrower, 2007). Three governance factors are examined in terms of financial disclosure: power centralization, financial management, and auditing.

Power centralization defines how power is distributed among the different levels of leadership in an organization (Duverger, 1963) and thus influences stakeholders' involvement in the organization's operations. Specifically, in a centralized power system, formal authority is privileged over expertise and competence in determining decision involvement (Bunderson, 2003). Like leaders in other sectors, nonprofit managers are reluctant to be held accountable for their decisions and relax their control over the organization (Burger

& Owens, 2010). Therefore, when there is a lack of effective accountability mechanisms, the power imbalance between nonprofit managers and underprivileged stakeholders leads to low accountability to the latter (le Dantec & Edwards, 2008). We thus posit:

H3a: The more centralized the decision-making system in a nonprofit organization, the less likely the organization discloses financial information downward.

Financial management is essential in an organization's internal control system. Facing financial stress and unsound accountability mechanisms, however, nonprofits may manipulate their financial reporting (e.g., overreporting program expenses, understating fundraising and administrative spending, etc.) to meet an authority's criteria and survive the competitive funding environment (Verbruggen, Christiaens, & Milis, 2011). To reduce the risk of exposure, nonprofits somehow involved in financial malpractice are reluctant to reveal their financial information (Burger & Owens, 2010). Therefore, we hypothesize:

H3b: The better financial management a nonprofit organization has, the more likely it discloses financial information downward.

Third, auditing apparently influences financial transparency as it signals the credibility of financial reports. For example, Kitching (2009) finds that donors are willing to give more to the nonprofits that hire quality auditors. Their confidence in auditing in turn is corroborated by the fact that the nonprofits hiring an audit firm demonstrate higher compliance with reporting standards (Verbruggen et al., 2011). Thus, with its financial statements audited by a third party, a nonprofit can increase its attractiveness among supporters by disclosing the statements, or can at least reduce the risk of financial mismanagement in case of disclosure on request.

H3c: A nonprofit organization is more likely to disclose financial information downward if its financial statements are audited by an independent auditor.

### **Environment**

The conditions in an organization's external environment may also affect its disclosure decision (Saxton & Guo, 2011). Here we examine two environmental factors: resource environment and sociopolitical environment.

Compared to their counterparts in small towns or the countryside, organizations located in medium or large cities enjoy more access to resources but are more subject to peer competition and peer learning. First, as resources and peer organizations usually are denser in cities, nonprofits are motivated to compete for resources by enhancing accountability to build their credibility (Gandía, 2011; Saxton et al., 2012). Second, nonprofits in medium or large cities have more of a chance to learn about good accountability practices used

by peer organizations as geographic closeness facilitates interorganizational communication and interaction (Boschma, 2005). We thus propose:

H4a: A nonprofit organization is more likely to disclose financial information downward if it is located in a medium or large city rather than in a small town or the countryside.

Sociopolitical environment may account for nonprofit accountability from the point of view of a social-political institution. Nonprofits are often found reflecting rather than challenging the cultural, social, and political settings in which they are situated. For example, in his study on Bangladesh nonprofits Wood (1997) argues that nonprofits often replicate the society's hierarchical and authoritarian social structures. Ndegwa (1996) also finds that the Kenyan civil society was fragmented along ethnic and class lines, mirroring wider social and political fissures in the country. In a study of American grantmakers working in China, Spires (2012) claims that the grantmakers accommodate their emphasis on empowerment and democracy practice to that of the Chinese Communist Party's state rhetoric. Based on these findings, we argue that the sociopolitical environment may affect nonprofits' financial disclosure. Specifically, considering the emphasis of liberal democracy on accountability and transparency (Piotrowski & Van Ryzin, 2007; Williams & Young, 1994), we posit:

H4b: A nonprofit organization is more likely to disclose financial information downward if it is subject to a more liberal sociopolitical environment.

### ***Organizational culture***

As stated above, we propose that organizational culture influence nonprofits' voluntary financial disclosure. We examine two factors concerning organizational culture: volunteer culture and stakeholder salience.

