Evaluating the effectiveness of a state funding increase to arts organizations: A literature review

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Abstract

The research task is to evaluate the effectiveness of state subsidies for arts organizations. For this purpose, the paper reviews cultural economics, organizational theory, arts and nonprofit management and management accounting literature that supports 1) to derive the objectives of arts organizations against which the effectiveness should be assessed, and 2) to identify and develop performance indicators for evaluating effectiveness. The paper strives for contributing to the discussion on performance measurement of an arts organization. The study also has a pragmatic purpose: to help guide decision making on state subsidies for arts institutions. Data for the empirical study was collected from Finnish professional theatres, orchestras and museums.

Key words: performance, performance measurement, public funding

Word count: 4983

INTRODUCTION

In Finland, professional performing arts institutions and museum services are mainly financed by the state and the municipalities. Central government financing covers the costs of state-owned national cultural institutions. Through a statutory system of subsidies, the central government also supports municipal cultural institutions and the activities of independent, non-profit cultural and arts institutions. The Finnish Ministry of Education and Culture increased statutory state subsidies to professional theatres, orchestras and museums by 50 million EUR in the three years from 2008 to 2010, an almost 80 % increase on that of 2007. The total government subsidy for these professional performing arts organizations and museums was 62.3 million EUR in 2007 and amounted to 111.8 million EUR in 2010.

The research task, to evaluate the effectiveness of state subsidies for arts organizations, is based on this real life case of an increase in central government funding for the arts. The research question is**: what kind of performance indicators reflect the organizational level effects of an increase in state funding?** In other words, we have to identify which measures have the capacity to reflect responsiveness to the demands of various interest or stakeholder groups upon which the organization depends for resources and support. Organizations, inclusive of arts organizations, survive to the extent that they are effective, and further, the effectiveness of arts organizations derives from the way they can handle the demands of their various interest or shareholder groups that are concerned with their activities (Pfeffer and Salancik, 1978, 2). In arts organizations, those interest groups include at least artists, managers, public and private financiers, customers, employees, and volunteers.

Empirical research has found a relationship between government funding and repertoire (e.g., Pierce, 2000; O'Hagan and Neligan, 2005; Luksetich and Hughes, 2008; Camarero, Garrido and Vicente, 2011). The effects of an increase in state funding seem to be rather unexamined. In solving the research problem, we look for inspiration from several research areas. From theoretical and empirical contributions in cultural economics, nonprofit and arts management we recollect some general objectives of arts organizations. In the next phase of the study, based on the literature on performance and performance measurement of organizational theory, nonprofit and arts management, and management accounting we will derive measures or indicators that provide information about the achievement of the objectives. Previous empirical research related to the effect of government funding on the activities of arts organizations helps focus the indicator development work on essential factors.

The paper is organized as follows. The next section reviews general and specific aspects of performance and performance measurement. Then, the objectives of arts organizations are discussed and findings of empirical studies on government funding are presented. Finally, we summarize the insights from the reviewed literature domains and suggest how to proceed in the next phase of the study.

ELEMENTS OF PERFORMANCE

In this section, general issues related to performance measurement are addressed first. Second, the concepts of efficiency, effectiveness, and types of effectiveness indicators are presented. Third, we introduce a framework model for performance evaluation. Although our task in this paper is not to construct a performance measurement system for arts organizations, we address on related issues, since the familiarity with its main characteristics and mechanisms supports to derive relevant indicators for the effectiveness evaluation task.

Performance measurement

Performance measurement is a major instrument that provides and integrates all information relevant for making decisions related to the task of managing organizational performance (Pavlov and Bourne, 2011). In early performance measurement, practices focused on the technical aspects, organizational performance was equated with financial results and measured with corresponding financial indicators. Lately the scope of measurement practices has widened to the measurement of intangibles and financial indicators have been complemented by non-financial counterparts. In recollecting the recent contributions in this research area, Pavlov and Bourne (2011) present notions that the primary value of measuring intangibles lies in stimulating the process of discovering the drivers of organizational performance, not in the accurate estimation of their value. Measurement as such can act as an information provider *ex post*. It communicates, similar to feedback, to the management the information about the performance of an organizational process that has been executed. It also can act as a guide for learning *ex ante*. In this role, it is prescriptive in nature and can focus attention on critical areas before any action is taken. (Pavlov and Bourne, 2001; Flamholz and Das, 1985.)

