



MICHAEL J. WORTH

NONPROFIT MANAGEMENT

Principles and Practice • **SIXTH EDITION**



NONPROFIT MANAGEMENT

Sixth Edition

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Principles and Practice

Sixth Edition

Michael J. Worth

The George Washington University



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Singapore | Washington DC | Melbourne



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Preface

The first edition of *Nonprofit Management: Principles and Practice* was published by SAGE in 2009. The second edition was published in 2012, the third in 2014, the fourth in 2017, and the fifth in 2019. It is striking how much the landscape of the nonprofit sector has continued to change over the years, requiring frequent updates to stay current with the state of the field in nonprofit management. Changes reflected in this sixth edition of the book include, most obviously, certain data but also trends, new concepts and research, and new cases that have drawn attention since the fifth edition was completed. The inevitable lag between research and writing and publication often means that readers should be alert to recent changes and events that may have occurred during the process of publishing the book. Thus, even this sixth edition may have some obsolescence by the time it reaches the reader. There are reminders of this reality throughout the book, and it is recommended that students consult referenced websites and other resources on points that seem subject to change.

It is, of course, impossible to know what economic conditions will prevail when this book reaches its readers. The recession that began in 2007, what some people called the Great Recession, took a significant toll on many nonprofit organizations, resulting in decreased financial resources at a time when the demand for services was increasing. Most nonprofit organizations survived the Great Recession, although the death rate was higher among smaller organizations. Even larger organizations found it necessary to reduce staff, programs, and expenditures (McKeever et al., 2016). A decade later, by 2017, the economy had largely recovered. By 2019, unemployment was low and financial markets had reached historic highs. Then, in 2020, the COVID-19 pandemic plunged the nation into crisis, including a significant economic downturn. At the time of this writing, it is impossible to predict what conditions may prevail by the time this edition reaches its readers. Perhaps the economy will have recovered or difficult conditions will continue. In either scenario, the Great Recession and the COVID-19 pandemic have produced a heightened awareness of financial uncertainty, of the need for nonprofits to use resources efficiently and effectively, and of the importance of achieving diverse revenue sources to weather various economic scenarios. Both historical events have also demonstrated the critical importance of nonprofits in meeting human and community needs.

Adding to the uncertainty of economic cycles, the federal tax law passed in 2017 had possible implications for the nonprofit sector, including reduced incentives for charitable giving. In the midst of the COVID-19 pandemic, emergency federal legislation was passed in 2020 to increase tax incentives for charitable giving on a temporary basis. It is not possible to predict at the time of this writing whether these changes will continue beyond the emergency period. Whatever may unfold, history suggests that the nonprofit sector will continue to face new opportunities and challenges in the years ahead, requiring leadership by knowledgeable and experienced professionals.

New to This Edition

This sixth edition includes a number of significant changes from the fifth. First, chapter topics continued from the previous edition have been updated to reflect new data, new research, and recent events. New material, drawn from both the scholarly and practitioner literatures, is incorporated at relevant points throughout the book.

In response to reviewer comments as well as the evolving landscape, some topics from the previous edition have been expanded. They include, for example, new material regarding diversity, equity, and inclusion; volunteer stewardship; nonprofit executive transitions;

models for pursuing earned income; ethical dilemmas and controversial donors; generational differences in the workplace; and the role of nonprofits in advancing social movements. New cases have been developed for this edition, including the Newseum, the National Geographic Society, Generation Hope, and Burning Man. Cases that appeared in the fifth edition have been updated to reflect recent events.

Philosophy of This Book

A Balanced Approach

Students reading this book are likely to have varied backgrounds. Some may be undergraduates who do not yet have substantial work experience and perhaps wish to explore nonprofit management as a possible career direction. Others may be graduate students who have an interest in nonprofit careers but have not previously studied management. Still others might have studied management but may have limited knowledge of the unique values, characteristics, and circumstances of the nonprofit sector or how the management principles they know can be applied in the nonprofit environment. Yet others may be individuals with considerable experience working in nonprofit organizations who are pursuing further study to increase and broaden their understanding and professional skills.

Some students reading this book may be undergraduates taking a course that is an introduction to the nonprofit sector. Some may be enrolled in a certificate program intended to increase the skills of nonprofit professionals. Others may be enrolled in a program leading to a master's degree in nonprofit management. Some may be pursuing a master's degree in business, social work, public administration, or public policy, with a concentration in nonprofit management. Still others may be taking only one course in nonprofit management as an elective in their undergraduate or graduate degree program, seeking only a broad and general orientation to the field.

Given the diversity of backgrounds and goals often found among students taking a course in nonprofit management, a textbook that seeks to provide an overview of the field must include both theoretical concepts and practical applications; it must cover some basics as well as intellectually stimulating issues; it must be both rigorous and accessible to students of varied academic backgrounds; and it must provide both a foundation of knowledge that may serve as a springboard to more advanced study and a comprehensive overview for those students whose one experience with the field will consist of a single course.

This book strives to address all these diverse needs and interests, with the author's humble recognition that it may not succeed in meeting all of them for all students. It attempts to provide a comprehensive exposure to topics relevant to the field of nonprofit management, but it obviously must be selective in its discussion of those topics. This intended balance between comprehensiveness in topics and selectivity in their treatment may disappoint some readers. Some may find their appetites whetted but unsatisfied by the quick tour provided in some parts of the book. It is possible that others may find that some chapters include ideas they have seen before in other courses. Of course, some will find the discussion just right for their level of previous knowledge and desire for new understanding.

Students are encouraged to tailor their use of the book to their own interests and backgrounds. Readers who, for example, already have studied some of the organizational and management theories we will discuss are encouraged to read relevant sections as a refresher but to pay closer attention to material that is new to them. Those to whom the theories are new, and who find their discussion in this book to be too brief, are encouraged to explore the additional resources suggested throughout the book. In sum, it is hoped that this book will provide a kind of comprehensive menu, from which students may select the topics or

approaches on which they wish to “click” for more information. Both novices and more experienced individuals may find it a foundation on which they can build, seeking appropriate avenues for further information and learning. Suggested additional readings are included at the end of every chapter. And, in all likelihood, professors also will elaborate on some topics and skip lightly over others, as they sense the tempo of their individual classes.

Focus on Charitable Nonprofits

As will be discussed in Chapter 2, the nonprofit sector encompasses an amazing array of organizations with different characteristics, structures, and purposes. This book focuses primarily on that category known as charitable nonprofits and, in particular, on those that provide services, such as education and research, health care, arts and cultural programs, and social and legal services. The following chapters will also sometimes mention member-serving organizations—for example, trade and professional associations—but primarily as points of contrast with charitable nonprofits. Religious congregations make up a significant component of the overall nonprofit sector, but religion is the subsector that is the least professionalized—that is, it employs relatively few professional managers. Thus, this book does not devote significant discussion to the management of churches, synagogues, mosques, or other religious congregations. We will discuss foundations, but primarily as sources of support for service-providing nonprofits; we will not discuss the management of foundations per se. This book does not exclude, but also does not emphasize, those nonprofits that are primarily advocacy organizations, also known as social welfare organizations. While they are nonprofits, they are also different from charitable nonprofits in important ways, as we will discuss further in Chapter 2. Of course, some principles discussed in this book apply to all nonprofits and will be of relevance to students intending to work in any component of the nonprofit world.

Focus on U.S. Nonprofits

This book includes a chapter on nonprofits in the global environment, but it primarily addresses the management of nonprofit organizations in the United States. The American nonprofit sector is the largest in the world; it operates under unique cultural, economic, and legal circumstances. It is where most American students of nonprofit management will pursue their careers. In addition, as governments around the world seek to reduce their expenditures and devolve many functions to nonprofit organizations, many also are looking to relevant aspects of the American model in developing their own nonprofit sectors. This is evidenced by the significant number of international students who come to the United States to study in this field. Previous editions of this book are in use in countries outside of the United States; thus, even for students primarily interested in working on the international stage, an understanding of nonprofit management in the United States is both relevant and useful.

Overview of the Book

The first three chapters of this book provide an orientation to the nonprofit sector and a theoretical foundation for the more applied topics considered later. Chapter 1 introduces nonprofit management, both as a profession and as an academic field of study, and offers a justification for studying the topic as distinct from management in government or business. Chapter 2 offers a look at the structure, boundaries, and characteristics of the nonprofit sector and establishes some basic definitions. It also discusses emerging new organizational forms that may reshape the sector in the future. Chapter 3 expands our understanding of the

nonprofit sector by reviewing theories that explain its existence and its role in relation to government and business. That chapter also examines selected theories that describe the nature of nonprofit organizations and explain their behavior.

The next two chapters, Chapters 4 and 5, consider the roles and responsibilities of governing boards and nonprofit chief executive officers (CEOs) and the ways in which these two vital actors interact in leading organizations. The nonprofit governing board has functional, moral, and legal responsibilities. Nonprofit chief executives, whether titled “executive director,” “president,” “CEO,” or something else, lead their organizations in a complex and dynamic environment that will be described. The partnership between the CEO and the board is critical to a well-operating and effective organization.

The next six chapters focus on applied aspects of nonprofit management. Chapter 6 reviews the increasing demands for nonprofit accountability and various approaches to measuring the performance of nonprofit organizations. Chapter 7 discusses the development of organizational strategy and the tools of strategic planning and strategic management now employed by many nonprofits. Strategic planning is often the first step in the larger undertaking of building the organization’s capacity or its ability to achieve the goals identified in the plan; thus capacity building is also considered in this chapter. The management of risk is a topic that has gained more attention in recent years. Managing risk goes beyond the simple avoidance of liability or loss, for example, protecting against the possibility that a staff member brings a lawsuit or the building catches fire. It is a broader concept that relates to uncertainty that could affect achievement of the organization’s mission. It is thus related to the development of strategy and maintaining a process for managing risk is an important component of organizational capacity (Herman, 2011).

Chapter 8 explores collaborations and partnerships among nonprofit organizations and those that cross the sectors. In addition, recent years have brought mergers of nonprofit organizations, a topic that is also considered in Chapter 8. Chapter 9 discusses both the theory and the practice of human resource management in nonprofit organizations. This edition includes an expanded discussion of the important topic of diversity, equity, and inclusion and new materials related to volunteer stewardship. One of the significant differences between many nonprofits and business or government is the substantial employment of volunteers to provide the organization’s core services. Management of an unpaid workforce requires an understanding of human motivation and skill in managing effective relationships between an organization’s volunteers and its paid professional staff. Chapter 10 considers the management of programs for communication and marketing, essential for organizations that are highly interactive with and dependent on the world around them. This section concludes with Chapter 11, which discusses advocacy and lobbying, important activities for many nonprofit organizations that seek to bring about social change. This sixth edition includes new material regarding the role of nonprofits in building social movements.

