Nonprofit Studies Program

Working Paper 08-04
April 2008

Testing a Benefits Theory of Nonprofit Finance

Dennis R. Young
Amanda Wilsker

Georgia State University
Andrew Young School of Policy Studies

Testing a Benefits Theory of Nonprofit Finance

Working Paper 08-04

Dennis R. Young
Amanda Wilsker

April 2008

Nonprofit Studies Program
Andrew Young School of Policy Studies
Georgia State University
Internet: aysps.gsu.edu/nonprofit

Testing a Benefits Theory of Nonprofit Finance

Dennis R. Young, Professor, Andrew Young School of Policy Studies, Georgia State University
Amanda Wilsker, PhD Candidate, Andrew Young School of Policy Studies, Georgia State University

Abstract

Nonprofit organizations finance themselves in highly diverse ways. Recent research (Young, 2006) hypothesizes that nonprofit income composition is related to the kinds of service benefits an organization provides. Testing this idea has been difficult (Fischer, Wilsker, and Young, 2008) because existing data sources (990 tax forms) tend to conflate government-generated and private fee income, and existing classifications of nonprofits (NTEE codes) are too coarse to reflect service benefits and beneficiaries. The present paper attempts to overcome these limitations by testing a hypothesis derived from the benefits theory. In particular, the theory suggests that the mix of financing sources becomes more homogeneous as one examines more narrow categories of nonprofit organizations. This hypothesis is investigated by examining the 990 data of a random sample of nonprofit organizations in several NTEE fields and subfields. The results appear to offer strong support for the notion of a benefits-based theory of nonprofit income portfolios.

Introduction

Nonprofit organizations support themselves from many different sources of income, including earned income, government grants and contracts, private and institutional gifts and grants, investment income, volunteer resources and gifts-in-kind, and they combine these sources in many different ways. Even gross aggregations of nonprofit organizations reveal substantial variation in charitable, government and fee-based support by major nonprofit subfields (Boris and Steuerle, 2006). Some recent research explores the determinants of a nonprofit organization's income portfolio – both its particular composition and its degree of diversification among different income sources. However, this research has been hampered by two factors – the lack of a theoretical framework and limitations of the principal data source on nonprofit finance – government data deriving from the 990 tax forms. This paper addresses these limitations by building on a recently framed "benefits theory" of nonprofit finance (Young, 2006) and testing a hypothesis derived from that theory. In particular, if nonprofit income portfolios reflect the benefits of a nonprofit's services, then the more narrowly we can define fields of nonprofit activity, the less variation of income portfolios we should find within those fields. This hypothesis suggests an easy test of the theory using 990 data and NTEE classification categories. In particular, more narrowly defined NTEE subfields should exhibit smaller variations in income portfolios, as defined both by measures of revenue concentration and by percentage reliance on any particular source of income.

After reviewing the literature on nonprofit financing and summarizing the benefits theory of nonprofit finance, we present the results of the forgoing empirical investigation. We conclude with some commentary on the implications of benefit based financing theory for understanding and improving nonprofit financial performance, and offer suggestions for continued research on this subject.

Literature Review

Early studies of the determinants of nonprofit income mostly addressed the concentration of nonprofit revenues rather than its particular composition. For example, Chang and Tuckman (1994) found that revenue diversification was positively related to

the size of a nonprofit organization, as measured by its asset base, to indicators of financial health, such as operating surpluses, and to a relative reliance on donations compared to earned income. A number of other researchers have also confirmed that revenue diversification is negatively related to the level of fiscal stress experienced by a nonprofit organization, suggesting risk reduction behavior (Tuckman and Chang, 1991; Gronbjerg, 1993; Greenlee and Trussel 2000, 2002; Frumkin and Keating, 2002). An alternative explanation of revenue diversification was offered by Galaskiewicz and Bielefeld (1998) who argued that spreading of income sources increases community buy-in and organizational legitimacy (also, see Bielefeld, 1992 and Galaskiewicz, 1990).

Frumkin and Keating (2002) also explored the trade-offs that nonprofits make in diversifying their revenue base. Reflecting the tenets of portfolio theory, as studied in the nonprofit funding context by Kingma (1993), Frumkin and Keating hypothesized that revenue diversification (to achieve lower risk) would be associated with lower organizational growth. And because diversified portfolios are more costly to administer, they hypothesized that revenue diversification would be associated with decreased efficiency – an argument paralleling that of Gronbjerg (1992) who observed that focus on a few sources of income could achieve greater funding continuity and reliability. Frumkin and Keating found strong empirical evidence for the organizational growth effect, but not the efficiency effect. More recently, Foster and Fine (2007) have argued that nonprofit growth is often best achieved by concentrating funding on a particular source of income rather than by pursuing a strategy of diversification.

