

**Strategic Positioning and the Financing of
Nonprofit Organizations:
Is Efficiency Rewarded in the Contributions Marketplace?**

By

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Abstract

This article addresses the question of whether operational efficiency is recognized and rewarded by the private funders that support nonprofit organizations in fields ranging from education to social service to arts and beyond. Looking at the administrative efficiency and fundraising results of a large sample of nonprofit organizations over an 11 year period, we find that nonprofits that position themselves as cost efficient – reporting low administrative to total expense ratios – fared no better over time than less efficient appearing organizations in the market for individuals, foundations, and corporate contributions. From this analysis, we suggest that economizing may not always be the best strategy in the nonprofit sector.

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Today, the nonprofit sector plays an increasingly important role in the provision of vital services in fields such as health, social services, and education. The size of the nonprofit sector has increased rapidly over the past 50 years from a little more than 12,000 organizations in 1940 to over 1.5 million organizations today, including 501(c)(3) public-serving nonprofits that are organized for religious, educational, charitable, and scientific purposes, as well as a host of member-serving nonprofits, such as business leagues, social clubs, and labor associations (Borris 1999). While the sector has grown quickly, serious questions have arisen in recent years about the funding and management of these organizations, particularly the public-serving nonprofits that grant their supporters a tax deduction for their contributions. In response to contributors' concerns following a series of highly publicized financial scandals at nationally prominent charities,¹ the field of nonprofit management has quietly undergone a period of self-examination aimed at bringing greater financial controls and tighter operations to the sector (Bryson 1996; Kearns 1996; Pappas 1995; Letts, Ryan & Grossman, 1999). Reforms in the way nonprofit organizations operate have been aimed at reassuring the public that contributions are being wisely applied to the core charitable missions of these organizations.

The rapid rise in the number of nonprofits seeking a piece of the limited amount of private contributions (Boris 1999) has increased competition within the sector and

made it harder for many of these organizations to achieve long term financial stability. Charitable nonprofits raise funds through two principal means (Hansmann 1981). The first is through the charging of fees for the delivery of services or the creation of commercial ventures designed to generate a stream of earned income. Over the past two decades, these “commercial” forms of revenue have become a critical source of operating funds, one that has given nonprofits the ability to launch and sustain initiatives by having clients and consumers pay for part or all of the cost of delivering services (Weisbrod 1999). The second way nonprofits support their operation is through donations and grants. By emphasizing the public-serving nature of their work, many “donative” nonprofit service providers are able to elicit a stream of contributions that provides critical working capital for their operations (Gronbjerg 1993). For organizations that work with disadvantaged populations or that seek to provide a service for free or at a subsidized price, contributed income is often a critical ingredient in their financial strategy. Today, there are few entirely donative or entirely commercial nonprofit organizations. In the face of a tight market for contributions, many nonprofits have attempted to alter and diversify their funding bases from a predominant reliance on contributions toward a more balanced approach that includes earned income. All the while, there remains a significant ongoing need for contributed income to fund those activities that are part of the mission of a nonprofit organization but not easily supported by client payments.

Against the backdrop of these financial pressures, we examine in this paper the factors that drive private contributions to nonprofit organizations. Because nonprofits have received a great deal of advice on how to manage their operations efficiently, we are

interested in the question of whether strategic positioning around efficiency, defined as the reporting of a below average administrative to total expense ratio, increases the contributed income that a nonprofit organization is able to raise over time. Beyond a need to build legitimacy and donor confidence that may underlie the “new bottom-line” movement in the nonprofit sector, there has been much talk about the growing sophistication of philanthropy, evidenced in the expectation of donors that their contributions be well spent. This research asks how much reality lies behind this new rhetoric and whether the funders of nonprofit organizations have indeed begun to take more seriously the efficiency of the organizations they support. Thus, while the efficient management of nonprofit organizations may serve a range of purposes, we are interested here in whether it has an impact on an organization’s ability to attract public support as measured by contributed income.

The paper moves toward an answer in four steps. First, we set the stage by considering the background issues and previous research related to this question. Second, we define the research hypotheses that guided our work. Third, we present our model and analyze the findings. Finally, we conclude with some broader reflections on the question of nonprofit management and accountability.