The next section of the book, encompassing four chapters, is concerned with the acquisition and management of resources. The securing of revenue and the management of financial resources are interrelated activities. Like many of the topics covered in this book, financial management is large, complex, and important. Chapter 12 provides a few basic concepts and directs students to additional sources from which they can obtain the more detailed understanding they may seek. Chapter 13 discusses the principles of raising philanthropic funds from individual, corporate, and foundation donors, and it includes a discussion of controversial donors and tainted money, an issue that has gained wide attention in recent years. Chapter 14 explores the subjects of social enterprise and nonprofits’ earned income—that is, efforts to generate revenue through activities other than traditional philanthropy. The chapter examines the myriad and growing commercial partnerships between nonprofit organizations and corporations, including cause-related marketing, sponsorships, licensing agreements, joint ventures, and others. It also considers nonprofit business ventures, the development of revenue-generating activities that provide a stream of revenue to support mission programs.

This discussion has been expanded in this edition to include models for relating earned-income to the nonprofit's mission. Chapter 15 considers the principles involved in securing and managing grants and contracts from government, a significant source of revenue for many nonprofits.

The final section of the book includes two chapters that address special topics. Chapter 16 examines social entrepreneurship and social innovation. Social entrepreneurship is not necessarily synonymous with the generation of earned income revenue or even with the adoption of business methods by nonprofit organizations. Nor is social entrepreneurship always synonymous with the founding of new organizations. Rather, by the definition used in this book, it includes innovations that lead to “wide-scale change at the systemic level” (Leviner, Crutchfield, & Wells, 2006, p. 89). In other words, social entrepreneurship is related to social innovation, regardless of the specific methods or financial sources that may be involved. These distinctions will be explored fully in Chapter 16. Chapter 17 looks beyond the United States to discuss the work of nonprofit and nongovernmental organizations internationally. The conclusion offers some of the author's final reflections and observations.

Students may observe that the book does not include a chapter on nonprofit law. Nonprofits are subject to a large and growing body of law at the local, state, and federal levels. However, aspects of nonprofit law are covered in the various chapters where they are most relevant rather than in a separate chapter. The book provides references to other resources for students who may want to know more. The book also does not include a separate chapter on ethics; rather, ethical issues are addressed at various points throughout the text. For example, ethical points are included in the discussion of Chapter 6 concerning accountability and in the discussion of fundraising in Chapter 13. The discussion of ethics has been enhanced in this edition in all of the relevant contexts, reflecting an increased emphasis on ethical behavior throughout the sector.

Attentive readers will observe that there is some redundancy among the chapters, that is, some points are repeated, at least in summary, in various locations. The author has tried to minimize redundancy, but some points are woven throughout various topics and require brief revisiting as new discussions are introduced. In addition, some professors may not assign all chapters and some repetition of key points is thus essential to complete the discussion on some topics.

Again, all the following chapters draw on the theoretical and academic literature as well as the writing of experienced practitioners and consultants. Key points are illustrated with actual cases, some drawn from the daily headlines. Students are encouraged to include the cases in their reading of each chapter, to consider the questions suggested for discussion of the cases, and to consider the broader “Questions for Discussion” provided at the end of each chapter. The appendix includes four cases that cut across the topics covered in various chapters but that may have particular relevance to specific chapters as well. Students are also encouraged to think about the relevance of what they are reading to any nonprofit organizations with which they may have personal experience. In addition, the daily news within the span of almost any semester or academic year includes stories that relate to nonprofit organizations and provide real-time cases that illustrate points discussed in this book.

Teaching Resources

This text includes an array of instructor teaching materials designed to save you time and to help you keep students engaged. To learn more, visit sagepub.com or contact your SAGE representative at sagepub.com/findmyrep.

Acknowledgments

Writing a book is a collective enterprise, even when the book has one author. Any author builds on the work of others, and this text reflects the wisdom of the many scholars and practitioners who are cited throughout it.

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- Chapter 1** Nonprofit Management as a Profession and a Field of Study
- Chapter 2** Overview of the Nonprofit Sector
- Chapter 3** Theories of the Nonprofit Sector and Nonprofit Organizations



Visitor center of the Bill & Melinda Gates Foundation in Seattle. The Gates Foundation, founded in 2000, focuses its giving on world health and urban education in the United States, among other areas.

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Chapter Outline

A Revolution in Management

A Distinct Profession

Nonprofit Management as a Field of Study

Toward a Balanced Approach

Proceeding With Realism and Pride

Chapter Summary

Nonprofit Management as a Profession and a Field of Study

This is a book about the management of nonprofit organizations. The topic begs two fundamental questions: Why do nonprofit organizations need to be managed? And, is management of a nonprofit organization really different from management of a business or government agency? In other words, is there really a need for a book like this, or is management a generic activity that could be learned as well from a textbook on business or public management?

Some may hold a perception of nonprofit organizations as primarily collections of well-intentioned people who struggle with minimal resources to meet human needs, without much attention to the bottom line, and with some disdain for management as an unwelcome distraction from the all-important work of delivering vital programs and services. This stereotype, if ever true, does not describe all nonprofit organizations today. Indeed, there has been a management revolution in the nonprofit sector in recent decades, and many nonprofits face management challenges no less complex than those faced by major corporations or large government agencies.

For most people, the term “nonprofit” conjures up the image of a small organization, perhaps run by a tiny band of volunteers more focused on delivering services to people in need than on building or managing an organization. Indeed, most nonprofit organizations are small, with perhaps few, if any, professional staff, but there are also others with activities that span the nation and the globe and that employ thousands of people.

Mention the word “business” and people will likely think first of a large corporation such as Walmart or Apple, although, in reality, most businesses are small. But it is large business enterprises that are the focus of most management texts and MBA case studies. That is because, as in the nonprofit sector, the need for management varies with the size and scope of activity. The corner dry cleaner needs few management skills beyond basic accounting and a rudimentary understanding of how to manage a few employees. The young technology entrepreneur starting a new business in the family garage is focused not on management but on development and delivery of a product, much as the directors of small nonprofits are often more concerned with delivering programs than with

Learning Objectives

After reading this chapter, students should be able to

1. Describe the differences between management in the nonprofit sector and management in other sectors.
2. Explain various approaches to the study of nonprofit organizations.
3. Describe the growth of nonprofit management as a professional field and a field of study.
4. Explain forces that have led to the professionalization of nonprofit management.
5. Classify various authors in terms of their perspective on the nonprofit sector.

building or managing the organization. As a company grows, requiring outside investment and employing more people, its need for professional management increases. Founding entrepreneurs are often replaced by MBAs who have formal management training. So, too, as a nonprofit organization becomes larger, it faces more complex and interesting management challenges, especially if it comes to operate in more than one location across the United States or internationally. This book includes some examples drawn from small nonprofit organizations, but it is principally about organizations that have at least some full-time paid staff, and it includes examples and cases drawn from some of the nation's largest and best-known nonprofits.

A Revolution in Management

The nonprofit management revolution of recent decades has been driven by several forces, including the introduction of competition resulting from changes in funding patterns, the growth of the sector, and increasing demands for accountability. The decades since the 1980s have seen reductions in direct federal government funding for many social programs, the devolution of funding to state governments, and increased outsourcing of the delivery of social and human services by government agencies to nonprofit organizations. Nonprofits have been forced to compete for contracts against each other and, in some cases, against for-profit firms. In addition, many government benefits are now provided through voucher-type payments made directly to individuals, who are thus transformed into customers, free to purchase the services they need in the marketplace. Such customers can thus select the organizations that will provide services based on perceptions of quality and other considerations; this forces nonprofits to compete for their business. Like the competition for contracts, the competition for empowered customers has forced nonprofits to either become better managed or place their survival at risk.

But government has not been the only force driving change. Other funders, including foundations and even individual donors, have shown an increased concern with the results achieved by nonprofits through the programs they offer. This has been especially true of many newly wealthy entrepreneurs who amassed their fortunes during the technology boom of the 1990s, the thriving financial services and real estate industries of the mid-2000s, and the booming stock market and social media businesses of the 2010s. Many view their philanthropic giving as a type of investment from which they expect to see a measurable return in the form of effective programs and services. The requirement that nonprofits meet such expectations for measurable results has also increased the need for management.

In recent decades, there has also been a shift in thinking about nonprofit organizations that focuses more on the organization itself rather than merely on the programs and services it delivers. This new focus emphasizes the capacity and sustainability of organizations, ideas we will discuss later in this book. The 1990s brought searing critiques of traditional philanthropy and the management of nonprofits. Among them was a *Harvard Business Review* article by Christine Letts, William Ryan, and Allen Grossman (1997), titled “Virtuous Capital: What Foundations Can Learn From Venture Capitalists.” The article essentially was an indictment of traditional foundations’ grant-making practices, arguing that the short-term program grants made by most foundations were not meeting the need for investment in the long-term capacity of nonprofit organizations themselves. Letts et al. advocated an approach to philanthropy that would parallel the approach of venture capitalists to investing in companies, including a more sustained commitment to support along with the requirement that organizations meet performance standards. Bill Shore’s book *The Cathedral Within* (1999), published two years after the article by Letts et al., expressed similar criticisms of traditional philanthropy. Shore argued that funders’ emphasis on programs rather than on building organizations was in fact preventing

many successful programs from “going to scale,” that is, growing to a point that they could have significant impact, because the organizations did not have the capacity to expand. A decade later, Ann Goggins Gregory and Don Howard (2009) made similar points, identifying a “nonprofit starvation cycle,” a term that became part of the vocabulary in discussing nonprofits. It refers to a vicious cycle, in which organizations minimize their overhead costs to please funders, which in turn reduces their ability to produce the results that funders desire.

The ideas of Letts and colleagues, Shore, Gregory and Howard, and others have contributed to a change in thinking about nonprofits, one that shifts focus from the programs they offer to the strength and sustainability of the organizations themselves. It was, in the words of Jim Collins and Jerry Porras (1994), a shift of emphasis from “telling time” to “building clocks.” This new emphasis on nonprofit organizational development has also been a force in increasing the demand for professional nonprofit management.

Some philanthropists have come to view nonprofit organizations as vehicles through which they can address social problems that are of particular interest and concern to them. With frustration about the persistence of problems such as poverty, despite decades of government efforts to overcome them, many entrepreneurial philanthropists believe that private philanthropy and private, nonprofit organizations offer a more promising strategy of attack. This is illustrated, for example, by the work of the Bill & Melinda Gates Foundation, which focuses its giving on world health and urban education in the United States, among other areas, and which has had significant impact by virtue of the substantial financial resources at its disposal. This conflation of national issues and concerns with the work of nonprofits has increased the importance of the sector and contributed to the emphasis on measurable results (Brest, 2012).

Another reality is that the dramatic growth of the nonprofit sector and its assets has simply raised the stakes. Fueled in part by a wave of philanthropy based on the growing wealth of entrepreneurs and investors, in part by the continued devolution of government programs, and in part by an increased worldwide interest in voluntary action, nonprofits now employ more people and control more resources than ever before. The nonprofit sector has become a consequential part of the American economy that cannot be ignored. Therefore, it has captured the increasing attention of legislators, the media, and others who demand that nonprofits be accountable for the assets entrusted to them and for the results that they achieve with those assets. This reflects an increased concern with accountability throughout American society, affecting government agencies and businesses as well as nonprofits. Demands for accountability and the need for systems and procedures to comply with greater scrutiny and regulation have also contributed to the need for trained managers.