First, we argue that whether a nonprofit is run by volunteers or by paid employees affects how it manages financial disclosure. According to Hwang and Powell (2009, p. 289), "the difference between 'amateurs' and 'professionals' is of particular importance as it raises issues that are at the heart of nonprofits' identity and culture," as amateurs (volunteers) are less likely to contribute to organizational rationalization than professionals (paid employees). Kreutzer and Jäger's (2011) find that in nonprofits, organizational culture is to some extent determined by the identity of both volunteers and paid employees. While paid employees present a managerial identity that is characterized by predictability and cost-efficiency in resources management, volunteers uphold a volunteer identity that stresses frugality. While paid employees emphasize standards and procedures in organizational operations, volunteers stress operational flexibility and engagement with the target groups. Their findings were corroborated by

Brainard and Siplon's (2004) conclusion that compared to professional nonprofits with sound staff and governing structures, grassroots nonprofits that are run by volunteers or a handful of paid employees are more likely to emphasize solidarity, participation, and pursuit of purpose in their operations. Given that downward financial disclosure can serve to engage the downward stakeholders, we posit:

H5a: A nonprofit organization is more likely to disclose financial information downward if it is staffed only by volunteers.

The second organizational culture factor is stakeholder salience. According to Mitchell et al. (1997), managers' perception of stakeholders is important in determining organizational resource allocation in response to stakeholder claims. In light of resource constraints, nonprofits managers shall assess the salience of each stakeholder based on the stakeholder's power, legitimacy, and urgency and give a degree of priority to the competing and very often conflicting accountability requirements from multiple stakeholders (Andrews, 2014; Christensen & Mohr, 2003; Ebrahim, 2003; Gugerty, 2009; Najam, 1996). For example, in a comparative study of service nonprofits, Laratta (2011) finds that Japanese executives stress the interests of the community while British executives place priority on individual users. As information disclosure can serve as an important means for engaging the stakeholders, building trust, and pursuing their support in the future (Guo & Saxton, 2014), we propose that nonprofit managers prefer to disclose important information to their salient stakeholders.

H5b: A nonprofit organization is more likely to disclose financial information downward to a stakeholder with higher salience.

## Methods & data

### Research context

Independent nonprofit organizations (also termed nongovernmental organizations, or NGOs) emerged in China in the late 1980s and experienced a rapid growth in numbers after the mid-1990s (Wu, 2010). Their focus areas include community development, environment, education, children and youth development, disability service, HIV/AIDs, labor rights, and other issues (Spires, Tao, & Chan, 2014). There are three legal forms of nonprofit registration in China: social association (*shetuan*), private nonenterprise unit (*minban feiqiye*), and foundation (*jijinhui*). However, the government has long imposed rigorous regulations on nonprofit organization registration that require an organization to get approval from both a supervisory agency (usually a government agency) and the registration authority (Lee, 2009). Therefore, the number of independent nonprofits that have been properly registered remains

small while many stay unregistered (Spires et al., 2014). In addition, nonprofits have faced a series of government restrictions concerning work areas, fundraising, and tax exemption (Lee, 2009). In recent years, however, the Chinese government has shifted to support community-based and service-oriented organizations by relaxing regulations regarding their registration and extending government procurement with them (Zhao, Wu, & Tao, 2016).

In terms of financial disclosure, registered nonprofits were required by the government to submit an annual financial report to the registration authority. In addition, the government required foundations to make its financial reports open to the public and suggested that social associations and private nonenterprise units do the same in principle. However, financial transparency in the Chinese nonprofit sector has remained low partially due to the absence of nonprofit law and operational criteria on disclosure practice (Nie et al., 2016; Peng & Liu, 2011). To enhance nonprofit accountability, the Ministry of Civil Affairs of China (2011) established the first national practice guide on nonprofit disclosure in December 2011, suggesting that all types of registered nonprofits should annually disclose their financial information to the public. But enforceable national policy or legislation was still absent until the 2016 Charity Law was passed, which stipulates, “Charities should annually publicize their program report and financial statements to the public” (National People’s Congress, 2016).

## **Data**

The data used in this study are part of “The Chinese NGO Development Research Dataset” collected by the Sun Yat-Sen University Center on Philanthropy in 2011. It is noted that when the data were collected, those nonprofits were legally required to report financial statements only to the registration authority. However, disclosure to staff, beneficiaries, and the public were performed generally based on the organizations’ discretion. This dataset thus serves as a good fit for examining voluntary financial disclosure in the Chinese nonprofit sector.

