



PART ONE

Introduction to Fundraising and Donor Behavior

<http://www.pbookshop.com>

COPYRIGHTED MATERIAL

<http://www.pbookshop.com>



CHAPTER ONE

INTRODUCTION TO THE NONPROFIT SECTOR

By the end of this chapter you should be able to:

1. Describe the difference between the public, private, and nonprofit sectors
2. Understand different perspectives on the scope of the nonprofit sector
3. Describe a variety of ways of categorizing nonprofit organizations in the United States.
4. Locate information on the size and performance of different categories of nonprofit or cause.
5. Describe the key sources of nonprofit income.

This chapter begins our exploration of fundraising by studying the sector that is typically the focus of our activity, reviewing definitions of the nonprofit sector, distinguishing it from the public and private sectors, and examining its primary sources of income. We conclude by exploring how such knowledge of the sector can assist fundraisers in developing their practice.

A “Third” Sector

Over the years many authors have developed widely differing terminology for what is ostensibly the same cohort of organizations. Labels such as *third sector*, *independent sector*, *not-for-profit sector*, *nonprofit sector*, *charitable sector*, and *voluntary sector* are used with varying frequency in different countries. Unfortunately these labels are all too often used interchangeably and with rather different emphases of meaning, making it impossible to be sure with any degree of certainty that any two writers are addressing the same facet of society. Salamon and Anheier (1997, p. 3) argue that this complexity has developed because of the great range of organizations that are included under these umbrella headings, “from tiny soup kitchens to symphony orchestras, from garden clubs to environmental groups.”

Our first task in this text must therefore be to begin to navigate a way through this complexity. The logical starting place is the term *third sector*, which is now in common usage and reflects the distinctive role the sector has in society. The third sector is distinguished by being somehow different from either government or the private sector. All three sectors are important facets of human society and all three have a role to play in the satisfaction of human need.

The private sector or “market” caters to the majority of human needs—certainly in the developed world—matching the supply of producers with consumer demand for goods and services. This market ensures that people can obtain much of what they want and need from others at a reasonable price—or at least those who have money are facilitated in doing so! Economists argue that the market works because suppliers are prevented from charging excessive prices by the knowledge that if they do so, others will enter the market to cater to the need. Similarly, the market ensures that a multitude of needs are met by ensuring that a reasonable profit will be available to suppliers in each case. There is no philanthropy at work here. The market works purely on the notion of self-interest. As Adam Smith (1776, p. 119) noted, “It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their own advantages.”

There are instances, however, in which this market mechanism fails and governments may be compelled to intervene to ensure that certain minimum standards of consumption are met for all individuals in a given

society. During and immediately after the Second World War many governments had to introduce food rationing to ensure that those on low incomes were not priced out of the market and starved as a consequence. Equally, in the United States the Medicaid scheme ensures that the poorest members of American society have access to health care, which they couldn't otherwise afford. The term *public sector* is typically used to refer collectively to those institutions and mechanisms a society considers necessary for the basic well-being of its members. Adam Smith (1776, p. 122) defined the public sector as "those public institutions and those public works, which though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual, or small number of individuals; and which it, therefore, cannot be expected that any individual, or small number of individuals, should erect or maintain." Such institutions are both founded and funded by the state, with both its own interests in mind (to prevent civil unrest and to facilitate reelection) and those of its citizens. The funds to provide these institutions and works are derived from taxation (either local or national), and the funding that each receives is a function of what politicians deem appropriate rather than a reflection of the level of use per se.

In the public sector, the state takes legal responsibility for institutions and the work they undertake. Indeed, as Chapman and Cowdell (1998, p. 2) note, "it is one of the characteristics of public sector organizations that they are bounded by and operate within extensive legislation which creates an often creaking bureaucracy, much of which is concerned with the 'proper' use of public monies."

This notion of "proper" use warrants elaboration. In a democracy, what may be deemed proper use will be subject to change. As various parties stand for election, they map out in their manifestos the role that government should play in all aspects of social life, but in particular in balancing the needs of society for the provision of public services against the burden of the additional taxes that would be needed to pay for them. Although it would be ideal for government to meet every basic human need, it is probably unrealistic to expect that wage earners in a given society would be willing to fund such comprehensive social provision through taxation, and in practice a balance is therefore created with only the most widespread, popular, or fundamental needs being met in this way. Other facets of need are simply neglected.

It is within this neglected space, where neither government nor private sector enterprise is willing to engage, that the so-called third sector has a

critical role to play. The third sector is distinctive because it comprises individuals or groups of individuals coming together to take “voluntary” action. In other words, the sector comprises people who elect to help other people to resolve issues or concerns. “The essence of voluntary action is that it is not directed or controlled by the State and that in the main it is financed by private, in contradistinction to public, funds. It embodies the sense of responsibility of private persons towards the welfare of their fellows; it is the meeting by private enterprise of a public need” (Nathan, 1952, p. 12).