In sum, if it were ever true that the typical nonprofit organization fit the image of a well-intentioned but unmanaged endeavor, nonprofit organizations today, other than perhaps the smallest, must be managed. To be otherwise is not only to risk failure in meeting society's needs and expectations but also to place the organization's survival at risk. However, the question remains whether managing a nonprofit organization is different from managing a government agency or a business corporation. Is management generic, or is management in the nonprofit sector a distinguishable endeavor?

A Distinct Profession

Throughout most of the history of management as a recognized discipline, most theorists have advocated a generic approach, arguing that common management principles would apply equally to all organizations, whether businesses, government agencies, or nonprofits. And there remain some who are skeptical that management in the nonprofit sector is unique or that it requires particularly distinctive skills.

At an operational level, surely management in the nonprofit sector requires many of the same skills that are also important in government or business management. There may not be a particularly nonprofit way of processing payroll or implementing a new information system, and indeed, many of the techniques of business management have been adopted by nonprofit organizations as well. But this book is predicated on the view that nonprofit management is different from management in the business or governmental sector in a variety of ways, including the following four.

First, as Robert Herman (2016) explains, nonprofit management requires a unique set of trade-offs:

A [nonprofit] chief executive, in conjunction with the board, must integrate the realms of mission, resource acquisition, and strategy. To oversimplify but phrase the issue more memorably, *mission, money, and management* are interdependent. Making progress on mission achievement depends, in part, on the potential for resource acquisition. Any mission, no matter how worthy, is likely to fail if the organization lacks necessary and sufficient resources to pursue it. Conversely, the acquisition of some kinds of resources can influence the mission. Moreover, decisions about strategies for acquiring resources must be consistent with the mission and ethical values of the organization. Actions in one realm affect the other realms. The leadership challenge is to see that decisions and actions in one realm are not only consistent with those in other realms but also mutually reinforcing. (pp. 167–168)

Managers of government agencies generally have a single source of revenue—for example, the U.S. Congress or a state legislature—and carry out programs mandated by the law. Managers in business receive revenue from the sale of products or services and have the freedom to decide what goods or services they will provide and to which customers. More sales translate into increased revenues, and activities that are not profitable can be discontinued. The same relationships do not always hold true for a nonprofit. Most nonprofits obtain resources from multiple sources and, like businesses, have considerable freedom to determine the activities in which they will engage. However, one important difference is that increased activity may strain resources rather than enhance them. That is because not all of a nonprofit's customers may pay the full cost of producing the good or service, and indeed, some may not pay at all. Judy Vredenburg, president and CEO of Girls Inc. and a former executive of Big Brothers Big Sisters and the March of Dimes, describes the dilemma: “Every time we in nonprofits satisfy customers, we drain resources, and every time for-profits satisfy a customer, they get resources. That sounds very simple, but it has huge implications” (Silverman & Taliento, 2006, p. 41).

Thus, as Herman (2016) suggests, management of a nonprofit organization requires constant trade-offs among the mission, the acquisition of resources, and strategy. That distinguishes nonprofit management from the management function in the business or public sectors. Management in those sectors, while also complex, at least begins with some fixed points of clear goals and positive relationships between activities and revenues. Managing a nonprofit is more like swimming in the air, with everything variable and in constant motion.

Second, the complex relationships among a nonprofit organization's stakeholders require management that is especially skilled in negotiation and compromise, with a high tolerance for ambiguity. In corporations and in government agencies, the flow of authority from the top down is generally clear. But, as Helmut Anheier (2014) describes,

nonprofit organizations consist of multiple components and complex, internal federations or coalitions among stakeholders . . . [therefore] the structure of nonprofit organizations may require a multi-faceted, flexible approach to management and

not the use of singular, ready-made models carried over from the business world or from public management. (p. 328)

Jim Collins (2005) recounts a meeting between Frances Hesselbein, chief executive officer (CEO) of the Girl Scouts of the United States of America at the time, and a *New York Times* columnist, in which the CEO addressed this unique characteristic of nonprofit management:

[The columnist] asked what it felt like to be on top of such a large organization. With patience, like a teacher pausing to impart an important lesson, Hesselbein proceeded to rearrange the lunch table, creating a set of concentric circles radiating outward—plates, cups, saucers—connected by knives, forks, spoons. Hesselbein pointed to a glass in the middle of the table. “I’m here,” she said. Hesselbein may have had the title of Chief Executive Officer, but her message was clear: *I’m not on top of anything.* (p. 9)

Nonprofit management is unique because nonprofit organizations are different from businesses and governmental entities—often reliant on the support of donors and the work of volunteers, pursuing missions derived from values and principles about which there may be disagreement, and engendering a sense of ownership and a desire for influence among multiple constituencies both inside and outside the walls of the organization itself. In this environment, a nonprofit CEO must provide leadership as well as management, a distinction we will explore further in Chapter 5. Robert Higgins, who worked as both a nonprofit executive and a venture capitalist and thus was able to observe the differences between the sectors firsthand, explains,

In most for-profit organizations . . . people arrive with common goals. The board of directors may have different viewpoints, but shareholder value as a fundamental goal is something shared by the board, by the CEO, and by senior management. You start off differently in the not-for-profit world, with each board member arriving with a different set of goals and often different agendas. To manage that as a CEO is much more complex. (Silverman & Taliento, 2006, p. 38)

Third, managers of nonprofit organizations must measure their success by a **double bottom line**. A nonprofit exists to pursue a social mission, and success must be measured in terms of its ability to achieve that mission. That is one bottom line. But, in today’s competitive environment, nonprofit managers must also pay close attention to the *financial* bottom line if their organizations are to survive and succeed. Some people add a third bottom line—the impact, positive or negative, that the organization has on the environment. Ask a room of people, “What’s the purpose of Apple?” and some may quickly reply, “To produce electronic devices,” or perhaps some will joke, “To control the world!” But both responses miss the point because Apple, like all businesses, has one clear purpose: to increase the value of the business and thus the wealth of its owners. Producing products and controlling the world are but means to that end. To be sure, many corporations today are also guided by principles of social responsibility and ethics, but social progress is not their *purpose*. Indeed, social concerns are properly viewed as constraints on the pursuit of the purpose for which every business exists: to maximize profit in order to increase the value of the owners’ equity. Managers may have their own personal social goals, but if they make them a central element of the company’s purpose, they will not fulfill their principal responsibility to the owners of the firm.

In contrast, a nonprofit *exists* to serve a social purpose. But as we have discussed, in today’s competitive environment, financial results also require the executive’s attention—he or she must manage the double bottom line of financial and social return. And the latter may

be ambiguous in its definition, even a subject of disagreement and dissension among the organization's many stakeholders, or difficult to measure.

Fourth and finally, many of the problems that nonprofit managers address are exceptionally difficult and intractable. In other words, it may be more challenging to reduce poverty, prevent disease, or improve the global environment—especially when not everyone recognizes the problem or agrees on what the solutions might be—than it is to increase the sale of attractive products that people already desire to own. To say that managing a nonprofit is inherently more complex than managing a business of comparable size is not to demean the skills of business managers or to disparage their clear focus on profit. The creativity and problem-solving skills of business leaders have built great organizations and propelled economic progress. Moreover, wealth created by the business sector helps to sustain nonprofits and make social advancement possible. But the need to manage the double bottom line, to relate to disparate and competing constituencies, and often to work against the weight of deep-seated historical and cultural barriers adds complexity to the nonprofit CEO's challenge, a challenge that is too often underestimated by some who observe the nonprofit sector from a business perspective. William Novelli, a former businessman who built the public relations firm Porter Novelli and later served as the CEO of the nonprofit AARP, explains the challenge:

It's harder to succeed in the nonprofit world. . . . It may be hard to compete in the field of consumer packaged goods or electronics or high finance . . . but it's harder to achieve goals in the nonprofit world because these goals tend to be behavioral. If you set out to do something about breast cancer in the country, or about Social Security solvency, it's a lot harder to pull that off. [And] it's also harder to measure. (Silverman & Taliento, 2006, p. 37)

This book is based on the premise that nonprofit management is distinguishable from management in business or government. It is necessary, however, to acknowledge that some see a convergence of management across the sectors in recent years, as both public managers and nonprofit managers are expected to be more businesslike and business managers are expected to demonstrate more responsibility toward the social, environmental, and human impact of their actions (Salamon, 2012b). New types of organizations have emerged that combine characteristics of businesses and nonprofit organizations, some of which will be discussed later in this text. Some authors also observe a convergence of nonprofit management and public administration (Mitchell & Schmitz, 2019, p. 14). As we will discuss in the next section of this chapter, trends in nonprofit management education in universities have reflected the changing perceptions and realities of the field over the years.

Nonprofit Management as a Field of Study

Students taking a course in nonprofit management today might reasonably assume that such courses have always existed. But they are a relatively recent addition to the curriculum at many colleges and universities, and scholarly research in the field, while growing, still does not approach the volume of study devoted to public or business management.

Indeed, recognition of management as an identifiable function—in any organizational setting—is relatively recent in the scope of history. While management-like functions have been performed throughout civilized history, the beginning of management as a field of study dates approximately to the development of an industrial economy in the late 19th century. Stephen Block (2001) credits an 1886 paper by the engineer Henry R. Towne as the first call for

the development of management as an independent field of study with its own literature. The nation's first school of management, the Wharton School at the University of Pennsylvania, was established shortly thereafter, in 1898. The first two decades of the 20th century saw the growth of professional management societies, the publication of new books, and the introduction of additional university programs. The first doctoral dissertation in management was written in 1915. According to Block, interest in management was increased by the experience of American manufacturing during World War II, and the decades since have brought explosive growth in business management education and research, including the development of theories we will explore at relevant points in this book. But the early study of management was focused on business organizations, with attention to public management and nonprofit management developing later. Mordecai Lee (2010) has identified some pioneering initiatives undertaken by the YMCA that may have represented the first efforts in nonprofit management education. They included the offering of a bachelor of association science degree by Chicago's Central YMCA College in 1911 and a 1935 textbook on the subject produced by the YMCAs publishing house. Notwithstanding those early efforts, interest in nonprofit management has emerged primarily within the past few decades.

As mentioned previously, until about the 1960s, most management theorists advanced a “generic approach,” arguing that their theories applied equally in all types of organizations, whether businesses, government agencies, or nonprofits. As Hal Rainey (2014), a public administration scholar, emphasizes, “With some clear exceptions . . . the theorists repeatedly implied or aggressively asserted that distinctions such as public and private, market and non-market, and governmental and nongovernmental offered little value for developing theory or understanding practice” (p. 45). However, by the 1960s, some authors began to challenge this approach and to call for more research focused specifically on the management of public agencies. This coincided with a period of growth in the federal government and the development of master of public administration (MPA) degree programs in universities, which for the first time emphasized management skills in government and differentiated the study of public management from the discipline of political science. The **Network of Schools of Public Policy, Affairs, and Administration (NASPAA)** was founded in 1970 and began to accredit such programs.