Given the lack of a reliable complete list of independent nonprofit organizations in China at the point of data collection, researchers developed a sampling frame of 1,144 independent nonprofit organizations (not including foundations and government-affiliated nonprofits) by consulting the major supporting nonprofits across the country and searching major portal websites of nonprofits. Considering the various densities of nonprofit populations in different regions, weighted sampling was applied to select participant organizations by dividing China into three geographic parts: West China (weight = 0.5), Northeast and Middle China (weight = 1.0), and East China (weight = 0.33). A total of 594 nonprofits were selected. From each, one

leader, usually CEO or senior manager, was identified and invited by researchers to complete a questionnaire via either a face-to-face interview, email, or online survey. A total of 461 valid responses were collected, resulting in a response rate of 77.6%. A total of 311 responses from formal organizations that established both formal organizational structures and regular programs were included in this study after data cleaning.

## **Measurement**

### ***Dependent variables***

The dummy dependent variable, financial disclosure, is measured by asking whether a nonprofit organization revealed financial statements (including a balance sheet, income statements, and statements of retained earnings and cash flows) in any form (e.g., pamphlet, website, or social media) respectively to its staff (including employees and volunteers), beneficiaries, and the general public in the past fiscal year. An answer “Yes” is coded 1, and otherwise 0.

### ***Independent variables***

We operationalize the hypotheses through 11 independent variables representing the five sets of financial disclosure predictors.

Specifically, two strategy variables, legal status and functional type, are tested on the determination of financial disclosure. Legal status is operationalized by a nonprofit’s legal registration with the government. The organizations that were registered either as nonprofits or enterprises are coded 1 and the unregistered are coded 0. The functional type variable is measured by the primary function of a nonprofit: service organizations are coded 1 and expressive organizations 0.

Organizational capacity is operationalized in two aspects: organizational size and utilization of the Internet. Organizational size is measured by the natural log of a nonprofit’s total spending (in Chinese *yuan*) in the previous fiscal year of 2010. Utilization of the Internet is measured by the total number of Internet-based instruments (e.g. official website, e-mail, blog, and microblog) that a nonprofit employed in its everyday operations.

Three variables are used to operationalize organizational governance, including power centralization, financial management, and auditing. Power centralization is an ordinal variable and is set a value 1 if the general assembly of an organization had the ultimate power to make major decisions, a value 2 if the board of members did, and a value 3 if the CEO or president did. Financial management is operationalized by asking how satisfactorily a nonprofit observed its financial management rules in the past fiscal year. In a 5-point Likert scale, a response “Very unsatisfactorily” to this question is coded 1; “Unsatisfactorily” 2; “Neither unsatisfactorily nor

satisfactorily” 3; “Satisfactorily” 4; and “Very satisfactorily” 5. Auditing is a dummy variable, coded 1 if a nonprofit’s financial statements in the previous year was audited by an independent auditor, and otherwise 0.

A nonprofit’s environment is measured both by its resource environment and by the sociopolitical environment in which it is situated. In terms of resource environment, a nonprofit located in a medium or large city is coded 1 and otherwise 0.<sup>2</sup> Sociopolitical context is classified into three categories: conservative (coded 1), central (coded 2), and liberal (coded 3), following Pan and Xu’s (2016) findings about China’s ideological spectrum at the provincial level. Specifically, people living in conservative areas tend to support authoritarianism, traditional social values, and nonmarket economy, people living in liberal provinces prefer democracy, nontraditional social values, and market economy, and people living in other areas are the remaining. In this study, each nonprofit organization’s sociopolitical environment is identified by the provincial jurisdiction in which it is based.

Finally, two variables are operationalized for measuring organizational culture, including volunteer culture and stakeholder salience. Volunteer culture is a dummy variable, coded 1 if a nonprofit is run only by nonpaid volunteers, and otherwise 0. Stakeholder salience is measured by asking whether a nonprofit assumed its primary accountability to a particular stakeholder group. For example, if staff member is ranked by the respondent among the top three stakeholders to whom it assumed its primary accountability, it is coded 1 for the particular stakeholder group and otherwise 0. The same goes for beneficiaries and the general public.

