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## Chapter **1**

# Journeying into the World of Nonprofit Organizations

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 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 help you walk Plato before she's dropped off at her pre-school 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 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 hear its pledge drives three or four times a year 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. Cynthia's preschool and the community center where the preschool rents its space are likely nonprofit organizations. Whether you realize it or not, all of us — rich, poor, or somewhere in between — benefit from the work of nonprofit organizations every day.

Nonprofits find revenue from a variety of sources in order to provide services. Because most nonprofits serve a need in the community, tax-deductible donations are an important revenue source. Sometimes nonprofits charge a fee for the service they provide or the work they do. Other nonprofits may sign contracts with your city or county to provide services to residents. Usually, nonprofit organizations scrounge up 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 the day. It's more like a thread of a common color that's laced throughout the economy and people's lives. No matter where people live or what they do, it's not easy to reach the end of a day without being affected by the work of a nonprofit organization.

Perhaps your lifelong goal is to find a way to help others in your community, your state, your country, or the world. (If this statement is true of you, thank you, kind citizen.) You think about your options every day, but you haven't the foggiest notion about the next steps to take to help you reach this admirable goal. You have so many topics to research and tasks to determine how to complete — and so much necessary funding to nail down to help you get started. Think of this chapter as the beginning of the journey. Here we help you understand exactly what a nonprofit organization is and how to start and manage one.



TIP

Check out File 1-1 at [www.wiley.com/go/nonprofitkitfd6e](http://www.wiley.com/go/nonprofitkitfd6e) for a list of web resources related to the topics we cover in this chapter.

## What Is a Nonprofit Organization?

People hear the term *nonprofit* and picture a different type of business where the owner isn't allowed, by tax law, to make a profit or draw a paycheck. But, in fact, some nonprofit organizations end their fiscal year with a profit, and that's good because surplus cash (also referred to as *reserves*) keeps a nonprofit operating in the black versus the red.

# Comparing for-profits to nonprofits



REMEMBER

The main difference between a for-profit corporation and a nonprofit corporation is what happens to the profit. In a for-profit company like Amazon, Google, United Parcel Service, or your favorite fast-food chain, profits are distributed to the owners (or 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 stored in reserve for a rainy day. 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. Rather than shareholders, nonprofit organizations have *stakeholders* — they're the people who benefit from the nonprofit's mission and services to their target population (those in need, from animals to humans). These people are often called *stakeholders* because they're committed to the success of the nonprofit, such as board members, volunteers, community partners, and the people whom the nonprofit serves directly and indirectly.

## Introducing the coveted 501(c)(3) status for nonprofits

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 organized formally) 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.



TECHNICAL STUFF

Private foundations also have the 501(c)(3) classification, but they aren't *public charities*. They operate under different regulations, and we don't cover them in this book.

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 Internal Revenue Code describes the allowable purposes of 501(c)(3) nonprofit organizations, which include serving religious, educational, charitable, scientific, and literary ends.



TIP

Check out File 1-2 at [www.wiley.com/go/nonprofitkitfd6e](http://www.wiley.com/go/nonprofitkitfd6e) for a more-detailed list of the activities that 501(c)(3) nonprofits take on.



REMEMBER

Being a nonprofit organization doesn't mean that an entity is exempt from paying all taxes. Nonprofit organizations pay employment taxes, employee salaries, and wages 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 jurisdiction's laws and nonprofit reporting requirements. Also, check with the appropriate office in your state to see whether you're required to apply for a state tax exemption or a license to solicit funds.

## A SECTOR BY ANY OTHER NAME

Not everyone thinks that *nonprofit sector* is the best name. 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. Here are some alternative terms you may hear:

- **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 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.

# Knowing Your Mission Before 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 (see Chapter 4) to guiding you through this process.

You must also examine your personal mission before 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 or Form 1023-EZ. If you submit Form 1023, you will 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 5.

## 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. This continuous planning process for nonprofit leaders (founders and board members) is called *strategic planning*. And you need to do a substantial amount of strategic planning before you're ready to send in your IRS application for tax exemption.

Don't be frightened by this recommendation to plan strategically early on in the nonprofit formation process. The act of strategic 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 and writing it down. Your strategic plan becomes the map that guides you toward achieving your nonprofit's mission, vision, and goals. Strategic planning is something you should pay attention to every day.



You should always begin with a strategic plan, but that doesn't mean that the original 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 8 and 12 cover strategic planning and budgeting. Chapter 9 addresses how to evaluate your work and know whether your plans are achieving the results you want to see. Chapters 13 and 14 discuss planning for marketing and fundraising.

### BIGGER THAN A BREAD BOX

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:

- Nearly 1.6 million organizations were registered as public charities with the IRS in 2020.
- Assets held by these groups in 2020 totaled more than \$3.79 trillion.
- Nearly 30 percent of public charities that reported to the IRS in 2019 had annual expenses of less than \$100,000.

