



# Snapshots

Research Highlights from the Nonprofit Sector Research Fund

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## The Resilient Sector:

### The State of Nonprofit America

by Lester M. Salamon

America's nonprofit organizations—that vast assortment of hospitals and universities, orchestras and opera companies, family service agencies and religious congregations, environmental advocacy and civil rights organizations, soup kitchens, homeless shelters, and more—have demonstrated enormous resilience in the face of extraordinary challenges over the past 20 years. As a consequence, this set of organizations has entered the new millennium in surprisingly robust condition, though the re-engineering that has made this possible may be pulling the sector in directions that are highly corrosive of its special character and role.

*In This Issue:  
Current challenges facing  
nonprofit organizations.*

These are the principal conclusions that emerge from a major new assessment of *The State of Nonprofit America* prepared by Dr. Lester M. Salamon and a team of associates (see box inside) and published jointly by the Brookings Institution Press and the Aspen Institute. In his introduction to this book, Salamon provides an overview of the challenges and opportunities nonprofit organizations have faced in the United States in recent years and details the responses of the sector's organizations and the implications these responses seem to hold for the sector's character and role.

*The State of Nonprofit America* is a joint undertaking of the Aspen Institute's Nonprofit Sector and Philanthropy Program and Lester M. Salamon of Johns Hopkins University. Generous support for this project has been provided by the Carnegie Corporation of New York, The Nathan Cummings Foundation, The John D. and Catherine T. MacArthur Foundation, Charles Stewart Mott Foundation, The David and Lucile Packard Foundation, and the Rockefeller Brothers Fund.

## The Invisible Sector

Nonprofit America is one of the least understood segments of national life, yet also one of the most crucial. A diverse collection of private institutions that mobilizes individual initiative for the common good, these organizations employed an estimated 11 million workers, or 7 percent of the nation's workforce as of 1998. In addition, they engaged a volunteer workforce equivalent to another 5.7 million full-time workers.

Encompassing multi-million dollar health complexes and far larger numbers of small operations with annual budgets of less than \$25,000, nonprofit organizations deliver much of the hospital care, higher education, social services, cultural

entertainment, employment and training, low-income housing, community development, social welfare and emergency aid services available in our country. They also perform a crucial advocacy role, identifying unattended problems and bringing them to public attention. Most of the social movements that have animated American life over the past century or more operated in and through this set of institutions.

Nonprofit organizations also give expression to a wide variety of artistic, religious, cultural, ethnic, social, and recreational impulses that add richness to community life. And they help foster "social capital," the bonds of trust and reciprocity that seem to be crucial for a democratic polity and a market economy to function.

## Challenges

Despite the important contributions they make, nonprofit organizations have recently found themselves in a time of testing.

### The Fiscal Challenge

In the first place, a considerable portion of America's nonprofit organizations experienced a significant fiscal squeeze in the early to mid-1980s that has left a continuing scar of uncertainty. Government support, which had fueled much of the growth of the sector over the previous two decades, declined sharply in the early 1980s, at least outside of the health field, and did not return to its 1980 level until the mid-1990s.

Not only the amount, but also the form, of government support to the nonprofit sector changed during this period as government grants and contracts, which provide assistance directly to the providers of services, increasingly gave way to vouchers and tax expenditures, which channel money instead to clients, forcing nonprofits to compete for it in the market. Already by 1986, 70 percent of all federal support to nonprofit organizations took the form of such consumer-side subsidies. What is more, the rise of "managed care" in the health and social service fields has added to the competitive and financial pressures on nonprofits.

Private philanthropy, meanwhile, while growing absolutely, has not kept pace either with the growth of the overall economy or of the nonprofit sector. Until the latter 1990s, in fact, giving had declined steadily as a share of personal income. And the recent stock market sell-off and recession of 2000-2002 have reversed the growth spurt that was evident in the boom period of the late 1990s despite the outpouring of support in response to September 11.

