

# Myths about the Nonprofit Sector

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**C**reative and realistic solutions to the social problems of the day require a realistic understanding of the role and capacity of nonprofit organizations. Their contributions to the quality of life in this country are varied and occur both independently and in collaboration with government and business. Both public policy and private efforts to address social needs must acknowledge the strengths and limitations of nonprofits as the demands of devolution and welfare reform grow. Moreover, social services are only one of many activities undertaken by the nonprofit sector.

## Diverse Roles

Misperceptions about the extent to which the nonprofit sector focuses on welfare provision and about its capacity to do so, absent significant government funding, can be traced back to the early 1980s. Nonprofit organizations were propelled into U.S. public consciousness during Reagan's budget cutbacks, which were designed to dismantle inefficient and ineffective government social programs. "Charities" were promoted as the nongovernmental saviors of the poor and of children, the elderly, and the disabled. The prevailing view of a charitable sector sustained exclusively by volunteerism and donations led to exhortations to increase giving and volunteering to compensate for government funding cuts. At the time, it was not generally known that government grants and contracts provided a significant and growing proportion of nonprofit revenues and that philanthropic contributions were a small and decreasing proportion.

Better information now documents the long-standing financial and programmatic relationship between American nonprofits and government. But the notion of an independent charitable social safety net that can offset decreasing government support for social services has persisted through the 1990s. Nonprofits are expected to become less dependent on a shrinking and devolved government sector and more businesslike: lean, efficient, and effective.

*Prodded by heightened expectations of an increased poverty-alleviation role for nonprofits in the 1990s, some Americans hold a narrow view of nonprofits as service providers rather than community organizations or social action groups.*

The nonprofit sector, however, is composed overwhelmingly of small, community-based entities with meager resources. Even among those organizations that meet the threshold for reporting to the IRS, most have modest budgets, use only volunteer labor, and operate locally. Resources and employees are highly concentrated in the largest organizations, chiefly hospitals and universities. (Large health care providers and higher education institutions dominate national statistics on the nonprofit sector, masking what those data say about the smaller groups that make up the majority of the sector.) Furthermore, fewer than 4 percent of nonprofits (excluding foundations) that report to the IRS have expenses higher than \$10 million, but are responsible for more than three-quarters of the sector's assets (figure 1).

## Diverse Types

Nonprofit organizations constitute a distinctive sector in that they engage people in collective purposes outside of the market and the state and are independently organized and self-

**Table 1**  
**Finances of Nonprofit Subsectors**  
 (As Percentage of Total Funds), 1982, 1992

	Government <sup>a</sup>		Private-Sector Payments <sup>b</sup>		Private Contributions <sup>c</sup>		Other <sup>d</sup>	
	1982	1992	1982	1992	1982	1992	1982	1992
Health Services	34.8	40.7	49.1	48.3	5.9	3.6	10.2	7.4
Education/Research	17.0	20.0	53.0	57.0	8.4	12.7	21.6	10.3
Social and Legal Services	54.9	50.1	15.2	17.5	25.0	20.0	4.9	12.4
Civic, Social, and Fraternal	50.0	33.3	13.8	20.4	29.3	31.3	6.9	15.0
Arts and Culture	16.7	14.6	29.2	24.4	39.6	40.2	14.5	20.8

Source: Hodgkinson et al. 1996.

(a) Includes grants, contracts for providing services, and payments for individuals (i.e., Medicaid or Medicare).

(b) Includes dues, fees, and charges.

(c) Includes individuals, foundations, corporations, and federated fundraising organizations such as United Way.

(d) Includes endowments, investment income, and other.

governing. That said, nonprofit groups are characterized by tremendous diversity in origins, size, finances, types of activities they undertake (poverty alleviation being only one of them), the people they serve, and the means they use to reach their goals.

Nonprofit causes may include environmental preservation, health education, youth recreation, and the arts. Some nonprofit organizations aim to benefit their own members, others to promote broader well-being among the public. The products they generate can include audio tapes for the blind, artistic and cultural productions, consumer information, political advocacy, spiritual guidance, and care for the poor, sick, and disabled. Nonprofit groups are so diverse, in fact, that some observers question whether they form a distinctive sector in any meaningful sense, other than their common designation as organizations exempt from taxes and their legal constraint against the distribution of profits (thus the term “nonprofit”).