I. BACKGROUND AND LITERATURE REVIEW

To date, research on the private funding of the nonprofit sector has tended to focus on donor motivations. Starting with the question of what determines the amount of giving, many studies have looked at the sensitivity of contributions to various changes in the external funding environment. The goal of this work has been to explain donor decisions and to do so

almost always without taking into consideration the activity of the recipient organizations. Studies of individual charitable contributions have modeled donations as a function of disposable income and the price of giving as measured by the price of contributions (Clotfelter 1985). This work has argued that the current policy of allowing donors to deduct charitable contributions from their income is a more effective tool for stimulating donations to charitable organizations than lowering income tax rates and allowing individuals to have greater disposable incomes. In short, this research has found that the price elasticity is greater in absolute terms than the income elasticity. In the field of corporate contributions, the impact of taxation on giving has also been studied, though the results are more mixed (Navarro 1988). Studies of the giving patterns of private foundations have focused on the multiple roles and responsibilities that frame the strategic decisions that foundations make about how to use their resources (McIlroy 1998). In these and other cases, modeling and theorizing has tended to treat the contributions process from one side, where the donor is actively involved in weighing alternatives and where the recipient is a passive vessel of benevolence.

Another important line of inquiry is the relationship between other sources of nonprofit revenue and private donations. Specifically, this research addresses whether government grants and contracts “crowd out” charitable contributions (Brooks 2000; Kigima 1989; Okten and Weisbrod 2000; Steinberg 1993). The findings are mixed, however, across various subsectors and geographic regions with some studies finding evidence of a partial crowd out effect and other studies finding opposite evidence of a partial “crowd in” effect. Nonetheless, the thrust of this literature has been to evaluate the responsiveness of various revenue streams without explicitly taking in account the actions of the nonprofit itself.

In this article, we start with a different set of concerns and assumptions about contributions to the nonprofit sector. Rather than begin with the question of what determines the amount of contributions made by supporters of nonprofit organizations, we draw on a different research tradition, one that starts with the role that information asymmetry (Akerlof 1970) plays in the market for charitable contributions and that more recently has asked the question of what determines the fundraising success of nonprofit organizations (Kelly 1997). Far from being bystanders to the deliberative process of donors, nonprofit organizations are in fact actively engaged in courting supporters by pressing the importance of their mission. This positioning is a critical part of the giving process since it determines what information reaches donors as they make their decisions on where to direct their funds. The most basic form of positioning is around mission. Nonprofits define themselves around the causes they are established to serve, which they hope the public views as important enough to support through both volunteering and charitable giving. As the public shifts its attention to issues ranging from homelessness to early childhood education to famine relief, different sectors of the charitable market benefit from successive surges of public support. Because an organization's mission is not usually subject to quick or radical change, maintaining financial support over long periods of time can be a difficult task. Donors are notorious for experiencing "compassion fatigue," as the demand for charitable resources for what seems like an endless range of causes marches on and on. Over the past two decades, there has been a conscious effort to change some of the dynamics of the contributions game and to help nonprofits find a dimension other than mission on which to position themselves, namely managerial and administrative efficiency. This has led to an explosion of handbooks and

management manuals designed to give nonprofit leaders tools to improve their operations (Light 2000).²

On a daily basis, many nonprofit managers are confronted with a long list of challenges, including staff turnover, unreliable volunteers, difficult clients, and demanding funders. As a consequence, the successful nonprofit manager must be constantly working to find ways to sustain the myriad of complex personal relationships that together allow a nonprofit organization to pursue its mission. While all nonprofits would like to develop long-term organizational plans and improve management practices, a harried agency director may, more often than not, be drawn to focus on the more immediate objective of simply making it through the day and keeping the organization afloat. Of course, some well-funded nonprofits have succeeded in freeing themselves from these mundane constraints, but many organizations, particularly community-based service agencies, struggle mightily simply to keep their programs functioning. Funders have become increasingly selective in their awarding of gifts and grants to nonprofits. Under-financed and duplicative nonprofit organizations have had to contend with the inability of private funders to finance the explosive growth of this sector. One consequence of this development has been the rise in nonprofit bankruptcies and closings (Hager, Galaskiewicz, Bielfeld, and Pins 1996). What then is a nonprofit organization to do?