### The Competition Challenge

In addition to a fiscal squeeze, nonprofits have also been facing increased competition from for-profit firms that have entered fields that nonprofits earlier dominated. The nonprofit share of day care jobs, for example, dropped from 52 percent to 38 percent between 1982 and 1997, and similar declines have occurred in other fields as well, such as rehabilitation services, home health, health insurance, kidney dialysis, mental health services, and hospice care.

This increased competition has resulted in part from the growth of government voucher-type payments, which opened new markets for for-profit firms. Also at work has been the advantage that for-profit firms enjoy in raising capital by issuing stock, something nonprofit organizations cannot do. Nonprofits are thus at a competitive disadvantage in fields where rapid increases in demand or new technological innovations necessitate increased capital expenditures.

### The Effectiveness Challenge

In the face of increased competition, nonprofits are also confronting growing pressures to demonstrate their effectiveness. Earlier notions of the inherent trustworthiness of nonprofit organizations have given way to a pervasive "accountability environment" in which performance must be proved, typically with empirical performance measures. In response, organizations like United Way of America have launched elaborate efforts to establish performance measures for its funded agencies and a new "venture philanthropy" model has taken root encouraging grantmakers to take a more active hand in organizational governance and to insist on measurable results.

### The Technology Challenge

Rapid technological change has added further to the pressures nonprofit organizations are confronting. While opening new opportunities to nonprofits in such areas as advocacy, health care, education, and the dissemination of culture, technology also poses an enormous risk because of the structural disadvantage nonprofits face in raising capital. This is especially true of small agencies, creating a significant digital divide within the sector and putting nonprofits generally at a disadvantage *vis-à-vis* their for-profit competitors. For example, the difficulties nonprofit health insurers have confronted in financing needed information-processing equipment have led to a rapid loss of market share to for-profit firms. Technology also poses philosophical challenges related to creative control and intellectual property rights that have become particularly significant in the arts field.

### The Legitimacy Challenge

A serious fault-line also seems to have opened in the public's confidence in the nonprofit sector. In 1994, only a third of Americans expressed "a great deal" or "quite a lot" of confidence in nonprofit human service agencies. Although this improved considerably by 1998, still only 20 percent "strongly agreed" that "charitable organizations play a major role in making our communities better places to live," and only 10 percent were willing to agree "strongly" that most charities are "honest and ethical in their use of donated funds."

### Human Resource Challenge

Inevitably, fiscal stress, increased competition, expanded accountability demands, and significant public ambivalence have taken their toll on the sector's human resources. The job of executive director has become especially demanding, leading to considerable turnover and burn-out. But the pressures on front-line workers have also been intense due to relatively low wages and benefits. Leadership recruitment has become a particular challenge in the arts field where the vacancy rate for art museum directors hit a 15-year high in 1999.

## Opportunities

Side by side with the challenges that nonprofit America has been confronting, however, are an important set of opportunities. Included here are:

- **Social and demographic shifts** such as the growth of the elderly population and the increased female participation in the labor force that are expanding demand for many of the services that nonprofit organizations provide, as well as the emergence of a new population group—the “cultural creatives”—whose search for a better balance between work and personal values has attracted them to the nonprofit sector.
- **New philanthropic resources** resulting from the inter-generational transfer of wealth, the new wealth created by the dot-com economy, and the growing willingness of businesses to forge partnerships with nonprofit organizations in order to help build consumer confidence, ensure corporations a “license to operate,” and promote employee loyalty and morale.
- The **increased visibility and credibility** that nonprofits have gained as a result of the attention lavished on them by conservative politicians such as Ronald Reagan, the role civil society organizations seemed to play in the collapse of Communism in Central Europe, the new-found interest in “social capital,” and the events of September 11, which reawakened Americans to the importance of the functions that nonprofit institutions perform.
- **Resumption of government social welfare spending growth** in the mid-1980s as a result of a massive broadening of entitlement program eligibility and coverage, the inauguration of new programs in such fields as care for people living with HIV/AIDS and homelessness, and the financial windfall that state governments received when the welfare reform law of 1996 guaranteed federal payments to them at pre-existing levels while welfare rolls unexpectedly declined sharply.