### **Qualitative analysis**

The questionnaire asked each respondent an open-ended question: “What are the major constraints to financial disclosure in your organization?” Respondents’ answers were transcribed, open coded to identify key concepts, and categorized across respondents (Strauss & Corbin, 1990). The results then were repetitively compared with the explanatory model developed in previous text until the information became saturated.

### **Results**

Table 1 presents the descriptive statistics of the nonprofits included in the analyses. Within the sample of 311 nonprofits, 69% of the nonprofits were located in medium and large cities while 31% were in small towns or the countryside; 72% were legally registered with the government, and the remaining 28% were unregistered; 72% were social service organizations, and 28% were expressive organizations; 29% were volunteer organizations run



**Table 1.** Downward Financial Disclosure and Its Determinants in Chinese Nonprofit Organizations ( $N = 311$ ).

	<i>Range</i>	<i>M</i>	<i>SD</i>
Dependent variables			
Disclosure to staff	0–1	0.53	0.500
Disclosure to beneficiaries	0–1	0.33	0.470
Disclosure to the public	0–1	0.45	0.498
Independent variables			
Legal status	0–1	0.72	0.448
Service organization	0–1	0.72	0.450
Organizational size (logged)	3.0–7.48	5.203	0.775
Utilization of Internet	0–4	2.08	1.193
Power centralization	1–3	1.91	0.644
Financial management	1–5	3.95	0.798
Auditing	0–1	0.59	0.492
Volunteer culture	0–1	0.29	0.453
Staff as salient stakeholder	0–1	0.42	0.494
Beneficiaries as salient stakeholder	0–1	0.71	0.454
The public as salient stakeholder	0–1	0.23	0.422
Medium or large city	0–1	0.69	0.464
Sociopolitical context			
Conservative: 32.2%			
Central: 33.1%			
Liberal: 34.7%			

merely by nonpaid volunteers, and 71% were professional organizations staffed by at least one paid employee. Their annual spending in the previous fiscal year ranged from a minimum of ¥1,000 to a maximum of ¥30 million. The average number of Internet instruments used daily was 2.08.

With respect to disclosure to downward stakeholders, we find that 53% of all the 311 nonprofit organizations included in the analyses reported that they performed financial disclosure to their staff in the previous year; 33% of the nonprofits reported financial disclosure to their beneficiaries; and 45% of the nonprofits reported financial disclosure to the general public. Thus, large proportions of nonprofits did voluntarily reveal their financial information to their downward stakeholders.

Following the extended model developed in text above, we proceed to examine what factors help predict the nonprofits' downward financial disclosure. The results of logistic analyses on the determination of disclosure are presented in Table 2.

### **Disclosure to staff**

In light of voluntary financial disclosure to staff (Model 1), only two independent variables, legal status and power centralization, are significantly associated. Specifically, registered nonprofits are less likely to disclose financial information to staff than unregistered nonprofits ( $\beta = -0.640$ ,  $p < 0.05$ ); therefore, hypothesis H1a is rejected in terms of disclosure to staff. Power centralization is also significantly negatively associated with financial disclosure to staff. Specifically, compared to the nonprofits in

**Table 2.** Results of Logistic Analyses on Financial Disclosure in Chinese Nonprofit Organizations ( $N = 311$ ).

	<i>Model 1 Disclosure to staff</i>	<i>Model 2 Disclosure to beneficiaries</i>	<i>Model 3 Disclosure to the public</i>
Constant	-0.276	-2.352*	-5.146***
Legal status	-0.640*	-0.193	-0.548
Service organization	0.067	0.391	1.622***
Organizational size	0.191	-0.047	0.584*
Utilization of Internet	-0.031	-0.051	0.881***
Power centralization (Ref. = Plenary session)			
Board of directors	-0.673*	-0.394	0.101
CEO	-1.238**	-0.858*	-0.403
Financial management	0.113	0.469**	0.245
Auditing	0.079	0.697*	-0.557
Volunteer culture	0.093	0.200	1.515***
Stakeholder salience <sup>a</sup>	0.020	0.094	0.807*
Medium or large city	0.205	0.262	-0.551
Sociopolitical context (Ref. = Conservative)			
Central	-0.323	-0.453	-0.253
Liberal	0.017	-0.235	-0.128
Model			
Likelihood ratio test	19.542	23.323*	109.123***
-2log( $\lambda$ )	410.67	370.24	318.92
Nagelkerke $R^2$	0.081	0.101	0.396
Overall % of correct	57.6%	67.2%	78.1%