One popular response has been that nonprofit organizations need to manage better and more efficiently in the new competitive and performance driven world they now face. Improving management has been seen both as a way of raising operational effectiveness and a method of reducing costs. Dozens of books now aim to help nonprofit practitioners

improve their organizations and manage more effectively and efficiently (Antos and Brimson 1994; Dropkin and LaTouche 1998; Drucker 1992; Eadies and Schrader 1997; Firstenberg 1996; Pynes and Schrader 1997; Wolf 1990). Many of these titles attempt to bring business concepts such as reengineering, quality management, and benchmarking to bear on the nonprofit sector, usually with the intent of raising the level of organizational and program performance. A common theme that emerges from these texts is that the absence of a traditional bottom line in the nonprofit sector – far from freeing nonprofits to blindly pursue their missions – means that these organizations must manage especially well and develop a special kind of operational discipline. Though rarely expressed directly, these books suggest that a management lag between nonprofit and business sectors can be closed with a direct transfer of managerial technology.

The push toward efficiency and performance has been fueled by the rapid professionalization of large parts of the nonprofit sector over the past three decades (Frumkin 1998). Many professional staff want to bring a new rigor to their work and develop standards to measure their performance, both as the basis for their own advancement within the field and in the effort to build a growing body of expert knowledge. For professionals, the ideas of reengineering processes, introducing quality management systems, and benchmarking are appealing because these techniques hold out the promise of supporting and justifying the move from volunteer labor to well compensated professional staffing. With their desire to avoid charges of amateurism that have plagued this sector in the past, the growing ranks of nonprofit professionals have turned out to be the perfect audience for claims that cost effectiveness represents the new frontier of nonprofit management.

As professionalism has set in, competition for contributed income has intensified, particularly among start-up organizations. Many nonprofit managers confront the fact that there are often several nonprofit organizations with similar missions operating close by one another with little coordination. In some fields, the competition has gotten quite heated. In the case of international relief, efforts to win support have led to efforts at differentiation around overhead costs and programmatic efficiency. Knowing that individual donors to famine relief would, all things considered, prefer to see their funds reach those in need at the lowest cost possible, many relief agencies have come to compete for the distinction of having the lowest administrative and overhead costs -- a competition that is encouraged by the media, which regularly publishes, particularly around the holidays, ratings of charities designed to lead donors to lean and well run organizations. Under such conditions, it would appear that few managers could afford to ignore the question of cost efficiency, measured often in terms of the ratio of administrative to total expenses. Of course, the categorization of costs as either administrative or programmatic is a subject of considerable dispute and little practical guidance exists (Wilson, Hay and Kattelus, 1999). This imprecision, in turn, can be seen as having the potential of intensifying the inclination of nonprofits to enter into the efficiency positioning game, since standards for challenging claims of efficiency are difficult to locate.

At the same time, foundations and corporations have become increasingly tough minded in their dealings with nonprofit organizations (Freund 1996). Within institutional philanthropy there has been a move to gain greater levels of control over the entire grantmaking process. The most visible manifestation of this move has been the rise of

project grants, which now outnumber general operating grants by a ratio of close to three to one (Foundation Center 1998). Individual contributors, who together donate more than foundations and corporations combined, have also become more aggressive in the way they conduct their philanthropy. Although many small contributions are made on a wish and prayer, larger individual donors have begun seeking more information before making commitments and then demanding greater involvement and engagement with the organizations they support (Miller 1997).

For nonprofits, changes in the way large institutional contributions are made has meant more fund-raising work and more post-grant work as well. To satisfy grantmakers, nonprofit organizations must now -- at a minimum -- specify in great detail how funds will be spent, discuss their plans with foundation staff, submit to a site visit, write a project narrative, and provide a financial report on the project. The greater level of oversight and heightened emphasis on effectiveness and efficiency have necessitated the recruitment and training of program staff who know not only how to provide services but also how to handle donors and the new rigors of securing contributed income. This has led to an even greater emphasis on fundraising skills within the sector and to the rising salaries of development professionals (Duronio 1997).

There are currently significant limits to the ability of the contributions market to absorb and use information, however. Although many nonprofits are required to file on an annual basis a financial disclosure form with the Internal Revenue Service and then make this information available to the public upon demand, it remains unclear how well this information shapes the contributions decisions of many donors (Chisolm 1995). Foundations and corporations routinely scrutinize audited financial statements and public

reporting forms, but small individual contributors rarely inquire in any depth into an organization's finances. In addition, there is considerable concern about the accuracy of the information detailed on the federal reporting forms because of the vagaries of some of the categories and because audits of nonprofit organizations have become an increasing rarity. The IRS has only a small enforcement office that has struggled to keep up with the explosive growth of the sector (Gaul and Borowski 1993, Greene and Williams 1995). Still, the information contained on the reporting forms can help us understand how many nonprofit organizations present themselves to the public. This public disclosure of information represents an organization's most visible statement of its financial condition and managerial priorities.