## The Nonprofit Response: A Story of Resilience

How has nonprofit America responded to this combination of challenges and opportunities? From the evidence at hand, the answer appears to be “very well.” Though largely unheralded, nonprofit America has undergone a quiet revolution over the past 10-15 years, a massive process of reinvention and re-engineering that is still very much under way. To be sure, the resulting changes are hardly universal. Nor are they without significant risks. Still, there is no denying the dominant impression of extraordinary resilience, adaptation, and change.

### Overall Sector Growth

Perhaps the most vivid evidence of this resilience is the recent record of sector growth. Between 1977 and 1997, the revenues of America’s nonprofit organizations increased by 144 percent after adjusting for inflation, nearly twice the growth rate of the nation’s economy. Especially robust was the revenue growth among arts and culture, social service, and health organizations. Not only nonprofit revenues but also the number of organizations has grown substantially. Between 1977 and 1997 the number of 501(c)(3) and 501(c)(4) organizations registered with the Internal Revenue Service increased by 115 percent, or about 23,000 organizations per year. This compares with a 76 percent growth rate among for-profit businesses.

### Successful Marketing to Paying Customers

An important reason for this growth has been the success that nonprofit organizations have had in competing for paying customers. Fee income accounted for 47 percent of total sector growth, 51 percent with religious congregations excluded. Moreover, reliance on fee income spread well beyond the fields of health and education, where it was formerly concentrated, into arts and culture and social services. For example, a significant 35 percent of the considerable growth of social service organization income during this period came from this source.

In addition to boosting their income from fees, nonprofits have also aggressively pursued a variety of *business-type ventures*. Examples here include museum gift shops and on-line stores, church rentals of social halls, and licensing agreements between research universities and commercial firms. The Guggenheim Museum has even gone global, with franchises in Italy, Germany, and Spain. More generally, the Internal Revenue Service reports a 35 percent increase in the number of charities reporting so-called “unrelated business income” between 1990 and

1997. Perhaps the most interesting facet of this development is the recent tendency of some nonprofit organizations to form “social ventures,” businesses that are designed not simply to generate income but to build skills, develop self-confidence, and teach work habits among chronically unemployed people.

### Successful Pursuit of Public Funds

Equally striking has been the success with which nonprofits have adapted to the new government funding terrain and taken advantage of the recent growth in government spending. Nonprofit revenues from government increased in real terms by 195 percent between 1977 and 1997, proportionally more than any other source, and these figures do not even include the welfare reform windfall discussed earlier. Nonprofit health, social service, and arts organizations were particularly successful in attracting government funds, in each case boosting their government support by 200 percent or more after adjusting for inflation. Housing and community development organizations were also effective in mobilizing public sector support, though in their case this took the form of exploiting tax incentives designed to leverage private-sector funds.

This government support has not been without its downsides. Particularly problematic has been the tendency for Medicaid (and to some extent Medicare) to reimburse at less than the cost of providing services, forcing nonprofits to subsidize government-supported initiatives with limited private charitable support. What is more, the economic recession of 2001-02 and the tax cuts of 2001 are again putting significant constraints on the growth of government support, so it is far from clear whether this source of growth will persist.

### The Revolution in Charitable Fundraising

Nonprofit America has also responded to the recent challenges it has faced by significantly re-making charitable fundraising. Fundraising has been thoroughly professionalized over the past twenty years and new techniques such as telephone solicitation and direct mail developed to reach a broader cross-section of the population. New for-profit companies have also gotten into the act, offering a variety of “planned giving” mechanisms. Indeed, an alternative entrepreneurial model of institutional philanthropy seems to be

emerging modeled on the decentralized, entrepreneurial firms that have been the source of much of the new-economy wealth. While these changes have not succeeded in countering the effects of other developments, such as tax and other policies that have discouraged the growth of giving, they have doubtless boosted charitable giving above what it might otherwise have been.