It is the notion that the sector is not controlled by the state or by business that leads to the description of the sector in the United States as the “independent sector.” Although organizations in this sector may indeed be free of direct control, the difficulty with this terminology is that in financial terms such organizations can often be far from independent, drawing financial support from a plethora of government departments, private businesses, or both. This has particularly been an issue in the past thirty years as government has sought to withdraw progressively from many facets of social life, leaving the third sector to shoulder the burden (albeit with support from often large government grants). In the United States the sector is of particular significance—as Tempel and Mortimer (2001, p. vii) note: “Philanthropy and the nonprofit sector occupy a position in the American institutional landscape unlike that in any other developed country. Undertaking functions typically assigned to government in other countries and also accorded unparalleled tax advantages for so doing, these American institutions are thought to be central to furthering democracy and the search for social justice.” The fact that the sector occupies this third space means that the activities it undertakes can be quite unique. Third sector, or “nonprofit,” organizations often deal with local issues, with politically unpopular issues, or with facets of life that attract little interest from politicians, all too often because few votes hang on the issue. Nevertheless, these can be critical issues for a society to address, and the need is nonetheless pressing simply because the state or private sector enterprise fails to take an interest.

Nonprofit organizations meet these collective demands by collecting financial resources from the government sector and the business sector, and through philanthropy by individuals, corporations, and foundations. Government support comes in the form of contracts, grants, tax benefits, and other public policies that favor the nonprofit sector (Sargeant, Shang, and Shabbir, 2009). Corporate support comes in the form of corporate giving and gifts from corporate foundations. Individual philanthropy takes the form of individual giving, bequest giving, and giving by individual trusts, endowments, and foundations.

A nonprofit organization may be constituted as either a trust or a nonprofit corporation under U.S. federal law. In the case of the latter, whereas for-profit corporations exist to earn and distribute after-tax business earnings to shareholders, the nonprofit corporation exists solely to provide programs and services that are of benefit to the public. Often these programs and services are not otherwise provided by local, state, or federal entities. The term *nonprofit* is slightly misleading in that these organizations can and do earn a profit (or more accurately, an operating surplus). The key difference in the case of a nonprofit is that such earnings must be retained by the organization to invest in the future provision of programs and services. The monies are not dispersed to shareholders.

In this book, although we recognize that a plethora of other terms might be applied, we employ the term *nonprofit* throughout. Readers should be aware that this term has been rightly critiqued for its unfortunate predilection to define the sector by what it is not rather than by what it is (Young, 1983), but it remains the term most commonly used in the United States and for that reason we employ it here.

A Tax-Based Definition

The United States defines nonprofit organizations in tax law laid down by the Internal Revenue Service (IRS). The tax code lists some thirty different types of entity that can benefit from exemption from corporate income tax. These include social clubs, cemetery companies, fraternal benefit societies, and religious and charitable organizations. A full list is provided in Table 1.1. Additional tax benefits are offered to some organizations that permit their donors to claim a tax deduction in return for their support. The majority of those that are able to receive such tax-deductible contributions fall into one specific category of the code: Section 501(c)(3). To qualify for this additional benefit, organizations must fulfill three tests:

1. They must operate to fulfill one of the following broad purposes:
 - a. Educational
 - b. Religious
 - c. Charitable
 - d. Scientific
 - e. Literary

(Text continues on page 11.)

**TABLE 1.1 TYPES OF TAX-EXEMPT ORGANIZATIONS
AND NUMBER, EXPENSES, AND ASSETS BY TYPE, 2005**

| Section of 1986 IRS Code | Description of Organization | Entities Registered with the IRS | Entities Reporting to the IRS | Expenses of Reporting Entities (\$ Millions) | Assets of Reporting Entities (\$ Millions) |
|--------------------------------|--|---|-------------------------------------|---|---|
| 501(c)(1) | Corporations organized under act of Congress | 100 | 4 | 8 | 146 |
| 501(c)(2) | Title-holding corporations for exempt organizations | 5,850 | 2,783 | 1,220 | 13,177 |
| 501(c)(3) | Religious, charitable, and similar organizations | 984,386 | 400,709 | 1,099,799 | 2,436,067 |
| 501(c)(4) | Civic leagues and social welfare organizations | 116,890 | 24,327 | 44,067 | 66,766 |
| 501(c)(5) | Labor, agricultural, and horticultural organizations | 56,819 | 20,591 | 18,844 | 26,143 |
| 501(c)(6) | Business leagues, chambers of commerce, real estate boards, and trade boards | 71,872 | 30,798 | 29,872 | 54,954 |
| 501(c)(7) | Social and recreational clubs | 56,369 | 16,567 | 10,466 | 20,608 |
| 501(c)(8) | Fraternal beneficiary societies and associations | 63,318 | 7,077 | 12,919 | 91,088 |
| 501(c)(9) | Voluntary employee-beneficiary societies and associations | 10,088 | 6,887 | 126,975 | 143,134 |
| 501(c)(10) | Domestic fraternal societies and associations | 20,944 | 2,822 | 541 | 2,710 |
| 501(c)(11) | Teachers' retirement fund associations | 14 | 7 | 157 | 1,228 |