It is important to note that one of the well-known academic journals publishing nonprofit-related research, *Nonprofit and Voluntary Sector Quarterly*, was founded in 1972. But national attention was drawn to the nonprofit sector by an important national study conducted by the Commission on Private Philanthropy and Public Needs during the period 1973 to 1975. That commission, often called the “Filer Commission” in honor of its chair, business leader John H. Filer, issued a report titled *Giving in America* (Commission on Private Philanthropy and Public Needs, 1975), which was the most detailed study of philanthropy in the United States up to that time. The first academic center devoted to the study of nonprofits, the Yale Program on Nonprofit Organizations (PONPO), was founded shortly thereafter, in 1978, and social scientists began to turn their attention to understanding the role of nonprofit organizations in economic and political life. The generic approach was beginning to yield to the view that nonprofit organizations might have unique characteristics that distinguish them from organizations in the other two sectors.

As previously discussed, the 1980s marked a turning point in public policy, with government outsourcing more of the delivery and management of social and human services to nonprofits. That development further increased the need for professional management in nonprofit organizations and captured the interest of some students previously aiming for careers in government. Public administration faculty members saw that a growing number of their students were interested in working in nonprofit organizations and responded by developing programs to teach nonprofit-specific skills (Joslyn, 2004). That decade also saw the establishment of new research centers and programs focused on the nonprofit sector,

including Case Western Reserve University's Mandel Center for Nonprofit Organizations and the Center on Philanthropy at Indiana University.

Management scholars and writers turned significant attention to the nonprofit sector beginning in the 1990s. Writing in 1990, management guru Peter Drucker observed a “management boom” going on in nonprofit organizations, but he also noted the lack of recognition of nonprofit management as worthy of attention. “For most Americans,” he wrote, “the word ‘management’ still means business management” (p. xiv). But as the nonprofit sector continued to grow throughout the 1990s and into the 2000s and 2010s, a burgeoning literature sought to adapt the theories and skills of business management to the planning, managing, and financing of nonprofits. Courses in the strategic management of nonprofits and on social entrepreneurship—a term we will discuss further later—began to appear in business schools, and new books applied the techniques used by companies and governments to the nonprofit sector (Oster, 1995; Steiss, 2003). The *Harvard Business Review* came to include occasional articles on the management of nonprofit organizations. The late 1990s brought an economic boom and a boom in the literature of venture philanthropy, social enterprise, entrepreneurial nonprofits, and business techniques applied to nonprofit organizations (Dees, 1998; Dees, Emerson, & Economy, 2001; Kearns, 2000; Letts et al., 1999; Oster et al., 2004). The Stanford University Graduate School of Business began publishing a journal, the *Stanford Social Innovation Review*, in 2003. New textbooks focused on nonprofit management began to appear, including the first edition of this text in 2009. Online journals, blogs, and other forums related to nonprofit management, social innovation, social entrepreneurship, and related topics continue to proliferate. In 2012, the Center on Philanthropy at Indiana University became the Lilly Family School of Philanthropy, the first such academic institution in the country (“IU’s Philanthropy School to Be Named for Lilly Family,” 2013).

The literature of nonprofit management is drawn from three principal areas: (1) the work of social scientists who study nonprofit organizations as social and economic institutions; (2) organizational theory, theories of organizational behavior, and management theory from the business and public sectors that have particular relevance for nonprofit organizations; and (3) a rich practitioner literature that offers important understandings. This book is based on the view that a balanced and integrated approach requires drawing on all three literatures, and that is reflected in the materials presented in the chapters that follow.

A significant portion of the nonprofit management literature is still written by or for practitioners and has a prescriptive, how-to-do-it approach. Consultants, including professionals working in for-profit consulting firms, also have made important contributions to the literature of nonprofit management. But there is a growing body of academic research, including the work of economists, sociologists, historians, and other social scientists. Scholars have developed taxonomies to identify and track the major components of the nonprofit sector, theories to explain the existence and behavior of the sector, theories describing its relationship to government and the business sector, examinations of its role and impact in the U.S. economy, and analyses of related public policy issues. The management of nonprofits also has been the focus of more applied studies drawn from the fields of public administration and business management.

Some scholars advocate defining a new academic field of “nonprofit studies” that would broaden the focus of nonprofit research beyond management (Mendel, 2014). Observing that “published scholarship on nonprofit organizations continues to cover primarily matters of interest to public management, business, social work, and other fields,” Stuart Mendel (2014) argues that “nonprofit studies is approaching a tipping point [and is] ready to become an autonomous field of study” (p. 61). He also calls for a new approach to the training of nonprofit professionals that would go “beyond the management of transactional accountability” to include “the study of civil society; the dynamics of advocacy, community organizing, and public policy development; the political nature of the social sector; and the

role that nonprofits play as places of employment” (Mendel, 2014, p. 62). However, some argue that public administration, public policy, and nonprofit management are “intersectional” and that the study of any one requires applying knowledge from the others as well (Pandey & Johnson, 2019). Others advocate a “nonprofit/philanthropy-first” curriculum and the development of degree programs in nonprofit management apart from those in public administration, public policy, or business (Mendel, 2015).

This book is a textbook, not a manual for nonprofit executives. But neither is its purpose to offer an entirely theoretical examination of the nonprofit sector. Although it draws on a wide range of literature, it is intended to provide a background for nonprofit management rather than a foundation for nonprofit studies, although the latter is important to developing a full understanding. It is intended to provide students who are considering or pursuing careers in nonprofit management with a broad overview, blending theoretical and practical topics relevant to the work they do or will do. This approach incurs the risk that some pragmatic individuals may find it too academic and that some academics may find it insufficiently grounded, but it is appropriate to provide a comprehensive and useful overview of a field that is still evolving.

Concomitant with the increase in the research literature, educational programs related to nonprofit management have grown rapidly since the 1990s. Indiana University was the first to offer a bachelor's degree in philanthropy and, as mentioned previously, in 2012 became the first university to establish a school of philanthropy. Recent years have also seen a virtual explosion in the availability of training for nonprofit managers and professional expertise directed toward the improvement of management practices in nonprofit organizations, including programs offered by educational institutions, regional associations of nonprofits, nonprofit infrastructure organizations, and for-profit consulting firms. Formal professional certification is available in some specialties of nonprofit management. For example, a professional specializing in fundraising can become a certified fundraising executive (CFRE) by successfully meeting criteria established by CFRE International, including an examination (see www.cfre.org for more information). And nonprofit professionals who manage volunteer programs can obtain certification from the Council for Certification in Volunteer Administration (see <http://cvacert.org/> for more information).

Formalization of the nonprofit management curriculum in universities also has progressed. In 2001, NASPAA issued “Guidelines for Graduate Professional Education in Nonprofit Organizations, Management, and Leadership.” The **Nonprofit Academic Centers Council (NACC)**, a membership association of academic centers and programs that focus on nonprofit organizations, issued its first “Curricular Guidelines for Graduate Study in Philanthropy, the Nonprofit Sector, and Nonprofit Leadership” in 2004. A second version was released in 2008 and a third version in 2015. NACC undergraduate program guidelines were developed in 2007 and revised in 2015. Development of a new edition (the fourth for graduate programs and the third for undergraduate programs) was in progress at the time of this writing (Nonprofit Academic Centers Council, 2018).

The content of MPA and MPP degree programs has increasingly included nonprofit-related skills and some have proposed that even more emphasis be given to nonprofits within these programs (Cantrell-Bruce & Blankenberger, 2015). Accreditation standards released by NASPAA in 2019, which apply to all master's degree programs it accredits, reflect an increased emphasis on the nonprofit sector, although they do not include specific nonprofit curricular guidelines. Using the phrase “nonprofit at the core,” the revised accreditation standards “establish nonprofit management as fundamental to public service education. Changes to language throughout the Standards, including the universal required competencies, explicitly integrate the third sector” (NASPAA, 2019). In 2018, NACC began accrediting stand-alone programs focused on nonprofit management and related topics (NACC, 2018). Also in 2018, NASPAA for the first time accredited a stand-alone master's degree program in nonprofit management, at the University of Central Florida (NASPAA, 2018).

Many business schools offer courses and programs relevant to the nonprofit sector, programs often identified by the term “**social entrepreneurship**.” The term is used in different ways by various authors, and it is important to understand the distinctions. Some authors use the term to mean the application of business principles and the generation of earned income by nonprofits. Others use the term to mean social innovation (Dees & Anderson, 2006). These distinctions are discussed further in Chapter 14 of this text, which explores social enterprise, and in Chapter 16, which is concerned with social entrepreneurship from the social innovation perspective.

Discussion and debate on the appropriate content of programs to prepare nonprofit leaders will likely continue. Many observers see a blurring of the nonprofit and business sectors, requiring that future nonprofit executives be trained in business skills. To some, that suggests that nonprofit management programs would be better located in business schools than in either schools of public affairs and administration or colleges of arts and sciences. But Michael O’Neill (2007), founder and former chair of the Institute for Nonprofit Organization Management at the University of San Francisco, notes that “[n]onprofits have different values, different financial systems, different laws to abide by, different people (like volunteers) to manage, and very different goals [than business organizations]” (p. 171S). He predicts that the future will see continued experimentation with regard to nonprofit programs but that business schools are unlikely to become the predominant hosts of nonprofit management programs. In addition, he predicts that nonprofit management curriculum is unlikely to become as standardized as the MBA curriculum.

Roseanne Mirabella and Dennis Young (2012) observe the increase in the number of business school programs focusing on social entrepreneurship and speculate as to whether the future might see convergence of the content of such business school programs and traditional nonprofit management programs, meaning primarily those offered in schools of public policy and administration. One possibility that Mirabella and Young identify is that the traditional programs may come to incorporate more courses on social entrepreneurship, while business schools come to include more emphasis on such topics as philanthropic and political skills; in other words, the programs might become more alike. Another possibility is that the traditional and business school programs remain distinct. Echoing O’Neill (2007), the authors note that the respective academic units have different cultures and, in addition, that entrepreneurship more generally “has historically not been high in the pecking order of subjects valued within business schools” (Mirabella & Young, 2012, p. 55).

There is an increasing number of collaborations and partnerships between nonprofits and government and between nonprofits and businesses—a topic that we will discuss in more detail in Chapter 8. This reality has contributed to some nonprofits becoming hybrids; that is, they include characteristics of businesses and government agencies as well as of traditional nonprofit organizations. For that reason, some observers suggest that education about nonprofits should be integrated into the core curriculum of programs in all professional schools—including those focused on business, public policy and administration, and other professional fields (S. Smith, 2012).

Toward a Balanced Approach

The literature of nonprofit management reveals a variety of perspectives, not only on the questions and issues discussed previously but indeed about the very nature of nonprofit organizations and their role in society.