### Adoption of the Market Culture

Behind these various responses lies a broader and deeper penetration of the market culture into the fabric of nonprofit operations. Nonprofit organizations are increasingly “marketing” their “product,” viewing their clients as “customers,” segmenting their markets, differentiating their output, identifying their “market niche,” formulating “business plans,” and generally incorporating the language, and the style, of business management into the operation of their agencies. Significant changes are also occurring in the basic governance of nonprofit organizations. Boards are being made smaller and more selective, substituting a corporate model for a more community-based one. In addition, the internal structure of organizations is growing more complex. Behind the comforting facade of relatively homey charities, nonprofit organizations are being transformed into complex holding companies, with multiple nonprofit and for-profit subsidiaries, significantly complicating the task of operational, and financial, management and control.

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***The State of Nonprofit America at:***

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Montreal, Canada  
November 15, 2002  
7:30 AM – 9:00 AM

### New Business Partnerships

As part of this overall trend as well, nonprofits have been taking increasing advantage of the growing willingness of businesses to forge strategic alliances with them in order to generate “reputational capital.” “Cause-related marketing” arrangements, in which a nonprofit lends its name to a commercial product in return for a share of the proceeds from the sale of that product, as well as broader corporate-nonprofit partnerships have thus become commonplace.

### The Creation of a Nonprofit Infrastructure

Nonprofit America has also been busy developing its own institutional infrastructure to provide services, support, and representation for the nonprofit sector as a whole. Independent Sector, the largest and most visible of the sec-

tor-wide infrastructure groups, was created only in 1980 and now counts over 700 foundations, corporations, and nonprofit umbrella organizations among its members. Other infrastructure organizations represent organized philanthropy, nonprofits in particular regions, and nonprofits serving particular populations. While infrastructure organizations were once a scatteration of largely overlooked institutions, they have now become a booming cottage industry of organizations, publications, educational offerings, research institutes, conferences, and websites.

### Meeting the For-Profit Competition

Nonprofits have also begun to hold their own in the face of growing for-profit competition. For-profits, it turns out, have competitive advantages during growth spurts in particular fields when their superior access to capital allows them to build new facilities, acquire new technology, and attract sophisticated management. But when contractions occur or reimbursement rates decline, they are often unable to maintain the continuing expectation of stock price escalation on which their financial viability often depends. Nonprofits have thus been able to reclaim lost ground in such fields as nursing home care and general hospitals after periods of for-profit growth. All of this demonstrates why nonprofit involvement is so crucial, especially in fields where the public has an important stake in the maintenance of a reasonable level of quality care.

### Meeting the Political Competition

Finally, in addition to fending off for-profit competition in the economic sphere, nonprofit organizations have demonstrated unusual, and growing, effectiveness in the political sphere. Though representing only 7 percent of the Washington interest group universe, for example, nonprofit citizen groups managed during the 1970s-90s to dominate the Washington policy agenda, to claim disproportionate shares of the media coverage and Congressional testimony, and to prevail 80 percent as often in passing legislation they favored as the business lobbies against which they were often arrayed. What is more, they have recently extended their reach upward to the international level and downward to states and localities.

## Implications

On balance, the resilience that nonprofit America has displayed over the past twenty years has worked to the sector's advantage, strengthening its fiscal base, upgrading its operations, enlisting new partners and new resources in its activities, and generally improving its image for organizational effectiveness. But they have also brought significant risks that may well overwhelm the gains.

