CHAPTER ONE

INTRODUCTION TO THE NONPROFIT SECTOR

Objectives

By the end of this chapter you should be able to:

1. Describe the differences across the public, private, and nonprofit sectors
2. Understand different perspectives on the scope of the nonprofit sector
3. Describe a variety of ways of categorizing nonprofit organizations in the United States
4. Locate information on the size and performance of different categories of nonprofit or cause
5. Describe the key sources of nonprofit income

Introduction

In this initial chapter we begin our exploration of fundraising by studying the sector that is typically the focus of our activity, reviewing definitions of the nonprofit sector, distinguishing it from the public and private sectors, and examining its primary sources of income. We conclude by exploring how such knowledge of the sector can assist a fundraiser in developing his or her practice.

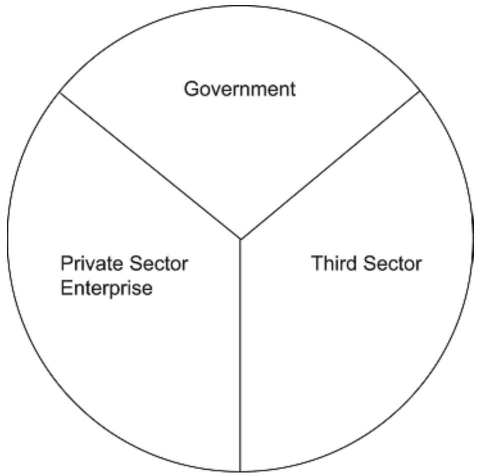
A "Third" Sector

Over the years many authors have developed widely differing terminology for what is ostensibly the same cohort of organizations. Labels such as the *third sector*, *independent sector*, *not-for-profit sector*, *nonprofit sector*, *charitable sector*, and *voluntary sector* are used with varying frequency in different countries. Unfortunately they are all too often used interchangeably and with different emphasis of meaning, making it impossible to be sure with any degree of certainty that any two writers are addressing the same facet of society. Salamon and Anheier (1997, p. 3) argue that this complexity develops because of the great range of organizations that are included under these umbrella headings, "ranging from tiny soup kitchens to symphony orchestras, from garden clubs to environmental groups."

Our first task in this text must therefore be to begin to navigate a way through this complexity. The logical starting place is the term *third sector,* which is now in common usage and reflects the distinctive role the sector has in society. The notion of a third sector is illustrated in Figure 1.1. The third sector is distinguished by being somehow different from either government or the private sector. All three sectors are important facets of human society, and all three have a role to play in the satisfaction of human need.

The private sector or "market" caters to the majority of human need, certainly in the developed world, matching the supply of producers with consumer demand for goods and services. This market ensures that people can obtain much of what they want and need from others at a reasonable price—or at least those with money are facilitated in doing so! Economists argue that the market works because suppliers are prevented from charging excessive prices by the

FIGURE 1.1 THE ROLE OF NONPROFITS IN SOCIETY



knowledge that others will enter the market to cater for the need if their prices are too high. Similarly, the market ensures that a multitude of different needs are met by ensuring that a reasonable profit will be available to suppliers in each case. There is no philanthropy at work here. The market works purely on the notion of self-interest. As Adam Smith (1776, p. 119) noted:

> It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their own advantages.

There are instances, however, when this market mechanism fails and when governments may be compelled to intervene to ensure that certain minimum standards of consumption are met for all individuals in a given society. During and immediately after the Second World War, many governments had to introduce food rationing to ensure that those on low incomes were not priced out of the market and starved as a consequence. Equally, in the United States the Medicaid program ensures that the poorest members of American society have access to health care that they couldn't otherwise afford. The term *public sector* is typically used to refer collectively to those institutions or mechanisms a society considers necessary for the basic well-being of its members. Adam Smith (1776, p. 122) defined the public sector as

> those public institutions and those public works, which though they may be in the highest degree advantageous to a great society, are, however, of such a nature that the profit could never repay the expense to any individual, or small number of individuals; and which it, therefore, cannot be expected that any individual, or small number of individuals, should erect or maintain.

Such institutions are both founded and funded by the State, both with its own interests in mind (to prevent civil unrest and to facilitate reelection) and those of its citizens. The funds to provide these institutions and works are derived from taxation (either local or national), and the funding each will receive is a function of what politicians deem appropriate rather than the level of use per se.

In the public sector, the State takes legal responsibility for institutions and the work they undertake. Indeed, as Chapman and Cowdell (1998, p. 2) note:

> It is one of the characteristics of public sector organizations that they are bounded by and operate within extensive legislation which creates an often creaking bureaucracy, much of which is concerned with the "proper" use of public monies.

This notion of "proper" use warrants elaboration. In a democracy, what may be deemed proper use will be subject to change. As various parties stand for election, they map out in their programs the role that government should play in all aspects of social life, but in particular in balancing the needs of society for the provision of public services against the burden of the additional taxes that would be needed to pay for them. Although it would be ideal for government to meet every basic human need, it is probably unrealistic to expect that wage earners in a given society would be willing to fund such comprehensive social provision through taxation, and in practice a balance is therefore created with only the most widespread, popular, and/or fundamental needs being met in this way. Other facets of need are simply neglected.