| Section of 1986 IRS Code | Description of Organization | Entities Registered with the IRS | Entities Reporting to the IRS | Expenses of Reporting Entities (\$ Millions) | Assets of Reporting Entities (\$ Millions) |
|--------------------------------|--|---|-------------------------------------|---|---|
| 501(c)(12) | Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, and so on | 5,901 | 3,540 | 34,807 | 81,722 |
| 501(c)(13) | Cemetery companies | 9,808 | 2,221 | 790 | 8,255 |
| 501(c)(14) | State-chartered credit unions and mutual reserve funds | 3,565 | 1,304 | 14,366 | 2,890,440 |
| 501(c)(15) | Mutual insurance companies or associations | 1,646 | 558 | 2 | 2,807 |
| 501(c)(16) | Cooperative organizations to finance crop operations | 16 | 12 | 22 | 344 |
| 501(c)(17) | Supplemental unemployment benefit trusts | 300 | 115 | 325 | 287 |
| 501(c)(18) | Employee-funded pension trusts created before June 25, 1959 | 1 | 1 | 146 | 1,701 |
| 501(c)(19) | War veterans organizations | 35,113 | 6,576 | 1,103 | 2,451 |
| 501(c)(20) | Legal service organizations | 9 | 5 | 2 | 2 |
| 501(c)(21) | Black lung benefits trusts | 28 | 0 | 0 | 0 |
| 501(c)(22) | Withdrawal liability payment funds | 0 | 0 | 0 | 0 |
| 501(c)(23) | Veterans organizations created before 1880 | 2 | 2 | 228 | 2,680 |

(Continued)

TABLE 1.1 CONTINUED

| Section of 1986 IRS Code | Description of Organization | Entities Registered with the IRS | Entities Reporting to the IRS | Expenses of Reporting Entities (\$ Millions) | Assets of Reporting Entities (\$ Millions) |
|--------------------------------|--|---|-------------------------------------|---|---|
| 501(c)(24) | Trusts described in section 4049 of the Employment Retirement Security Act of 1974 | 1 | 0 | 0 | 0 |
| 501(c)(25) | Title-holding corporations or trusts with multiple parents | 1,133 | 931 | 913 | 27,856 |
| 501(c)(26) | State-sponsored organizations providing health coverage for high-risk individuals | 10 | 8 | 269 | 103 |
| 501(c)(27) | State-sponsored workers' compensation reinsurance organizations | 12 | 4 | 1,231 | 6,056 |
| 501(d) | Religious and apostolic organizations | 160 | 0 | 0 | 0 |
| 501(e) | Cooperative hospital service organizations | 18 | 11 | 449 | 571 |
| 501(f) | Cooperative service organizations of operating educational organizations | 1 | 0 | 0 | 0 |
| Other | Organizations not classified above, including charitable risk pools | 4,105 | 163 | 424 | 475 |
| | Total | 1,448,485 | 528,023 | 1,401,454 | 3,291,886 |

Notes: Not all Internal Revenue code Section 501(c)(3) organizations are included, because certain organizations, such as churches (and their integrated auxiliaries or subordinate units) and conventions or associations of churches, need not apply for recognition of tax exemption unless they specifically request a ruling. Private foundations are included among 501(c)(3) organizations.

Sources: Wing, K. T., Pollak T. H., and Blackwood, A. (2008). *The nonprofit almanac* (pp. 2–3). Washington, DC: Urban Institute Press.

- f. Testing for public safety
 - g. Fostering certain national and international amateur sports competitions
 - h. Prevention of cruelty to children and animals
2. No substantial part of the organization's activity should be focused on attempts to influence government, either directly or indirectly, through participation in political campaigns. A maximum of 20 percent of their annual expenditure can be applied to mission-related lobbying activity, and they are barred from preparing or distributing campaign literature on behalf of political parties and from electioneering for particular candidates. Other categories of nonprofit, such as 501(c)4 organizations, can engage in lobbying for social change, but contributions to these organizations are not tax deductible.
 3. These nonprofits must also demonstrate procedures to prohibit assets or income from being distributed to workers, managers, or the equivalent, except as fair compensation for service rendered. Organizations cannot be used for the personal benefit of founders, board members, staff, or associates.

To complicate matters further, the IRS divides 501(c)3 organizations into two categories. Fundraisers should be aware of the distinction between public charities and private foundations (IRS 2008):

Generally, organizations that are classified as public charities are those that (1) are churches, hospitals, qualified medical research organizations affiliated with hospitals, schools, colleges and universities, (2) have an active program of fundraising and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations or other public charities, (3) receive income from the conduct of activities in furtherance of the organization's exempt purposes, or (4) actively function in a supporting relationship to one or more existing public charities. Private foundations, in contrast, typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs.

