

Nonprofit Organizations (Definition and Examples)

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Definition

Nonprofit organizations are organized for a public or mutual benefit other than generating profit for owners or investors (Salamon 1999). They can take a variety of forms from informal neighborhood associations, soup kitchens, local churches or traditional charities serving the poor to labor unions, self-help groups or museums, hospitals and large universities. Though they may be different in size and form, nonprofit organizations share five common characteristics: 1. they are organized, 2. private (separate from the government) 3. self-governing, 4. non-profit-distributing and 5. voluntary. The non-profit distributing characteristic means that – contrary to the common belief – nonprofits can generate profit but they cannot distribute it to owners or directors. The profit must all be used to support the operation of the organization (Anheier 2014).

The legal form of nonprofits can vary too, however, the Internal Revenue Code differentiates two major types: the 501 (c) (3) and the 501 (c) (4) organizations. Although both types are exempt from taxation, only the 501 (c) (3)s or the so-called public benefit organizations are eligible for tax-deductible donations from individuals or corporations. 501 (c) (4)s are called social welfare organizations, many civic leagues and advocacy organizations which represent social and political causes belong to this group (Anheier 2014). Some nonprofits - like Planned Parenthood – have both types of 501 (c) organizations incorporated.

Nonprofits can be grouped based on their field of interest as well. The National Taxonomy of Exempt Entities Core Codes classifies 10 groups: 1. arts, culture and humanities 2. education 3. environment and animals 4. health 5. human services 6. international, foreign affairs 7. public, societal benefit 8. religion related 8. mutual/membership benefit 10. unknown, unclassified (Ott and Dicke 2016).

Historical Roots

Volunteers have formed groups to help people in need or to promote cultural, social or educational causes since the early history of the United States. In colonial times, Americans already liked to think of themselves as a “self-governing nation” who did not trust governmental involvement and preferred to address social problems locally (Ott and Dicke 2016, 59). Charity was seen as a religious duty and people in need could rely on their neighbors or the community to help them. Churches collected money for the needy while the wealthy founded schools such as Harvard and Yale Colleges.

To solve the problem of poverty and strengthen civic virtues in citizens, Benjamin Franklin advocated for mutual aid and educational groups. His ideas proved to be popular and by the time the famous Frenchman, Alexis de Tocqueville traveled the US in the early 19th century, he could observe an immense number of associations

(Ott and Dicke 2016). One of the most important movements of the century was the abolition movement which was also fueled by churches and nonprofit organizations fighting for the end of slavery. After the Civil War, newly freed slaves received help from the Freedman's Bureau established by the federal government and from the numerous self-help groups former slaves themselves formed. In the next decades, people in northern states started to establish national associations to address a wide-range of social issues. These organizations had paid staff and critics considered them as bureaucracies who substitute "traditional links of personal charity" to impersonal services (Ott and Dicke 2016, 62).

Until the 1930s, wealthy individuals and foundations provided most of the revenue for nonprofit organizations. After the Great Depression, the vast number of impoverished citizens made the federal government provide a wider range of social services such as public programs for the unemployed or benefits for the elderly and dependent children (Ott and Dicke 2016). The roles of the public, nonprofit and the for-profit sector were also clarified. By the mid-twentieth century the growing endowments of private foundations – which are founded by individuals or corporations and not by the government – created a public need for greater regulation of foundations. The Tax Reform Act in 1969 created two new regulations:

1. foundations had to distribute at least 5 percent of their assets yearly (called payout)
2. and they had to report their income and expenses on the 990 tax form.

The twentieth century saw two more shifts regarding the role of federal government in providing social services. During Lyndon Johnson's presidency in the 1960s, the "Great Society" legislation created a wide range of support for community projects helping people in need (Ott and Dicke 2016). The Reagan administration in the 1980's greatly cut federal support for such services and moved the responsibility to provide funding to these programs to state and local governments. Therefore nonprofit organizations had to compete for a reduced pool of resources. This led to increased fundraising efforts and a growing public demand for accountability regarding nonprofit's finances and operations.

Importance

The size of the sector in the United States is much larger than many would imagine. According to the National Center for Charitable Statistics, in 2016, more than 1.5 million organizations were registered with the IRS. It is estimated that many more small formal and informal associations exist that do not register because religious organizations and organizations with revenues of less than \$5,000 per year are not required to do so (Payton and Moody, 2008). The nonprofit sector is a significant economic force, in 2013, it contributed to 5.4% of the country's GDP and it accounted for 9.2% of all salaries and wages.

The population of the US has a generous attitude toward the sector: in 2013, more than a quarter of the adult population volunteered an estimated total of 8.1 billion hours (Giving USA 2016). Total charitable giving in 2015 reached \$373.25 billion, making it America's most generous year – although giving is steady as a percentage of GDP, at around 2%. Most of the giving came from individuals, who account for 71% of all donations. Giving by foundations followed by 16%, bequests contributed 9% and corporations by 5%. The most popular recipients are religious organizations, they received 32% of all charitable giving. Educational organizations are second by 15% while human service organizations were donated 12%.