It is within this neglected space, where neither government nor private sector enterprise is willing to engage, that the so-called third sector has a critical role to play. The third sector is distinctive because it comprises individuals or groups of individuals coming together to take "voluntary" action. In other words, the sector comprises people electing to help other people to resolve issues or concerns.

> The essence of voluntary action is that it is not directed or controlled by the State and that in the main it is financed by private, in contradistinction to public, funds. It embodies the sense of responsibility of private persons towards the welfare of their fellows; it is the meeting by private enterprise of a public need. (Nathan, 1952, p. 12)

It is the notion that the sector is not controlled by the State or by business that leads to the description of the sector in the United States as the "independent sector." Although organizations in this sector may indeed be free of direct control, the difficulty with this terminology is that in financial terms they can often be far from independent, drawing financial support from a plethora of government departments and/or private businesses. This has been a particular issue in the past 30 years as government has sought to withdraw progressively from many facets of social life, leaving the third sector to shoulder the burden (albeit with support from often-large government grants). In the United States the sector is of particular significance; Tempel and Mortimer (2001, p. vii) note:

> Philanthropy and the nonprofit sector occupy a position in the American institutional landscape unlike that in any other developed country. Undertaking functions typically assigned to government in other countries and also accorded unparalleled tax advantages for so doing, these American institutions are thought to be central to furthering democracy and the search for social justice.

The fact that the sector occupies this third space means that the activities it undertakes can be unique. Third-sector or "nonprofit" organizations often deal with local issues, politically unpopular issues, or with facets of life that attract little interest from politicians, all too often because few votes hang on the issue. Nevertheless, it can be critical for a society to address these issues, and the need is nonetheless pressing simply because the state or private sector enterprise fails to take an interest.

Nonprofit organizations meet these collective demands by acquiring financial resources from the governmental sector, the business sector, and philanthropy from individuals, corporations, and foundations. Government support comes in the form of contracts, grants, tax benefits, and other public policies that favor the nonprofit sector (Sargeant, Shang, & Shabbir, 2009). Corporate support comes in the forms of giving and gifts from corporate foundations. Individual philanthropy takes the forms of individual giving, bequest giving, and giving by individual trusts, endowments, and foundations.

A nonprofit organization may be constituted as either a trust or a nonprofit corporation under US federal law. In the case of the latter, for-profit corporations exist to earn and distribute after-tax business earnings to shareholders, and the nonprofit corporation exists solely to provide programs and services that are of benefit to the public. Often these programs and services are not otherwise provided by local, state, or federal entities. The term *nonprofit* is slightly misleading in that these organizations can and do earn a profit (or more accurately, an operating surplus). The key difference in the case of a nonprofit is that such earnings must be retained by the organization to invest in the future provision of programs and services. The monies are not dispersed to shareholders.

In this text, although we recognize that a plethora of other terms might be applied, we will employ the term *nonprofit* throughout. Readers should be aware that it has been rightly critiqued for its unfortunate predilection to define the sector by what it is not rather than by what it is (Young, 1983), but it remains the term in most common usage in the United States, and for that reason we employ it here.

A Tax-Based Definition

The United States defines nonprofit organizations in tax law laid down by the Internal Revenue Service (IRS). The tax code lists some

30 different types of entity that can benefit from exemption from corporate income tax. These include social clubs, cemetery companies, fraternal benefit societies, religious and charitable organizations. A full list is provided in Table 1.1. Additional tax benefits are offered to some organizations that permit their donors to claim a tax deduction in return for their support. The majority of those that are able to receive such tax deductible contributions fall into one specific category of the code: Section 501(c)(3). To qualify for this additional benefit organizations must fulfill three requirements:

1. They must operate to fulfill one of the following broad purposes:
   Educational
   Religious
   Charitable
   Scientific
   Literary
   Testing for public safety
   Fostering certain national and international amateur sports competitions
   Prevention of cruelty to children and animals
2. No substantial part of the organization's activity should be focused on attempts to influence government, either directly or indirectly through participation in political campaigns. A maximum of 20 percent of their annual expenditure can be applied to mission-related lobbying activity, and they are barred from preparing or distributing campaign literature on behalf of political parties or electioneering for particular candidates. Other categories of nonprofit, such as 501(c)4 organizations, can engage in lobbying for social change, but deductions to these organizations are not tax deductible.
3. These nonprofits must also demonstrate procedures to prohibit assets or income from being distributed to workers, managers, or the equivalent, except as fair compensation for service rendered. Organizations cannot be used for the personal benefit of founders, board members, staff, or associates.

(Text continues on page 11.)