When developing performance management systems (see e.g., Ferreira and Otley, 2009), it is assumed that the overall direction that an organization wishes to pursue is manifested in its mission statement. A mission statement aims to identify the expectations and requirements of stakeholders for attracting and maintaining them. Together with a vision about the desired future state of an organization, the mission guides the planning and decision making about the strategy and activities of an organization. The mission is often articulated in more or less clear, usually multiple, and sometimes even competing objectives.

Second, it is assumed that for achieving its objectives, whether they are formally specified or implicit, an organization will undertake actions and activities that forward the achievement of its objectives. Activities, attributes, competencies, and capabilities seen as central, critical pre-requisites for the success of an organization are called key success factors. Further, financial and non-financial measures called key performance measures or indicators are used to evaluate success in achieving the objectives of an organization. (Ferreira and Otley, 2009.). The explicit development of interaction links or relationships between measures is a typical characteristic of performance measurement models. The idea of the so called feed-forward control means that we should have foreknowledge about which process variables will be mediators in achieving or cause the achievement of outcome targets. Having this foreknowledge, those process measures should be selected that possess anticipatory capacity and consequently, have predictive value regarding related outcome or result measures. (de Haas and Kleingeld, 1999.)

Weinstein and Bukovinsky (2009) show that the Balanced Scorecard framework by Kaplan and Norton (1992) is an effective and proven performance measurement tool for arts and cultural organizations. They provide a detailed presentation of the framework and describe experiences of the Boston Lyric Opera in designing, implementing and using it. Only recently Zorloni (2012) constructed a model for evaluating the performance of art museums based on the Balanced Scorecard framework and demonstrated how the model can be implemented.

The concepts of efficiency and effectiveness

Organizational performance can be assessed internally or externally. As Pfeffer and Salancik (1978, 2) posit, organizations, inclusive of arts organizations, survive to the extent that they are effective. The effectiveness of arts organizations derives from the way they can handle demands of different interest groups upon which the organization depends for resources and support. Those interest groups include at least artists, public and private financiers, customers, employees, and volunteers. Organizational ***efficiency*** is an <u>internal</u> standard of performance and measures how well an organization accomplishes its stated or implied goals or objectives given the resources used (Pfeffer and Salancik, 1978, 33.).

The ***effectiveness*** of an organization is an <u>external</u> standard of how well an organization is meeting the demands of the various groups and organizations that are concerned with its activities. The effectiveness is sought as a natural outcome of the organization's requirements for survival. The first task of being effective is to have an adequate model of the reality within which the organization operates: to understand the factors that determine how the organization defines its world, because it responds to what it perceives and believes about the world. (Pfeffer and Salancik, 1978, 11, 89.)

The effectiveness of nonprofit organizations has been studied theoretically by Herman and Renz (1999) and Sowa et al. (2004) among others. Herman and Renz (1999) review the research on the involvement of boards of directors in the effectiveness of nonprofit organizations and report that boards make a difference but state that how they do it is not well understood. The model of Sowa et al. (2004) distinguishes between two levels or dimensions of organizational effectiveness: management effectiveness and program effectiveness. The authors decompose them further into two subcomponents, capacity and outcome and suggest objective and subjective or perceptual indicators for management capacity (structures and processes), management outcomes, program capacity (structures and processes), and program outcomes. Their suggestions related particularly to management capacity and program capacity support the indicator development of this study.

Performance in the short term may conflict with the long term performance (Child, 1984). Also, different criteria may be appropriate for the short, intermediate, and long runs. For example, in the short term, criteria related to production and customer satisfaction are emphasized. In the intermediate term effectiveness can be defined in terms of environmental adaptability and the capacity to improve one's position on the market, and in the long run, in terms of survival in the competition or in terms of cultural and social significance. Moreover, it has been proposed that performance criteria may vary according to the stage of the life cycle of the organization (Scott, 1998, 346). This study makes an effort to study the effectiveness of arts organizations on the short and intermediate term, but their long-term performance is left outside the scope of the paper. Neither does the study appraise the societal value or economic impact on the community of the arts organizations in focus.