Fischer, Wilsker and Young (2008) explain both income diversification and the reliance of nonprofits on particular sources of income by testing a benefits theory of nonprofit finance, advanced in Young (2006). According to this theory, nonprofits produce four different kinds of benefits, each best suited to financing by different sources of income. Thus, "private" benefits can be financed by some form of fees, "group benefits" can be supported with gifts and grants by interested constituencies, "public benefits" that affect large segments of society can be supported through government finance, and "trade benefits" allow nonprofits to derive income through transactions with various institutional partners or groups. Thus, a nonprofit's particular mix of income

should be related to its mission and core competencies, since various kinds of benefits, targeted to different groups of beneficiaries, are likely to be financed in different ways.

While the benefits theory is conceptually straightforward, it is difficult to test empirically because existing sources of data such as 990 tax forms tend to conflate various sources of income, e.g. they may fail to separate private and government reimbursed fee income, and because there is no ready source of consistent and comparable data on nonprofits' missions, benefits and beneficiaries. The closest thing to the latter is the NTEE classification of nonprofits, which even at its most disaggregated levels, tends to mix nonprofits into groups that are not homogeneous. Fischer, Wilsker and Young (2008) used 990 data in an attempt to discern whether nonprofit income portfolios were determined by NTEE subcategories that reflected different combinations of private, group and societal benefits, but with limited success because of the forgoing difficulties.

Benefits Theory of Nonprofit Finance

It is clear that nonprofits provide a wide spectrum of goods and services ranging in character from pure public goods to pure private goods. Public goods, defined by economists as "non-rival" and "non-excludable" (e.g., public green space) are a classic manifestation of private "market failure". Profit-maximizing firms fail to provide these goods (or to produce them in socially optimal quantities) because it is very difficult to charge individuals for consuming them. Non-excludability results in free-riding and a failure of consumers to reveal their preferences, resulting in under-provision (Samuelson 1954). Thus the existence of public goods may justify government intervention in the marketplace. However, public goods may also be addressed through nonprofit provision (Weisbrod, 1977) and various possible strategies for support on a voluntary basis despite the free-rider problem (Olson, 1965).

For the same reason that for-profit firms are not able to charge users for public goods, nonprofits also have difficulty requiring users to pay amounts commensurate with the benefits gained from consuming the good. Goods that are not excludable by their very nature require a source of support other than fees; nonprofits providing these services must therefore rely on gifts and grants or other income such as that generated from investments or commercial ventures.

In contrast, some nonprofits provide essentially private goods that are rival and excludable in nature, their services offering few benefits beyond the specific clientele served by the organization. These services presumably could be provided by the private market as well, helping to explain so-called "mixed industries" (Ben-Ner 2002). Nonprofits providing these private goods, therefore, are more likely to earn revenues through fees, although they may structure or supplement these fees to accommodate particular (e.g., low income) target groups or externalities associated with their provision.

Most nonprofit services fall between the extremes of pure public and pure private. They operate, for example, where there is market failure deriving from asymmetric information (Hansmann, 1987) or in areas featuring substantial externalities. Asymmetric information may lead consumers to prefer nonprofits as a trustworthy alternative to for-profit providers. Externalities occur when the private market fails to internalize all the possible costs and benefits associated with a particular service, resulting in an insufficient level of service provision. In these (mixed) cases, nonprofits can be expected to offer services supported by fees supplemented by other sources of income such as contributions or government support.

We may also expect the degree of publicness of a nonprofit's services to influence its degree of revenue diversification. In particular, nonprofits that offer a mix of public and private goods may be expected to combine contributions and earned income to reflect the relative degrees of publicness and privateness of their services, and generally become more diversified than those offering strictly public or strictly private type goods or services.

In addition to the degree of publicness/privateness of their services, other characteristics of nonprofits are relevant to determining the proportion of revenues from any particular source, as well as overall level of diversification. Different fields of service can be more or less appealing to the preferences of donors or taxpayers. For example, social services attract more direct government support than private donations, but the reverse is true for the arts. The geographic localities in which a nonprofit operates may reflect differences in residents' preferences and needs for services, with consequent variations in tax levels and government funding (Brooks, 2000). In addition, membership in a supportive network such as a regional or national association may also

reduce risk (and hence the incentive to diversify), as suggested by Derryck's and Abzug's (2002) study of nonprofits in the New York region following the disaster of 9/11.

The maturity of a nonprofit organization is also likely to affect diversification decisions (Kimberly and Miles, 1980). New nonprofits confront the "liability of newness" (Chambre and Fatt 2002; Stinchcombe, 1965) and likely reflect the entrepreneurial risk taking and pragmatic cobbling together of resources of their founders (Young, 1985). Their capacity to manage multiple, complex streams is limited. Lack of experience may constrain the ability of young nonprofits to diversify revenues or generate income from investments or commercial ventures. In contrast, a mature nonprofit is more likely to have gradually differentiated its sources of income over time, including the building of endowments to generate investment income.