TABLE 1.1 TYPES OF TAX-EXEMPT ORGANIZATIONS AND NUMBER, EXPENSES, AND ASSETS BY TYPE

Section of 1986 IRC	Description of Organization	Entities Registered with the IRS, 2012	Entities Reporting to the IRS, 2010	Expenses of Reporting Entities, 2010 ($ millions)	Assets of Reporting Entities, 2010 ($ millions)
501(c)(1)	Corporations organized under acts of Congress	237	8	11	237
501(c)(2)	Title-holding corporations for exempt organizations	4,581	3,001	1,197	12,487
501(c)(3)	Religious, charitable, and similar organizations	1,057,486	467,776	1,515,587	3,335,334
	501(c)(3) Public charities	*958,740*	*366,086*	*1,454,753*	*2,708,905*
	501(c)(3) Private foundations	*98,746*	*101,690*	*60,834*	*626,429*
501(c)(4)	Civic leagues and social welfare organizations	86,916	30,255	83,932	89,438
501(c)(5)	Labor, agriculture, and horticulture organizations	46,812	22,327	22,355	33,577
501(c)(6)	Business leagues, chambers of commerce, real estate boards, and trade boards	63,988	36,442	39,031	65,582
501(c)(7)	Social and recreational clubs	47,210	19,835	12,587	25,625
501(c)(8)	Fraternal beneficiary societies and associations	50,711	9,994	17,175	114,594
501(c)(9)	Voluntary employee beneficiary associations	7,163	6,686	161,158	201,254
501(c)(10)	Domestic fraternal societies and associations	15,527	2,356	403	2,771

Section of 1986 IRC	Description of Organization	Entities Registered with the IRS, 2012	Entities Reporting to the IRS, 2010	Expenses of Reporting Entities, 2010 ($ millions)	Assets of Reporting Entities, 2010 ($ millions)
501(c)(11)	Teachers' retirement fund associations	7	7	35	300
501(c)(12)	Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, etc.	5,202	3,901	53,701	124,843
501(c)(13)	Cemetery companies	8,173	2,635	905	9,819
501(c)(14)	State-chartered credit unions and mutual reserve funds	2,472	2,861	22,949	435,246
501(c)(15)	Mutual insurance companies or associations	822	306	70	349
501(c)(16)	Cooperative organizations to finance crop operations	13	9	15	406
501(c)(17)	Supplemental employment benefit trusts	130	101	394	232
501(c)(18)	Employee-funded pension trusts created before June 25, 1959	2	1	163	1,153
501(c)(19)	War veterans organizations	32,286	8,449	1,351	3,077
501(c)(20)	Legal service organizations	5	4	1	1
501(c)(21)	Black lung benefits trusts	28	0	0	0
501(c)(22)	Withdrawal liability payment funds	0	0	0	0

(Continued)

TABLE 1.1 CONTINUED

Section of 1986 IRC	Description of Organization	Entities Registered with the IRS, 2012	Entities Reporting to the IRS, 2010	Expenses of Reporting Entities, 2010 ($ millions)	Assets of Reporting Entities, 2010 ($ millions)
501(c)(23)	Veterans organizations created before 1880	3	3	308	3,333
501(c)(24)	Trusts described in section 4049 of the Employment Retirement Security Act of 1974	1	0	0	0
501(c)(25)	Title-holding corporations or trusts with multiple parents	825	688	1,045	22,327
501(c)(26)	State-sponsored organizations providing health coverage for high-risk individuals	11	10	391	170
501(c)(27)	State-sponsored workers" compensation reinsurance organizations	9	3	1,187	6,644
501(c)(40) formerly 501(d)	Religious and apostolic organizations	218	0	0	0
501(c)(50) formerly 501(e)	Cooperative hospital service organizations	10	9	505	516
501(c)(60) formerly 501(f)	Cooperative service organizations or operating educational organizations	1	0	0	0
Other	Organizations not classified above, including charitable risk pools	126,461	395	1,225	345
	Total	**1,557,310**	**618,062**	**1,937,681**	**4,489,660**

To complicate matters further, the IRS divides 501(c)(3) organizations into one of two categories. Fundraisers should be aware of the distinction between public charities and private foundations:

> Generally, organizations that are classified as public charities are those that (i) are churches, hospitals, qualified medical research organizations affiliated with hospitals, schools, colleges and universities, (ii) have an active program of fundraising and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations or other public charities, (iii) receive income from the conduct of activities in furtherance of the organization's exempt purposes, or (iv) actively function in a supporting relationship to one or more existing public charities. Private foundations, in contrast, typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs. (IRS, 2008)

An alternative perspective on defining the sector would be to categorize nonprofits by the nature of the activities they undertake. The IRS has done exactly this by developing the National Taxonomy of Exempt Entities (NTEE). A list of the NTEE major categories is provided in Table 1.2, together with the number of entities registered with the IRS in each case. Putting aside grant-making foundations (which typically fund work in other categories), it is interesting to note the dominance of education, arts, community improvement, and recreation/sports.

Notes: Not all Internal Revenue Code (IRC) Section 501(c)(3) organizations are included because certain organizations, such as churches (and their integrated auxiliaries or subordinate units) and conventions or associations of churches, need not apply for recognition of tax exemption unless they specifically request a ruling. Organizations that had their tax-exempt status revoked for failing to file a financial return for three consecutive years are excluded. Registered organizations have applied for and received their tax-exempt status from the Internal Revenue Service (IRS). Reporting organizations had more than $50,000 in gross receipts in 2010 and were therefore required to file a financial return (either the Form 990 or the Form 990-EZ) with the IRS. Because of lags in filing and processing Forms 990, financial information on nonprofit organizations is two years behind registration information.

