# NONPROFIT LEADERSHIP TOOLS for UNCERTAIN TIMES

e-book SET

## The Essential Collection

Nonprofit Finance for Hard Times: Leadership Strategies When Economies Falter

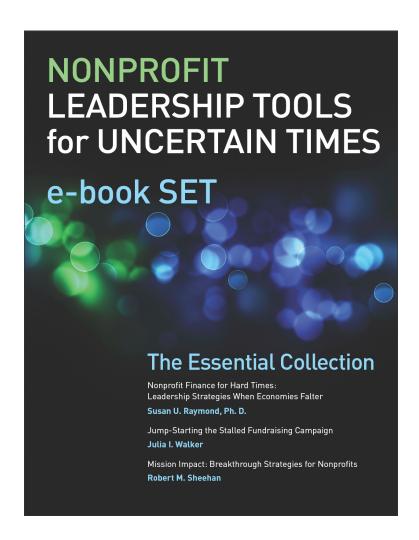
Susan U. Raymond, Ph. D.

Jump-Starting the Stalled Fundraising Campaign

Julia I. Walker

Mission Impact: Breakthrough Strategies for Nonprofits

Robert M. Sheehan



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### Nonprofit Leadership Tools for Uncertain Times

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#### INTRODUCTION

2011 was tough for American nonprofits. With a global recession in full swing, nonprofits are searching for new ways to stretch their budgets, do more with less, and maximize their return on investment. We don't know how long the recession will last, but clearly the economy will be presenting challenges for nonprofits in the foreseeable future.

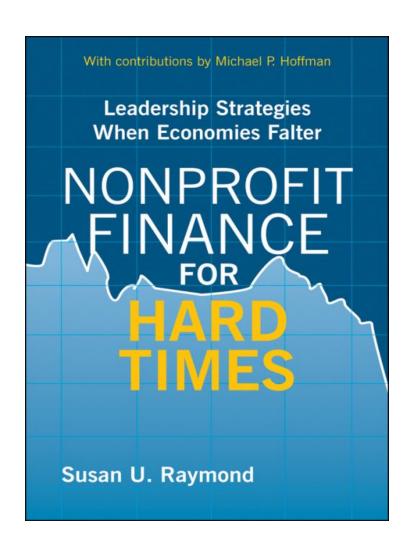
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## Nonprofit Finance for Hard Times

Leadership Strategies When Economies Falter

SUSAN U. RAYMOND, Ph.D.

With Contributions by Michael P. Hoffman



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HG4027.65.R 658.15-dc22 For colleagues, here and abroad, who have encouraged this work. With friends, everything is possible. Without them, all is lost.

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#### **Preface**

The two most important considerations for any organization faced with scarce resources are efficiency of operations and effectiveness of effort. This is (or ought to be) as true in the nonprofit as it is in the commercial sector. As this book vividly points out, however, the past decades of change and growth among American nonprofits has created a serious problem for the sector.

On the one hand, the strength of nonprofit and philanthropic activity is its breadth. The nation's 1.2 million nonprofits address an extraordinary sweep of societal needs, from storefront clinics to cancer research, from the air quality of a small town to the astrophysics of the universe. Nothing is too small, and few things are too large, for the efforts of nonprofits.

On the other hand, that very strength is itself an emerging weakness. Proliferation of organizations has led to duplication, replication, and fears of inefficiency. The growth of philanthropy has not kept pace, and many (perhaps most) nonprofits find increasing competition for resources. In an economic crisis, such as that of 2008-2009, severe resource constraints make the social price of inefficiency exceedingly high.

What is needed is entrepreneurial innovation in the way we are organized and in the way we work. Philanthropies and nonprofits must seek ways to cut through duplication and find collaborative synergies. The emphasis must be on demonstrated effectiveness and efficiency. That demonstration, in turn, will trigger an outpouring of even more philanthropy as people come to trust that every dollar

is being put to work to its highest value for the purpose of solving problems.