II. RESEARCH HYPOTHESES

Talk of "social investments" rather than "grants" and "social return on investment" rather than "stewardship" have become popular in recent years (Emerson 1996). The question that remains to be answered is whether the changes that have swept across the funding landscape reflect a new rhetoric for philanthropy or whether these changes have transformed the contributions market into one where the business of benevolence takes seriously the performance of recipient organizations. A good way to address this question is to look at nonprofit organizations to see whether those that have followed the growing literature on nonprofit management and tightened operations have been rewarded with greater levels of contributed income.

Therefore, the first hypothesis we test reflects the position that efficiency matters and that it is recognized and rewarded in the market for contributions. H1 incorporates

the underlying assumptions of the new literature on nonprofit management and the push towards greater attention to the bottom line within nonprofit organizations.

H1: Nonprofit organizations that have low administrative to total expense ratios and that appear efficiently managed will have more success raising contributed income than organizations that have higher administrative expense ratios.

The second hypothesis we test rests on the assumptions held by some practitioners that competition for contributions does not take place in a well-functioning market where information about nonprofit performance is scrutinized and where efficiency is rewarded. Instead, H2 argues that the best predictor of an organization's ability to solicit contributions is the amount of money that the organization spends selling itself and its mission to donors in every way imaginable, from face-to-face solicitation of major gifts to mass mail appeals to small contributors.³ What matters most is *not* how well a nonprofit is run from a managerial point of view or how efficiently it marshals its resources to accomplish its goals, but rather how well it "sells" itself to the public. H2 affirms that philanthropy may have developed an impressive business-based lexicon, but that the majority of giving remains idiosyncratic and emotive.

H2: Nonprofits that spend more on fundraising or marketing will have more success raising contributed income than organizations that spend less on fundraising or marketing.

By testing these two opposing propositions, our goal is to understand whether strategic positioning around operational efficiency is rewarded by donors or whether effective mission marketing ultimately drives charitable giving to nonprofit organizations.

III. DATA & METHODOLOGY

The data for this analysis is drawn from information provided to the Internal Revenue Service (IRS) by nonprofit organizations that are required to file an IRS Form 990 information return (Return of Organization Exempt From Income Tax). The data set covers the period 1985-1995. Although nonprofit organizations are generally exempt from paying income tax, they must nonetheless file an annual return with the IRS reporting detailed financial and other activity for the year. Three important categories of nonprofit organizations are not required to file IRS Form 990 information returns: religious organizations, private foundations, and nonprofit organizations with gross receipts less than \$25,000.

In order to qualify for tax-exempt status under section 501(c)(3) of the Internal Revenue Code, the primary mission of the organization must be charitable, religious, scientific, literary, educational, or promote public safety, prevent cruelty to children or animals, or foster amateur sports competition. Operating under this broad umbrella of exempt purposes that has been amended and extended over the years, nonprofit organizations not only enjoy the benefits of income tax exemption but also donors are entitled to deduct charitable contributions from their income tax returns. Yet each nonprofit organization must serve the public good as opposed to private gain in order to maintain exempt status. Thus, exempt organizations may not distribute their net earnings (i.e., profits) to shareholders or other individuals but rather must use them to further the mission of the organization.

A. Sample Selection

Following common practices in setting up a panel study, our sample consists of

only those nonprofit organizations appearing in each panel year. This balanced panel consists of 2,359 nonprofit organizations, yielding a total of 25,949 observations. This panel constitutes a stratified random sample of the universe of nonprofit organizations that are required to file an IRS Form 990 information return. The IRS adopts a stratified sampling approach in which the sample is classified into five strata based upon total asset size with each stratum being sampled at a different rate (IRS 1991; 1993).

B. Dependent Variable

The dependent variable in our model is private donations in a given tax year. Some researchers have cautioned, however, that a potential problem may exist because of the confusion of nonprofit managers over the various contribution categories of the IRS Form 990 (Froelich and Knoepfle 1996; Froelich 1997). To account for this possibility, we perform a separate analysis of our model using total contributions as the dependent variable. We report our results in the following section. A natural logarithm transformation of both variables was used in the regression analysis.

