

## Changing Times: A New Era for the Nonprofit Sector

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An understanding of how and why nonprofit organizations are changing requires consideration of a key threshold question: What is the nonprofit sector? The number (over a million nationwide) and diversity of organizations that comprise the nonprofit sector complicate efforts to meaningfully analyze any issue on a sector-wide basis. Consider these two dramatically divergent descriptions:

- ▶ The nonprofit sector . . . 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.<sup>1</sup>
- ▶ Many nonprofits operate just like for-profit businesses. They make huge profits, pay handsome salaries, build office towers, invest billions of dollars in stocks and bonds, employ lobbyists and use political action committees to influence legislation.<sup>2</sup>

While both of these statements are factually accurate, what you see when you look at the nonprofit sector clearly depends on where you direct your gaze. Rather than a monolithic whole, the “nonprofit sector” can more accurately be described as a multitude of subsectors, including health care, education, social services, visual and performing arts, legal services, as well as religious, civic, social, philanthropic, fraternal and advocacy organizations, among others. These subject matter differences represent just one of the fault lines running through the conceptual territory occupied by the sector. As one commentator observed: “The fact is, the subsectors of the nonprofit world . . . are enormously varied. They get their resources from different places, they exhibit varying degrees of independence from the public sector, they are more or less engaged in the market economy, and they have quite distinct corporate cultures.”<sup>3</sup> While this

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<sup>1</sup> Elizabeth T. Boris, *Myths about the Nonprofit Sector*, A brief in the Series, “Charting Civil Society,” by the Center on Nonprofits and Philanthropy. This report is based on a longer paper entitled, “The Nonprofit Sector in the 1990s,” written for the 93<sup>rd</sup> American Assembly, held in Los Angeles in April 1998. This brief is available on The Urban Institute’s website at: [www.urban.org/periodcl/cnp/cnp\\_4.htm](http://www.urban.org/periodcl/cnp/cnp_4.htm).

<sup>2</sup> Gilbert M. Gaul and Neill A. Borowski, *Free Ride: The Tax-exempt Economy* (Kansas City, MO: Andrews and McMeel, 1993), p. 4.

<sup>3</sup> Edward Skloot, “The Market Economy, Social Responsibility, and the Future of the Nonprofit Sector,” *Competing Visions: The Nonprofit Sector in the Twenty-First Century* (Washington, D.C.: The Aspen Institute; Nonprofit Sector Research Fund Dialogue Series, 1997), p. 40.

complexity increases the challenge of identifying the distinct values of nonprofit organizations, it also points out the need for such inquiry.

### ***The Distinct Values of Nonprofit Organizations***

Although they defy easy generalizations, nonprofits' common denominator is that they "provide a private means to pursue public purposes outside the confines of either the market or the state."<sup>4</sup> Nonprofits serve the public good by assisting those who are poor, sick, underserved, or otherwise vulnerable. Some nonprofit organizations, such as the Blue Cross and Blue Shield plans that we studied, took risks that for-profit companies eschewed. Similarly, the nonprofit student loan secondary markets provided funding for higher education that simply was not available from private banks. These nonprofits were truly pioneers and set an example that others – often for-profit companies – would later follow.

Service delivery is not the exclusive mission of many nonprofit organizations. "They also act as educators, advocates, and vigorous agents of social change, challenging society to respond to human problems in new ways – particularly through public policy."<sup>5</sup> Nonprofits have been at the forefront of every movement for social change during the last five decades of American history. They led the civil rights movement, the battle for a cleaner environment, the fight for equality for women, and many other social causes that have changed the nation. By working to serve society's unmet needs, nonprofits acquire a unique perspective on these needs. This special window on the world has placed the nonprofit sector at the center of our nation's struggle to achieve a civil society.

A vigorous nonprofit sector encourages civic participation and strengthens local communities by mobilizing individuals into groups and turning private initiative into public action. Although nonprofits are sometimes under attack from some quarters, many contend that these organizations represent the "embodiment of a fundamental national value emphasizing *individual initiative in the public good* and a means to "foster pluralism, diversity, and freedom."<sup>6</sup> In this way, nonprofits serve as "the repository of the civic values, virtues, and volunteer spirit that

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<sup>4</sup> Charles Halpern, Preface to Lester M. Salamon, *Holding the Center: America's Nonprofit Sector at a Crossroads* (New York: The Nathan Cummings Foundation, 1997), p. ix.