Generalization can, of course, sometimes lead to oversimplification; differences in perspective or approach are often nuanced. But students will likely observe that authors writing about nonprofit organizations and nonprofit management today reflect one of two

perspectives on the purposes and role of the nonprofit organization that are distinguishable, at least in tone and emphasis.

Some see nonprofit organizations primarily as social institutions. The services they provide are important, but nonprofits also are essential for creating civil society, pursuing social change, and sustaining the free expression of ideas and opinions in a democratic society—indeed, for preserving our most important values as a society. Process and involvement are valued nearly as much as the end results. In this view, involvement builds community and provides an important experience for participating individuals, in addition to the benefits it may produce for other members of society. This is what Peter Frumkin (2002) calls the **expressive purposes of nonprofits**; that is, they provide an outlet for individuals to express their values and passions through their involvement with such organizations.

From this perspective, nonprofit managers often are portrayed as stewards of their organizations or servants of society. With regard to the education of nonprofit managers, those who hold this perspective usually emphasize the need to develop an appreciation of nonprofit values, an understanding of nonprofits' role in society, and a capacity for ethical decision making. In discussing charity and philanthropy, they tend to focus on their cultural and historical roots and view giving as an expression of moral and religious values. They do not necessarily deny the usefulness of business methods in managing nonprofit organizations, but some do express skepticism about the possibility of measuring organizations' effectiveness against sometimes lofty missions. Some express concern that the application of business methods and business thinking holds the risk of undermining traditional nonprofit values and diminishing nonprofit organizations' unique contributions to society. They are often uncomfortable about nonprofits becoming too engaged in commercial activities or forming close relationships with business, fearing that nonprofit culture will be eroded and that organizations will lose sight of their social purposes in the pursuit of financial success. And, of course, depending on their social and political perspectives, some may even find it objectionable to see nonprofits associated with private business or government at all, perhaps viewing one or both of the other sectors as sources of problems that nonprofits are trying to correct.

From the other common perspective, nonprofit organizations are social enterprises, essentially *businesses* that have a social purpose. Those who hold this view do not dismiss the importance of nonprofits' social missions, nor do they necessarily deny the unique qualities and contributions of the nonprofit sector. Most give at least lip service to the idea that a business approach may not be appropriate for every nonprofit organization. However, they tend to emphasize the commonalities between nonprofit organizations and business firms and encourage the use of business principles and techniques in managing nonprofits.

Those who hold this perspective often discuss the education of nonprofit managers in terms of developing business skills. Their discussions often focus on building the capacity of nonprofits and the application of business methods, such as strategic planning, strategic management, performance management, and marketing. They often use the vocabulary of business, for example, discussing a nonprofit organization's "competitive advantage" and "market position." Some criticize traditional charity and philanthropy and prefer that nonprofits rely more on earned income rather than on gifts. They emphasize what Frumkin (2002) calls the **instrumental purposes of nonprofits**, that is, the services that they provide and the needs they meet, rather than their role as vehicles for individuals' expression. They are concerned about results and the measurement of organizational performance against defined metrics. Some even support the idea of nonprofit capital markets that would allocate funds rationally to nonprofit organizations that show high performance, much as stock markets allocate investment dollars to the companies that produce the highest financial returns. Indeed, recent years have seen the initiation of new corporate forms and market-based approaches, which are addressed further in the next chapter of this book.

Again, the above characterizations of these two perspectives are oversimplified, and some writers take a moderate or blended stance between the two poles described. But it is

usually not difficult to identify a particular book or article as leaning toward one perspective or the other. This text draws on literature from both approaches and strives to present a balanced and integrated understanding. Where disagreements may exist, it attempts to fairly summarize both sides of the argument. That is because this author believes that effective nonprofit management in today's environment does indeed require a balanced and integrated approach that draws upon diverse perspectives, skills, and tools.

That approach leads to the frequent use of the expression “on the one hand, but on the other hand” throughout this book. Some might prefer to know the “right answer” and learn what is the best way to lead a nonprofit organization. The philosophy reflected in this book is that there is often no one right answer and that the best way is often pragmatic and eclectic. It includes viewing a problem from multiple perspectives and drawing from various approaches selectively as situations may dictate. Students will find abundant other materials written by authors who come from one particular viewpoint or another that they may find to be especially attractive or persuasive.

Proceeding With Realism and Pride

This book is based on the view that while there is a need to improve the management of nonprofit organizations, it is a misperception to believe, as some do, that they are generically less well managed than businesses. This misperception is based in part on our society's bias toward defining success primarily in financial terms. The results of good business management are evident in bottom-line earnings, while the results of nonprofit management are reflected in progress toward a social goal, which may be less visible or easy to measure. In addition, the misperception is often reinforced when apples are compared with oranges, which may occur, for example, if someone's image of a nonprofit is as a small organization and that person's image of a business is that of a larger corporation. It may be accurate to observe that some small nonprofits are not well managed. But, it is important to note, the same is true of many small businesses, most of which fail in the first five years of their existence. It might be difficult to demonstrate that a family-run bed and breakfast is really better managed than the local homeless shelter, which would be more appropriate than comparing the shelter with a Marriott hotel.

When nonprofit organizations and companies are compared fairly, we find poor and excellent management in both. For example, the American Red Cross, one of the nation's largest nonprofits, was criticized for its management of recovery efforts following the Haitian earthquake in 2010. In the 2000s, there were highly visible scandals concerning executive compensation and expenses at American University and the Smithsonian Institution, which led to congressional hearings and the development of new governance guidelines, discussed later in this text. In 2015, the Federal Trade Commission (FTC) alleged that James T. Reynolds Sr. had used nearly \$200 million that had been given to cancer charities that he operated to pay for personal benefits for himself, friends, and family members. The FTC characterized it as one of the largest charity scandals in history (Ruiz, 2015). However, it is fair to ask, was the Red Cross less well managed than General Motors, which required a federal government bailout? Or were ethical failures at nonprofits more egregious than those at many financial institutions in the late 2000s, which required bailouts as well? Were the allegations against Reynolds more shocking than those against Bernard Madoff, who was convicted of running a Ponzi scheme that cost investors millions of dollars? We might also ask, are Habitat for Humanity and Doctors Without Borders less innovative organizations than Facebook or Google? Is the Mayo Clinic less capable of managing risk than BP? In a sequel to his best-selling book on business management, which focuses on the social (or nonprofit) sector, Jim Collins (2005) argues that the important difference is not between business management and nonprofit management but between mediocrity and greatness:

Most businesses—like most of anything else in life—fall somewhere between mediocre and good. Few are great. Mediocre companies rarely display the relentless culture of discipline . . . that we find in truly great companies. [But] a culture of discipline is not a principle of business; it is a principle of greatness. (p. 1)

The author's purpose in making this point is to dispel any misperceptions that students may hold that nonprofit management is somehow second rate or, as implied by critical articles seen in the popular media, that incompetence and corruption are rampant in nonprofit organizations. Nonprofit managers are in general highly capable and dedicated individuals, worthy of the respect and regard of their counterparts in the other sectors of business and government. They work in organizations that are different from businesses or government, they have different purposes and goals, and they often work with fewer resources available to them, but they are not categorically less able or successful. Students pursuing education in nonprofit management should do so with a pride and confidence equal to that of their classmates who may be preparing for careers in business, government, or other distinguished professions.

At the same time, students should hold no illusions about the challenges of a nonprofit management career. Although salaries are improving, nonprofit managers are unlikely to achieve the wealth of their counterparts in business or the job security of their colleagues who hold civil service positions in the government. The pressures are significant. As Julie Rogers (2006), former president of the Eugene and Agnes Meyer Foundation, observes, nonprofit executives face a never-ending stream of advice from their boards, funders, clients, volunteers, and others: "Focus on finding dependable sources of income. Produce measurable results. Evaluate whether you are making a difference. Be strategic, not opportunistic. Build diverse boards. Spend more time on advocacy. Collaborate with other organizations" (pp. 45–46). And, too often, nonprofit managers are advised to do all this with smaller budgets, smaller staffs, less training, the ever-present threat of reduced public support, and less recognition than is provided to managers in business or government. Indeed, a 2011 study found that the complexity of the nonprofit manager's job and the multiple pressures he or she must handle frequently lead to frustration and burnout (Moyers, 2011).

However, nonprofit managers also enjoy unique rewards, including the satisfaction of knowing that they are working to advance those aspects of human life that many consider to be the most important—the arts, education, the preservation of culture, the protection of our environment, the advancement of health, the alleviation of poverty, and the development of young people. They experience the excitement of tackling some of society's most daunting problems and protecting society's most vulnerable members, making a difference in their lives and in the future of society. And they know the camaraderie and fellowship that come from working alongside others who share their values, priorities, and commitments. For many who have dedicated their careers to working in nonprofit organizations, the value of such intangible rewards is beyond measure.

Through most of history, management scholars pursued a generic approach, believing that management in companies, government agencies, and nonprofits shared similar principles. But nonprofit management is a distinct profession because of the unique characteristics, missions, and cultures of nonprofits. Since the 1980s, this uniqueness has been

recognized in the development of research centers and academic programs focused on the nonprofit sector and nonprofit management.

There continues to be discussion about whether such programs should be located within other academic programs or established as independent degree programs. Some business



Andrew Carnegie's "Gospel of Wealth" articulated the distinction between charity and philanthropy and influenced America's tradition of giving.

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Chapter Outline

America's Nonprofit Sector: A Historical
Overview

Searching for a Common Vocabulary

Alternatives to Nonprofit

Size of the U.S. Nonprofit Sector

Differentiating the Nonprofit Sector

National Taxonomy of Exempt Entities

IRS Classifications

Salamon's Anatomy

The Spectrum of Organizations

Emerging New Models

The Commercialization Debate

Commercialization and Tax Exemption

Implications for Nonprofit Managers

Chapter Summary

Cases

Overview of the Nonprofit Sector

America's nonprofit sector is large, complex, and diverse, including organizations very different from one another in purpose, size, and other characteristics. As J. G. Simon wrote in 1987, "The sprawling and unruly collection of animals that populate the nonprofit world—from churches to civil rights groups to garden clubs to the National Council on Philanthropy—makes this field hard to grasp and study all at once" (p. 69). And, as we will soon discover, the nonprofit sector is even more sprawling and unruly today than it was in 1987.

In this chapter, we will look at the nonprofit sector as a whole and establish basic concepts and definitions that will help bring some order to our understanding of its structure, boundaries, and characteristics. Let's start by taking a brief imaginary tour around one American city, starting from the author's office on the campus of the George Washington University, located in the Foggy Bottom neighborhood of Washington, DC, near the White House. As the nation's capital, Washington, DC, is home to a significant number of nonprofits, but the variety of organizations that we will see on our tour is typical of what we might find in many American cities. A walk through this one city helps give us a sense of the complexity to be found in today's nonprofit sector all across the country.

Leaving the author's office at the university, we might walk past the George Washington University Hospital, then turn down the street and pass Western Presbyterian Church, just a few blocks from the edge of campus. We might see men and women waiting to enter the basement of the church to visit Miriam's Kitchen, an organization that provides food and services to homeless people and works to end chronic homelessness.