Source: Roeger, K. L., Blackwood, A. S., and Pettijohn, S. L. (2012). *The Nonprofit Almanac* (pp. 4–5). Washington, DC: The Urban Institute Press.

TABLE 1.2 ORGANIZATIONS, EXPENSES, AND ASSETS IN THE NONPROFIT SECTOR BY TYPE, 2010

Nonprofit Category	Organizations Reporting to the IRS	% of Organizations Reporting to the IRS	Reported Expenses ($ millions)	% of Total Expenses	Reported Assets ($ millions)	% of Total Assets
Arts, culture, and humanities	46,538	7.5	38,620	2.0	122,079	2.7
Education	86,188	13.9	250,875	12.9	857,864	19.1
Environmental quality, protection, and beautification	11,085	1.8	9,993	0.5	27,424	0.6
Animal-related	9,975	1.6	6,239	0.3	15,565	0.3
Health	27,425	4.4	888,487	45.9	1,172,128	26.1
Mental health and crisis intervention	10,161	1.6	28,804	1.5	23,718	0.5
Diseases, disorders, and medical disciplines	12,792	2.1	16,241	0.8	23,910	0.5
Medical research	2,728	0.4	9,786	0.5	35,622	0.8
Crime and legal-related	10,058	1.6	8,847	0.5	9,221	0.2
Employment and job-related	18,470	3.0	34,549	1.8	41,398	0.9
Food, agriculture, and nutrition	8,095	1.3	11,033	0.6	10,241	0.2
Housing and shelter	22,485	3.6	23,062	1.2	83,315	1.9
Public safety, disaster preparedness, and relief	12,262	2.0	3,298	0.2	9,554	0.2
Recreation, sports, leisure, and athletics	52,577	8.5	29,863	1.5	52,333	1.2
Youth development	9,638	1.6	6,886	0.4	14,215	0.3

Nonprofit Category	Organizations Reporting to the IRS	% of Organizations Reporting to the IRS	Reported Expenses ($ millions)	% of Total Expenses	Reported Assets ($ millions)	% of Total Assets
Human services-multipurpose and other	47,894	7.7	122,325	6.3	171,246	3.8
International, foreign affairs, and national security	8,658	1.4	30,262	1.6	34,154	0.8
Civil rights, social action, and advocacy	3,232	0.5	4,123	0.2	5,198	0.1
Community improvement and capacity building	55,625	9.0	38,752	2.0	124,833	2.8
Philanthropy, voluntarism, and grant-making foundations	90,206	14.6	75,734	3.9	664,827	14.8
Science and technology research institutes and services	3,619	0.6	14,902	0.8	20,603	0.5
Social science research institutes and services	1,096	0.2	2,402	0.1	4,425	0.1
Other public and societal benefit	22,525	3.6	92,116	4.8	630,711	14.0
Religion-related	26,145	4.2	12,947	0.7	33,978	0.8
Mutual/ membership benefit organizations	17,885	2.9	177,227	9.1	300,638	6.7
Unknown	700	0.1	308	0.0	460	0.0
Total	**618,062**	**100**	**1,937,681**	**100**	**4,489,660**	**100**

Notes: (i) Only organizations required to file annually with the IRS (all private foundations, public charities, and 501 (c) other organizations that receive at least $50,000 in gross receipts annually) are included in these figures. Expenses include both operating expenses and grants or transfer payments made to individuals and other organizations.

Source: Roeger, K. L., Blackwood, A. S., and Pettijohn, S. L. (2012). *The Nonprofit Almanac* (pp. 4-5). Washington, DC: The Urban Institute Press.

The NTEE is of interest for fundraisers because it categorizes the nonprofit sector into 26 major categories. Each of these broad categories is further divided to provide a greater degree of specificity. As an example, Arts Cultural and Humanities is the A category in NTEE code. Within this category, Media and Communications are A30. The A30 category includes four industries: File & Video (A31), Television (A32), Printing & Publishing (A33) and Radio (A34). Each of the other 25 categories is further subdivided, making it possible to access statistics on particular parts of the sector. Fundraisers can use these categorical codes to search for information on any category of organizations (http://nccs.urban.org/classification/NTEE.cfm). This can be particularly helpful when researching trends or looking to identify organizations for a competitor analysis.

A Structural-Operational Definition

The tax-based definition we discuss previously is specific to the United States, derived as it is from the tax code in this country. As a consequence, it suffers from several disadvantages, notably that because tax laws vary it cannot serve as the basis for international comparison, something that may be relevant for fundraisers looking for international funding opportunities (James, 1987). Salomon et al. (2004) have developed a structural-operational definition of the nonprofit sector to facilitate such international comparison. Their approach is illustrated in Table 1.3 (Salamon et al., pp. 9–10). Their classification defines the nonprofit sector as a collection of entities that satisfy five requirements. They need to be organized, private, self-governing, not profit-distributing, and voluntary.

TABLE 1.3 THE STRUCTURAL-OPERATIONAL DEFINITION

Organized, that is, they have some structure and regularity to their operations, whether or not they are formally constituted or legally registered. This means that our definition embraces informal, that is, nonregistered groups as well as formally registered ones. What is important is not whether the group is legally or formally recognized but that it has some organizational permanence and regularity as reflected in regular meetings, a membership, and some structure of procedures for making decisions that participants recognize as legitimate.