C. Independent Variable

The independent variable in our model, efficiency, measures the ratio of administrative expenses to total expenses in a given tax year. This is the most common way to measure administrative efficiency in nonprofits. It is a measure that is sometimes employed by auditors and accreditors to compare the operations of organizations with similar missions, with the goal of seeing which have the leanest operations. In our model, this variable is employed to measure differences in operational efficiency among nonprofits working in common subsectors as defined by the National Taxonomy of Exempt Organizations (NTEO). Our model includes the following major category groups

of the NTEE: arts, education, health, human service⁴, public benefit⁵ and other⁶. By measuring efficiency within subsectors and seeing if it is a good predictor of contributions, we take a first step toward testing our main hypotheses. In order to address potential issues of simultaneity, we use the lagged value of efficiency in our model.

D. Control Variables

The following four variables were included as controls in the regression analysis: (1) *program expenditures* or the amount of money dedicated to service delivery or core mission-related work; (2) *fundraising expenditures* or the amount of money spent on marketing a nonprofit organization to donors with the goal of securing contributions; (3) *total revenue* or the amount of money flowing into the organization each year from all sources; and (4) *government grants and contracts* or the amount of money flowing into the organization each year specifically from government sources. A natural logarithm transformation was performed on each independent variable in order to facilitate the analysis. As with our independent variable, we use the lagged value of each control variable in our model to address potential issues of simultaneity.

E. Model Specification

A simple pooled cross section time series model that is estimated using ordinary least squares (OLS) will not yield consistent coefficient estimates if unobserved firm-specific characteristics have a unique but constant impact upon charitable contributions. In this case, the simple pooled model will suffer from omitted variable bias. Moreover, diagnostics performed on the sample reveal the presence of first-order serial correlation.⁷ We correct for these problems by using a general least squares (GLS) estimator.

IV. RESULTS & ANALYSIS

We began this investigation with the question of whether efficiency – reflected in below average administrative to program expenses – helped nonprofit organizations in the marketplace for contributions. We looked at the influence of efficiency on contributions within the major fields of activity that nonprofits populate. This means we sorted organizations by their areas of activity (i.e., arts, health, education, human service, public benefit, and other) and then asked whether being more efficient than the competition in one’s own field yielded greater levels of contributions. Our belief is that few donors make their charitable giving decisions by comparing, for example, an arts organization to a hospital. Instead, we believe that donors are more likely to compare one nonprofit day-care center to another nonprofit day-care center.

Table 1 reports descriptive statistics for the entire sample including the means, standard deviations, and pooled correlation matrix for all 11 panel years of data. Table 2 presents the results of our regression model. The results of our analysis indicate that reporting low administrative to total expense ratios and positioning an organization as efficient does not lead to greater success in garnering contributions. In none of the six fields of activity did we observe a statistically significant effect of efficiency on contributions.

Tables 1 and 2 about here

What then did drive contributions? One variable, the lagged log of fundraising expenditures, was statistically significant at the 0.001 level across 5 out of the 6 subsectors in our model and at the 0.01 in the sixth. Given the fact that efficiency

positioning did not appear to be a factor in determining the level of contributions received, these are intriguing and substantively significant findings. They indicate that nonprofit organizations that spend more marketing themselves to the donating public do better at raising contributed income. No matter the field of activity, positioning around mission influenced the flow of contributions. These results strongly support the second of the two hypotheses we defined earlier.⁸

With R-Squares ranging from .13 to .44 our models did only moderately well in predicting contributions. Still, in order to assure ourselves that concerns over errors in the completion of the 990 Forms might have skewed our results, we did a sensitivity analysis. On the assumption that nonprofit managers may not fully understand the various reporting categories of contributions, we estimated another version of our model using total contributions as the dependent variable. A general pattern emerged with the coefficient estimates similar in both sign and magnitude, which suggests that any “problematic” Form 990 filers do not pose a threat to our analysis.⁹

We believe that the results of the analysis are important for two reasons. First, they cast doubt upon the wisdom, at least in part, of the growing tidal wave of advice that nonprofit organizations are receiving from the new literature on nonprofit management. While tighter operations, leaner staffing, and other tools designed to lower administrative costs might well increase margins on earned or commercial income within some nonprofits, such steps appear not to impress or influence contributors. Second, the results in our model, particularly the significance of fundraising expenses, indicate that when the more donative nonprofits carry their message to funders aggressively, they often reap rewards in the form of higher contribution levels. Our findings suggest that giving may

still be driven more by donor identification with organizations than by economizing and positioning based on low administrative expense ratios.