Most seriously, an identity crisis seems to be growing between the market character of the services the nonprof-

it sector is increasingly providing and the continued nonprofit character of the institutions providing them. Nonprofit missions emphasizing quality or service to the poor are particularly at risk as a consequence. This has vastly complicated the task of nonprofit management and subjected nonprofit managers to escalating tensions. Smaller agencies are at a particular disadvantage as successful nonprofit operation comes to require advanced technology, professional marketing, corporate partners, sophisticated fundraising, and complex government reimbursement systems, all of which are problematic for smaller agencies. Market pressures are therefore creating not just a digital divide, but a much broader "sustainability chasm" that smaller organizations are finding it increasingly difficult to bridge. All of this puts the public's understanding of this sector, and hence its trust in it, in further jeopardy.

All of this suggests the need for a better balance between the steps nonprofits must take to survive and those they must take to remain distinctive. This will require a clearer understanding and articulation of the sector's special purposes as well as concrete efforts to address the survival challenges the sector faces. For example, efforts are needed to ease the sector's access to capital through tax incentives for nonprofit bonds of the sort that nonprofit housing and community development organizations have recently used effectively. Similarly, both public and private health insurers must be persuaded to give greater weight to the special nonprofit contributions in such areas as charity care and commitment to education and research in setting their reimbursement rates.

## Conclusion

It has been said that the quality of a nation can be seen in the way it treats its least advantaged citizens. But it can also be seen in the way it treats its most valued institutions. Americans have long paid lip service to the importance they attach to their voluntary institutions while largely ignoring the challenges these institutions face. Now we need to re-think in a more explicit way whether the balance between survival and distinctiveness that nonprofit institutions have had to strike in recent years is the right one for the future, and, if not, what steps might now be needed to shift this balance for the years ahead. Hopefully, this book will help inform that re-thinking.

*The State of Nonprofit America* is co-published by the Brookings Institution Press and the Aspen Institute. The book is available from the Brookings Institution at [www.brookings.edu](http://www.brookings.edu), as well as in bookstores and on commercial websites. Visit the Aspen Institute website at [www.aspeninstitute.org/stateofnonprofitamerica](http://www.aspeninstitute.org/stateofnonprofitamerica) for summaries of additional chapters and order information for individual chapters.

# The State of Nonprofit America

Lester M. Salamon, ed.

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The thousands of organizations that comprise America's private nonprofit sector represent a national treasure. Yet serious pressures are altering the playing field on which nonprofits operate, and many are responding in ways that may undermine their popular support.

Despite the significance of these developments, little has been done to analyze and interpret them in a clear and understandable way. Lester M. Salamon, a leading authority on the nonprofit sector, and the Aspen Institute have joined forces with more than a dozen experts to produce *The State of Nonprofit America*, an integrated, authoritative assessment of the state of nonprofit America and the key trends affecting its evolution.

*The State of Nonprofit America* summarizes critical opportunities and challenges, examines each of the sector's major fields, and assesses important cross-cutting trends and issues. It provides a basic sourcebook for sector leaders, the press, public officials, and citizens concerned about the future of America's nonprofit sector and eager to understand the forces affecting it.

## Overview

The Resilient Sector: The State of Nonprofit America . . . . . Lester M. Salamon

## Major Fields

Health . . . . . Bradford H. Gray and Mark Schlesinger  
Education and Training . . . . . Donald M. Stewart, Pearl Rock Kane, and Lisa Scruggs  
Social Services . . . . . Steven Rathgeb Smith  
Arts and Culture . . . . . Margaret Wyszomirski  
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Individual Giving and Volunteering . . . . . Virginia A. Hodgkinson  
with Kathryn E. Nelson and Edward D. Sivak, Jr.

## Major Challenges

Commercialization, Social Ventures, and For-Profit Competition . . . . Dennis R. Young and Lester M. Salamon  
Devolution, Marketization, and the Changing Shape of  
Government-Nonprofit Relations . . . . . Kirsten Grønbjerg and Lester M. Salamon  
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