Types of effectiveness indicators

As organizations often state their goals in very general terms, they have to be articulated in more specific terms for the purpose of measuring performance or effectiveness through setting quantitative and qualitative targets as against which the results are evaluated. Scott (1998) has identified three types of indicators or measures of organizational effectiveness: indicators based on outcomes, on processes, and on structures (Scott, 1998). ***Outcome indicators*** focus on specific characteristics of the quality of output or objects on which the organization performs some operation. Changes in the knowledge, attitudes or satisfaction of the visitors are examples of outcome indicators. To measure efficiency, the output should be related either to specific stated goals or resources used. Clearly, the outcome measures relate to individual level changes resulting of the output of an arts organization. When aggregated those changes result as impacts on the community or society level.

Scott (1998) says that outcomes are never pure indicators of quality of performance, but they also reflect the current state of the technology and the organization's environment. Thus, Scott suggests that because of the inadequate knowledge of cause-effect relations, the performance should be compared with other organizations carrying on similar work, which means using relative rather than absolute performance standards.

Since there are many difficulties in assessing and interpreting outcome measures (e.g. timing of measurement, losing contact with the customers served), ***process measures*** are often preferred. Process measures focus on the quantity or quality of activities carried on by the organization, and they assess effort rather than effect. For example, they assess how well a program or plan is followed, but not the adequacy or success of the programs themselves. Unfortunately, to gather information on real work inputs and processes may also be problematic and expensive, and self-reported activities may be biased. Therefore, ***structural indicators*** of effectiveness are used. They assess the capacity or competencies of the organization to achieve effective performance, e.g. the number of work force, expertise of the personnel, and the size of budgets. Structural indicators mainly focus on inputs as surrogate measures for outputs. They focus not on the work performed but the capacity to perform work. (Scott, 1998, 354-359.).

The different types of performance indicators are preferred by different constituency groups. For example, managers might emphasize structural measures of effectiveness, because these reflect factors that are more under their control than other types of indicators, performers might emphasize process measures, because they control their own performance, and customers prefer outcome measures, because they want results instead of mere promises (Scott, 1998, 359; Kanter and Summers, 1994, 228).

Measuring the effectiveness of an organizations' performance: a model

Epstein and McFarlan (2011) propose a model of nonprofit performance metrics by grouping the organization's resource acquisition and allocation into five clusters: inputs, activities, outputs, outcomes, and impacts**.** ***Inputs*** are the key tangible and intangible resources that enable the organization to perform its tasks: cash, personnel, equipment, other material items along with the mission statement and strategy. Input measures suggested by Epstein and McFarlan are subsidy, funding, donation and sponsorship. **Activities** are the specific programs and tasks that the organization undertakes. ***Outputs*** are the results of the organization's activities: the tangible and intangible products and services. ***Outcomes*** are the specific changes in behaviors and individuals affected by the delivery of these products and services. ***Impacts*** include benefits to communities and society as a whole as a result of the nonprofit organization's outcomes.

The present research problem in mind, the effects of the increase in state funding should be tracked in the clusters of inputs, activities, and output. The model of Epstein and McFarlan (2011) is therefore a suitable framework for the study. When we assess the clusters of input, activities, and output, we are actually assessing internal organizational effectiveness and could utilize various process and structural indicators. The studies of Belfiore and Bennett (2009), Hooper-Greenhill (2004), and Seaman (1987), demonstrating the effectiveness of funding, have focused on the clusters of outcomes and impacts on the measurement hierarchy of Epstein and McFarlan (2011). However, as the impacts on individual and community level are outside the scope of the study, we do not further the discussion on those impacts.

OBJECTIVES OF ARTS ORGANIZATIONS

In general, for evaluating performance, it is necessary to identify the goals or objectives of various interest groups of an organization against which performance is evaluated. In this section, we review cultural economists' studies on the behavior and objectives of nonprofit cultural organizations first. Next, we present related empirical results in the area of arts management.