Notes: <sup>a</sup>This variable changes to different models to analyze the fixed effect of a particular stakeholder (staff, beneficiaries, or the public) on disclosure decision. \* $p < 0.05$ ; \*\* $p < 0.01$ ; \*\*\* $p < 0.001$ .

which a general assembly of organization members was in charge of major decisions, the nonprofits in which the board of directors or only the CEO made major decisions are less likely to disclose their financial information to nonexecutive employees or volunteers. Given that the coefficient of the CEO decision-making pattern ( $\beta = -1.238$ ,  $p < 0.01$ ) is significantly smaller than that of the board of directors' decision-making pattern ( $\beta = -0.673$ ,  $p < 0.05$ ), hypothesis H3a is supported in Model 1 that the more centralized a nonprofit's decision-making system is, the less likely it voluntarily reveals financial information to employees and volunteers.

### **Disclosure to beneficiaries**

Only the three governance variables are significantly associated with voluntary financial disclosure to beneficiaries, as shown in Model 2. Compared to the nonprofits in which a general assembly made major decisions, their counterparts with a CEO who was in charge of major decisions were less likely ( $\beta = -0.858$ ,  $p < 0.05$ ) to reveal financial information to their beneficiaries. However, there is no significant difference between the nonprofits with a general assembly as decision maker and those with a board of directors as decision maker. Financial management also helps predict financial disclosure to beneficiaries, supporting hypothesis H3b. A one-unit increase in financial management practice increases the odds of financial disclosure

by 1.60 times ( $e^{0.379} = 1.60$ ). In addition, the nonprofits with its financial statements being audited by a third party was 2.01 times ( $e^{0.697} = 2.01$ ) more likely to disclose financial information to their beneficiaries than their counterparts whose financial statements were not audited by a third party. Thus, hypothesis H3c is supported in Model 2.

### ***Disclosure to the public***

Voluntary financial disclosure to the general public (Model 3) can be predicted by functional type, organizational size, utilization of the Internet, volunteer culture, and stakeholder salience. First, the odds a social service organization discloses financial information to the general public is 5.06 times ( $e^{1.622} = 5.06$ ) that of an expressive organization, supporting hypothesis H1b in Model 3. Nonprofits with larger annual spending are also more likely to disclose financial information to the public ( $\beta = 0.584$ ,  $p < 0.05$ ), supporting hypothesis H2a. The utilization of the Internet has a significantly positive correlation with financial disclosure to the general public ( $\beta = 0.881$ ,  $p < 0.001$ ), indicating that the more internet-based techniques used by a nonprofit, the more likely it makes financial information public. Therefore, hypothesis H2b is supported. In addition, volunteer culture also helps predict financial disclosure to the public, supporting hypothesis H5a in Model 3. Specifically, the odds a volunteer-run nonprofit performs financial disclosure to the public are 4.55 times ( $e^{1.515} = 4.55$ ) that of a nonprofit with paid employees. Finally, hypothesis H5b is also supported in Model 3 that the nonprofits that perceived the public as their highly salient stakeholders are more likely to disclose their financial information to the public than other nonprofits that gave no salience to the public ( $\beta = 0.807$ ,  $p < 0.05$ ).

It is noted that the two environmental variables, resource environment and sociopolitical environment, are not significantly associated in all three types of financial disclosure. Thus, hypotheses H4a and H4b are not supported in any model. This finding may suggest that downward disclosure in nonprofit organizations is primarily internally-driven and little influenced by environmental factors (Striebing, 2017).

### ***Sensitivity tests***

We take robustness tests on our findings by employing alternative independent variables in the models. First, we measure legal status alternatively by coding 1 for the organizations that were registered as social associations or private nonenterprise units, and coding 0 for others. The results of the models remain nearly the same as those presented in Table 2. Second, we

recode nonprofits' resource environment by classifying their locations into two types: metropolitan and nonmetropolitan areas. Running the models yields very consistent results. Third, an alternative measure for stakeholder salience, whether a nonprofit ranks a particular stakeholder first when assuming its primary accountability, is used to test the models. The results are very consistent with those in Table 2 but with one exception: the coefficient of stakeholder salience becomes insignificant in the disclosure-to-the-public model (Model 3).