An alternative perspective on defining the sector would be to categorize nonprofits by the nature of the activities they undertake. The IRS has done exactly that by developing the National Taxonomy of Exempt

**TABLE 1.2 ORGANIZATIONS, EXPENSES, AND ASSETS
IN THE NONPROFIT SECTOR, 2005**

| Nonprofit Category | Organizations Reporting to the IRS | % of Organizations Reporting to the IRS | Reported Expenses (\$ Millions) | % of Total Expenses | Reported Assets (\$ Millions) | % of Total Assets |
|---|---|--|--|----------------------------|--------------------------------------|--------------------------|
| Arts, culture, and humanities | 43,392 | 8.22 | 26,632 | 1.90 | 94,722 | 2.88 |
| Education | 78,074 | 14.79 | 165,339 | 11.80 | 611,567 | 18.58 |
| Environmental quality, protection, and beautification | 10,382 | 1.97 | 9,487 | 0.68 | 31,840 | 0.97 |
| Animal related | 7,381 | 1.40 | 4,576 | 0.33 | 12,466 | 0.38 |
| Health | 26,904 | 5.10 | 637,067 | 45.46 | 787,570 | 23.92 |
| Mental health, crisis intervention | 9,421 | 1.78 | 23,500 | 1.68 | 19,203 | 0.58 |
| Diseases, disorders, medical disciplines | 12,636 | 2.39 | 18,820 | 1.34 | 22,849 | 0.69 |
| Medical research | 1,798 | 0.34 | 7,098 | 0.51 | 33,107 | 1.01 |
| Crime, legal related | 9,307 | 1.76 | 7,591 | 0.54 | 8,301 | 0.25 |
| Employment, job related | 17,124 | 3.24 | 28,947 | 2.07 | 33,404 | 1.01 |
| Food, agriculture, and nutrition | 6,620 | 1.25 | 7,710 | 0.55 | 7,115 | 0.22 |
| Housing, shelter | 20,146 | 3.82 | 18,579 | 1.33 | 62,820 | 1.91 |
| Public safety | 9,495 | 1.80 | 2,403 | 0.17 | 6,843 | 0.21 |
| Recreation, sports, leisure, athletics | 42,753 | 8.10 | 24,561 | 1.75 | 39,673 | 1.21 |
| Youth development | 7,254 | 1.37 | 5,756 | 0.41 | 12,956 | 0.39 |
| Human services—multipurpose and other | 38,795 | 7.35 | 91,540 | 6.53 | 135,402 | 4.11 |

| Nonprofit Category | Organizations Reporting to the IRS | % of Organizations Reporting to the IRS | Reported Expenses (\$ Millions) | % of Total Expenses | Reported Assets (\$ Millions) | % of Total Assets |
|---|------------------------------------|---|---------------------------------|---------------------|-------------------------------|-------------------|
| International, foreign affairs, national security | 5,732 | 1.09 | 20,843 | 1.49 | 19,630 | 0.60 |
| Civil rights, social action, advocacy | 2,779 | 0.53 | 3,098 | 0.22 | 3,434 | 0.10 |
| Community improvement, capacity building | 45,433 | 8.60 | 29,757 | 2.12 | 91,124 | 2.77 |
| Philanthropy, volunteerism, and grantmaking foundations | 72,825 | 13.79 | 54,842 | 3.91 | 493,945 | 15.00 |
| Science and technology research institutes, services | 3,281 | 0.62 | 12,234 | 0.88 | 14,860 | 0.45 |
| Social science research institutes, services | 926 | 0.18 | 1,520 | 0.11 | 3,129 | 0.10 |
| Other public and societal benefit | 17,803 | 3.37 | 31,866 | 2.27 | 391,442 | 11.89 |
| Religion related, spiritual development | 2,160 | 0.41 | 2,006 | 0.14 | 14,408 | 0.44 |
| Mutual/ membership benefit organizations | 34,316 | 6.50 | 165,318 | 11.80 | 339,668 | 10.32 |
| Unknown | 1,286 | 0.24 | 313 | 0.02 | 409 | 0.01 |
| Total | 528,023 | 100.00 | 1,401,454 | 100.00 | 3,291,886 | 100.00 |

Notes: Only organizations required to file annually with the IRS (organizations that receive at least \$25,000 in gross receipts annually) are included in these figures. Expenses include both operating expenses and grants or transfer payments made to individuals and other organizations.

Source: Wing, K. T., Pollak T. H., and Blackwood, A. (2008). *The nonprofit almanac* (pp. 4–5). Washington, DC: Urban Institute Press.

Entities (NTEE). A list of the NTEE major categories is provided in Table 1.2 along with the number of entities registered with the IRS in each case. Putting aside grantmaking foundations (which typically fund work in other categories), it is interesting to note the dominance of education, arts, community improvement, and recreation and sports.

The NTEE is of interest for fundraisers because it categorizes the nonprofit sector into twenty-six major categories. Each of these broad categories is further divided to provide a greater degree of specificity. As an example, arts, culture, and humanities are the A category in NTEE code. Within this category, media and communications are A30. The A30 category includes four industries: film and video (A31), television (A32), printing and publishing (A33), and radio (A34). Each of the other twenty-five categories is further subdivided, making it possible to access statistics on particular parts of the nonprofit sector. Fundraisers can use these categorical codes to search for information on any category of organizations (<http://nccs.urban.org/classification/NTEE.cfm>). These codes can be particularly helpful when researching trends or looking to identify organizations for a competitor analysis.

A Structural-Operational Definition

The tax-based definition we have just discussed is specific to the United States, derived as it is from the tax code in this country. As a consequence, it suffers from several disadvantages, notably that because tax laws vary it cannot serve as the basis for international comparison, which may be relevant for fundraisers looking for international funding opportunities (James, 1987). Salomon, Sokolowski, and Associates (2004) have developed a structural-operational definition of the nonprofit sector to facilitate such international comparison. Their approach is illustrated in Table 1.3. Their classification defines the nonprofit sector, or *civil society organizations* in their terminology, as a collection of entities that satisfy five requirements: they need to be organized, private, self-governing, nonprofit distributing, and noncompulsory.