If we take another turn, we would walk past the headquarters of the National Park Service and then in front of the national headquarters of the American Red Cross. Proceeding farther into town, we would see the headquarters of the National Geographic Society. Eventually, we might walk past the Smithsonian Institution, located in several buildings along the National Mall, which extends from the Washington Monument to the Capitol building. If we walked a loop around the Capitol, we would pass the massive buildings of the Library of Congress. Walking back toward campus over Massachusetts Avenue, we would pass the headquarters of the Cato Institute

Learning Objectives

After reading this chapter, students should be able to

1. Identify various types of nonprofit organizations.
2. Explain the historical growth of the nonprofit sector.
3. Compare various terms used to identify the nonprofit sector and explain their implications.
4. Classify nonprofit organizations according to the National Taxonomy of Exempt Entities and the Internal Revenue Code.
5. Explain the differences between organizations classified under 501(c)(3) and 501(c)(4) and the advantages and limitations related to each classification.
6. Explain differences among charitable subsectors.
7. Classify organizations as purely philanthropic, purely commercial, or hybrid, depending on various characteristics.
8. Explain new organizational forms and the concept of the fourth sector.
9. Analyze cases, applying concepts from the chapter.

and the Brookings Institution, both public policy think tanks. Depending on our route, we might see the Phillips Collection, which is an art gallery; the Urban Institute; and Anderson House, home to the Society of the Cincinnati, which promotes interest in the Revolutionary War. Arriving back at the George Washington University, we would be tired—it would have been a long walk. Thankfully, there are a number of Starbucks nearby, so we could sit down for a cup of coffee and rest. We might be thinking about the various sights we have seen in our day and trying to identify which are nonprofits and which are not. That would not be as easy a task as it might initially seem.

We would indeed have encountered a number of nonprofits on our tour, but some may seem more nonprofit-like than others. When the word nonprofit is used, many people think first of an organization like Miriam's Kitchen. While it is located in Western Presbyterian Church, it is a separate organization. It is small and supported mostly by charitable gifts. Its workforce includes many volunteers, and it provides its services to people who pay nothing for them. Most people also probably recognize the American Red Cross as a nonprofit organization, which it is, although it is chartered by the U.S. Congress and has a mandate from government to provide services to the U.S. military and to the general population in times of disaster. Some may not think of Western Presbyterian Church or other religious congregations as nonprofits in the same way they think of the Red Cross or Miriam's Kitchen, but religious congregations are indeed a part of the nonprofit sector. So are many art galleries, such as the Phillips; research organizations, such as Brookings, Cato, and the Urban Institute; and many fraternal organizations, such as the Society of the Cincinnati.

Some organizations may seem like nonprofits, but the reality is more complex. For example, the George Washington University Hospital, which we would have passed early on in our walk, doesn't seem any different from other hospitals that are nonprofit. But it is in fact a for-profit hospital owned jointly by the George Washington University (a nonprofit institution) and Universal Health Services (a for-profit hospital management corporation). Although the hospital is right down the street from Miriam's Kitchen and provides services to some of Miriam's clients, as an organization, it is really more like Microsoft than Miriam's.

Some organizations display combinations of nonprofit missions and business operations. Our imaginary tour of Washington, DC, touched two of these—the Smithsonian and National Geographic. The National Geographic Society is a nonprofit organization dedicated to geographic exploration and education. But National Geographic Partners is a for-profit company that controls the iconic *National Geographic* magazine and various media entities bearing the National Geographic name. Since 2019, this for-profit business has been jointly owned by the National Geographic Society and Disney (Littleton, 2019). The National Geographic Society remains a nonprofit organization with its historic mission of exploration and education. (The National Geographic Society is discussed in more detail in Case 14.1 in this text.)

The Smithsonian Institution is a national museum, and many people may think of it as a government agency. But it is a complex organization, operating in part like a government agency, in part like a nonprofit organization, and in part like an entrepreneurial business. The Smithsonian receives a significant portion of its support from federal appropriations, but it was founded through a charitable bequest from James Smithson, after whom it was named, and it actively solicits philanthropic gifts. A separate nonprofit division, called Smithsonian Enterprises, manages the business activities of the Smithsonian Institution, including retail stores, a mail-order catalogue, product development and licensing, magazine publishing, an educational travel program, theaters, restaurants and other concessions, business partnerships for book publishing, and the Smithsonian TV channel. Some staff members at the Smithsonian are federal government employees while others are supported by private sources of revenue (Smithsonian Institution, n.d.).

If the line between nonprofit organizations and for-profit businesses is sometimes difficult to distinguish, the line between the nonprofit sector and government itself is also increasingly blurry. One third of the revenue of **charitable nonprofits** (33 percent) comes from

government grants and payments for services under programs such as Medicare and Medicaid (Independent Sector, 2016a). Some nonprofit organizations exist primarily as government contractors implementing government-funded programs. However, some government agencies also have begun to tap the private sector for support to supplement the funds they receive from tax revenues, including two we passed on our journey around Washington, DC—the National Park Service and the Library of Congress. Both are agencies of the federal government that are increasing their efforts to raise private funds to supplement government appropriations.

Some relationships engage all three sectors. For example, car manufacturer Subaru, a corporation, contributes vehicles to the National Park Foundation, a nonprofit organization, for use in the parks managed by the National Park Service, a government agency (Subaru of America, 2016). Further confusing the landscape, there are for-profit companies that look, feel, and sometimes sound nonprofit-like in the way they describe their missions, programs, and goals. Some compete directly with nonprofits engaged in similar activities. Consider, for example, the three goals articulated by one organization: “helping government, serving people, improving outcomes.” That sounds like the description of a nonprofit organization’s goals, but it is indeed drawn from the website of MAXIMUS, a large for-profit corporation that manages government programs and maintains offices in various locations around the world (MAXIMUS, 2019).

Clearly the lines between the for-profit, nonprofit, and public sectors of our society are sometimes difficult to perceive without close examination. As we will discuss later in this chapter, some have indeed become hybrids that operate in more than one sector at once. The popular image of a nonprofit organization as a small band of volunteers intending to do good, working with minimal resources, serving people in need, and sharply distinct from business and government is far from the reality of many nonprofit organizations today. To understand how we came to where we are and make sense of the “sprawling and unruly collection of animals” that is today’s nonprofit sector, we will need some understanding of the history that brought us to this point—and perhaps some road maps to lead us through the “zoo” (J. G. Simon, 1987).

America’s Nonprofit Sector: A Historical Overview

The roots of America’s nonprofit sector lie in the ancient traditions of charity, philanthropy, and voluntarism. Virtually all cultures and religions include some emphasis on the importance of service to others, which includes giving or voluntary action. Kevin Robbins (2012) traces the origins of these traditions in the Western world to early Greek, Roman, and Judeo-Christian thinking.

The legal foundations of America’s nonprofit sector are drawn from English law, particularly the Statute of Charitable Uses and the Poor Law, both passed in 1601. These laws clarified the relationship between the British government and the Church of England, defined the legitimate activities to be supported by charity, and established a means to make the trustees of charitable institutions accountable (Hammack, 1998). The philosophy reflected in these statutes influenced the development of U.S. law regarding nonprofits and is still reflected in American legal traditions.

Although their roots are ancient, it is in the United States that the traditions of charity, philanthropy, and voluntarism have reached their most elaborated expression. As early as 1835, the Frenchman Alexis de Tocqueville observed the unique propensity of Americans to form “voluntary associations” to address social and political objectives, which he reported in his famous book *Democracy in America* (1838). Indeed, in a young nation born in revolution against the authority of the British government, voluntary organizations and institutions provided many of the services, from schools to volunteer fire departments. A certain mistrust

of government has been a pervasive and continuing aspect of American culture and has provided philosophical support for private, voluntary initiatives throughout the nation's history. As we saw in our tour of Washington, DC, there appears to be some blurring of the nonprofit sector and government in today's environment. But it is important to recognize that the blur was even greater in the earliest days of the nation, when government supported churches, and churches sponsored many of the young institutions that served communities.

The beginnings of our modern nonprofit sector lie in the early years of the 20th century. Amid the rise of great wealth resulting from the Industrial Revolution, charity and philanthropy became organized activities undertaken on a large scale. This was the time of great philanthropists such as John D. Rockefeller and Andrew Carnegie, who endowed universities, libraries, colleges, and other institutions across the nation. Carnegie's essay, popularly known as the "Gospel of Wealth," published in 1889, remains a classic statement of the philosophy underpinning the American tradition of philanthropy. Carnegie expresses the responsibility of wealthy individuals to give back to the society that has enabled their accumulation of wealth, saying, "The man who dies thus rich dies disgraced" (p. 664). Carnegie's philosophy remains deeply a part of American culture, as evidenced by many contemporary entrepreneurs and investors, such as Bill Gates and Warren Buffett, who have created charitable foundations with similar expressions of obligation. Indeed, Gates and Buffett were leaders in promoting the Giving Pledge, a commitment by some of the world's wealthiest people to use the majority of their wealth to give back to society. By 2019, the pledge had been signed by 204 individuals (Giving Pledge, 2019).

Carnegie also helped establish a distinction between the concepts of charity and philanthropy. Although the words are often used interchangeably, and philanthropy is sometimes used as the broader, encompassing term, they describe two different types of giving. **Charity** is appropriately defined as giving intended to meet current individual human needs or to alleviate current human suffering—for example, to feed the homeless or aid the victims of a natural disaster. It is emotionally driven and often impulsive, as evidenced by the outpouring of gifts made through the mail, by phone, and online within days of any natural disaster, such as Hurricanes Michael and Florence in 2018, as well as the deadly Camp Fire in California that same year. The website GoFundMe (<https://www.gofundme.com>) provides a vehicle for individuals to respond to the critical needs of specific individuals, reflecting similarly charitable motivations.

Philanthropy, on the other hand, is a more rational form of long-term investment in the infrastructure of society, seen, for example, in gifts made to construct new hospitals, endow universities, or create new charitable foundations intended to exist in perpetuity. If the goals of philanthropists are ultimately achieved, it is arguable that the need for charity will be eliminated since there will exist institutions prepared to meet any human needs that may arise. However, in the imperfect world of the present, both types of giving are important and complementary in their impacts.

Some writers, notably Robert Payton (1988), have defined philanthropy to encompass **voluntarism** (also called *volunteerism*), calling philanthropy "voluntary action for the public good." But most people would make a distinction. Philanthropy could involve giving money from afar while having little or no involvement with the organization or its beneficiaries, but volunteering implies a more hands-on role.