It is a challenge to constantly emphasize maximum value of the investment dollar in the commercial sector. It is even more of a challenge in the nonprofit sector where clear measures of alternative social returns to the use of a philanthropic dollar are often not clear and are usually not shared among competing organizations. But always, and even more in times of economic difficulty, when demands are great and resources are limited, that hard job must be undertaken with dedicated diligence.

Nonprofit Finance for Hard Times documents the evolution of nonprofit and philanthropic institutions in the United States. It emphasizes that preparing for economic difficulties is not a task to be undertaken in crisis; it is a constant responsibility that flows from the core purpose of nonprofits to address our common needs. Nonprofit Finance for Hard Times teaches that constant attention to value, constant engagement of community, and constant reexamination of effectiveness is the only pathway to sustainability. It is also the only way to keep faith with those who lend not just wealth, but their most precious commodity—time—to the betterment of our communities and our nation.

William I. Campbell Senior Advisor JPMorgan Chase

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#### **CHAPTER 1**

#### **Beginning at the Beginning**

#### Public Charities on the Economic Landscape

[Americans] have all the lively faith in the perfectability of man, they judge that the diffusion of knowledge must necessarily be advantageous, and the consequences of ignorance fatal; they all consider society as a body in a state of improvement, humanity as a changing scene, in which nothing is, or ought to be, permanent; and they admit that what appears to them today to be good may be superseded by something better tomorrow.

Alexis de Tocqueville, 1835

Americans have long believed in the ability to perfect society, to solve problems by force of effort. Further, and despite enshrining individualism at the core of its psyche, Americans really do prefer to solve problems together rather than alone. There is a legendary mystique about the dust-covered lone sheriff who rides into town at sunset to rescue the community from the vile hands of evildoers. Legends make excellent movies; they just don't jibe with reality.

Citizen engagement, which is a recurring theme throughout this book, is the more common historical model of community problem solving. The lone voice in the wilderness is less a national role model than the "everyone-in-it-together" potluck dinner fund-raiser for social change.

#### **Thematic Summary**

Common, voluntary action on the societal commons has a long history in the United States. But the size and nature of the "nonprofit sector" has changed markedly in the last two decades. Public charities are now a social and an economic force, and financial health and welfare is equally a social and an economic concern when economic turbulence threatens the underpinnings of all institutions.

The nation does not take well to fatalism; it believes betterment is constantly possible.

The exemption from taxation of money or property devoted to charitable or other purposes is based upon the theory that government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare.

House Ways and Means Committee Report to Congress, 1939

The role of public charities on the societal commons to pursue that betterment is as old as the nation itself. Private effort through charitable institutions to address community social needs had its roots in religious organizations, but the branches and leaves quickly grew in multiple directions and

nonreligious groupings of like-minded rise to individuals focused on mutual aid. That early growth was not motivated by tax benefits. Formal tax-exempt status for nonprofit charities is relatively recent, beginning with the 1913 Revenue Act, which imposed federal corporate income taxes for the first time but explicitly exempted charities. Still, the legal roots of the concept of some type of tax relief for charities are older. The Tariff Act of 1894 and the Revenue Act of 1909 both contained foreshadowing of the 1913 initiative, indicating a long-standing concern among lawmakers that formal organizations established for the public good be treated differently from those organized for gain. $\frac{1}{2}$  The intent—at least in part—was encourage private investment in meeting societal needs in order to avoid the public budget costs of equivalent government action. If private voluntary action could forestall tax expenditures, then the culture of U.S. governance could opt for the former over the latter.