Private, that is, they are not part of the apparatus of the state, even though they may receive support from governmental sources. This feature differentiates our approach from the economic definitions noted previously that exclude organizations from the civil society sector if they receive significant public sector support.

Not profit-distributing, that is, they are not primarily commercial in purpose and do not distribute profits to a set of directors, stockholders, or managers. Civil society surpluses must be reinvested in the objectives of the organization. This criterion serves as a proxy for the "public purpose" criterion used in some definitions of civil society, but it does so without having to specify in advance and for all countries what valid public purposes are. Rather, it leaves these decisions to the people involved on the theory that if there are people in a country who voluntarily support an organization without hope of receiving a share of any profit the organization generates, this is strong evidence that they must see some public purpose to the organization. This criterion also usefully differentiates civil society organizations from for-profit businesses.

Self-governing, that is, they have their own mechanisms for internal governance, are able to cease operations on their own authority, and are fundamentally in control of their own affairs.

Voluntary, that is, membership or participation in them is not legally required or otherwise compulsory. As noted earlier, this criterion also helped relate our definition to the concept of public purpose, but in a way that allows each country's citizens to define for themselves what they consider to be a valid public purpose by virtue of their decisions to take part on their own initiative in the organizations affected.

Source: Global Civil Society, Volume Two: Dimensions of the Nonprofit Sector, edited by Lester M. Salamon and S. Wojciech Sokolowski. Copyright © 2004 by Lynne Rienner Publishers, Inc. Used with permission of the publisher.

The United Nations and the Center for Civil Society Studies at the Johns Hopkins Institute for Policy Studies are currently collaborating to improve basic statistics on the scope, structure, financing, and activities of the nonprofit sector in different countries. Their project categorizes the nonprofit sector into twelve groups (as shown in Table 1.4) and about 30 subgroups. These categories resemble but are not exactly the same as the NTEE categorizations. If looking for funding overseas, it will be necessary to be sensitive to these variations.

TABLE 1.4 INTERNATIONAL CLASSIFICATION OF NONPROFIT ORGANIZATIONS

Group 1: Culture and Recreation
1 100 Culture and arts
1 200 Sports
1 300 Other recreation and social clubs
Group 2: Education and Research
2 100 Primary and secondary education
2 200 Higher education
2 300 Other education
2 400 Research
Group 3: Health
3 100 Hospitals and rehabilitation
3 200 Nursing homes
3 300 Mental health and crisis intervention
3 400 Other health services
Group 4: Social Services
4 100 Social services
4 200 Emergency and relief
4 300 Income support and maintenance
Group 5: Environment
5 100 Environment
5 200 Animal protection
Group 6: Development and Housing
6 100 Economic, social and community development
6 200 Housing
6 300 Employment and training
Group 7: Law, Advocacy, and Politics
7 100 Civic and advocacy organizations
7 200 Law and legal services
7 300 Political organizations
Group 8: Philanthropic Intermediaries and Voluntarism Promotion
8 100 Grant-making foundations
8 200 Other philanthropic intermediaries and voluntarism promotion

Group 9: International

9 100 International activities

Group 10: Religion

10 100 Religious congregations and associations

Group 11: Business and Professional Associations, Unions

11 100 Business associations

11 200 Professional associations

11 300 Labour unions

Group 12: (Not Elsewhere Classified)

Source: International Classification of Nonprofit Organizations (ICNA) in Lester M. Salamon and Helmut K. Anheier's, *Defining the Nonprofit Sector*. (Manchester, UK: Manchester University Press, 1997), pp. 70–74

Size and Economic Significance of the Nonprofit Sector

The nonprofit sector contributed $905.9 billion to the gross domestic product (GDP) of the United States in 2015, which represented 5.4 percent of the total. Business accounts for 77.3 percent of GDP and government for 11.4 percent (McKeever, 2015). The size of the nonprofit sector doubles every decade or so, making it by far the fastest-growing sector in terms of its proportional rate of growth. In 1929, for example it contributed only $1.5 billion and 1.4 percent of the total (Wing et al., 2008).

Approximately 1.41 million 501(c)(3) organizations were registered with the IRS in 2015 (McKeever, 2015). This estimate includes private foundations as well as public charities that have more than $5,000 in annual gross receipts. Organizations with more than $50,000 in gross receipts must complete an annual report using the IRS Tax Return Form 990 or a Form 990-EZ (for use by organizations with gross receipts of less than $100,000 and total assets of less than $250,000). Organizations with less than $50,000 in gross receipts are required to file an information return known as the Form 990-N (e-postcard). Another variant, Form 990-PF, is available for private foundation organizations. The form requires the organization to provide (among other things) a summary of the organization's finances. This includes their revenue, assets, income, and expenses for the relevant tax year. The growth trends explained following are based on this self-reported information.

Filing requirements by year are available at "Which Forms Do Exempt Organizations File?" (IRS, 2015).