The United Nations and the Center for Civil Society Studies at the Johns Hopkins Institute for Policy Studies are currently collaborating to improve basic statistics on the scope, structure, financing, and activities of the nonprofit sector in different countries. Their project categorizes the nonprofit sector into twelve groups (as shown in Table 1.4) and about thirty subgroups. These categories resemble but are not exactly the same as the NTEE categorizations. If you are looking for funding overseas, it will be necessary to be sensitive to these variations.

TABLE 1.3 THE STRUCTURAL-OPERATIONAL DEFINITION

1. *Organized*, that is, they have some structure and regularity to their operations, whether or not they are formally constituted or legally registered. This means that our definition embraces informal, that is, nonregistered, groups as well as formally registered ones. What is important is not whether the group is legally or formally recognized but that it has some organizational permanence and regularity as reflected in regular meetings, a membership, and some structure of procedures for making decisions that participants recognize as legitimate.
2. *Private*, that is, they are not part of the apparatus of the state, even though they may receive support from governmental sources. This feature differentiates our approach from the economic definitions noted above that exclude organizations from the civil society sector if they receive significant public sector support.
3. *Not profit-distributing*, that is, they are not primarily commercial in purpose and do not distribute profits to a set of directors, stockholders, or managers. Civil society organizations can generate surpluses in the course of their objectives, but any such surpluses must be reinvested in the objectives of the organization. This criterion serves as a proxy for the “public purpose” criterion used in some definitions of civil society, but it does so without having to specify in advance and for all countries what valid “public purposes” are. Rather, it leaves these decisions to the people involved on the theory that if there are people in a country who voluntarily support an organization without hope of receiving a share of any profit the organization generates, this is strong evidence that they must see some public purpose to the organization. This criterion also usefully differentiates civil society organizations from for-profit businesses.
4. *Self-governing*, that is, they have their own mechanisms for internal governance, are able to cease operations on their own authority, and are fundamentally in control of their own affairs.
5. *Voluntary*, that is, membership or participation in them is not legally required or otherwise compulsory. As noted above, this criterion also helped relate our definition to the concept of public purpose, but in a way that allows each country’s citizens to define for themselves what they consider to be a valid public purpose by virtue of their decisions to take part on their own initiative in the organizations affected.

Source: Salamon, L. M., Sokolowski, S. W., and Associates. (2004). *Global civil society: Dimensions of the nonprofit sector* (Vol. 2; pp. 9–10). Bloomfield, CT: Kumarian Press. Reproduced with permission.

Size and Economic Significance of the Nonprofit Sector

In 2006, the nonprofit sector contributed \$666.1 billion to the gross domestic product (GDP) of the United States—5.0 percent of the total GDP. Business accounted for 77.3 percent and government accounted for 11.4 percent. The size of the nonprofit sector doubles every decade or so, making it by far the fastest growing sector in terms of its proportional rate of growth. In 1929, for example, it contributed only \$1.5 billion, or 1.4 percent of the total (Wing, Pollak, and Blackwood, 2008).

TABLE 1.4 INTERNATIONAL CLASSIFICATION OF NONPROFIT ORGANIZATIONS

Group 1: Culture and Recreation

- 1 100 Culture and arts
- 1 200 Sports
- 1 300 Other recreation and social clubs

Group 2: Education and Research

- 2 100 Primary and secondary education
- 2 200 Higher education
- 2 300 Other education
- 2 400 Research

Group 3: Health

- 3 100 Hospitals and rehabilitation
- 3 200 Nursing homes
- 3 300 Mental health and crisis intervention
- 3 400 Other health services

Group 4: Social Services

- 4 100 Social services
- 4 200 Emergency and relief
- 4 300 Income support and maintenance

Group 5: Environment

- 5 100 Environment
- 5 200 Animal protection

Group 6: Development and Housing

- 6 100 Economic, social and community development
- 6 200 Housing
- 6 300 Employment and training

Group 7: Law, Advocacy and Politics

- 7 100 Civic and advocacy organizations
- 7 200 Law and legal services
- 7 300 Political organizations

Group 8: Philanthropic Intermediaries and Voluntarism Promotion

- 8 100 Grant-making foundations
- 8 200 Other philanthropic intermediaries and voluntarism promotion

Group 9: International

9 100 International activities

Group 10: Religion

10 100 Religious congregations and associations

Group 11: Business and Professional Associations, Unions

11 100 Business associations

11 200 Professional associations

11 300 Labour unions

Group 12: (Not Elsewhere Classified)

Source: International Classification of Nonprofit Organizations (ICNA) in Lester M. Salamon and Helmut K. Anheier, *Defining the Nonprofit Sector*. (Manchester, UK: Manchester University Press, 1997), pp. 70-74.