### ***Evidence from qualitative analysis***

Our analyses of qualitative data corroborated and supplemented the findings shown in the quantitative analyses above. First, respondents identified two major constraints regarding organizational strategy when considering financial disclosure: risk control and organizational promotion. Some nonprofit managers were worried about the risks of financial disclosure. Quotes included: "The public has no sound knowledge about charity and is too demanding (in terms of operational expenses) for us"; "The community may make ill-intentioned yet groundless comments"; "The beneficiaries may misinterpret our budget"; "The media may take a biased and unfair stand when covering our program"; and "Our organization was not legally registered." In addition, lack of incentive for organization promotion also leads to withholding information. As respondents claimed, "We don't have strong Internet-based promotion channels," or "We may receive inadequate attention from the stakeholders (by disclosing financial information)."

Second, with respect to organizational capacity, respondents reported inadequate staff and lack of skills to perform financial disclosure properly. They claimed: "We lack information outlets"; "We had no budget to perform disclosure"; "We don't have adequate staff"; "Our staff lacks computer skills"; "(We) had limited communication skills"; and so forth. Some explained that they had very small budgets and unstable programs, which "makes little sense" to reveal financial information.

Third, the internal governance constraints identified by respondents involve nonprofit leaders, financial malpractice, and auditing. For example, they claimed that they did not disclose financial information due to "the CEO/board's decision on what to be disclosed"; "(having) no disclosure mechanism"; "our unsound financial management"; or because "We don't have a special financial manager nor get our financial statements audited."

Fourth, a handful of organizations mentioned the influence of environmental constraints, particularly political concerns. For example, one organization claimed that they are concerned about "the government's sensitivity to overseas grants (we received)." Another respondent wrote, "NGOs had

many unsayable stories due to unsound government policies.” Other organizations pointed at “the closed/conservative atmosphere in our society.”

Fifth, organizational culture constraints primarily concern nonprofits’ low awareness of transparency or their belief of no need of information from their constituency. For example, some nonprofit managers reported: “We lacked awareness of financial disclosure”; “It is unnecessary for us to disclose information as we received no request from the community”; “We communicated little with our beneficiaries”; and “The staff is unwilling to perform disclosure.”

In general, though not specified for each downward stakeholder group, the respondents’ comments were clearly in line with the factors we identified in our enhanced model of downward financial disclosure in the non-profit sector.

## Discussion

Our study contributes to the understanding of downward financial disclosure in the nonprofit sector. First, we found that a substantial proportion of nonprofit organizations did disclose financial information to their downward stakeholders when they had no legal responsibility to do so, unlike the concerns in the literature (e.g., O’Dwyer & Unerman, 2010). However, the rates of financial disclosure varied substantially among the three stakeholder groups (staff, beneficiaries, and the public).

Second, this study reveals different decision-making patterns of voluntary financial disclosure across the three downward stakeholder groups. Disclosure to staff is associated with legal status and power centralization, suggesting that unregistered nonprofits resort to internal transparency to enhance legitimacy among their members and that governance structure affects internal transparency. Disclosure to beneficiaries is associated with governance factors such as power concentration, financial management, and auditing, indicating that in addition to governance structure, risk control is a major concern regarding disclosure to beneficiaries. Thus, disclosure to beneficiaries may be perceived as being unnecessary and bring obstacles to resource allocation as a result of reducing information asymmetry. Disclosure to the general public is determined by functional type, organizational capacity, and organizational culture. Specifically, service-oriented organizations may resort to financial disclosure to enhance legitimacy to the public. Nonprofits having more financial and technological resources are more capable of revealing financial information to the public. In addition, volunteer culture and salience of the general public also determine financial disclosure to the public. The cross-stakeholder differences indicate that there exist different disclosure decision-making patterns for the different downward stakeholders. This finding clearly echoes the Mitchell et al. (1997) argument

about the diversity of stakeholder attributes. But the mechanisms leading to such difference in decision making remain unclear, encouraging further investigation in future research.