<sup>5</sup> William P. Ryan, "The New Landscape for Nonprofits," *Harvard Business Review* (January-February 1999), p. 135.

<sup>6</sup> Salamon, *Holding the Center*, p. 7 (emphasis in original).

ground American democracy and give it meaning and strength.”<sup>7</sup> The battles waged by nonprofits to provide services and to strive for a just society need stalwart support; the vitality of the sector is inextricably intertwined with the health of American democracy.

### ***Blurred Boundaries: New Opportunities and New Challenges for Nonprofits***

The conversions and other restructurings that our research uncovered have not occurred in a vacuum. Instead, they are part of a broader trend toward “marketization” or “commercialization.”<sup>8</sup> The very words commercialism and commercialize, used throughout much of the literature about nonprofit organizations, each have several different meanings. Some are value neutral, while others have strong negative connotations.<sup>9</sup> This paper uses the terms “commercialize” and “commercial” simply to describe some of the ways in which nonprofits are applying business methods or principles to their activities or engaging in activities with for-profit enterprises. How “commercial” activity will affect the ability of nonprofits to fulfill mission-related objectives is difficult to determine in the abstract and will vary from organization to organization.

The causes of the trend toward increased commercial activity are complex, but financial need is a major factor. Securing adequate, stable funding streams has always been a challenge for the vast majority of nonprofit organizations. Traditional sources of nonprofit revenues, such as government subsidies, have waxed and waned and have not proven to be a dependable source of funding. And competition among nonprofits for foundation grants and charitable donations is intense. Rather than rely on philanthropic or government funding alone, nonprofits increasingly generate revenue by selling goods and services.

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<sup>7</sup> Edward Skloot, “Rising to the Challenge of For-Profit Competition,” *Chronicle of Philanthropy* (February 26, 1998), p. 53.

<sup>8</sup> See, for example, Burton A. Weisbrod, ed., *To Profit or Not To Profit: The Commercial Transformation of the Nonprofit Sector* (Cambridge: Cambridge University Press, 1998); J. Gregory Dees, “Enterprising Nonprofits: What do you do when traditional sources of funding fall short?” *Harvard Business Review* (January-February 1998), pp. 54-67; Brenda Zimmerman and Raymond Dart, *Charities Doing Commercial Ventures: Societal and Organizational Implications* (Toronto: Trillium Foundation, 1998); Ryan, “The New Landscape for Nonprofits;” Salamon, *Holding the Center*; and Jed Emerson and Fay Twersky, eds., *New Social Entrepreneurs: The Success, Challenge, and Lessons of Nonprofit Enterprise Creation* (San Francisco: The Roberts Foundation, 1996).

<sup>9</sup> The definitions of “commercialism,” for example, are “1. The practices, methods, aims, and spirit of commerce or business[;] 2. An attitude that emphasizes tangible profit or success.” *American Heritage College Dictionary*, 3<sup>rd</sup> Edition, (Boston: Houghton Mifflin Co., 1993), p. 280. The definitions of “commercialize,” include “1. To apply business methods to for profit[;] 2.a. To do, exploit, or make chiefly for financial gain. b. To sacrifice the quality of for profit.” *Ibid.*

Of course, many nonprofits historically have financed their operations by charging for their services. Particularly in the two most capital-intensive segments of the nonprofit sector – health care and higher education – institutions have always relied on fees for a substantial portion of their revenue. The buzz these days stems not from the mere fact that nonprofits are earning money by selling goods and services, but rather from the extent and nature of the commercial activities in which nonprofits are engaged. Growing numbers of nonprofits, borrowing from the playbook of the business world, pursue strategies that include mergers, acquisitions, for-profit subsidiaries, and joint ventures. Nonprofit organizations more aggressively market their products and services and engage in benchmarking and branding.

These flexible, innovative, entrepreneurial approaches may hold the key to survival and growth for nonprofits.<sup>10</sup> New sources of income have helped some organizations serve their charitable missions more effectively and become more independent. But the blurring boundary between the nonprofit and for-profit sectors also presents risks.