The size of a nonprofit organization may also influence its diversification behavior. Larger organizations are likely to have greater "slack" in the form of reserve funds, endowments, and staff and infrastructure from which greater efficiencies can be squeezed in times of difficulty. Such slack can serve as a hedge against risk, possibly even mitigating the pressure to diversify revenue sources or generate new income streams. Finally, the overall field of service in which a nonprofit operates may affect its degree of diversification. Notably, some fields or subfields may be characterized by greater volatility in their principal sources of revenue, leading to greater emphasis on diversification in order to manage risk.

The forgoing discussion strongly suggests that nonprofit revenue portfolios should reflect the public/private nature of services that a nonprofit provides, and since that mix is likely to vary with field of service, nonprofit subfields should be good predictors of both a nonprofit's dependence on any particular source of income as well as the degree to which it diversifies its income or concentrates on a few sources. Below, we describe our empirical approach to testing this theory.

Methodology

Fischer, Wilsker and Young (2008) directly investigate the connection between program and gift revenues and field of nonprofit service, hypothesizing that nonprofits that produce public goods rely more on donations and less on program revenues (fees), while nonprofits that provide private goods rely more on program revenues and less on

donations. Their approach is to associate specific NTEE subfields with particular types of benefits and to correlate these subfields with reliance on donations and program revenues. The principal limitations of that analysis are that (a) 990 data conflate government derived and privately paid program revenues, thus making it very difficult to parse the financing sources associated with private vs. public benefits, and (b) NTEE subfields that contain numbers of observations sufficient for statistical analysis, tend to exhibit substantial internal heterogeneity. In this paper, we attempt to circumvent this problem by testing two hypotheses derived from the benefits theory and which allow us to use 990 data and NTEE classifications in a new way. In particular, we take advantage of the fact that the NTEE classification system is nested and that fields can be specified both broadly, such as "the arts", or more narrowly, such as "performing arts". Since more narrowly defined fields are likely to contain nonprofits with more homogeneous service (hence benefit) portfolios than broader ones, we surmise that their corresponding income portfolios will also be more homogeneous. Thus, we investigate the following specific hypotheses:

H1: The narrower the NTEE field is defined, the less variation there will be in reliance on any particular source of income. This hypothesis can be separately tested for (proportional) reliance on program revenues, public support (gifts), government grants, and investment income, using the 990 data., for any broad NTEE category (and its component subcategories) of nonprofit organizations.

H2: The narrower the NTEE field is defined, the less variation there will be in its concentration on particular sources of income. This hypothesis can also be separately tested for any broad NTEE category of nonprofit organizations.

Our "super" hypothesis is that both of these hypotheses will be confirmed for each major NTEE category. The degree to which this is validated will be considered an overall test of the benefits theory.

Sampling and Data

Our analysis utilizes data from the Core Files on all nonprofits filing IRS returns in 2003. The NTEE classifies nonprofit organizations first into a large umbrella

category, and then into a smaller field within the general heading. Our analysis involves aggregation at each possible level for analysis. First, we collapse data for all nonprofits finding the average levels of diversification and reliance on the major streams for funding. More importantly, we obtain estimates of the standard deviation for our variables of interest – diversification, proportion of revenues which are earned, and proportion of revenues generated from contributions. The second step aggregates data for each of the major categories, again retaining information on the standard deviation within the category. Finally, we aggregate data at the narrowest level, that of the subfield. For each level of disaggregation (from the larger grouping to smaller categories), we compare the standard deviations of the smaller level to that of the larger level, analyzing the distribution of the smaller, more homogeneous categories around the standard deviation of the larger, more diverse category. Since we are dealing with the entire population of filing nonprofits, we do not apply tests of statistical significance to determine if observed differences are due to chance. Rather, we gauge the size of these observed differences with some heuristic measures.

Results

We first consider results from our analysis of the major NTEE categories relative to the population as a whole. For each of the following tables, we are comparing the standard deviations of smaller classes of nonprofits to the standard deviation of the larger group.

In Chart 1, we graphically depict the distribution of the major NTEE categories relative to the standard deviation of diversification for the entire sample. Each interval represents a 5% departure from the standard deviation of diversification for all nonprofits. Notice that the modal category is actually just above the standard deviation for all nonprofits, with 9 of the 26 categories falling into the group that ranges from the overall standard deviation of the group (.2176) to 5% above the overall standard deviation (.2285). At the same time, more than half (15 out of 25) our categories fall below the overall standard deviation, with a wider distribution on this side of the average. Of those major categories with standard deviations below the standard deviation for the sample, a third of them have standard deviations that are between 10% and 15% below the standard deviation for the group. Based on these findings, it appears that the

Chart 1: A comparison of standard deviations by major categories - Diversification