Approximately 1.71 million 501(c)(3) organizations were registered with the IRS in 2008 (IRS 2009). This estimate includes private foundations as well as public charities that have more than \$5,000 in annual gross receipts. Organizations with more than \$25,000 in gross receipts must complete an annual report using IRS Tax Return Form 990 or Form 990EZ (for organizations with gross receipts of less than \$100,000 and total assets of less than \$250,000; another variant, Form 990-PF, is available for private foundation organizations). This form requires the organization to provide (among other things) a summary of the organization's finances, including their revenue, assets, income, and expenses for the relevant tax year. Any growth trends noted are based on this self-reported information.

For example, the number of public charities reporting to the IRS increased from 243,430 in 1998 to 420,187 in 2008, or 73 percent. In the same period, total revenues for reporting organizations increased by 91 percent, from \$695.3 billion to \$1,328.6 billion, and the total assets of these nonprofits increased from \$1,182.3 billion to \$2,433.8 billion. These latter figures are dominated by the largest organizations, primarily hospitals and higher education institutions, which account for more than half of total assets (Wing, Pollak, and Blackwood, 2008).

Churches and religious organizations are not required to register with or report to the IRS. This includes integrated auxiliaries, subordinate units, and conventions or associations of churches. They are generally exempt from income tax and receive other favorable treatment under the tax law. Although registration is not required, about half of all churches

and religious organizations voluntarily do so (Weitzman and others, 2002), and these are included in the estimates based on the self-reported information.

Impressive though these aggregate figures for the sector are, they dramatically underestimate the real size of the nonprofit sector in the United States. Sociologist David Horton Smith (2000) argues that a tax-based description of the sector cannot do justice to the majority of grassroots nonprofit organizations. Reliance on tax data focuses attention on the larger, wealthier, older, more visible nonprofits, in which most of the work is done by paid staff rather than by volunteers (Hodgkinson and Weitzman, 1992; Hodgkinson and others, 1992). Data from grassroots organizations are excluded. Smith defines these as “locally based, significantly autonomous, volunteer-run, formal nonprofit (i.e., voluntary) groups that manifest substantial voluntary altruism as groups and use the associational form of organization, and thus have official memberships of volunteers who perform most, and often all, of the work/activity done in and by these nonprofits” (7). To help distinguish grassroots organizations from other forms of association, Smith provides a helpful summary of their characteristics (see Table 1.5).

**TABLE 1.5 ELEMENTS OF THE DEFINITION OF
GRASSROOTS ASSOCIATIONS**

| Characteristics of Grassroots Associations | Omitted from Grassroots Associations Category |
|---|---|
| 1. Group form | Individual, unorganized, amorphous behavior |
| 2. Voluntary altruism based | Business, government, or household/family goals |
| 3. Significantly autonomous of other groups (even if formally affiliated) | Completely controlled subunit of another group/organization |
| 4. Association form (common interest, members elect officers, members pay dues, etc.) | Non-membership-dominated groups |
| 5. Local (small in territorial base or scope) | Supra-local territorial base or scope (from several counties up to international scope) |
| 6. Volunteer staffed (majority of work done by volunteers) | Paid-staff workers based (majority of work done by paid staff) |

Source: Smith, D. H. (2000). *Grassroots associations* (p. 9). Thousand Oaks, CA: Sage Publications, Inc. Reprinted with permission.

Smith's research shows that IRS data include data from only half of the existing nonprofits who have assets of \$5,000 or more and 10 percent of all nonprofits in 1990. He estimates that there are actually more than 18 million nonprofit organizations in the United States. From a fundraising perspective, this distinction matters because Smith's data suggest an altogether more cluttered market for funding than IRS data might suggest. It also matters because fundraising in traditional and large nonprofit organizations may be different from fundraising in grassroots organizations. We would argue that most of the fundraising techniques included in this book are applicable to all organizations, whether large or small. However, we do recognize that many fundraisers in grassroots organizations will be volunteers, possibly performing multiple roles for their organization and working with very limited resources.

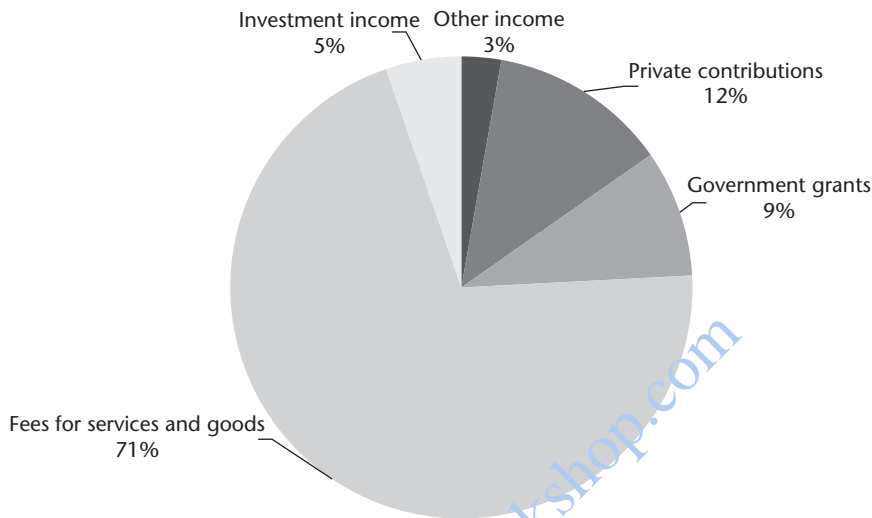
Sources of Income

In 2005, public charities reported total revenues of \$1.1 trillion and total assets of \$2.0 trillion to the IRS (Wing, Pollak, and Blackwood, 2008). Fees for services and goods accounted for 70.3 percent of total revenue. This number includes income streams such as tuition payments, hospital patient revenues (such as Medicare and Medicaid), and ticket sales.