The reality is . . . that more and more activity is hard to characterize as public, market or nonprofit as partnerships and hybrid forms of organization come to be the rule. The advantage of this shift is that sectoral interpenetration may facilitate social innovation and efficiency. This blurring of sectoral functions may also, however, erode public awareness of, and confidence in, the nonprofit sector and bring into question the values and moral authority of the sector.<sup>11</sup>

As nonprofits adopt the structures and strategies of their for-profit counterparts, both policymakers and the public may question whether nonprofits will be pulled away from serving charitable purposes and fulfilling civic goals. Indeed, serving the twin masters of mission and market can be difficult – if not impossible – as conversions from nonprofit to for-profit status demonstrate. Nonprofits walk a tightrope suspended delicately between the public and private spheres. Markets are here to stay, but so are market failures and social or non-economic needs.

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<sup>10</sup> A discussion of several very successful entrepreneurial nonprofits is provided in: Bill Shore, *The Cathedral Within: Transforming Your Life by Giving Something Back* (New York: Random House, 1999).

<sup>11</sup> *Trust, Service, and The Common Purpose: Philanthropy and the Nonprofit Sector in a Changing America* (Final Report of the Ninety-third American Assembly, 1998), p. 7. This document was produced at the conclusion of a three-day meeting of nearly 100 nonprofit leaders who gathered in Los Angeles, California in April 1998. The meeting was sponsored by The American Assembly and the Indiana University Center on Philanthropy and was entitled “The Future of Philanthropy in a Changing America.” The final report is available on the following website: [www.columbia.edu/cu/amassembly/phil/report.html](http://www.columbia.edu/cu/amassembly/phil/report.html).

Society needs nonprofits as a distinct sector because they characteristically serve purposes that are not met by market mechanisms.

The nonprofit sector is now poised to cross the Rubicon. The gradual transformation of the sector “has happened largely without notice, forethought or national debate about the consequences and public policy implications for the country.”<sup>12</sup> The continued evolution of the nonprofit sector will reverberate widely, however. The key challenge for nonprofits is “to frame a set of civic-based service goals and strategies for the 21<sup>st</sup> century.”<sup>13</sup> Foundations, as both grantmaking and operating nonprofits, similarly have a responsibility – and a unique capability – to maintain and support the nonprofit sector.<sup>14</sup> Evolving institutional changes should “also prompt a searching review by governments, corporations and nonprofits of their respective responsibilities to the American public.”<sup>15</sup>

### ***Viewing the Nonprofit Sector through the Lens of Conversions***

Consumers Union’s interest in conversions and the trend toward commercial activity by nonprofit charitable organizations stems in part from its own experience as a strong mission-driven organization operating in an increasingly competitive environment. In addition to providing unbiased information on a host of products and services, Consumers Union serves its mission by advocating for consumer interests in legislative, judicial, and regulatory proceedings. Monitoring conversions among health care and student loan organizations has focused our thinking about the role of nonprofits in a pluralistic economy. Our collaborations with Community Catalyst and local coalitions to ensure that proposed conversions protect the public’s interest have provided a vehicle for communities to voice their expectations of nonprofit organizations and to debate what the public may lose when nonprofits convert to for-profit status. When a conversion occurs, the for-profit corporation often operates on the presumption that it has no obligation to the public beyond what it takes to retain customer good will. Regulators and community leaders must work to dispel this notion and ensure that conversions do not result in a net loss of services and other public benefits.

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<sup>12</sup> Gaul and Borowski, *Free Ride*, p. 3.

<sup>13</sup> Skloot, “The Market Economy,” p. 47.

<sup>14</sup> See, for example, Jonathan Alter, “New Windows on the World: As Gates gives away billions, he has a chance to show leadership where it really counts,” *Newsweek* (August 30, 1999), p. 50.

<sup>15</sup> Skloot, “The Market Economy,” p. 47.

Viewing the nonprofit sector through the lens of conversions is a bit like picking up a novel and reading only the final chapter. One knows how the story ends, but not how the plot develops. Conversion represents the end of the line for a nonprofit; the point at which it seeks to formally inter its charitable, public purposes and to be resurrected as an organization dedicated to maximizing profits and serving private interests. The conversion trend among nonprofit health care and student loan institutions illuminates many of the forces driving nonprofit organizational change generally. The outcomes of these transactions can help explain how market forces and government policy influence the nonprofit sector, and how institutional change affects the public.