			Arts, Culture, & Humanities	
			Environmental	
			Recreation, Sports & Leisure	
			Public Safety	
Employment, Job Related	Education	Diseases, Disorders & Medical Disciplines	Youth Development	
International, Foreign Affairs, and National Security	Health	Medical Research	Community Improvement	
Civil Rights, Social Action, Advocacy	Mental Health / Crisis Intervention	Food, Agriculture, & Nutrition	Science and Technology Research Institutes	
Philanthropy, Voluntarism, and Grantmaking Foundations	Crime/ Legal Related	Human Services	Social Science Research Institutes	
Religion Related, Spiritual Development	Housing/ Shelter	Mutual/ Member Benefit	Public society Benefit	Animal Related
15% below	10% below	5% below	5% above	10% above

Chart 2: A comparison of standard deviation by major categories - Program Revenues

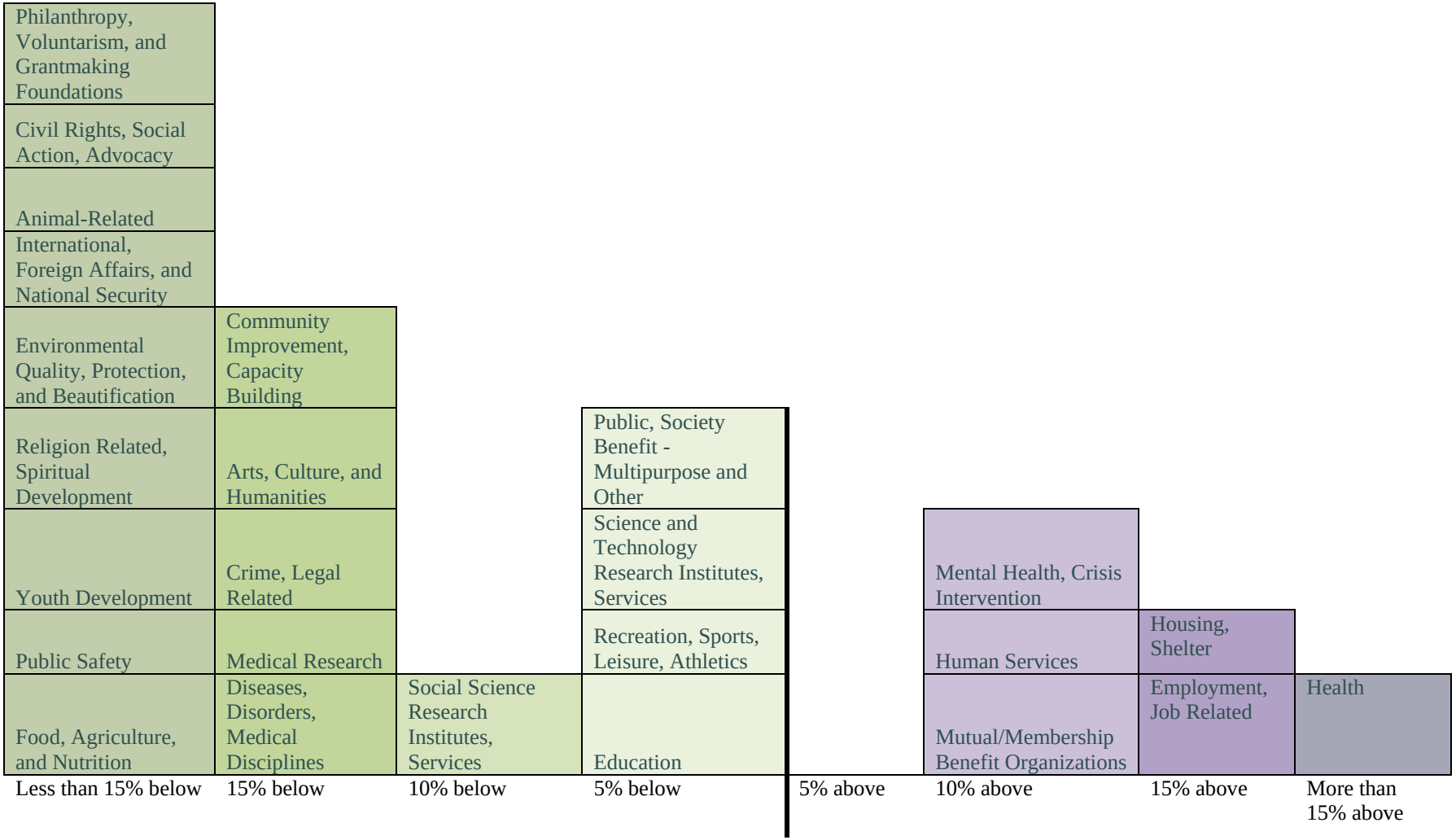

Chart 3: A comparison of standard deviation by major categories - Contributions

				Crime, Legal Related		
				Education		
			Environmental Quality, Protection, and Beautification	Medical Research		
	Animal Related		Food, Agriculture, and Nutrition	Health	Science and Technology Research Institutes, Services	
	Arts, Culture, and Humanities		Public Safety	Housing, Shelter	Human Services - Multipurpose and Other	
	Recreation, Sports, Leisure, Athletics	Youth Development	Mutual/Membership Benefit Organizations, Other	Community Improvement, Capacity Building	Public, Society Benefit - Multipurpose and Other	Philanthropy, Voluntarism, and Grantmaking Foundations
Civil Rights, Social Action, Advocacy	International, Foreign Affairs, and National Security	Religion Related, Spiritual Development	Diseases, Disorders, Medical Disciplines	Mental Health, Crisis Intervention	Social Science Research Institutes, Services	Employment, Job Related
Less than 15% below	15% below	10% below	5% below	5% above	10% above	15% above

diversification indices display less variance for individual categories than diversification for the entire sample for most NTEE categories

