

Chapter 1

Tuning In to the World of Nonprofit Organizations

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It'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 research institute's study reports that economic indicators are on the rise and that a health clinic across town is testing a new regimen for arthritis. Plato, your Golden Retriever/Labrador mix, adopted from the animal shelter when he was five 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 help you walk Plato before she's dropped off at her 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 research institute 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, poor, or somewhere in between — benefit from the work of nonprofit organizations every day.

Nonprofits receive revenue from a variety of sources in order to provide services. Because most nonprofits serve a defined need in the community, tax-deductible donations are an important revenue source. 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 with a 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 Mobil Corporation, Microsoft, the Walt Disney Company, or your favorite fast-food chain, 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 programs, spent to strengthen the nonprofit's infrastructure, 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. These people are often called stakeholders because they are committed to the success of the nonprofit.

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 types of nonprofit status. Some of these organizations are formed to benefit their members — such as 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 provides research, advocacy, and public programs for and about the nonprofit sector.)
- ✓ **Charitable sector:** This term emphasizes the charitable donations these organizations receive from individuals and institutions.
- ✓ **Third sector:** This term emphasizes the sector'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.

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 that are tax deductible for their donors.

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



Check out File0101 for a more detailed list of the activities that 501(c)(3) nonprofits take on. Pop in the CD or click the link in the table of contents to view this file.



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 and property 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 some condition in the world, either for a specific group of people or for 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 decide how to 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.

It's also important to examine your personal mission before embarking on the path of launching a nonprofit. 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 requires 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 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 and should be reviewed by an accountant and legal representative before filing. 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 fundamentally comes down 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 11 cover planning and budgeting. Chapters 12 and 13 discuss planning for marketing and fundraising. Chapter 8 addresses how to evaluate your work and know if your plans are achieving the results that you want to see.

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, and the Independent Sector, regarding 501(c)(3) public charities in the United States:

- ✓ More than 979,000 organizations were registered as public charities with the IRS in 2010.
- ✓ Assets held by these groups in 2010 totaled more than \$2.7 trillion.
- ✓ The number of public charities increased by 47 percent between 2000 and 2010.
- ✓ Approximately 75 percent of public charities in 2010 had annual gross receipts 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 social-service programs, 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 serve as 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 doing.

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 9. If your nonprofit employs paid staff or hopes to someday, Chapter 10 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, time, and property make up the largest portion of that voluntary support. This portion is also the oldest of the voluntary traditions 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 have become important income sources. Earned income through fees for service, ticket sales, and tuition charges also can be an important revenue source for many nonprofits.

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 2011. The best fundraising strategy for most organizations is to take a balanced approach that includes individual giving as well as grants and corporate contributions.

Table 1-1 Sources of Private Contributions: 2011

<i>Source of Income</i>	<i>Amount of Total Giving in Billions</i>	<i>Percentage of Total Giving</i>
Individuals	\$217.79	73%
Foundations	\$41.67	14%
Bequests	\$24.41	8%
Corporations	\$14.55	5%
Total	\$298.42	100%

Source: Giving USA: The Annual Report on Philanthropy for the Year 2011 (2012). Chicago: Giving USA Foundation.

Fundraising for fun and profit

Nearly every nonprofit organization depends on generous donors for the cash it needs to pay its bills and provide its services. 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 12 helps you figure out what your 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.