Public charities are the largest category of the more than 30 types of tax- exempt nonprofits. In 2015, more than 950,000 organizations were classified as public charities. Between 2003 and 2013, the number of public charities grew 19.5 percent, faster than the growth of all registered nonprofits (8.6 percent). The category grew faster than other subgroups such as private foundations (which declined by 8.3 percent) and 501(c)(4) organizations (which declined by 0.32 percent). As a consequence public charities made up a larger share of the nonprofit sector in 2013 (67.5 percent) than in 2003 (58.1 percent) (McKeever, 2015). They reported $1.73 trillion in revenues and $1.62 trillion in expenses. Assets held by public charities accounted for more than three-fifths of the sector's total ($3.22 trillion).

Churches and religious organizations are not required to register or to report to the IRS. This includes integrated auxiliaries, subordinate units, and conventions or associations of churches. They are generally exempt from income tax and receive other favorable treatment under the tax law. Although registration is not required, about half of all churches and religious organizations voluntarily choose to do so (Weitzman, Jalandaloni, Lampkin, & Pollak, 2002). In all the figures quoted earlier, churches and religious organizations that do choose to register (and report) are included in the estimate.

Impressive though these aggregate figures for the sector are, they dramatically underestimate the real size of the nonprofit sector in the United States. Sociologist David Horton Smith (2000) argues that a tax-based description of the sector cannot do justice to the majority of grassroots nonprofit organizations. Reliance on tax data focuses attention on the larger, wealthier, older, more visible nonprofits in which most of the work is done by paid staff rather than by volunteers (Hodgkinson & Weitzman, 1992; Hodgkinson, Weitzman, Toppe, & Noga, 1992). Data from grassroots organizations is excluded. He defines these as:

> locally based, significantly autonomous, volunteer-run, formal nonprofit (i.e., voluntary) groups that manifest substantial voluntary altruism as groups and use the associational form of organization, and thus have official memberships of volunteers who perform most, and often all, of the work/activity done in and by these nonprofits. (p. 7)

To help distinguish grassroots organizations from any other forms of associations, Smith provides a helpful summary of their characteristics. (See Table 1.5.)

His research shows that IRS data include data from only half of the existing nonprofits who have assets of $5,000 or more and 10 percent of all nonprofits in 1990. He estimates that there are more than 18 million nonprofit organizations in the United States. From a fundraising perspective, this distinction matters because Smith's data suggest an altogether more cluttered market for funding than IRS data might suggest. It also matters because fundraising in traditional and larger nonprofit organizations may be different from fundraising in grassroots organizations. We argue that most of the fundraising techniques included in this book are applicable to all organizations whether large or small. However, we recognize that many fundraisers in grassroots organizations are volunteers, possibly performing multiple roles for their organization, working with very limited resources.

TABLE 1.5 ELEMENTS OF THE DEFINITION OF GRASSROOTS ASSOCIATIONS

Characteristics of Grassroots Associations	Omitted From Grassroots Associations Category
1. Group form	Individual, unorganized, amorphous behavior
2. Voluntary altruism based	Business, government, or household/family goals
3. Significantly autonomous of other groups (even if formally affiliated)	Completely controlled subunit of another group/organization
4. Association form (common interest, members elect officers, members pay dues, etc.)	Non-membership-dominated groups
5. Local (small in territorial base or scope)	Supra-local territorial base or scope (from several counties up to international scope)
6. Volunteer staffed (majority of work done by volunteers)	Paid staff workers–based (majority of work done by paid staff)

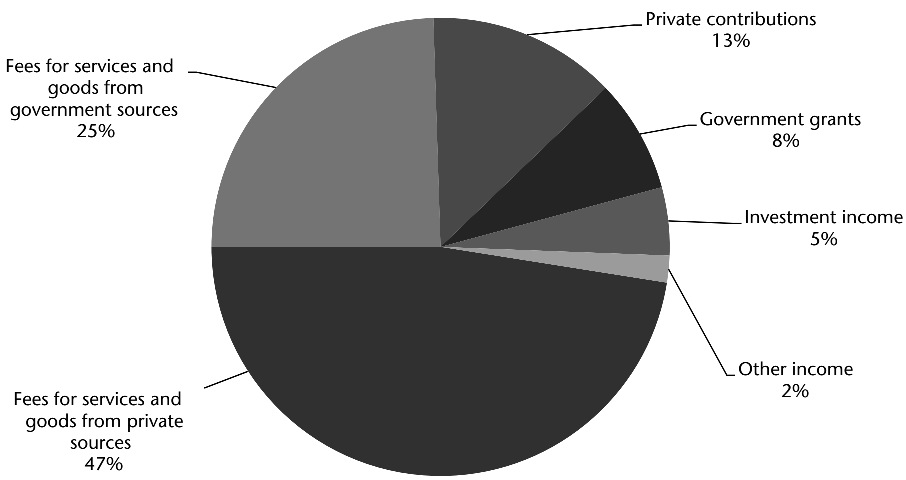
Source: Smith, D. H. (2000). *Grassroots associations* (p. 9). Thousand Oaks, CA: Sage Publications, Inc. Reprinted with permission.

Sources of Income

In 2013, 47.5 percent of the total revenue for public charities came from fees for services and goods from private sources percentage of total revenue. This includes income streams such as tuition payments, hospital patient revenues (excluding Medicare and Medicaid), and ticket sales. Fees from government sources, such as government contracts and Medicare and Medicaid payments, accounted for 24.5 percent of total revenue in 2013 (McKeever, 2015).