Third, this study contributes to the understanding of organizational culture in downward financial disclosure, and thus enriches the four-factor (strategy, capacity, governance, and environment) model developed by Saxton and Guo (2011). Our analyses find that the two cultural factors, volunteer culture and stakeholder salience, do affect nonprofits' voluntary financial disclosure, but merely disclosure to the general public. This finding suggests nonprofits' emphasis on engaging the public, perhaps in the interest of resource mobilization. This needs further examination in future research. However, it should be noted that while claiming that their staff or beneficiaries are highly salient stakeholders in a general sense of accountability, nonprofit managers did not let such perception affect their financial disclosure to these stakeholders. This finding perhaps can also apply to their financial disclosure to the public, as indicated in the sensitivity tests. Therefore, stakeholder salience in a general sense has limited, if any, influence on nonprofits' financial disclosure to their downward stakeholders.

Admittedly, this study has limitations. First, the measurement of financial disclosure is subject to bias as the study uses nonprofit leader's self-reported data. Previous studies (e.g. Burger & Owens, 2010; Hofmann & McSwain, 2013) found that nonprofit managers tend to overstate their accountability by exaggerating their performance and transparency. Since not verified by triangulating different information sources, self-reported disclosure in this study may be overstated, as in previous studies, although such reporting at least indicates strong willingness to performing disclosure to intended stakeholders. Therefore, triangulation of evidence from different sources (e.g., pamphlets, website, and even intended stakeholders) to reduce measurement bias is recommended in future research.

Second, all data were collected in China, where the nonprofit sector has a short history, and is faced with rigorous restrictions by the government (Lee, 2009; Spires et al., 2014), which may make their financial disclosure behavior different from their counterparts in Western countries. For example, unregistered nonprofits disclose financial information to employees and volunteers (and perhaps also beneficiaries and the public) more frequently than do registered nonprofits, indicating that nonprofits seek to build legitimacy through downward stakeholders when they lack legal support from the government. Nonprofits, especially those run by volunteers, also prefer to engage the public by means of financial disclosure, with assistance from the strikingly growing information technology in China. Interestingly, however, our study found no influence of sociopolitical settings on financial disclosure. The reason remains unclear and needs to be explored. Given the attributes of Chinese nonprofits,

we suggest future research should examine nonprofits' downward financial disclosure in other social contexts.

## Conclusion

This study empirically examines nonprofit organizations' voluntary financial disclosure to their downward stakeholders by using an extended model based on Saxton and Guo's (2011) work. It enriches the understanding of downward accountability in the nonprofit sector. In assuming their "felt responsibility" (Christensen & Ebrahim, 2006), nonprofit managers perform downward accountability usually in informal manners centering on participation of the disadvantaged (Awio et al., 2011; Jacobs & Wilford, 2010; Kilby, 2006). Such downward accountability was often criticized for being "largely tokenistic, rhetorical, and to garnish legitimacy" (e.g., Bawole & Langnel, 2016). However, our study of Chinese nonprofits suggests that formal accountability instruments such as financial statements have been voluntarily employed in downward accountability practice. This may reflect that the nonprofit sector substantially answers the call across the globe for higher transparency and accountability (Bendell, 2006; McGann & Johnstone, 2006). Nonetheless, how the formal accountability mechanisms affect nonprofits' pursuit of their mission deserves further examination (Mitchell, 2014; Moxham, 2010), as well as the variation of decision-making patterns for different stakeholders as revealed in this study.

## Disclosure statement

No potential conflict of interest was reported by the authors.

## Notes

1. It is controversial whether accountability to staff is downward accountability as some researchers (e.g., Ebrahim, 2003) classify it to a third type of accountability—lateral accountability—along with upward and downward accountability. In this study, we follow the dichotomous typology by assigning it to downward accountability (Edwards & Hulme, 1996).
2. China's National Bureau of Statistics created a list of large and medium cities in 2011, which consists of the 70 largest cities across the country. See [http://www.stats.gov.cn/tjsj/zxfb/201603/t20160318\\_1332610.html](http://www.stats.gov.cn/tjsj/zxfb/201603/t20160318_1332610.html)

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