While it is difficult to comprehend the nonprofit sector's diversity, it is important to recognize that what we know about the sector is largely limited to the public-serving organizations that are eligible to receive tax-deductible donations (501[c][3] organizations), are large enough to file annual reports to the IRS (over \$25,000 in revenues), and are required to do so. Religious congregations, for instance, are not required to report to the IRS, so we lack much information about them and the other small and informal organizations of civil society.

**Table 2**  
**Changes in Philanthropic Giving by Source, 1977–1997**  
 (Inflation-Adjusted \$ in Billions)

Type	1977	1982	1989	1992	1997	% Change 1977–1997
Individuals	78.3	79.2	102.8	100.3	109.3	39.6
Foundations	5.3	5.3	8.5	9.9	13.4	152.8
Corporations	4.1	5.2	7.1	6.8	8.2	100.0
Bequests	5.6	8.7	9.0	9.3	12.6	125.0
<b>Total</b>	<b>93.3</b>	<b>98.4</b>	<b>127.4</b>	<b>126.3</b>	<b>143.5</b>	<b>53.8</b>

Source: AAFRC Trust for Philanthropy, *Giving USA 1998*.

## Changing Revenue Bases

Nonprofit revenues are a complex mix of private and public dollars raised through grants, contracts, fees for services, sales, donations, investment income, special events income, and income from commercial ventures. In general, over the last few decades the proportion of private donations decreased—from 26 percent in 1977 to 19 percent in 1996. By 1996, government revenues increased to 32 percent and program service fee revenues reached 39 percent, becoming the nonprofit sector's largest revenue source.

While the proportion of government revenues increased for educational organizations and health services (mainly fueled by Medicare and Medicaid payments to hospitals and other health providers), they decreased for social and legal services,

for arts and culture, and most substantially for civic, social, and fraternal organizations (table 1). In 1992, the fraction of government funding clearly varied by type of organization, from less than 15 percent in the arts to half of social services. Philanthropic (private) contributions received by nonprofits in 1992 varied from a low of less than 4 percent of revenues for hospitals to 40 percent for arts and culture.

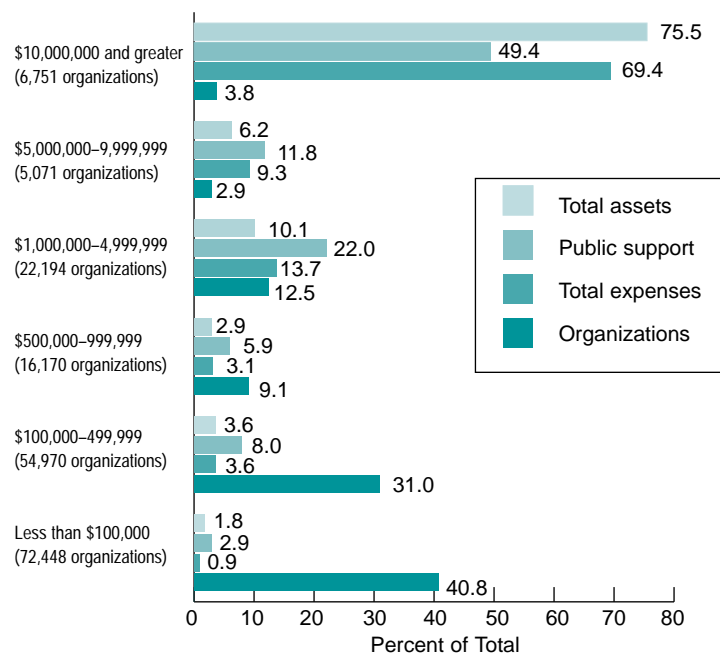
At the same time, philanthropic giving by foundations and corporations grew more robustly than individual giving, reflecting strong financial markets. Corporate contributions and grants from corporate foundations reached an estimated

\$8.2 billion in 1997, which represented a 21 percent increase since 1992 (table 2). A surge in stock values and a sustained record of corporate profits between 1995 and 1997 suggest that many companies have a renewed capacity to rebuild corporate foundation assets that declined over the last decade. Private and community foundation grants also increased sharply to an estimated \$13.4 billion in 1997. Foundation assets continued to grow, reaching \$227 billion, and gifts to both types of foundations rose.

## Blurred Lines between Sectors

Businesses and government entities often provide services similar to those of nonprofits. As a result, there may be few obvious differences

**Figure 1**  
Nonprofit Finances by Total Expense Level, 1996



Source: U.S. Internal Revenue Service Return Transaction File, 1997, as adjusted by the National Center for Charitable Statistics.