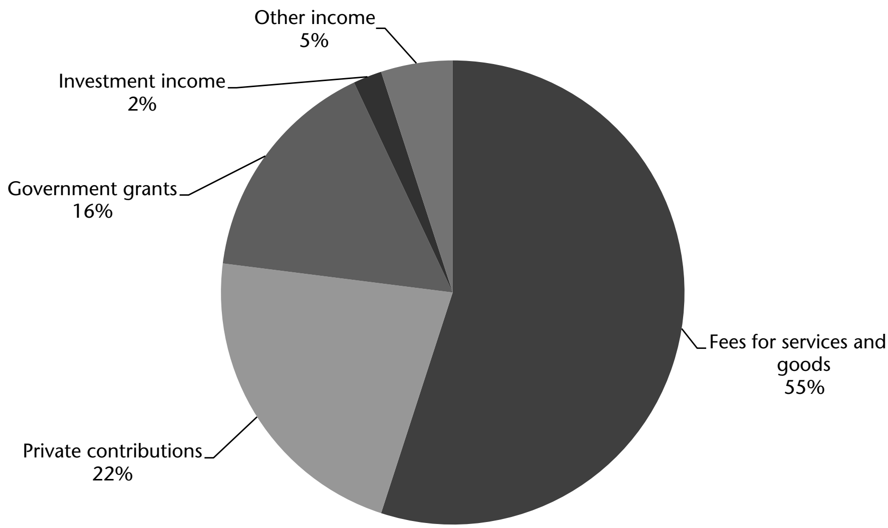
Private contributions accounted for 13.3 percent of total revenue. This in turn comprises individual donations and grants from foundations and corporations. Eight percent of total revenue came from government grants. Investment income and so-called "other" income (which includes rental income and income from special events) accounted for 4.8 percent and 1.9 percent of revenue, respectively. The data are summarized in Figure 1.2. It should be noted that excluding hospitals and higher education institutions from this analysis changes the distribution of sources of revenue substantially, as shown

FIGURE 1.2 REVENUE SOURCES FOR REPORTING PUBLIC CHARITIES, 2013 (PERCENTAGE)



Source: National Centre for Charitable Statistics, Calculations of IRS Statistics of Income Division Exempt Organizations Sample (2009, 2011); Urban Institute, National Centre for Charitable Statistics, Core Files (Public Charities, 2013); American Hospital Association 2012 survey; and National Health Accounts (Centre for Medicare and Medicaid Services).

FIGURE 1.3 SOURCES OF REVENUE FOR REPORTING PUBLIC CHARITIES, EXCLUDING HOSPITALS AND HIGHER EDUCATION, 2013 (PERCENTAGE)



Source: Based on Data Supplied by the Urban Institute.

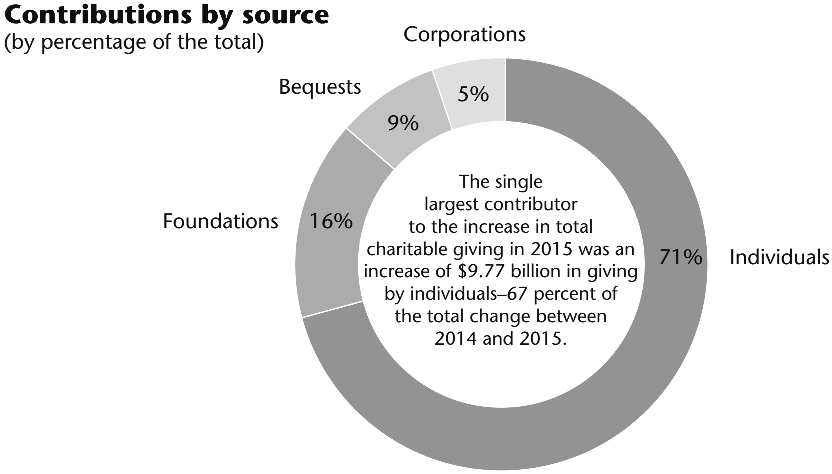
in Figure 1.3. These two categories of organization rely heavily on fee income and thus less on donations. For other categories of nonprofit almost one-quarter of their income is derived from philanthropy.

When viewed in aggregate the growth of income to the sector has been impressive. Total revenue increased by 40.6 percent in the ten years prior to 2013 despite the impact of the recession in the later years of this period. Some sectors have, of course, fared better than others. Growth in total revenue ranged from 52.3 percent for religion-related groups, for example, to only 19 percent for arts, culture, and humanities organizations.

Philanthropic Income

Data from the Giving USA Foundation (2016) allow us to take a closer look at the philanthropic income attracting to the sector. It also provides a more recent snapshot of performance. Philanthropic income to the nonprofit sector stood at $373.25 billion in 2015. A breakdown of the sources of that income is provided in Figure 1.4.