While the diversification of the major categories fits our hypothesis of less variation for more narrowly defined categories, the question remains whether the same holds true for each source of income. Charts 2 and 3 present information similar to that of Chart 1, where we analyze the standard deviation of the shares of earned income and contributions, respectively. In the case of earned income, 19 of the 25 categories exhibit standard deviations that are smaller than that for the overall sample, and the modal range consists of those categories with standard deviations more than 15% below the standard deviation for the entire sample. However, contributions, in chart 3, do not exhibit the same, strong pattern. In this case, the sample is split, with only 12 of the 25 NTEE categories with standard deviations below that of the overall sample, and our modal range is once again just about the standard deviation for the sample.

Will these patterns hold as we further disaggregate major categories of nonprofit organizations? In the following set of tables, we consider each of the major 25 categories independently, and analyze the distribution of diversification, share of earned income, and share of contributions within the smaller subfields. In the first four columns, we present the proportion of subfields with standard deviations more than 5% below the deviation for the major NTEE category, within 5% below the mean, within 5% above the category standard deviation (CSD), and more than 5% above the CSD. We then use these data to test our hypotheses. First, we ask - are a majority of the subfields below the category standard deviation? If so, we consider this as evidence which *weakly* supports our hypothesis. Second, we consider the possibility that these numbers may exhibit some natural variation, for example from year to year. Therefore we should be wary of distinguishing between those that are within say 5% of a category's standard deviation in either direction. In this test, we exclude these smaller middle range deviations and consider the magnitude of the tails only. In particular, we examine whether the tails that are more than 5% below the CSD are substantially larger in magnitude than those more than 5% above the CSD. We deem this as *strong* support of our hypothesis.

- **Table 1: Diversification Comparison by subfields within Categories**

Category	below .95CSD	between (.95 & 1) CSD	between (1 & 1.05) CSD	above 1.05 CSD	weakly Supports Hypothesis (ab > cd)	Strongly supports hypothesis (a>1.25d)
Arts, Culture and Humanities	42%	23%	12%	23%	X	X
Education	45%	17%	24%	14%	X	X
Environmental Quality	40%	10%	15%	35%		
Animal Related	39%	17%	6%	39%	X	
Health	68%	25%	7%	0%	X	X
Mental Health, Crisis Intervention	58%	29%	8%	4%	X	X
Diseases, Disorders, Medical Disciplines	49%	11%	9%	31%	X	X
Medical Research	33%	6%	0%	61%		
Crime, Legal Related	40%	12%	12%	36%	X	
Employment, Job Related	67%	7%	20%	7%	X	X
Food, Agriculture, and Nutrition	63%	0%	0%	37%	X	X
Housing, Shelter	60%	30%	10%	0%	X	X
Public Safety	40%	7%	13%	40%		
Recreation, Sports & Leisure	47%	17%	23%	13%	X	X
Youth Development	58%	0%	4%	38%	X	X
Human Services	71%	6%	17%	6%	X	X
International, Foreign Affairs, Nat'l Security	40%	24%	8%	28%	X	X
Civil Rights, Social Action, Advocacy	50%	14%	0%	36%	X	X
Community Improvement	30%	26%	4%	39%	X	
Philanthropy, Grant Making	22%	6%	11%	61%		
Science and Tech Research Inst.	42%	16%	21%	21%	X	X
Social Science Research Inst.	32%	14%	14%	41%		
Public, Society Benefit	47%	16%	5%	32%	X	X
Religion / Spiritual Development	33%	0%	29%	38%		
Mutual/Member Benefit Orgs.	59%	6%	6%	29%	X	X

