

## Chapter 1

# Tuning In to the World of Nonprofit Organizations

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### *In This Chapter*

- ▶ Defining the nonprofit sector
  - ▶ Getting started with a nonprofit
  - ▶ Encouraging volunteerism
  - ▶ Getting the resources your nonprofit needs
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**I**t's a typical day in your hometown. Your alarm wakes you from a restful sleep and you switch on your radio to hear the latest news from your local public radio station. You hear that a think tank's study reports that economic indicators are on the rise and a new treatment regimen for arthritis is being tested at a health clinic across town. Plato, your Golden Retriever/Labrador mix, adopted from the animal shelter when he was 5 months old, bounds onto your bed to let you know it's time for breakfast and a walk. Plato is followed by Cynthia, your 4-year-old daughter, who wants to go on a walk with you before she's dropped off at the preschool housed in the community center. You remember that you promised to bring canned goods to the food bank that's next door to Cynthia's school. You haven't even had your coffee yet, but already your morning is filled with news and services provided by nonprofit organizations.

You know that your public radio station is a nonprofit because you listen three or four times a year to its pledge drives, and you volunteer a few hours each month for the food bank, so clearly it's a nonprofit. But you may not know that the think tank is probably a nonprofit organization, just like the health clinic where the arthritis research is being tested and the animal shelter where you found Plato. It's likely that Cynthia's preschool and the community center where it rents its space are nonprofit organizations as well. Whether we realize it or not, all of us — rich or poor — benefit from the work of nonprofit organizations every day.

Sometimes nonprofit services are paid for mostly by tax-deductible donations and sometimes nonprofits charge a fee for what they do. Other nonprofits may enter into contracts with your city or county to provide services to

residents. Usually, nonprofit organizations get their income from a combination of all these revenue sources.

The nonprofit sector isn't a distinct place — it isn't some plaza or district that you come upon suddenly as you weave your way through your day. It's more like a thread of a common color that's laced throughout the economy and our lives. No matter where we live or what we do, it's not easy to get through the day without being affected by the work of a nonprofit organization. So, in this chapter, we help you understand exactly what a nonprofit organization is and how to start and manage one.

## *So What's a Nonprofit Organization?*

People hear the term *nonprofit organization* and picture Mother Hubbard's cupboard, as in awfully bare or zero bank balance. But in fact, some nonprofit organizations turn very tidy profits on their operations, and that's good, because cash flow keeps an enterprise humming, whether it's a for-profit business or not.

### *Comparing for-profits to nonprofits*



The main difference between a for-profit and a nonprofit enterprise is what happens to the profit. In a for-profit company like Exxon, Microsoft, Disney, or your favorite fast-food establishment, profits are distributed to the owners, including shareholders. But a nonprofit can't do that. Any profit remaining after the bills are paid has to be plowed back into the organization's service program or kept in reserve. Profit can't be distributed to individuals, such as the organization's board of directors.

What about shareholders — do nonprofits have any shareholders to pay off? Not in terms of a monetary payoff, like a stock dividend. But in a broad, service sense, nonprofits do have "shareholders." They're the people who benefit from the nonprofit's activities, like the people who tune in to public radio or enroll their children in a nonprofit preschool.

### *Introducing the one and only 501(c)(3)*

When we use the term *nonprofit organization* in this book, for the most part, we're talking about an organization that has been incorporated (or recognized in some way) under the laws of its state and that the Internal Revenue Service (IRS) has classified as a 501(c)(3) and determined to be a public charity. If the

term 501(c)(3) is new to you, add it to your vocabulary with pride. In no time, “five-oh-one-see-three” will roll off your tongue as if you’re a nonprofit expert.

Other kinds of nonprofit organizations *do* exist; they’re formed to benefit their members, to influence legislation, or to fulfill other purposes. They receive exemption from federal income taxes and sometimes relief from property taxes at the local level. (Chapter 2 discusses these organizations in greater detail.)

Nonprofit organizations classified as 501(c)(3) receive extra privileges under the law. They are, with minor exceptions, the only group of tax-exempt organizations that can receive contributions from individuals and organizations that are tax deductible for the donor.

The IRS tax code describes allowable purposes of 501(c)(3) nonprofit organizations as serving religious, educational, charitable, scientific, and literary purposes.



Check out CD0101 for a more detailed list of the activities that 501(c)(3) nonprofits take on.