Notwithstanding the ancient roots and long history of charity and philanthropy in the United States, the concept of a definable nonprofit sector, comparable with the for-profit and governmental sectors, is of relatively recent origin. It dates to the work of the Commission on Private Philanthropy and Public Needs (the Filer Commission, mentioned in Chapter 1) from 1973 to 1975. The commission's 1975 report, titled *Giving in America*, was the first to characterize nonprofits as constituting a recognizable sector of society. The Filer Commission report came at a time when the nonprofit sector was expanding, in part reflecting changes in government policy. The 1960s and early 1970s were a period of increasing government spending on social programs, starting with the Great Society programs of President Lyndon B. Johnson. In

many cases, government funds were channeled to nonprofit organizations, which provided the actual services. “Indeed,” Lester Salamon (2012b) observes, “much of the modern nonprofit sector as we know it took shape during this period as a direct outcome of expanded government support” (p. 22). In the 1980s, under President Ronald Reagan, federal spending for many social programs was sharply reduced. Since the 1980s, there also has been a change in the form in which federal support is provided, with important implications for the management of nonprofit organizations. The shift has been away from direct grants to nonprofit organizations and toward providing aid to individuals in the form of voucher-type subsidies. This occurred, for example, in health care, where Medicare and Medicaid reshaped the industry. And it also occurred in higher education, where government funds going directly to colleges and universities diminished while aid directed to individual students and their families increased. This created a new generation of student consumers and transformed higher education institutions into competitive, marketing organizations. The shift was also illustrated in the welfare reform legislation of 1996, which brought competition to many areas of human services. This empowerment of individuals as consumers through direct subsidies to them has forced nonprofits to compete for customer dollars not only with other nonprofits but also with for-profit companies that have entered fields that were previously the exclusive preserve of the nonprofit sector. For example, the for-profit firm MAXIMUS, mentioned previously, is now among the nation’s largest managers of Medicaid and the Children’s Health Insurance Program. Future changes in government funding, in both scale and method, are always possible and would have an inescapable impact on the nonprofit sector.

Changes in government funding also account in part for the growing commercialization of the nonprofit sector itself, the increased need for professional nonprofit management, and the demands that nonprofits demonstrate greater accountability and results. Nonprofit organizations comprise a vital and growing sector of our economy and society, but questions about their effectiveness and accountability are topics of national discussion and debate. There are even occasional challenges to the tax exemption of nonprofits, especially those that are highly commercialized.

Searching for a Common Vocabulary

The nonprofit sector is so diverse and its structure is so complex that it can be confusing, and there are various ways in which people understand it. Diverse understandings are reflected in the fact that there are multiple terms by which the sector is identified.

As Thomas Wolf (1999) points out, describing an elephant as a “non-horse” would seem to most people an unsatisfactory definition (p. 19). But the term *nonprofit organization* really refers to one thing nonprofit organizations do not do, rather than capturing much about what they are or the diverse programs and services they offer to society. One thing nonprofit organizations do *not* do is distribute profits to individual owners in the form of dividends or use those profits to enhance the wealth of owners through the increasing value of the enterprise.

However, it is important to dispel any misunderstanding that nonprofits cannot earn profits. Nonprofits can and do earn profits, but these are defined as simply an excess of revenues over expenses. Indeed, one well-known study (Chang & Tuckman, 1990) found that, contrary to what many theories might predict, nonprofit managers do try to earn profits and build up the assets of their organizations. But these profits must be retained within the organization and eventually used to further its programs rather than enrich individuals personally. Unlike corporations, nonprofits cannot distribute their profits to individuals in the form of dividends. This prohibition against the distribution of profits, also called the **nondistribution constraint**, is one defining characteristic of nonprofit organizations, but it is clearly not *the* defining characteristic. Indeed, by this narrow standard, the Department of Defense and

the state of New York might be called “nonprofits,” since they also have no stockholders or owners to whom any profit is distributed.

While the term *nonprofit organization* or just *nonprofit* is the most commonly used term for these organizations in the United States, those nonprofits that work internationally are generally known as **nongovernmental organizations**, although there is no identifiable nongovernmental sector with the same meaning as the term *nonprofit sector* in the United States. The term *nongovernmental* is one that originated with the United Nations and reflects in part the reality that many such organizations are performing government-like functions in the countries they serve and that most receive a substantial portion of their revenue from government sources. Many are like arms of government operating just outside the public sphere. Like *nonprofit*, the term *nongovernmental* defines organizations by what they are *not*—they are not government agencies. But this term seems equally inadequate. It could apply as well to profit-making companies such as Google and Amazon, which are also clearly nongovernmental in their ownership and legal control.

Alternatives to Nonprofit

While *nonprofit* is the term most commonly used to describe the sector, there is no shortage of alternatives that some people employ. Each alternative has its own virtues, and shortcomings as well. It is worth examining those terms in order to understand the different views and perspectives that they reflect.

The term **independent sector** has some prominence since it is also the name of the principal organization representing the interests of nonprofits in Washington, DC—Independent Sector (www.independentsector.org). But the term itself raises the question of “independent from what?” Nonprofits are financially dependent on resources derived from both government and private donors and are subject to an increasing array of state and federal law, so independence would not seem to capture their essence.

Some prefer the term **third sector**, placing nonprofits in the universe alongside the commercial economy and government. The term is accurate in terms of size—both the business sector and government employ more people, generate larger revenues, and account for a larger share of economic output. But it also seems to imply a rank order of importance, which would not agree with the values of many people, who may consider religion, education, the arts, medical research, and other purposes served by the nonprofit sector to be among the most important of human endeavors. Furthermore, some scholars suggest that American society encompasses not three but four sectors: business, government, the nonprofit sector, and families and communities. In this broader array, it becomes more difficult to rank the sectors, except by size, in which case families and communities would come first and the nonprofit sector would be fourth rather than third.

The term **charitable sector** is sometimes used, but it is contrary to the reality that charitable gifts, while important, are not the largest source of nonprofit revenues. Nor is the term synonymous with *nonprofit sector*, since there are organizations that qualify as nonprofit under the U.S. tax code but that neither seek nor receive any form of charitable support. This is true, for example, of membership organizations that are funded entirely through dues and those nonprofits whose revenues may consist entirely of grants and contracts received from government. Nor does the term seem appropriate to encompass major institutions, such as Harvard University, that are nonprofit but hardly consistent with most people’s understanding of a charity.

Some use the term **voluntary sector**. Indeed, that term is part of the title of one of the leading academic journals in the field, *Nonprofit and Voluntary Sector Quarterly*. Voluntarism is one of the foundations of the sector, and many organizations do indeed rely on volunteers,

both as members of their governing boards and for at least part of their workforce. But the term does not reflect the reality that, in many nonprofits, paid staff members far outnumber volunteers. It also may perpetuate an inaccurate image of nonprofits as universally small and amateurish in their operations, when in fact many nonprofits are substantial enterprises, and professional management of nonprofits has been a growing trend.

The phrase **tax-exempt sector**, commonly used by accountants, attorneys, and other tax specialists, is similar to *nonprofit*. It identifies organizations entirely in terms of their status under U.S. tax law. With a few exceptions, nonprofits are exempt from paying federal income tax and generally from state and local income taxes as well. But, again, the term *tax-exempt* speaks to the legal status of such organizations and says nothing about what they actually do. As we will discuss shortly, the sector encompasses a variety of organizations with few apparent similarities aside from their tax-exempt status.^{1,2}

Another term that has been proposed is **civil society sector** (Salamon, 2012a). There are many different definitions of civil society, and while “the nonprofit sector provides the organizational infrastructure of civil society,” the concept itself is more abstract, including “the sum of institutions, organizations, and individuals located between the family, the state, and the market, in which people associate voluntarily to advance common interests” (Anheier, 2014, p. 9). And as Salamon (2012a) acknowledges, the term *civil society sector* is like *voluntary sector* in that it “emphasizes the citizen base” of these organizations, while most are not membership associations and many engage large paid staffs (p. 13).

In recent decades, nonprofits have come to be increasingly managed like businesses, and some undertake entrepreneurial ventures either directly, through for-profit subsidiaries, or with for-profit partners. Some people have adopted the term **social enterprise** to encompass nonprofits that have a social objective but employ commercial principles in their generation of revenue (Social Enterprise Alliance, 2019). Although the term *social enterprise* is generally associated with those who especially advocate organizations operating like businesses and undertaking efforts to increase revenues from commercial activities, it could be argued that the term captures the positive essence of *all* private organizations having a social purpose, perhaps better than *nonprofit*. Like companies, nonprofits bring together people, resources, and purposeful effort in pursuit of a mission, and they increasingly operate with plans, goals, and established criteria for success—they are indeed enterprises. But their missions relate to social purposes rather than to the enrichment of private individuals. Were *social enterprise* to become a general designation for all such organizations, the sector that contains them perhaps then would be called the **social sector** to differentiate it from business and government. That term is indeed used by some people, but it has not gained universal acceptance and the more common designations of nonprofit organization and nonprofit sector are generally used in this book.

Noting the increasing number of organizations that operate under both nonprofit and for-profit legal forms, often called **hybrid organizations**, some authors have suggested that there may be an emerging **fourth sector**, encompassing organizations that blend the features and methods of both forms (Fourth Sector Group, n.d.). Some new types of organizations have developed in alignment with this concept of the fourth sector, which will be discussed further later in this chapter. (This use of the term *fourth sector* should not be confused with the concept discussed earlier in which families and communities are considered a fourth sector of society in addition to business, government, and nonprofits.)

Size of the U.S. Nonprofit Sector

There are more than 1.5 million tax-exempt organizations in the United States that are registered with the Internal Revenue Service. That does not include all religious congregations or smaller organizations that are not registered; if they were included, the total number

would be larger (McKeever, 2018). These organizations serve a wide range of purposes. Some are “public-serving” and others are “member-serving,” terms that will be explained further later (Salamon, 2012b, p. 7). The largest group is the charitable nonprofits, classified under 501(c)(3) of the Internal Revenue Code, numbering approximately one million (McKeever, 2018). Those include many of the public-serving organizations that we all know—hospitals, museums, schools, colleges and universities, orchestras, youth organizations, and nonprofits that provide a range of human and social services. Another significant number, about 84,000, includes those classified under section 501(c)(4) of the tax code (McKeever et al., 2016, p. 3). This section of the tax code does include some large organizations that are health maintenance organizations (HMOs) or managed health plans, but the most well-known organizations in this category are distinguished by their advocacy on issues, for example, the National Association for the Advancement of Colored People (NAACP), the National Rifle Association (NRA), and the Sierra Club.

The nonprofit sector is a significant component of the U.S. economy. In 2016, nonprofits employed 12.3 million people, over 10 percent of the private workforce in the United States. That totals twice as many jobs as the nation’s transportation, wholesale, and finance industries (Salamon and Newhouse, 2019, p. 5). The sector paid over \$638 billion in wages in 2016, which is 30 percent more than the retail industry and 60 percent more than the construction industry (Salamon and Newhouse, 2019, p. 7). Thus, the nonprofit sector has a substantial economic impact.