Private contributions accounted for 12.3 percent of total revenue. This in turn comprises individual donations and grants from foundations and corporations. Nine percent of total revenue came from government grants. Investment income and so-called other income (which includes rental income and income from special events) accounted for 5.4 percent and 2.9 percent of revenue, respectively. The data are summarized in Figure 1.1. It should be noted that excluding hospitals and higher education institutions from this analysis changes the distribution of sources of revenue substantially, as shown in Figure 1.2. These two categories of organization rely heavily on fee income and thus less on donations. For other categories of nonprofit organization, almost one quarter of their income is derived from philanthropy.

When viewed in aggregate, the growth of income to the sector has been impressive. Total revenue broadly doubled in the ten years to 2005, with an average annual growth rate of 7.2 percent. Some subsectors have of course fared better than others. Growth in total revenue ranged from 80.6 percent for arts, culture, and humanities organizations to 224.3 percent for international and foreign affairs organizations.

FIGURE 1.1. SOURCES OF REVENUE FOR REPORTING PUBLIC CHARITIES, 2005 (PERCENT)



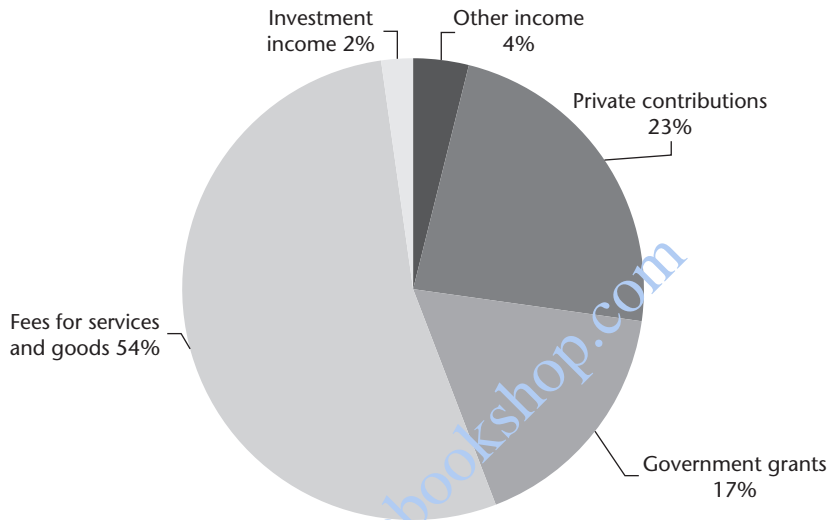
Source: Urban Institute, National Center for Charitable Statistics, NCCS-GuideStar National Nonprofit Research Database: Special Research Version (2005).

Philanthropic Income

Data from the Giving USA Foundation (2009) allow us to take a closer look at the philanthropic income attracted to the sector. They also provide a more recent snapshot of performance. Philanthropic income to the non-profit sector stood at \$307.65 billion in 2008. A breakdown of the sources of that income is provided in Figure 1.3.

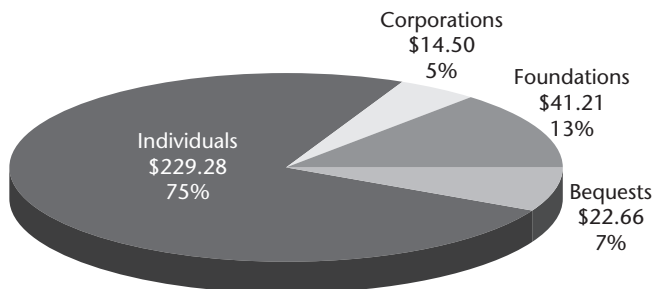
Perhaps the most striking feature of this graph is the generosity of individuals. Together they provide three quarters of the philanthropic income accruing to the sector. Factor in gifts from deceased individuals through bequests and the percentage climbs to well over 80 percent. Many readers new to the sector may be surprised by this, and equally surprised by the low percentage provided by corporations. Businesses have historically provided only around 5 percent of the total of charitable

FIGURE 1.2. SOURCES OF REVENUE FOR REPORTING PUBLIC CHARITIES, EXCLUDING HOSPITALS AND HIGHER EDUCATION, 2005 (PERCENT)



Source: Urban Institute, National Center for Charitable Statistics, NCCS-GuideStar National Nonprofit Research Database: Special Research Version (2005).

FIGURE 1.3. CHARITABLE GIVING 2008



Note: \$ in billions. Total = \$307.65 billion

Source: Giving USA Foundation/Giving USA 2009. Reprinted with permission.

giving, despite the hype that often surrounds gifts of this nature. We could be forgiven for assuming from the media coverage generated by this support that the figure would be much higher. It is important that fundraisers be aware of this, particularly those approaching the role for the first time. Many may be tempted to spread their resources across both corporate and individual giving, whereas these figures suggest that in many cases they would be wise to focus on the latter.