# Embracing and Sharing Your Inspiration

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. Nonprofit organizations combine 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.

Speaking from experience, volunteerism is inspiring. Everyone has heard stories of tightly knit communities where neighbors gather to rebuild a home that was lost to a fire or a hurricane. That spirit of pitching in to help is the best part of living in a community in which people share values and ideas.

Communities have become more diverse and are populated with neighbors who come from a wide variety of places and cultures. The nonprofit sector provides institutions and opportunities where everyone can come together to work toward the common good. Volunteerism gives everyone the chance to pitch in to rebuild “the house and make it a home again.”

Applying the term *voluntary sector* to nonprofit organizations came about for a good reason. The US Census Bureau reported that 77.3 million people volunteered at least once in 2020.

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 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 of 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 organized group activities. You need to depend on others to reach your goals, and they need to depend on you. We talk about boards of directors in Chapter 7 and working with volunteers in Chapter 10. If your nonprofit employs paid staff or hopes to someday, Chapter 11 provides some guidance in hiring and managing employees.

## CURIOSITY REWARDED THIS CAT

Here's a story about a nonprofit dreamer, perhaps much like yourself, who (spoiler alert!) started her own nonprofit and made it sustainable with hard work, self-investment, and resourcefulness.

I (Bev) had worked in the corporate sector of small- to midsize businesses for decades. My supervisors and their demeanor set the tone for each workday. There were good days and not-so-good days in my multiple workplaces. One day, I was approached by a nonprofit executive director who invited me to attend a board meeting. Somewhat perplexed at the invitation to attend a meeting for an organization that I was unfamiliar with seemed an overstretch given my business employment experiences. Yet, out of a wee bit of curiosity, I decided to attend.

I was greeted by the board of directors and the executive director (the source of my invitation to attend the meeting). Everyone seemed genuinely interested in getting to know me. I was asked if I had ever done any volunteer work or served on a board. I shared my longtime volunteer experiences with other agencies and my time as a foster parent. There were lots of smiles around the boardroom table. A board member asked me if I would stay for the entire meeting and listen to their updates on policies, programs, and processes for the Voluntary Action Center of Genesee and Shiawassee counties. At the end of the board meeting, I was invited to join the board of this well-established nonprofit organization. Guess what? I did! Thus began my learning process about nonprofit organizations, how they operate, their mission and vision statements, and clarification on ownership. It was that first experience, which lasted for two years, that made me start to dream about starting my own nonprofit organization. Yes, you read this right! I went on to form two successful nonprofit organizations.

## Finding the Resources to Do the Job

One distinctive feature of the nonprofit sector is its dependency on contributions. We devote many pages of this book — most of Part 3 — to advice about getting contributions from fundraising.

Gifts from individuals of money, goods, services, time, and property make up the largest portion of that voluntary support. This portion, which is also the oldest of the voluntary traditions in the United States, dates back to colonial times. Since the late 19th century, private philanthropic foundations have emerged as another source of support, and more recently — particularly after World War II — the federal government and corporations have become important income sources. Earned income from fees for service, ticket sales, and tuition charges also is an important revenue source for many nonprofits; in fact, in 2013 nearly three-quarters of the revenues for public charities was earned.

## Who is giving to nonprofit organizations?

Among private, nongovernmental sources of support, gifts from living individuals — as opposed to bequests from people who have died — have always represented a large portion of total giving, but philanthropic giving by foundations and corporations has been growing. According to the Giving USA Foundation, in 2019 corporations represented the largest portion of total giving and the COVID-19 pandemic is furthering this trend. This resulted in corporations giving the largest share of nonprofit sponsorships and grants. For new nonprofit organizations, the best fundraising strategy is to take a balanced approach that includes multiple forms of contributions.

## Supporting your mission with fundraising

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.

Corporate contributions are the largest source of contributed income to nonprofit organizations. But you can't just sit and wait by the mailbox for the donations to begin arriving. How will contributors even know that your new nonprofit is up and running, providing services? Two basic rules of fundraising are that potential funders need to be asked for donations and thanked after giving one. Chapter 15 focuses on raising money from individuals, Chapter 16 covers raising money with special events, and Chapter 19 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. Some organizations get most of their income from foundation grants; others get very little. Chapter 17 introduces you to resources to help you find potential grant sources. Chapter 18 walks you through the process of crafting a grant proposal.

Fundraising works better if people know you exist. That knowledge also helps draw people to your theater or to sign up for your programs. Here's where marketing and public relations enter the picture. Chapter 13 helps you figure out what your message should be and how to circulate it to the world.



REMEMBER

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.