#### The Present Departs from the Past

All was quiet for about 40 years. By the 1950s, however, concerns were growing that large nonprofits were engaging in activities akin to private commerce, and lawmakers began to take a closer look at the evolving collision course between tax exemption and the marketplace. Tax exemption was feared to be a veil behind which nonprofit organizations obtained market advantage, which they would then use for their own institutional interests quite apart from social needs. Despite sotto voce murmurings from commercial institutions and in the halls of Congress, there was no great public outcry, and policy concerns remained nascent. That was, in part, because the problem was largely invisible. According to testimony of the Internal Revenue Service to

Congress in 1953, there were only 32,000 public charities in the United States, a number too small to be the focus of anyone's statistical attention. 2

That was about to change, and change radically, in two ways. First, in midcentury, most secular nonprofits were not public charities. They were fraternal organizations, civic societies, and the like, so their numbers were small and engagement with service to members was large, but their interface with the larger public was small. Indeed, by the late 1960s only 32 percent of nonprofits were 501(c)(3) public charities. As recently as the early 1990s, that portion had risen to only 50 percent. As can be seen in <a href="Exhibit 1.1">Exhibit 1.1</a>, however, the period of the last 16 years has seen an explosion of growth in the number of public charities and a shift in proportions. Now there are some 1.2 million public charities in the nation, a quadrupling in the last 25 years, and they represent nearly two-thirds of all registered nonprofits. Public charities are no longer invisible.

The second related change is the consequent economic role. Rather than simply the recipients of public largess, nonprofits are increasingly a powerful force in the economy. Before embarking on an examination of their economic roles, the structure of their revenue, and their health in trying economic times, however, three caveats are in order.

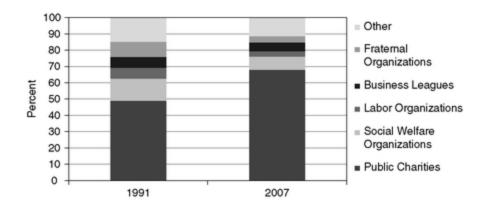
#### A Complex and Poorly Documented Sector

First, the term "nonprofit sector" covers myriad types of organizations, from soup kitchens to cemeteries to the pension funds of unions and certain types of insurance companies. There are actually more than 25 IRS codes for nonprofit organizations, with varying implications for the tax treatment of their revenues and the monies they either

make or that are donated to them. Exhibit 1.2 illustrates the relative size of each of the categories based on registrations with the Internal Revenue Service.

EXHIBIT 1.1 Change in Distribution of IRS Section (c) Organizations by Type, 1991-2007

Source: IRS.



For purposes of this book, the term "nonprofit" refers only to public charities that are categorized under section 501(c) (3) of the Internal Revenue Service tax code. This represents the nearly two-thirds of all nonprofits and 69 percent of the revenue in the total sector. $\frac{4}{}$  If only the median rate of growth of the last two decades holds (that is, growth every year is at the middle point of growth rates that have already been seen) there will be 1.7 million public charities by 2015. Exhibit 1.3 depicts this growth. Extraordinary growth, in turn, means extraordinary youthfulness in the Astonishingly, nearly three-quarters of those sector. charities were created since 1980. Parenthetically, this robust growth has not been seen in other types of nonprofits. The number of fraternal organizations, which dominated the sector in the mid-twentieth century, has declined by a third since 1991. So the proliferation has not been driven by some universal increase in the propensity to reject profit in preference to nonprofit among those who form organizations. Rather, growth seems driven by a combination of mission on the societal commons, and possibly, as is discussed in Chapter 3, "Philanthropy within Financial Structure," increasing government reliance on private institutions for community problem solving.

**EXHIBIT 1.2** Distribution of All Types of Nonprofits *Source:* IRS.

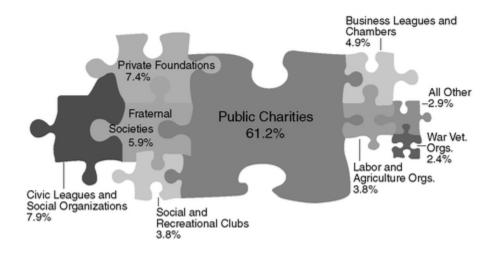


EXHIBIT 1.3 Number of Nonprofits, 1997 Projected to 2015 Source: 1997-2007 IRS; 2007-2015 author projection.