The Giving USA study has been conducted annually for more than fifty years and consequently allows us to track giving over an extended period and through many global recessions. The data indicate that despite periods of recession or economic uncertainty, both philanthropy in the United States and giving to most subsectors (or causes) have grown steadily over the past fifty years. Although in years of recession giving can decrease (in real terms), the long-term trend is remarkably robust. Perhaps disappointingly, though, total giving hasn't risen as a percentage of GDP. It remains at a stubborn 2 percent.

Focusing just on individual giving, we know that people typically donate to nonprofits about 2 percent of their disposable income (that is, the amount of income left to an individual after taxes have been paid and available for spending and saving). This figure too has remained static. A further way of looking at the amount spent by individuals on charity is to express it as a percentage of household expenditure. In this case it is helpful to draw a distinction between essential household expenditures and luxury household expenditures. In regard to the former, if we consider giving as essential spending, it will be included with purchases such as clothing, energy, and food and would equate to around 6 percent of this category. If it were regarded as a component of luxury private consumption and thus considered in the same category as purchases such as alcohol, international travel, recreation, restaurants, and tobacco, it would equate to around 16 percent of expenditure in this area. Giving to nonprofits is thus a small percentage of household expenditure regardless of the category to which one might assign it.

In interpreting these latter figures it would be easy to conclude that people care less about their giving than they care about their own luxury. As we shall see in Chapter Five, this would be a mistake. Although the amount given annually may be only a small percentage of household expenditure, it is often highly significant to the individual. Giving is closely linked to people's core sense of who they are and the values by which they live. Fundraisers should thus distinguish between the dollar level of donations and their psychological importance to donors.

**TABLE 1.6 CONTRIBUTIONS IN 2007: \$306.69 BILLION BY
TYPE OF RECIPIENT ORGANIZATION (\$ IN BILLIONS)**

| Sector | Amount | Percent |
|--|----------|---------|
| Religion | \$106.89 | 35.0 |
| Education | \$ 40.94 | 13.0 |
| Human services | \$ 25.88 | 9.0 |
| Health | \$ 21.64 | 7.0 |
| Public-society benefit | \$ 23.88 | 8.0 |
| Arts, culture, and humanities | \$ 12.79 | 4.0 |
| International affairs | \$ 13.30 | 4.0 |
| Environment/animals | \$ 6.58 | 2.0 |
| Gifts to grantmaking foundations | \$ 32.65 | 11.0 |
| Grants from foundations to individuals | \$ 3.71 | 1.0 |
| Deductions carried over and other unallocated giving | \$ 9.39 | 6.0 |

Source: Giving USA Foundation/Giving USA (2009). Reprinted with permission.

Table 1.6 indicates how the funds are applied. Religion is the largest recipient of giving. Religious organizations receive roughly one third of overall contributions, about \$106.89 billion. Education is second in line. Most subsectors experienced a decline in support from 2007 to 2008 (accounting for inflation) as a consequence of the downturn in the economy. After accounting for inflation, only giving to religious and public-society benefit organizations increased philanthropic income in this period (by 1.6 percent and 1.5 percent respectively). It is important to note that although a downturn in the economy is significant, it is not disastrous for giving. Although the recent recession has proven to be one of the worst on record, after adjusting for inflation, individual giving fell by only 5.7 percent from 2007 to 2008.

Summary

In this chapter, we have explored various definitions of the nonprofit sector, outlined the size and scope of it, and compared its characteristics and economic significance with those of the business and governmental sectors. We have also summarized the sources of income available to nonprofits and identified key historic trends in these data.

The diversity of the nonprofit sector makes it difficult for practitioners and academics to reach a consensus on what constitutes the full scope of the sector. It is therefore necessary to pay careful attention to the terminology when researching sector trends. Each term carries a unique meaning, and each way of capturing the size and scope of nonprofits presents only one perspective on the sector.

Among all the sources of income, individual philanthropy is obviously the most important source for fundraisers to monitor. Individual giving (including that offered in the form of bequests) has historically risen steadily in terms of its inflation-adjusted dollar values. It fell in 2008 as a consequence of the downturn in the economy, but the long-term trend remains upward. By contrast, giving expressed as a proportion of individual disposable income has remained static for more than fifty years. A significant challenge for fundraisers in the future will be both to increase the dollar value of giving and to increase its overall share of household expenditure.

Discussion Questions

1. What is the third sector and how does it differ from the private sector and the government or public sector?
2. What other terms are used to describe the third sector? How do they differ in scope?
3. Distinguish between the tax-based and structural-operational definitions of the sector. When should you use one definition rather than the other?
4. Explain the limitations of calculating the size of the nonprofit sector using IRS data, and explain how fundraisers can obtain a more accurate estimate.
5. Describe the major sources of income for the nonprofit sector.
6. Describe the major sources of philanthropic income for the nonprofit sector. Visit the Center on Philanthropy Web site at <http://www.philanthropy.iupui.edu>. Follow the links to the latest Giving USA study. What trends in giving to your own category of nonprofit can you identify?