The nonprofit sector has grown dramatically in recent decades. Sixty-four percent of all public charities were created since 1990 (McKeever et al., 2016, p. 157). From 2000 to 2013, the number of employees in the nonprofit sector increased by 23 percent, compared with 5 percent growth in government and less than 1 percent in business (McKeever et al., 2016, p. 29). The growth is attributable to a variety of forces. As discussed above, they include the trend that began in the 1980s toward the devolution of federal programs to state and local governments and outsourcing of the provision of many services to nonprofits by governments at all levels, as well as increased philanthropy. In addition, some argue, the growth of nonprofits has been fueled by a reawakening of the spirit of public service among the current generation of Americans. Events such as the attacks of September 11, 2001, and large-scale natural disasters, both in the United States and elsewhere over the past two decades, have called the nation’s attention to human needs and the role of nonprofit organizations in helping to alleviate human suffering. Increased and rapid communication has also raised awareness of human conditions and events on a global basis. The requirement of community service for graduation from high school has exposed a generation of young people to the idea of volunteering. Many companies also organize volunteer activities for their employees, extending the experience to more Americans and making it even more a part of American culture.

In his influential, though controversial, 1995 article, “Bowling Alone: America’s Declining Social Capital,” Robert Putnam discussed a decline in civic engagement among Americans, using the metaphor of his title to suggest that Americans were becoming more isolated and more involved in individual pursuits than in collective interests and activities. Yet a decade later, Putnam and his colleague Thomas Sander reported that young Americans who witnessed the events of September 11, 2001, in their adolescent years appeared to be more involved in public affairs and community life than their older siblings. As Sander and Putnam (2005) note, “We’ll have to wait some years to see if this budding civic engagement blossoms, but it could prove to be the largest civic shift in the past half-century” (p. A23). It will still require time to identify what the long-term trends may be, but there is some evidence that millennials do value volunteering more than some previous generations (“More Millennials Value Volunteering,” 2015). In 2017, more than 77 million Americans volunteered, providing services that were estimated to be worth \$167 billion (“Volunteer Hours Now Worth,” 2018). Trends in volunteering are discussed in further detail in Chapter 9 of this text.

Differentiating the Nonprofit Sector

As we saw from our imaginary walking tour of Washington, DC, nonprofits are a widely diverse group of organizations and institutions. Fortunately, there are ways of bringing order out of the apparent chaos by placing nonprofits into categories. Let’s review some of them and see if we can gain a clearer picture of this complex arena. We will look at two ways of categorizing nonprofits according to their purposes and activities (the National Taxonomy of Exempt Entities and the Internal Revenue Service classifications); one model that categorizes nonprofits according to who benefits from their activities (public serving and member serving); and another that places nonprofits along a continuum according to the degree they are commercialized or use business principles and methods.

National Taxonomy of Exempt Entities

One way to delineate the nonprofit sector is to use the **National Taxonomy of Exempt Entities (NTEE)** Classification System (Jones, 2019). The NTEE divides the universe of nonprofit organizations into 26 major groups under 10 broad categories (Jones, 2019). These categories are based on organizations’ purposes, activities, and programs and are similar to the industry classification codes used to group for-profit companies. Box 2.1 lists the 10 broad categories in the NTEE. The complete taxonomy, including subcategories, is available from the National Center for Charitable Statistics (<https://nccs.urban.org/publication/irs-activity-codes>).

Similar ways of classifying nonprofits include the North American Industry Classification System (NAICS), which uses the same breakout as for the for-profit sector. The Bureau of Economic Analysis of the U.S. Department of Commerce and some other agencies use a definition of “nonprofit institutions serving households” (NPISHs), which excludes nonprofits that serve businesses (McKeever et al., 2016, p. 7). The fact that different classification systems are used by various agencies that collect data on the nonprofit sector accounts in part for the fact that estimates of the sector’s size and impact are often not consistent. In addition, existing classification systems may provide a somewhat inaccurate picture. For example, one study that analyzed nonprofit mission statements concluded that the NTEE significantly undercounted the number of organizations providing housing and shelter (Fyall et al., 2018).

Box 2.1

National Taxonomy of Exempt Entities (NTEE) Major Groups

Arts, Culture, and Humanities	International, Foreign Affairs
Education	Public, Society Benefit
Environment and Animals	Religion Related
Health	Mutual/Membership Benefit
Human Services	Unknown/Unclassified

National Center for Charitable Statistics (2019).

IRS Classifications

One of the reasons that there are different definitions of the nonprofit sector is that classifications of organizations are developed with varied purposes. For the Internal Revenue Service (IRS), what is relevant is the exemption of nonprofit organizations from the corporate income tax, so the IRS places nonprofits into more than 30 categories (or “classifications”) that reflect the basis for their tax exemption (McKeever et al., 2016, p. 158). As discussed previously, the very term *nonprofit* relates to the treatment of organizations under the U.S. tax code, so the IRS classifications are perhaps the most often mentioned. Moreover, from a practical perspective, how an organization is classified under the tax code is also of the greatest significance to those who govern and manage it, since this status dictates many of the rules by which the organization must operate. Nonprofits qualify for tax exemption under various sections of the Internal Revenue Code (IRC), depending on the nature of their principal activities.

The tax code can be complicated, as you will know if you have ever filed your own personal tax return. Figure 2.1 provides a way to visualize the nonprofit sector and how various organizations are classified by the IRS. It first divides society into the three sectors:

Figure 2.1 Overview of the Nonprofit Sector



Source: Based on IRS Publication 557, revised January 2019 (retrieved from www.irs.gov/pub/irs-pdf/p557.pdf).

government, nonprofits, and for-profit business. The nonprofit sector then is divided into four categories. The largest category includes organizations that are tax-exempt under Section 501(c)(3). There are two types of organizations in that category: public charities and private foundations. Other organizations are exempt under Section 501(c)(4). They are referred to by the IRS as “social welfare organizations,” encompassing what many would call **advocacy organizations**, as well as others. There are a variety of other tax-exempt organizations, classified under various sections of the tax code, such as labor unions, chambers of commerce, social and recreational clubs, trade associations, and others. While this latter group is tax-exempt, the organizations are not ones we commonly think about when the term *nonprofit* is used. For example, the National Football League (NFL) was tax-exempt as a trade association under Section 501(c)(6) of the IRC, a fact that was controversial until the league voluntarily relinquished its tax exemption in 2015 (Strachan, 2015). Despite the wide array of organizations that are tax-exempt, most are not a focus of the discussion in this chapter or in this book, which emphasizes the charitable [501(c)(3)] and advocacy [501(c)(4)] organizations that most closely align with the conception of the nonprofit sector that most people hold.

Let’s take a closer look at the 501(c)(3) and 501(c)(4) organizations that are the primary types discussed in this book. Although they are fewer in number than the charitable nonprofits, this discussion will start with the 501(c)(4) nonprofits, known to the IRS as **social welfare organizations**. We then will turn to a longer discussion of the charitable nonprofits, which are the largest component of the sector.

Social Welfare Organizations

There are different types of organizations classified under Section 501(c)(4). A small number are health maintenance organizations (HMOs) and other medical and dental insurance plans, although these account for the major portion of the revenues in the 501(c)(4) category. In this book, we generally ignore those organizations and focus on the vast majority of 501(c)(4)s that are considered advocacy organizations because their purpose is to advance a cause or work for social change.

It is important at this point to distinguish between two concepts: the tax exemption of organizations themselves and the tax deductibility of gifts made to them. *All* nonprofit organizations represented in Figure 2.1 are tax-exempt; that is, they are generally not required to pay federal taxes on their *income*, although some may be subject to other taxes. For example, private foundations pay a tax on their investment earnings and, under federal tax legislation passed in 2017, a small number of colleges and universities are subject to an excise tax on endowment income. Under that same law, some nonprofits may be subject to a tax related to compensation exceeding \$1 million (National Council of Nonprofits, 2019b).

In addition, organizations exempt from federal income tax are usually also granted exemption from state and local income taxes, which increases the benefits attached to this status. However, *only* those classified under Section 501(c)(3)—the charitable nonprofits—are tax-exempt themselves and *also* eligible to receive gifts that are tax deductible for the donors. Thus, the NAACP and the NRA, which are classified under 501(c)(4), are tax-exempt, but gifts made to them are not tax deductible for the donor because the NAACP and NRA are not classified as charitable organizations.

Advocacy organizations are tax-exempt—under Section 501(c)(4)—because they work, in the IRS’s words, “to further the common good and general welfare of the people of a community (such as by bringing about civic betterment and social improvements)” (IRS, 2020c). But they *cannot* receive tax-deductible gifts. Why are advocacy organizations different from charitable nonprofits in the eyes of the tax code? One big difference between 501(c)(3) and 501(c)(4) organizations is that the latter do not face the same limitations on lobbying and political activity that are imposed on the former. They can spend money on lobbying without limitation (IRS, 2020b). This is a point we will discuss in more detail in Chapter 11 of this text.

Because of the different advantages enjoyed and disadvantages experienced by 501(c)(3) and 501(c)(4) organizations, in terms of the tax treatment of gifts and the limitations on lobbying and political activity, some organizations have two arms—actually, two separately incorporated but related organizations. One organization is qualified under Section 501(c)(4) and is free to engage in lobbying without restriction. It cannot receive deductible gifts, but it can raise funds through member dues and others types of revenue, which are not tax deductible. The other related organization is qualified under Section 501(c)(3) and is thus eligible to receive tax-deductible gifts. It pursues education, research, and other activities consistent with that classification.

Box 2.2 provides an example in the form of mission statements for the Sierra Club, an internationally known environmental organization, and the related Sierra Club Foundation. The Sierra Club itself is a 501(c)(4) social welfare organization that works to preserve the environment, including by lobbying for environmental protection legislation. The Sierra Club Foundation is a 501(c)(3) organization that supports certain activities of the Sierra Club and other environmental programs. As its mission statement and description of its activities explain, the foundation works to “educate and empower people,” activities that are consistent with the purposes allowed for 501(c)(3) organizations. Note the slight difference in the mission statement of the Sierra Club—it goes beyond educating and empowering and includes “enlisting” humanity, which suggests the possibility of building political coalitions and encouraging individuals to political action. This may seem like a subtle difference, but facing the possibility of an audit by the IRS and wishing to protect the tax status of both entities, most organizations are precise in monitoring their activities for consistency with tax law.

Charitable Nonprofits

Now let’s turn to the two boxes shown in the middle of Figure 2.1—the charitable nonprofits that are public charities and the charitable nonprofits that are private foundations, both tax-exempt under Section 501(c)(3). These two groups have some characteristics in common,

Box 2.2

Comparison of Charitable and Social Welfare (Advocacy) Organizations

Mission of the Sierra Club, a 501(c)(4) Organization

To explore, enjoy, and protect the wild places of the earth;

To practice and promote the responsible use of the earth’s ecosystems and resources;

Sierra Club website (<https://www.sierraclub.org/policy>).

To educate and enlist humanity to protect and restore the quality of the natural and human environment; and to use all lawful means to carry out these objectives.

Mission of the Sierra Club Foundation, a 501(c)(3) Organization

The Sierra Club Foundation promotes efforts to educate and empower people to protect and improve

the natural and human environment.

Sierra Club Foundation website (<https://www.sierraclubfoundation.org/about-tscf/our-values/mission>).