Note: Numbers are preliminary. Figure includes nonprofit organizations classified as operating public charities that report to the IRS (file Form 990) and are required to do so. Excludes private foundations, foreign organizations, government-associated organizations, and organizations without state identifiers. Organizations not required to report include religious congregations and organizations with less than \$25,000 in gross receipts.

among nonprofit, for-profit, and government services such as substance abuse prevention programs, child care centers, and hospitals. Although there is growing concern over the potential impact on communities of the conversion of hospitals from nonprofit to for-profit status, there is little documentation of the consequences.

The overlap among sectors sometimes occurs naturally and with positive effect. For instance, nonprofits may create for-profit subsidiaries that allow them to make a profit in one program that can be used to subsidize services in another. Nonprofits also use services provided by businesses when it is cost-effective to do so. Many colleges now provide commercial food services for students, for example.

Boundaries between the nonprofit, government, and business sectors always have been shifting and permit motivated entities to move in new directions. These changing boundaries can lead to innovation and new opportunities for problem-solving. Sometimes, for instance, the nonprofit sector

may pave the way for government and business to meet a social service need that they may not have known existed. The creation of nonprofits engaged in AIDS prevention and treatment in the 1980s is one illustration of how nonprofit advocacy can spark government and industry involvement in an important public cause.

## Diverse Pressures

The political and economic forces of the last decade differentially affected the growth rates, strength, and viability of nonprofit organizations, depending on their areas of activities, sources of revenues, and size. Financial indicators point to healthy growth rates for most types of organizations, but that growth appears not to be keeping pace with overall growth in the economy. An estimated two-fifths of public charities suffered a decline in inflation-adjusted dollars between 1989 and 1995. A similar number are operating on a very slim margin, with net worth less than or

equal to three months of expenses. Philanthropic giving is steady, at less than 2 percent of income, despite increased wealth and decreased tax burdens.

The nonprofit sector may be vulnerable not only to static growth in philanthropic contributions but also to civic disengagement, especially among lower-income people. Volunteering declined between 1989 and 1993, possibly because the economic fortunes of middle- and low-income people were declining. Between 1993 and 1995, however, this downward slide was reversed and the number of hours volunteered to the nonprofit sector returned to 1989 levels. Outside of religious congregations, the participation of the less well off in associations and in the political process is more limited than for those who are more affluent. This participation gap poses a major challenge for a democratic society, as studies show that involvement in civic activities increases with education and income.

Nonprofit organizations are also facing market pressures to work more efficiently. Applying the business acumen of the for-profit sector to the nonprofit arena may be a good thing. But community rather than business oversight is probably more appropriate in a sector where building communities through shared efforts—and not the “bottom line”—is the goal. Hospitals and nursing homes may be candidates for new entities that combine community oversight of nonprofits with for-profit business savvy. We still need to ask, however, about the harm or benefits when for-profits take over traditionally nonprofit institutions that serve vulnerable populations.

The devolution of federal government responsibilities to the state and local level may bring opportunities for nonprofits to play larger roles in planning and decisionmaking. Welfare reform is already generating new community coalitions and involvement of low-income people in the policy process. But nonprofit groups used to influencing policy at the national level, or unaccustomed to advocacy activities at all, may have to find a public voice in a landscape made more complicated by a transfer of decisionmaking from Washington to 50 state capitals.

This brief is based on a longer paper entitled "The Nonprofit Sector in the 1990s," written for the 93rd American Assembly, held in Los Angeles in April 1998.

#### Further Reading

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*The Urban Institute's Center on Nonprofits and Philanthropy (CNP) was established in September 1996 to explore the role and contributions of nonprofit organizations in democratic societies. The work of CNP will be communicated through the dissemination of timely, nonpartisan research to policymakers, practitioners, researchers, the media, and the general public.*

*The National Center for Charitable Statistics (NCCS) became part of the Urban Institute in July 1996 and is the statistical arm of the CNP. The mission of NCCS is to build compatible national, state, and regional databases and to develop uniform standards for reporting on the activities of charitable organizations. NCCS databases are available on CD-ROM, diskette, 9-track tape, or via File Transfer Protocol (FTP) in a variety of database formats. For information, call 202-828-1801 or visit our Web site (<http://www.urban.org/cnp>).*

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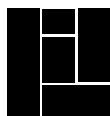
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