In light of these conclusions, arguments about bringing a new bottom line to the nonprofit sector will need to be based on something other than a claim that donors recognize and reward efficiency by increasing contributions to lean organizations. It may be that efficiency is critical to ensuring that the commercial side of nonprofit operations maximizes earned income. Who after all could quarrel with the logic of a claim that organizations with lower overhead and administrative costs are in a better position to increase the revenue derived from fees for service and ventures? However, when it comes to attracting the critical contributed income on which many nonprofits rely to fuel their charitable activities, particularly services that are offered to disadvantaged populations, operational efficiency does not appear to be a critical consideration in the eyes of contributors.

V. DISCUSSION

Some will surely object that efficiency has been shortchanged in this analysis. After all, proper marketing, positioning, and fundraising strategy only assure that an organization has made its case to the public, not that an organization has a record of efficient operation that will ensure its survival in the competitive environment of the increasingly commercial nonprofit sector. More than anyone else, Williamson (1994) has voiced a clear objection to the emphasis on strategy in the broader management literature. Williamson has forcefully argued that excessive concern over strategy and positioning obscures the fact that efficiency remains a more critical factor to organizational success and that economizing is much more fundamental than strategizing. Williamson's point

was that strategizing efforts will rarely prevail if a program is burdened by significant cost excesses in production, distribution, or organization. His conclusion was simple and direct: “Economizing is more fundamental than strategizing – or, put differently... economy is the best strategy. That is the central and unchanging message of the transaction cost economics perspective” (Williamson 1994:362).

Although these strong words were directed at all firms that operate in competitive markets, it is not clear that they hold true for nonprofits operating in the contributions market. When nonprofits engage in fundraising to support their charitable missions and make appeals based on emotion and urgency rather than efficiency and effectiveness, the unchanging message of transaction cost economics appears in need of some modification, both as a positive or normative conclusion. In fact, the results of this analysis indicate that strategy, which in the nonprofit world means choosing a distinctive position rooted in systems of activities that are difficult to match, may be a more viable approach to attracting the contributions on which many nonprofit organizations still critically depend.

The importance of strategy over economizing is evidenced in the fact that increased efficiency has often led to operational improvements in business firms, but rarely have these gains translated into sustainable profitability (Porter 1996). Many large business firms have become locked into hypercompetition, with the search for efficiency only driving profit margins down and down. The move to tighten controls and improve operational systems has had the effect of creating a rising tide of mutually destructive competitive battles that damage the profitability of many companies. The irony of the situation is clear: As managers push to improve on all fronts, they move further away from viable competitive positions. As Porter has noted, operational effectiveness,

although necessary to superior performance, is not sufficient because its techniques are easy to imitate. In contrast, the essence of strategy is choosing a unique and valuable position rooted in activities that are much more difficult to match. The economic basis of competitive advantage can thus be traced down to the level of the specific mix of activities within an organization and the fit of those activities in the market.

We believe this argument is strikingly relevant to the growing universe of nonprofit organizations. Today, many nonprofits face increasing competition and pressure as the sector's financial needs expand faster than income. For many nonprofits, the idea of economizing and lowering operational costs might appear appealing both as a way of making earned income go further and as a signal to donors that contributions will be used efficiently. While such a conclusion might conceivably hold for the commercial side of nonprofit finance, our analysis suggests that economizing is not rewarded by donors. Strategic positioning through the aggressive communication of mission is a more potent driver of contributions than maintaining efficient operations. We conclude therefore that the new literature on "bottom line" nonprofit management may well be giving practitioners useful tools for tightening their fee-based operations, but it does not appear to be helping nonprofits attract the contributions that remain critical to the ability of many organizations to carry out their charitable missions.