- **Table 2: Comparison of Earned Income Deviation - by subfields**

Category	below 95 CSD	between (.95 & 1) CSD	between (1 & 1.05) CSD	above 1.05 CSD	weakly Supports Hypothesis (ab > cd)	Strongly supports hypothesis (a>1.25d)
Arts, Culture and Humanities	42%	23%	12%	23%	X	X
Education	45%	17%	24%	14%	X	X
Environmental Quality	40%	10%	15%	35%		
Animal Related	39%	17%	6%	39%	X	
Health	68%	25%	7%	0%	X	X
Mental Health, Crisis Intervention	58%	29%	8%	4%	X	X
Diseases, Disorders, Medical Disciplines	49%	11%	9%	31%	X	X
Medical Research	33%	6%	0%	61%		
Crime, Legal Related	40%	12%	12%	36%	X	
Employment, Job Related	67%	7%	20%	7%	X	X
Food, Agriculture, and Nutrition	63%	0%	0%	37%	X	X
Housing, Shelter	60%	30%	10%	0%	X	X
Public Safety	40%	7%	13%	40%		
Recreation, Sports & Leisure	47%	17%	23%	13%	X	X
Youth Development	58%	0%	4%	38%	X	X
Human Services	71%	6%	17%	6%	X	X
International, Foreign Affairs, Nat'l Security	40%	24%	8%	28%	X	X
Civil Rights, Social Action, Advocacy	50%	14%	0%	36%	X	X
Community Improvement	30%	26%	4%	39%	X	
Philanthropy, Grant Making	22%	6%	11%	61%		
Science and Tech Research Inst.	42%	16%	21%	21%	X	X
Social Science Research Inst.	32%	14%	14%	41%		
Public, Society Benefit	47%	16%	5%	32%	X	X
Religion / Spiritual Development	33%	0%	29%	38%		
Mutual/Member Benefit Orgs.	59%	6%	6%	29%	X	X

- **Table 3: Comparison of Std. Deviations – Contributions**

Category	below .95 mean	between (.95 & 1) mean	between (1 & 1.05) mean	above 1.05 mean	weakly Supports Hypothesis (ab > cd)	Strongly supports hypothesis (a>1.25d)
Arts, Culture and Humanities	47%	14%	12%	28%	X	X
Education	21%	38%	17%	24%	X	
Environmental Quality	40%	30%	5%	25%	X	X
Animal Related	33%	11%	0%	56%		
Health	46%	25%	11%	18%	X	X
Mental Health, Crisis Intervention	46%	21%	21%	13%	X	X
Diseases, Disorders, Medical Disciplines	46%	29%	9%	17%	X	X
Medical Research	33%	24%	18%	24%	X	X
Crime, Legal Related	40%	8%	12%	40%		
Employment, Job Related	53%	20%	13%	13%	X	X
Food, Agriculture, and Nutrition	26%	32%	16%	26%	X	
Housing, Shelter	30%	25%	30%	15%	X	X
Public Safety	20%	13%	20%	47%		
Recreation, Sports & Leisure	27%	17%	3%	53%		
Youth Development	46%	8%	8%	38%	X	
Human Services	63%	17%	15%	6%	X	X
International, Foreign Affairs, Nat'l Security	40%	8%	12%	40%		
Civil Rights, Social Action, Advocacy	32%	9%	9%	50%		
Community Improvement	30%	48%	17%	4%	X	X
Philanthropy, Grant Making	56%	33%	11%	0%	X	X
Science and Tech Research Inst.	26%	21%	37%	16%		X
Social Science Research Inst.	41%	27%	5%	27%	X	X
Public, Society Benefit	26%	37%	16%	21%	X	
Religion / Spiritual Development	33%	10%	19%	38%		
Mutual/Member Benefit Orgs.	53%	6%	18%	24%	X	X

Table 1 present the results from our analysis of diversification within the major categories. We find that 18 of the 25 categories weakly support our hypothesis, and 17 categories strongly support our hypotheses. There are categories which weakly support our hypotheses but do not strongly support it, as well as those that strongly support our hypothesis, but do not weakly support it. There are categories which weakly support our hypotheses but do not strongly support it, as well as those that strongly support our

hypothesis, but do not weakly support it. This would include categories such as Health, which like our full sample chart, has a modal category just above its CSD, but a much larger distribution of subfields well below the CSD than above.

Share of earned income and share of contributions are presented in similar tables, Tables 2 and 3. In the case of earned income, 19 categories demonstrate weak support of our hypothesis, with another 16 strongly supporting the hypotheses. Finally, Table 3 demonstrates that subfields in 17 categories in our analysis weakly support and 14 strongly support our hypotheses.

The final table presents information from all 6 of the previous charts and tables in a more concise manner. The last 6 columns repeat finding from the previous tables, but the first column sums the number of hypotheses that a particular category supported. With a possible range of 0 to 9, the totals vary from 3 in the case of Religion and spiritual development (a problem category since most churches do not file with Form 990's) to a maximum of 8, for Arts, Culture, and Humanities and Diseases, Disorders, and Medical Disciplines. Further analysis is needed to explain why some categories conform to our hypotheses better than others.