Objectives and behavior of arts organizations in cultural economy literature

The economic approach to the arts considers both the demand and the supply of all kinds of art (Frey, 2003; Frey and Pommerehne, 1989, 12). Economic models of the behavior of nonprofit cultural organizations have mostly posited that those organizations try to maximize two main goals: artistic quality and audience size (DiMaggio, 1987; Throsby 1994). Two kinds of artistic quality has been distinguished: innovation or other aspects of the works such as repertoires appealing to the most refined tastes and production values such as virtuoso performance, lavish stage setting and costumes (DiMaggio, 1987).

Hansmann (1980; 1981; 1987) argues that nonprofit arts organizations are assumed to maximize quality, quantity, and budget. Quality maximizing organizations would use funds to employ better performers or have higher quality performances, quantity or attendance maximizing organizations would use funds to undertake activities that increase attendance, and budget maximizing behavior is preferred because it enhances the importance of the organization's managers ("organizational empirebuilders"). Hansmann employs his models to explore the welfare implications of the behaviors the models postulate and comes to a conclusion that quality, quantity or budget maximizing behavior may or may not constitute efficient behavior for the organization, depending on the structure of consumers' preferences and the way in which donations respond to organizational behavior. Optimizing models implicitly assume that the organizations involved minimize costs. Hansmann (1980) argues that owing to the absence of ownership claims to residual earnings, nonprofit organizations are "inherently subject to productive inefficiency (failure to minimize costs)". As the net earnings obtained by reducing costs cannot be distributed to individuals controlling over the organization (nondistributive constraint), the manager or members have little pecuniary incentive to operate the organization in a manner that minimizes costs.

Hansmann (1981) and Frey and Pommerehne (1989) suggest that participants in nonprofit arts organizations may try to use the organizations to achieve their own ends, though DiMaggio (1987) notes that economists have accepted quite readily the notion of artists and arts managers as being entirely unselfish and driven only by an ethic of cultural achievement on behalf of the organization. Frey and Meier (2006) model museum behavior applying, besides the neoclassical approach (see Hansmann, 1981), which assumes rational actors maximizing utility of a museum in a benevolent way, also the institutional approach, which emphasizes the importance of institutional settings for the behavior of the museum management. The suppliers of the arts compare the monetary and non-monetary benefits of alternative actions and behave differently with respect to output, inputs, and the production process depending on their institutional setting (whether the organization is supported fully or partly by public funds or is forced to cover costs themselves). In that case, the management is concerned primarily with the personal utility of its members depending on their own income, the prestige they get within their reference group of art lovers and the international museum community, and from amenities of the agreeable working conditions and job security. However, there are certain factors, the finances available being the most important one, that constrain their actions. Throsby (1994) maintains that maximizing one's standing among one's peer group is not necessarily inconsistent with long-run wealth maximization, because consumers see prestigious awards given by artists to artists as indicators of the quality of the product.

Also Luksetich and Lange (1995) argue that nonprofit organizations are likely to maximize the prestige and well-being of those managing the organization. Estimation of their model enabled them to draw some conclusions about the objectives of those managing the different size classes of nonprofit symphony orchestras. The results show that major orchestras have quality as a major organizational goal, with budget maximization as a complementary goal. Unconditional grants bear a positive and significant relationship to the administrative expense measure, indicating expense preference behavior. The greater administrative expenses are, in turn, positively related to the quality measure. Therefore, it is not possible to determine whether the relationship between unconditional grants and administrative and general expenses indicates expense maximization or quality maximization as a major orchestra goal. The strong positive and significant relationship between expenses and quality indicates that expense and quality maximization goals are complementary.

In public and government supported arts organizations, a subsidy might be withheld or reduced, if the organization begins to make a profit (Frey and Pommerehne, 1989, 40-43; Frey and Meier, 2006). Profits generate a cost in the form of a loss of subsidy and therefore, the incentive to earn profits is strongly diminished. Consequences of this might be that the quality of productions may be improved to above the level desired by the audience and rents may be distributed; for example, performers, managers, and other personnel may be overpaid. Performance excellence is achieved through specialization to a particular artist's production and completeness of exhibits. Managers do not actively aspire to provide exhibitions attracting large audiences or make the exhibitions, because they are not dependent on entrance fee income. Further, other sources of revenue not directly related to the artistic production like running museum shops, cafés and restaurants, are ignored.