An additional word about the other side of the giving equation is also in order. While there has been much talk recently of an increasingly hard-nosed approach by the funders of nonprofit organizations, our analysis of a decade of funding data suggests that contributions remain for the most part unrelated to operational efficiency. In thinking about how and why the financial performance of nonprofits does not affect donor

decisions, it is reasonable to ask whether there is an adequate supply of information. The answer is unclear at present.¹⁰ In fact, only within the past year has the IRS moved to put in place new disclosure requirements for nonprofit organizations. Nonprofits must now mail their Form 990 to any interested party or post it on the Internet. This marks a major change from the previous disclosure law, which only required that the forms be shown upon request in a charity's office. Few contributors ever made pilgrimages to see the forms and the supply of information on the management of public charities was therefore largely determined by what organizations chose to disclose in their annual reports.

Despite this recent reform, there is reason to believe that improvement in the quantity and quality of information supplied to donors will not be instantaneous. A study of 990 returns from exempt organizations in twelve states, begun after the new disclosure regulations took effect in June 1999, revealed that just 37% immediately fulfilled 990 requests, and 31% responded in ways coded as obfuscation—they referred survey takers to another office, or required them to leave voicemail messages that were not returned (Stokeld 1999). The study organizer suggested that many organizations appeared either to be following a long-established process, or to have no process at all, for responding to information requests. Whether 990s will become substantially more accessible in the future depends on several unknowns, including how quickly organizations communicate rules changes through their networks, and how aggressively the IRS is perceived to be monitoring compliance. Still, it appears that government could do more both to inform nonprofits of the rule change and to enforce disclosure requirements. This would require that government take an active role in simplifying Form 990, communicating more

directly with nonprofit organizations, and building a credible enforcement staff capable of letting nonprofits know that disclosure is a critical responsibility.

There is at least one major development on the horizon that may help answer questions about the supply of information. A new nonprofit organization has been formed to disseminate financial information on nonprofits over the Internet. The project, known as Guidestar, is still in its early stages, but it promises to overcome at least part of the information problem. The Guidestar web site will allow any person to access the essential financial data for a large number of nonprofit organizations. Information about operating expenses, administrative overhead, and fund raising costs will all be available to potential contributors and volunteers. The goal of the project is to make research on nonprofits easier for the average donor by putting this data where it is easiest to access.

While Guidestar has promise, it will need to address a key obstacle: Major gaps in what one might call the generally accepted accounting principles for nonprofits make it hard to ensure the accuracy of reported information. This is especially problematic given that Guidestar has also set up links to on-line giving programs. This allows contributors to look up information and then make pledges on-line very quickly. The obvious temptation for many charities will be to put their best foot forward and to engage in a kind of strategic “gaming” aimed at making themselves look as efficient as possible. With contributors’ dollars hanging in the balance, Guidestar may well end up fueling a race to the bottom as charities use creative accounting techniques to control their image. None of these technical problems is insurmountable with a few modest reforms, including separating more clearly the reporting and fund-raising functions of the service and developing a workable auditing system. To date, however, it remains unclear how

aggressively Guidestar will counter these pressures, while ensuring the broadest possible participation among nonprofits.

The problems associated with nonprofit accounting are significant enough to lead Herzlinger to argue that the only real solution to the accountability problem in the nonprofit sector may lie in the establishment of an SEC-type organization that could ensure openness and disclosure as way of regulating through information (Herzlinger 1996). The principal role of a “nonprofit SEC” would be to bring uniform accounting techniques to public charities, disseminate information on the financial condition of organizations, and create channels through which donors, volunteers, clients, and community members could access and use this information. Of course, this would be a far more complex proposition in the nonprofit sector, in which lines of ownership are overlapping and ill-defined, than in the business sector, in which one group of owners, namely shareholders, have clear interests in accurate information. For information to have a chance to work as regulation and for Herzlinger’s provocative idea of a “nonprofit SEC” to have an opportunity to succeed, a major transformation is needed not just in the kind of information that is made available, but in the outlook of the many stakeholders of nonprofit organizations, including donors, clients and the general public.

We believe that ambivalence about some of the recent developments bearing on nonprofit information may be wise. On the one hand, the creation of ever more information about the management and finances of nonprofit organizations only bodes well for increased transparency within the sector and for broader accountability. On the other hand, it may not be entirely problematic that decisions about contributions remain for the time being – as they have long appeared to be – largely driven by legitimacy and

positioning. After all, one of the best reasons to give is that a charity has communicated a clear and compelling mission with which donors can identify. Far from being an obstacle to be overcome at any cost, we think the findings reported here could be interpreted as pointing in the other direction. They remind us that contributors are still listening to fundraising pleas and that social cause, organizational mission, and personal commitment may all still matter in a sector not yet fully oriented toward efficiency.