## A sector by any other name

Not everyone thinks that *nonprofit sector* is the best term. That’s because of the array of organizations with different kinds of nonprofit status. Some of these organizations are formed to benefit their members — like fraternities and labor unions — and don’t share a broad public-serving intent. Another reason *nonprofit sector* may not be the best choice of terms is its negative connotation. After all, what’s worse than not making a profit? But, as we point out earlier, and we remind you again in later chapters, not making a profit isn’t the determining factor. Alternative terms that you may hear include the following:

✓ **Voluntary sector:** This term emphasizes the presence of volunteer board members and the significance of voluntary contributions and services to the work of 501(c)(3) organizations. In this definition, the organizations alone don’t represent the meaning of *nonprofit*; the definition includes the vast web of their supporters who participate as volunteers and donors.

✓ **Independent sector:** This term emphasizes the public-serving mission of these organizations and their volunteers and their independence from government. (Independent Sector is also the name of a nonprofit organization that sponsors research, publications, and public programs about the sector.)

✓ **Charitable sector:** This term emphasizes the donations these organizations receive from individuals and institutions.

✓ **Third sector:** This term emphasizes the organization’s important role alongside government and the for-profit business economy.

We use the term *nonprofit sector* throughout this book, but we want you to understand its limitations and be familiar with other commonly used terms.



Being a nonprofit organization doesn't mean that an entity is exempt from paying all taxes. Nonprofit organizations pay employment taxes just like for-profit businesses do. In some states, but not all, nonprofits are exempt from paying sales tax, so be sure that you're familiar with your local laws.

## ***Finding Your Mission and Entering the Nonprofit World***

People form nonprofit organizations in order to work toward changing conditions in the world, either for a specific group of people or society in general. The overall goal or purpose of a nonprofit is known as its *mission*. Taking the time needed to clearly outline a nonprofit's mission is time well spent because the mission guides the activities of the organization, helps the nonprofit's directors allocate resources wisely, and serves as a measure for evaluating the accomplishments of the group. We think developing a mission statement is so important that we devote an entire chapter (Chapter 3) to guiding you through this process.

Examining your personal mission before embarking on the path of launching a nonprofit is important. You're creating a legal entity that has responsibilities for reporting to both the state and federal governments. If the organization grows to the point where you must hire employees, you're responsible for paying regular salaries and providing adequate benefits. And although you can be compensated for your work as a nonprofit staff member, you can't develop equity in the organization or take away any profits at the end of the year. Chapter 2 has more information to help you make this important decision.

### ***Setting up a nonprofit***

Nearly all nonprofit organizations are established as corporations under the laws of a particular state. If you're located in Iowa and you plan to do most of your work in that state, you follow the laws in Iowa to set up the basic legal structure of a nonprofit corporation. Although you'll find some differences from state to state, in general, the process requires writing and submitting articles of incorporation to the state and developing *bylaws*, the rules under which the corporation will operate.

After your nonprofit is established under your state laws, the next step is applying for 501(c)(3) status from the IRS. This step entails completing and submitting IRS Form 1023. You need to specify in some detail the proposed activities of the new organization, and you're asked for projected revenue and expenses for the year in which you apply, and for start-up organizations, two years into the future. To be honest, you can't complete this form in one afternoon. It requires substantial time and thought to develop the necessary material. We discuss the incorporation and IRS application process in Chapter 4.

## *Making plans and being flexible*

After you start managing a nonprofit organization, you'll discover that planning is your best friend. Every task from budgeting to grant writing requires that you make plans for the future. And you need to do a substantial amount of planning before you're ready to send in your IRS application for tax exemption.

Don't be frightened by this recommendation to plan. The act of planning comes down fundamentally to thinking through what you're going to do as well as how and when you're going to do it. Your plan becomes the road map that guides you toward achieving your goals and your nonprofit mission. Planning is something that you should pay attention to every day.



You should always begin with a plan, but that doesn't mean that plans shouldn't be altered when the situation calls for it. Circumstances change; flexibility and adaptability are good traits to nurture if you're running a nonprofit organization. Chapters 7 and 10 cover planning and budgeting. Chapters 11 and 13 discuss planning for marketing and fundraising.

## **Bigger than a breadbox**

The nonprofit sector is larger than many people realize. Here are some figures from the National Center for Charitable Statistics, based on IRS data, regarding the number of 501(c)(3) public charities in 2008 in the United States:

- ✓ More than 950,000 organizations were registered as public charities with the IRS.
- ✓ Assets held by these groups totaled more than \$2.5 trillion.
- ✓ More than one-half of all the assets were owned by fewer than 2,200 charities.
- ✓ Nearly 80 percent of public charities had an annual gross revenue of less than \$100,000.

## Being Inspired and Inspiring Volunteers

The nonprofit sector is exciting. It encourages individuals with ideas about solving social problems or enhancing arts, culture, the environment, or education to act on those ideas. It creates a viable place within our society and economy for worthy activities that have little chance of commercial success. We think that it combines the best of the business world with the best of government, bringing together the creativity, zeal, and problem solving from the business side with the call to public service from the government side.