- **Table 4: Summary of Hypotheses Tests**

Category	Tests Passed	Diversification			Earned Income			Contributions		
		Pop.	SF-WS	SF-SS	Pop.	SF-WS	SF-SS	Pop.	SF- WS	SF-SS
Arts, Culture Humanities	8		X	X	X	X	X	X	X	X
Education	7	X	X	X	X	X	X		X	
Environmental Quality	6		X	X	X			X	X	X
Animal Related	5		X	X	X	X		X		
Health	6	X		X		X	X		X	X
Mental Health, Crisis Intervention	6	X		X		X	X		X	X
Diseases, Disorders, Medical Disciplines	8	X	X		X	X	X	X	X	X
Medical Research	4	X			X				X	X
Crime, Legal Related	5	X	X	X	X	X				
Employment, Job Related	7	X	X	X		X	X		X	X
Food, Agriculture, and Nutrition	6	X			X	X	X	X	X	
Housing, Shelter	5	X				X	X		X	X
Public Safety	4		X	X	X			X		
Recreation, Sports & Leisure	6		X	X	X	X	X	X		
Youth Development	7		X	X	X	X	X	X	X	
Human Services	7	X	X	X		X	X		X	X
International, Foreign Affairs, Nat'l Security	7	X	X	X	X	X	X	X		
Civil Rights, Social Action, Advocacy	6	X	X		X	X	X	X		
Community Improvement	6		X	X	X	X			X	X
Philanthropy, Grant Making	4	X			X				X	X
Science and Tech Research Inst.	6		X	X	X	X	X			X
Social Science Research Inst.	5		X	X	X				X	X
Public, Society Benefit	6		X	X	X	X	X		X	
Religion / Spiritual Development	3	X			X			X		
Mutual/Member Benefit Orgs.	7	X	X			X	X	X	X	X

Key

Pop: major NTEE category test

SF-WS: subfield weak support test

SF-SS: subfield strong support test

Conclusion

Nonprofit organizations vary widely in their mixes of revenues from different sources. There are various reasons for this, including the maturity and size of an organization and the particular economic circumstances in which it may operate. Correspondingly, there are various reasons for a nonprofit organization to strategically diversify its income portfolio, including management of risk and exploitation of special opportunities for funding. However, one outstanding fact about nonprofit financing is that the mix of nonprofit revenues from alternative sources, including earned income, charitable contributions, government funding and investment income, varies dramatically by field of service. This has led us to propose that nonprofit income portfolios are strongly influenced by the services and benefits that a nonprofit organization produces. Given that such services and benefits vary in their public vs. private nature, we presume that their means of financing are likely to vary correspondingly – with fee revenues reflecting private benefits, charitable contributions reflecting collective group benefits and government support indicative of society-wide benefits. Since nonprofit organizations vary widely in their missions and services, we surmise that their income portfolios will vary accordingly.

Testing this benefits-driven theory of nonprofit organizations is challenging for a number of reasons. Direct measurement and classification of benefits, through surveys or web site analyses, for example, requires considerable effort, judgment and expertise, seriously limiting the precision with which researchers can collect and analyze such information. In addition, there is arbitrariness and imprecision in IRS 990 data that reports nonprofit finances – especially the conflation of government and private fees. At the same time, there is no uniformity in the manner in which nonprofits report their programs or income in their own financial statements.

The test of the benefits theory of nonprofit financing presented here is indirect. In particular, we hypothesize that as we examine more and more homogeneous groups of nonprofits in terms of the services and benefits they produce, we will find smaller and smaller variations in their income portfolios. This paper has presented our testing of this hypothesis, using nested NTEE categories and three indicators of income portfolios – the degrees of dependence on earned revenues and contributed revenues, as well as the

overall degree of diversification or concentration of revenue portfolios. The results clearly show a strong tendency to conform to the hypothesized patterns.

The benefits theory of nonprofit finance is potentially important not only for explaining and understanding observed empirical patterns of nonprofit finance, but it also suggests that nonprofits need to think strategically about their support and must do so individually rather than follow general or set formulas for diversification or pursuit of particular sources of income based on generic parameters such as size or age of the organization, or the latest financing fashion – whether that be pursuit of endowments or earned income ventures. As with other nonprofit strategic decisions, options for nonprofit finance appear to begin with mission and are apparently transactional in nature. Mission implies programs, services, benefits and beneficiaries, from which decision makers can determine who is likely to be willing to pay and in what form such support can be secured.

References

Andreoni, J. (1989). "Giving with Impure Altruism: Applications to Charity and Ricardian Equivalence," *The Journal of Political Economy*, 97(6), 1447-1458.

Becker, G. (1976). "Altruism, Egoism, and Genetic Fitness: Economics and Sociobiology." *Journal of Economic Literature.* 14(3), 817-826.

Ben-Ner, A., 2002, "The Shifting Boundaries of the Mixed Economy and the Future of the Nonprofit Sector", *Annals of Public and Cooperative Economics*, 73:1, 5-40.

Bowman, W., E. Keating, and M. A. Hager, 2006. "Investment Income", chapter 6 in Dennis R. Young (ed.), *Financing Nonprofits*, Lanham, MD: AltaMira Press, pp.157-181

Boris, E.T. and C. E. Steuerle, 2006. "Scope and Dimensions of the Nonprofit Sector," Chapter 3 in W.W. Powell and R. Steinberg (eds) *The Nonprofit Sector: A Research Handbook 2nd ed.* New Haven, Yale University Press, 66-88.