FIGURE 1.4 CONTRIBUTIONS BY SOURCE (BY PERCENTAGE OF THE TOTAL)



Source: Giving USA Foundation (2016)

Perhaps the most striking feature of this graph is the generosity of individuals. Together they provide three-quarters of the philanthropic income accruing to the sector. Factor in gifts from deceased individuals through bequests and the percentage climbs to 80 percent. Many readers new to the sector may be surprised by this and equally surprised by the low percentage provided by corporates. Businesses have historically only ever provided around 5 percent of the total of charitable giving, despite the hype that often surrounds gifts of this nature. We could be forgiven for assuming from the media coverage that this support generates a figure that would be much higher. It is important that fundraisers are aware of this, particularly those approaching the role for the first time. Many may be tempted to spread their resources across both corporate and individual giving, although these figures suggest that in many cases they would be wiser to focus on the latter.

The Giving USA study has been conducted for more than 50 years, and as a consequence it allows us to track giving over an extended period of time and through many global recessions. The data indicate that despite periods of recession or economic uncertainty philanthropy in the United States and giving to most subsectors (or causes) has grown steadily over the past 50 years. Although in years of recession giving can fall (in real terms) the longer-term trend is remarkably robust. Perhaps disappointingly, though, total giving hasn't risen as a percentage of gross domestic product. It still remains at a stubborn 2 percent.

We know that individuals typically donate about 2 percent of their disposable income (i.e., the amount of income left to an individual after taxes have been paid, available for spending and saving) to nonprofits. This figure too has remained very static over time. A further way of looking at the amount spent by individuals on charity is to express it as a percentage of household expenditure. In this case it is helpful to draw a distinction between essential household expenditure and luxury household expenditure. In respect of the former, if we consider giving as essential spending, it will be included with purchases such as clothing, energy, and food and would equate to around 6 percent of this category. If it were regarded as a component of luxury private consumption, and thus considered in the same category as purchases such as alcohol, international travel, recreation, restaurants, or tobacco, it would equate with around 1.6 percent of expenditure in this area. Giving to nonprofits is thus a small percentage of household expenditure regardless of the category one might assign it to.

In interpreting these latter figures it would be easy to draw the conclusion that people care less about their giving than they care about their own luxury. As we shall see in Chapter 5, this would be a mistake. Although the amount given annually may be only a small percentage of household expenditure, it is often highly significant to the individual. Giving is closely linked to people's core sense of who they are and the values they live by. Fundraisers should thus distinguish between the dollar level of donations and their psychological importance to donors.

Table 1.6 indicates how the funds are applied. Religion is the largest recipient of giving. It receives roughly one-third of overall contributions at about $114.90 billion. However, as a category it is continuing a 30-year downward trend as a percentage of total giving. In 1987 its share of the total was 53 percent. In 2014 it was 32 percent. It seems likely that this category of giving may be falling because fewer Americans now identify with a religion and church attendance is correspondingly down.

TABLE 1.6 CONTRIBUTIONS BY RECIPIENT TYPE IN 2015 (BY PERCENTAGE OF THE TOTAL)

Sector	Percent
Religion	32.0
Education	15.0
Human services	12.0
Gifts to foundations	11.0
Health	8.0
Public-society benefit	7.0
Arts, culture, and humanities	5.0
International affairs	4.0
Environment/animals	3.0
Gifts to individuals	2.0

Notes: All figures are rounded

Source: Giving USA Foundation/Giving USA (2015). Reprinted with permission.

International giving was the only category to decline in 2014, and although that might be attributed to the lack of a significant major disaster in the year, it is interesting to note that international giving has experienced a decline since 2010. There may therefore be some evidence that American giving is switching in emphasis, although it is too early yet to determine whether this will prove to be a longer-term trend.

Summary

In this chapter, we explored various definitions of the nonprofit sector, outlined the size and the scope of it, and compared its characteristics and economic significance with those of the business and the governmental sectors. We also summarized the sources of income available to nonprofits and identified key historic trends in this data.

The diversity of the nonprofit sector makes it difficult for practitioners and academics to reach a consensus on what constitutes the full scope of the sector. It is therefore necessary to pay careful attention to the terminology when researching sector trends. Each term carries a unique meaning, and each way of capturing the size and the scope of the nonprofits presents only one perspective on the sector.

Among all the sources of income, individual philanthropy is obviously the most important source for fundraisers to monitor. Individual giving (including that offered in the form of bequests) has historically risen steadily in terms of its inflation-adjusted dollar values. By contrast, giving expressed as a proportion of individual disposable income has remained static for over 50 years. A significant challenge for fundraisers in the future will be to both increase the dollar value of giving and also to increase its overall share of household expenditure.

Discussion Questions

1. What is the third sector and how does it differ from the private and the government or public sectors?
2. What other terms are used to describe the third sector? How do they differ in scope?
3. Distinguish between the tax-based and structural-operational definitions of the sector. When should you choose to use one definition over the other?
4. Explain the limitations of calculating the size of the nonprofit sector using IRS data and how fundraisers can obtain a more accurate estimate.
5. Describe the major sources of income for the nonprofit sector.
6. Describe the major sources of philanthropic income for the nonprofit sector. Visit the Lilly Family School of Philanthropy website at https://philanthropy.iupui.edu/. Follow the links to the latest Giving USA study. What trends can you identify in giving to your own category of nonprofit?

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