Ties to the philanthropic sector

Nonprofit organizations make up the nonprofit sector which is also often referred to as the philanthropic sector, the third sector, the independent or the voluntary sector. The sector fulfills crucial functions for modern societies. According to Payton and Moody (2008), the philanthropic sector's five roles are:

1. Service role: "providing services (especially when the other sectors fail to provide them) and meeting needs" (Payton and Moody 2008, 34).
2. Advocacy role: representing and advocating for the interests of particular populations, for differing views of the public good and for reform.
3. Cultural role: expressing and preserving values, traditions and other aspects of culture.
4. Civic role: building community, fostering civic engagement.
5. Vanguard role: providing opportunities for innovation, experimentation.

To learn more about the nonprofit sector, read the related briefing paper on Philanthropy.

Key related concepts

There are several theories that explain why nonprofits exist. Some of them – such as the market failure, the contract failure and the government failure theory – are based on economic arguments, while others focus on ideas related to politics and communities.

Market failure theory: according to the market failure theory, the market system is good at supplying private goods, which are things that we consume individually such as cars or food. However, markets have a problem providing public or collective goods which are goods that "can only be consumed collectively, such as clean air, national defense or safe neighborhoods" (Ott and Dicke 2016, 229). The difficulty with public goods is that incur the "free-rider" problem which means that people who do not pay for these goods cannot be excluded from its benefits. Therefore, no one has the incentive to pay the costs of these services. The government can solve this problem by taxation, making everyone pay for national defense for example by their taxes. However, government has its own limitations as well therefore nonprofits often complement the public sector in providing public goods.

Contract failure: this theory (Ott and Dicke 2016) relates to the business sector as well. Contract failure occurs when there is an „information asymmetry" which means that consumers are unable to judge the real costs or the quality of the service. This can happen for different reasons. The service might be too complex to judge such as medical operations or the customer may not be competent in evaluating the service such as a child in a kindergarten. At times, the service is not consumed by the person who pays for it therefore the customer does not have the necessary information to evaluate its quality. In these cases, customers tend to trust nonprofits more because their primary aim is to serve the public and they cannot seek profit for personal gains.

Government failure: government can overcome the "freerider" problem, however it has its own limitations (Ott and Dicke 2016) Citizens seldom have a complete agreement on what public goods should be provided. Some people – for example citizens who belong to certain religious, ethnic or other minority groups - have needs that most other voters do not. Government usually responds to the "average" voter, to the needs of the majority. Therefore minority needs are often satisfied by nonprofit organizations. This theory predicts that one can find the most active nonprofit sector in areas where the population is most diverse since many different needs have to be

met in such places.

Voluntary failure: this expression refers to “situations in which nonprofits cannot adequately provide a service or address a social problem at a scale necessary for its alleviation” (Anheier 2014). Donations and other type of nonprofit revenue sources are often not enough to provide the service to everyone who needs it.

Political theories of nonprofit organizations: nonprofits are not only service providers but they also create opportunities for collective action, „for the mobilization of the disadvantaged” or for „the expression of diversity” (Ott and Dicke 2016, 147) Therefore, as the pluralist theory (Leroux and Fenney 2015) suggests they are crucial in maintaining a healthy democracy and in representing the interests of different interest groups. Many also argue that nonprofit organizations help maintaining democracy by building citizenship and community leadership skills, by preparing potential political leaders and by providing educational and networking opportunities for those who have been excluded from such circles (Ott and Dicke 2016). Many argue that volunteering encourages „good citizenship” by: 1. building trust, 2. helping people better understand the social and political system, 3. breeding more participation in local issues 4. teaching civic skills and increasing self-efficacy and 5. by making people more aware of social problems (Ott and Dicke 2016).

Community theories of nonprofit organizations: see under the briefing paper on community.

NGO (nongovernmental organization): it is a relatively new term which is used most often in international relations and developing countries. It most often means “more professionalized organizations promoting economic and social development, as differentiated from more grassroots, community-based associations” (Anheier 2014, 61). The expression is mostly used outside of the US and it differentiates philanthropy from the state. In the US, the term “nonprofit” is more common and it distinguishes philanthropy from the business sector.

Important people related to the topic:

Andrew Carnegie: see the briefing paper on Philanthropy

Benjamin Franklin: was a diplomat, scientist, writer and inventor, “the first citizen of the 18th century” who is probably most famous for his role in drafting the Declaration of Independence and the US Constitution ([Bio](#)). He played an important role in the historical development of the nonprofit sector. He was “an early advocate of mutual aid groups” and he believed that the problem of poverty should be solved by educational groups that teach people the skills they need to become self-supporting (Ott and Dicke 2016, 61). He was involved with many social issues, advocated for the abolition of slavery, helped create the “first subscription library in the Colonies” and he started the “first volunteer firefighter company in Philadelphia” ([The Franklin Institute](#)).

John D. Rockefeller: see the briefing paper on Philanthropy

Alexis de Tocqueville: see the briefing paper on Philanthropy

Related Nonprofit Organizations:

Charity Navigator: see the briefing paper on the organization

Foundation Center: a leading source of information on philanthropy, fundraising and grant programs. It maintains the most comprehensive database of grantmakers and grants in the US (<http://foundationcenter.org/>).

Guidestar: see the briefing paper on the organization

Independent Sector: a leadership network of nonprofits, foundations and corporations advancing the common good. A premier meeting ground for the leaders of the philanthropic sector in the US. Provides ground-breaking research on the sector (<https://independentsector.org/>).

National Center for Charitable Statistics: The national clearinghouse of data on the nonprofit sector in the US (<http://nccs.urban.org/>).

Reflection Question:

What nonprofit organizations do you benefit from?

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