DiMaggio (1987) includes survival and legitimacy as goals of nonprofit arts organizations. In addition, he reflects on what predicts the objective function of a nonprofit organization and mentions four major factors: size and degree of orientation to the market; the dependence on sponsorship; the respective roles of artists, managers, and trustees; and the niche the nonprofit sector occupies in a given industry.

Findings related to the mission, objectives, and success of arts organizations

Turbide and Laurin (2009) emphasize that the mission of arts organizations is articulated around the concept of artistic achievement; arts organizations are held accountable based mainly on budgetary and financial criteria. They surveyed more than 300 Canadian performing arts organizations and a majority of them used multiple performance indicators spanning several dimensions of mission fulfillment. Although the most important success factor was artistic excellence, their performance measurement system placed as much emphasis on financial and non-financial indicators.

Gilhespy (2001) develops, based on 27 interviews with the managers of arts organizations, a model rendering down the various and multiple objectives of arts organizations into a series of strategic options that may be pursued in relation to on another. The options are: access maximization, attendance maximization, diversity/multiculturalism, economy maximization, education, excellence/quality, innovation, revenue maximization, service quality maximization, and social cohesion. For each strategic option, he also suggests several performance indicators that measure effectiveness, efficiency, economy, or equity.

Zorloni (2012) identified nine areas crucial to the success of 16 museums in Washington, New York, and London: preserving collections, strengthening research, increasing public engagement, maximizing collaboration, serving the mission through organizational excellence, attracting and developing staff capacity, enhancing competitor intelligence, advancing museum governance and accountability, and managing and increasing financial support.

FINDINGS RELATED TO GOVERNMENT FUNDING

This section reviews empirical studies on the effects of government support for the arts. In his study seeking to determine how private and government support change the repertoire of American opera companies, Pierce (2000) found that local government funding encouraged program conventionality, while federal support such as the NEA (National Endowment for the Arts) funding encouraged program risk-taking.

O'Hagan and Neligan (2005) showed that in 40 grand-aided nonprofit English theatres, increases in state subsidies resulted in less conventionality. The findings of Alexander (1996) show that government support was associated with an increase in the number of three formats (travelling exhibitions, theme shows, and blockbuster exhibitions) and in the newer postmodern and contemporary styles of 15 large American art museum exhibitions.

Luksetich and Hughes (2008) examined the effect of lump-sum subsidies (unrestricted government grants) on the repertoire of the members of the League of Symphony Orchestras (former American Symphony Orchestra League) and found that while state lump-sum grants decreased the number of popular pieces performed by medium and small symphony orchestras, the impact of government support on contemporary programming was rather weak.

Camarero et al. (2011) analyzed how public funding impacts innovation and performance of 491 British, French, Italian, and Spanish museums. They found that public funding does not encourage innovation. Museums subsidized with more public funding seemed to have less of an incentive to adopt technological innovations and had a particularly restrictive effect on organizational change (training and progress of managerial staff) in museums. Instead, public funding helped museums to accomplish their social goals of preserving the collection, improvement and dissemination of culture within the local community.

From these findings, it can be reasoned that an increase in state funding influences the behavior and activities in arts organizations. Therefore, it is advisable to address the repertoires of theatres and orchestras and exhibition formats and styles of museums as well as administrative and management practices in these organizations before and after the increased state funding period for tracking changes.

SUMMARY AND CONCLUSION

For evaluating performance, it is necessary to identify the goals or objectives of various interest groups of an organization against which performance is evaluated. To sum up the objectives of nonprofit arts organizations identified in literature and empirical studies, we list the following: artistic quality maximization, quantity or attendance maximization, budget maximization, maximization of the prestige and well-being (personal utility) of those managing the organization, expense maximization, survival and legitimacy. Other related aspects are the managers' diminished incentive to minimize costs and earn profits and the size of an organization that might predict the objective function of a nonprofit organization.

The model of Epstein and McFarlan (2011) demonstrating the various acquisitions and allocations of an organization that have an effect on internal and external effectiveness suits well as an analysis tool for the next phase of the study. Particularly, the input, activities, and output clusters of the model are related to internal effectiveness. Components relevant for the study (probable targets of the state subsidy increase) in these clusters should be specified and measured using all of the three types of the effectiveness indicators suggested by Scott (1998): outcome, process, and structural indicators.

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