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Table 1

Descriptive Statistics and Pooled Correlation Matrix for All Variables								
Variable	Mean	S.D.	1	2	3	4	5	6
1. Log of contributions	10.76	5.75						
2. Efficiency*	0.17	0.17	-0.04					
3. Log of program expenses*	16.20	2.81	0.17	-0.53				
4. Log of fundraising expenses*	5.37	6.37	0.55	-0.05	0.11			
5. Log of total revenue*	16.79	1.91	0.17	-0.14	0.77	0.11		
6. Log of gov't grants & contracts*	5.51	6.87	0.31	-0.04	0.22	0.35	0.24	---

* Lagged values of these variables were used in the regression analysis.

Table 2

Regression Models of the Log of Contributions						
Independent Variables	Industry Subsector					
	Arts	Education	Health	Human Service	Public Benefit	Other
Lagged Efficiency	0.937 (0.565)	0.745 (0.404)	0.567 (0.459)	0.863 (0.603)	-0.387 (0.956)	-0.615 (0.989)
Lagged log of program expenses	0.058 (0.061)	0.304*** (0.050)	0.046 (0.036)	0.049 (0.047)	0.085 (0.076)	0.071 (0.082)
Lagged Log of fundraising expenses	0.054** (0.021)	0.064*** (0.010)	0.108*** (0.013)	0.110*** (0.019)	0.109*** (0.028)	0.173*** (0.043)
Lagged log of total revenue	0.118 (0.101)	0.150* (0.070)	-0.016 (0.078)	0.497*** (0.094)	0.091 (0.118)	-0.108 (0.136)
Lagged Log of gov't grants & contracts	0.028 (0.015)	0.005 (0.009)	0.055*** (0.010)	0.044** (0.016)	0.014 (0.021)	0.042 (.038)
Constant	9.854 (1.618)	5.072 (1.090)	8.335 (1.184)	0.294 (1.311)	7.501 (2.147)	10.14 (2.305)
Observations	1130	6250	10380	3350	1600	880
Adjusted <i>R</i> -squared	0.44	0.36	0.13	0.15	0.16	0.16

Standard errors in parentheses.
* $p < .05$; ** $p < .01$; *** $p < .001$.

Notes

¹ Over the past decade a number of major financial scandals have rocked the nonprofit world, including the conviction and imprisonment of the president of the United Way of American for embezzlement, the jailing of the head of Foundation for New Era Philanthropy for perpetrating an enormous investment fraud that turned out to a massive ponzi scheme designed to separate donors and institutions from their money, and prosecution of leaders of the Espiscopa and Baptist churches for outright theft. If crimes were not enough, ethical lapses have also hurt the credibility o the sector and some its largest institutions. The ouster of the head of the National Association for the Advancement of Colored People over the improper transfer of funds to the president's former mistress and the forced resignation of the president of Adelphi University following revelations of high living made possible by an extraordinarily generous compensation package did nothing but further tarnish the image of the sector.

² The growth of a literature on nonprofit management has coincided with the establishment of new nonprofit degree programs within business and public policy schools.

³ Note, however, that total investment in fundraising and marketing may not be reflected in reported expenditures since volunteers may assume significant responsibilities in these areas.

⁴ Human service includes those organizations whose missions are related to crime, employment, food/nutrition, housing/shelter, public safety, recreation/sports, and youth development.

⁵ Public benefit includes those organizations whose missions are related to civil rights, community development, philanthropy, science, technology and research institutes.

⁶ Other includes all remaining major category groups under the NTEE system, such as those organizations whose missions are related to environment and animals,

international and foreign affairs, religious, mutual benefit and membership, and unknown or unclassified.

⁷ The presence of autocorrelation was ascertained using the Durbin-Watson statistic.

⁸ Three other variables had sporadic effect on contributions: program expenses in education, total revenue in human service, and government grants and contracts in health and human service.

⁹ Although the results of these regressions were not reported, they are available upon request from the authors.

¹⁰ In testing the possibility of an information lag affecting contributions, we found little evidence in the data to support the claim that information about the past efficiency of an organization (going back several years) had any impact upon its present contributions.