We also find volunteerism inspiring. Everyone has heard stories of tightly knit communities where neighbors gather to rebuild a barn. That spirit of pitching in to help is the best part of living in a community in which people share values and ideas.

Many people live in places that contain groups from a wide variety of backgrounds. The nonprofit sector provides an array of institutions in which all people can come together, with both those who resemble them and others who are unlike them, to work toward the common good. Volunteerism enables everyone to pitch in to rebuild “the barn” in a wide variety of contexts.

Applying the term *voluntary sector* to nonprofit organizations came about for a good reason. In the United States, according to the Bureau of Labor Statistics, 61.8 million people volunteered at least once between September 2007 and September 2008.

When you’re working in a nonprofit, you’ll likely be supervising volunteers — and they’ll likely supervise you. What we mean is that (with very few exceptions) nonprofit boards of directors serve as unpaid volunteers. And if you’re the executive director, your supervisors are the trustees or board members of the organization. At the same time, you likely depend on volunteers to carry out some or all the activities of the organization. You may even be a volunteer yourself.



The word “supervision” sounds harsh, and we don’t mean to suggest that nonprofits are or should be run with an iron hand. The board of directors does have ultimate responsibility, however, for the finances and actions of a nonprofit organization, and, therefore, people serving in that capacity have a real duty to make sure that the organization has sufficient resources to carry out its activities and that it’s doing what it’s supposed to be.

We prefer to think of nonprofits as being an organized group activity. You need to depend on others to reach goals, and they need to depend on you. We talk about boards of directors in Chapter 6 and working with volunteers

in Chapter 8. If your nonprofit employs paid staff or hopes to someday, Chapter 9 provides some guidance in hiring and managing employees.

## *Finding the Resources to Do Your Job*

One distinctive feature of the nonprofit sector is its dependency on contributions. We devote many pages of this book — most of Part III — to advice about getting contributions through fundraising.

Gifts from individuals of money, goods, services, and property make up the largest portion of that voluntary support. This portion also is the oldest of the voluntary tradition in the United States and goes back to colonial times. Since the late 19th century, private philanthropic foundations have emerged as another major source of support, and more recently — particularly after World War II — the federal government and corporations became important income sources. Many nonprofits also sell some kind of service, and a trend in the sector shows earned income becoming a larger portion of total revenues.

## *Seeing where the money comes from*

Among private, nongovernmental sources of support, gifts from living individuals — as opposed to bequests from people who have died — have always represented the largest portion of total giving, but philanthropic giving by foundations and corporations has been growing. Table 1-1 gives estimates of the sources of private contributions in 2008. The best fundraising approach for most organizations is to take a balanced approach that includes individual giving as well as grants and corporate contributions.

<b>Table 1-1 Sources of Private Contributions: 2008</b>		
<b><i>Source of Income</i></b>	<b><i>Amount of Total Giving in Billions</i></b>	<b><i>Percentage of Total Giving</i></b>
Individuals	\$229.28	74.5%
Foundations	\$41.21	13.4%
Bequests	\$22.66	7.4%
Corporations	\$14.50	4.7%
<b>Total</b>	<b>\$307.65</b>	<b>100%</b>

*Source: Giving USA Foundation — Giving USA 2009*

## *Fundraising for fun and profit*

Every nonprofit organization depends on generous donors for the cash it needs to pay its bills. Even if you have income from ticket sales, admission charges, or contracted services, you'll find that raising additional money is necessary to keep your organization alive and thriving.

You can see from Table 1-1 that individual giving is the largest single source of contributed income to nonprofit organizations. But you can't just sit waiting by the mailbox for the donations to begin arriving. Two basic rules of fundraising are that people need to be asked for donations and thanked after giving one. Chapter 14 focuses on raising money from individuals, Chapter 15 covers raising money with special events, and Chapter 18 discusses campaign fundraising, which is used when you need to raise extra money for your building or your endowment.

Grants from foundations and corporations make up a smaller percentage of giving to nonprofits, but their support can be invaluable for start-up project costs, equipment, technical support, and, sometimes, general operating costs. Keep in mind that the figures given in Table 1-1 don't apply equally to every nonprofit. Some organizations get most of their income from foundation grants; others get very little. Chapter 16 introduces you to resources to help you find potential grant sources. Chapter 17 takes you through the process of crafting a grant proposal.

Fundraising works better if people know you exist. That knowledge also helps get people to your theater or to sign up for your programs. Here's where marketing and public relations enter the picture. Chapter 11 helps you figure out what your media message should be and how to circulate it to the world.



Make no mistake about it, fundraising is hard work, but if you approach the task with a positive attitude and make your case well, you can find the resources you need.