Brooks, A. C. (2000). "Public Subsidies and Charitable Giving: Crowding out, Crowing in, or Both?" *Journal of Policy Analysis and Management.* 19(3), 451-464

Chambre, S. M. and N. Fatt. 2002. "Beyond the Liability of Newness: Nonprofit Organizations in an Emerging Policy Domain." *Nonprofit and Voluntary Sector Quarterly.* 31(4), 502-524.

Chang, C.F. and H. P. Tuckman, 1994, "Revenue Diversification Among Nonprofits", *Voluntas*, 5:3, 273-290.

Derryck, D. and R. Abzug, 2002, "Lessons from Crisis: New York City Nonprofits Post-September 11", *The Nonprofit Quarterly*, 9:1, 6-10.

Fischer, R., Wilsker, A. and Young, D., 2007. "Exploring the Revenue Mix of Nonprofit Organizations – Does it relate to Publicness?", Working Paper, Nonprofit Studies Program, Georgia State University

Foster, W. and Fine, G., 2007. "How Nonprofits Get Really Big", *Stanford Social Innovation Review*, Spring,

Froelich, K. A., Knoepfle, T. W., and Pollak, T. H., 2000,"Financial measures in nonprofit organization research: Comparing IRS 990 return and audited financial statement data," *Nonprofit and Voluntary Sector Quarterly*, 29, 232-254.

Frumkin, P. and E K. Keating, 2002, "The Risks and Rewards of Nonprofit Revenue Concentration", draft, presented to the ARNOVA Annual Conference, Montreal, Quebec, November

Galaskiewicz, J., and Bielefeld, W., 1998, *Nonprofit Organizations in an Age of Uncertainty*, New York, Aldine De Gruyter.

Gordon, T., J. Greenlee, and D. Nitterhouse, 1999, "Tax-exempt Organization Financial Data: Availability and Limitations", *Accounting Horizons* (June), 277-299.

Greenlee, J. and J. Trussel, 2002, "A financial rating system for nonprofit organizations", Working paper.

Greenlee, J.S. and John M. Trussell, 2000, "Predicting the Financial Vulnerability of Charitable Organizations", *Nonprofit Management and Leadership*, 11:2, 199-210.

Gronbjerg, K., 1993, *Understanding Nonprofit Funding*. San Francisco: Jossey-Bass.

Hansmann, H., 1987, "Economic Theories of Nonprofit Organizations", chapter 2 in W. W. Powell, *The Nonprofit Sector: A Research Handbook*, New Haven: Yale University Press, 27-42.

James, E., 1983, "How Nonprofits Grow: A Model", *Journal of Public Policy Analysis and Management*, 2 (Spring), 350-365.

Kearns, K.P., 2006, "Income Portfolios in Nonprofit Organizations", Chapter 13 in D. R. Young (ed.), *Financing Nonprofits: Putting Theory into Practice*, Lanham, MD: AltaMira Press, 291-314.

Keating, E. K., Frumkin, P, 2003, "Reengineering nonprofit financial accountability: Toward a more reliable foundation for regulation", *Public Administration Review*, 63:1, 3-15.

Kimberly, J.R., Miles, R. H., and Associates, 1980, *The Organizational Life Cycle*, San Francisco: Jossey-Bass.

Kingma, B. R. (1997). "Public Good Theories of the Non-Profit Sector: Weisbrod Revisited." *Voluntas*, 8(2), 135-148.

National Center for Charitable Statistics. (2003). NCCS Core File, FY 2003. Washington: The Urban Institute. Center on Nonprofits and Philanthropy.

Okten, C. and B. A. Weisbrod, (2000), "Determinants of Donations is Private Nonprofit Markets", *Journal of Public Economics*, 75(2), 255-272.

Olson, M, 1965. *The Logic of Collective Action*, Cambridge: Harvard University Press

Samuelson, P. A. (1954), "The Pure Theory of Public Expenditure," *The Review of Economics and Statistics, 36(4), 387-389.*

Stinchcombe, A. L. (1965). "Social structure and organizations". In J. G. March (Ed.), *Handbook of organizations* Chicago: Rand McNally, 142-193.

Tuckman, H. and C. Chang, 1991, A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations. *Nonprofit and Voluntary Sector Quarterly,* 20 (4) 445-460.

Weisbrod, B.A. (ed.), 1977, *To The Voluntary Nonprofit Sector: An Economic Analysis*, Lexington: Lexington Books.

Weisbrod, B.A., 1988, *The Nonprofit Economy,* Cambridge: Harvard University Press.

Weisbrod, B.A. (ed.), 1998, *To Profit or Not to Profit*, New York: Cambridge University Press.

Young, D. R., 1985, *Casebook of Management for Nonprofit Organizations: Entrepreneurship and Organizational Change in the Human Services*, New York: Haworth Press.

Young, D.R. (ed.), 2006a. *Financing Nonprofits: Putting Theory into Practice*, Lanham, MD: AltaMira Pr