AN ANALYSIS OF STRATEGIES TO STRENGTHEN THE ECONOMIC IMPACT OF NONPROFITS

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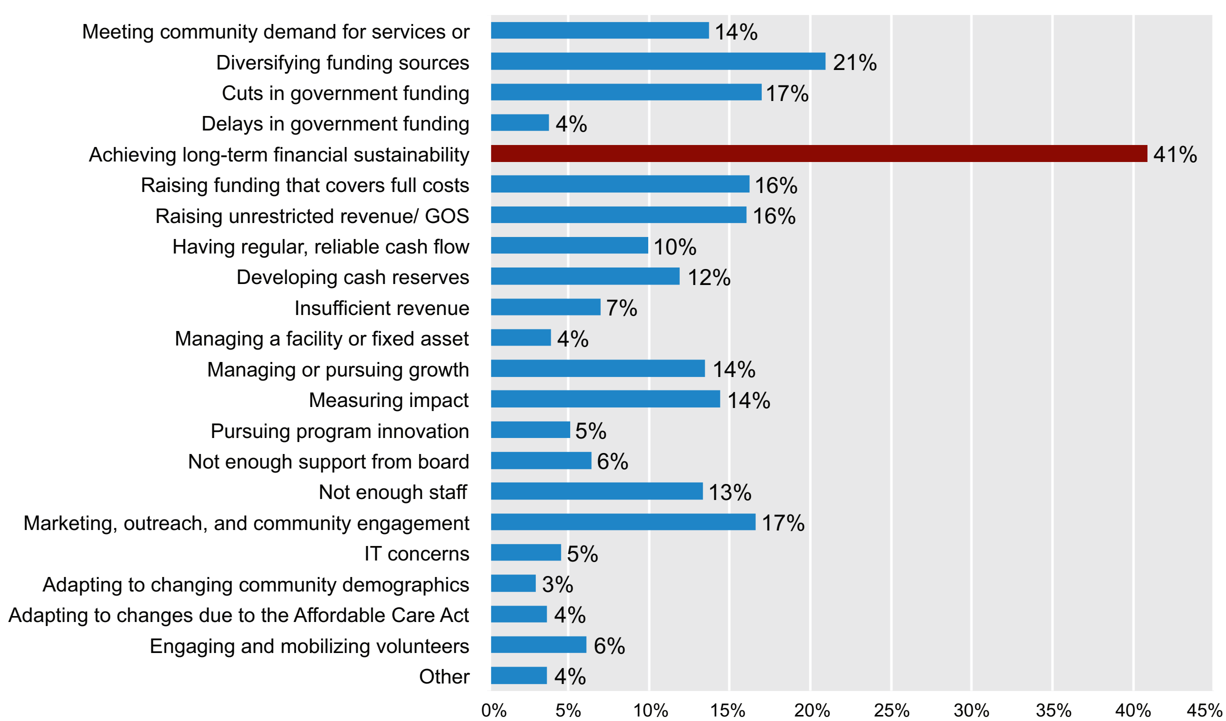
I. Introduction

On December 16, 2014, the New York City Economic Development Corporation (NYCEDC) convened a roundtable with over twenty stakeholders from the nonprofit community entitled: Challenges, Opportunities and Potential Solutions. Bringing together the city's nonprofit leadership in this way—as NYCEDC astutely has done—is a powerful recognition of the important, yet not fully realized, economic potential of the sector. There are 1,500,000 nonprofits in the United States, including 35,000 in New York City alone, which account for over $1 trillion in annual revenue.[1] Yet the resounding message among participants in NYCEDC's roundtable was that the sector seemed relatively "invisible" to those concerned with growing the city's economy.[2] As one president of a nonprofit association noted, while nonprofits "comprise 15% of the workforce, they are rarely, if ever, touted as city job creators in the same vein as businesses."[3] This historical failure to perceive the importance of the nonprofit sphere may stem, in large part, from public officials not knowing how to better leverage the impact of nonprofits. Further, the typical tools possessed by economic development agencies may not appropriately meet the needs of nonprofits. Temple University professor, Dr. Carolyn Adams, explained this phenomenon:

> If the tool at your disposal is a hammer, you search for problems that look like nails. If the primary tool at your disposal is the tax concession (as it is for most economic development agencies), you look for projects where tax concessions can be applied. Because nonprofit institutions cannot be helped by tax breaks (they pay no taxes), they are simply not "on the radar screen" for many development agencies.[4]

The lack of attention given to nonprofits in economic development is exacerbated by the very real problems the independent sector is confronting. The Nonprofit Finance Fund conducted a nationwide survey of nonprofit leaders in 2014, which found that 28% of organizations had a deficit the previous year; 31% broke even; and only 40% of nonprofits ended the year with a surplus.[5] Indeed, when questioned about the top challenges facing their nonprofits, four of the top five issues cited by these leaders related to their financial situation (see chart below).[6]

Figure I. Top Challenges that Nonprofits are Facing



Source: "2014 State of the Nonprofit Sector Survey"

Clearly, the critical need is to develop a comprehensive strategy to better harness the potential of nonprofits as economic engines. Toward this end, economic development agencies should pursue the following seven approaches to strengthen the independent sector: 1) transform the perception that nonprofits should not behave like businesses; 2) pursue opportunities to promote colocation among nonprofits; 3) help facilitate collaboration within the nonprofit sector and with the private sector; 4) bolster the role of the "nonprofit liaison" within local and state governments; 5) improve the system of government procurement; 6) expand the human capital capacity of nonprofits; and, lastly, 7) expand the financial capacity of nonprofits.

Discussion about the components of this strategy should emphasize that the independent sector is not a monolithic entity. The goals and needs of small nonprofits vary drastically from large anchor institutions, and, similarly, the conditions for arts and cultural institutions are distinct, for example, from hospitals. Accordingly, this analysis will draw particular attention to the unique challenges confronting various nonprofit communities. It is helpful to provide a brief taxonomy of the diverse constituents in the nonprofit realm:

- Arts, culture, and humanities: museums, performing arts, historical organizations and media and communications
- Education: lower, middle and secondary schools, post-secondary institutions and other educational organizations
- Environment and Animals: conservation and preservation, animal welfare, zoos and aquariums
- Health: hospitals, medical research, substance abuse prevention and disease advocacy groups
- Social Service: legal services, disaster relief, crime prevention, civil rights, veteran's groups, workforce training, food banks and homeless shelters, child abuse prevention, family counseling and senior citizen centers
- International and Foreign Affairs: international development and international associations
- Religious organizations: churches and faith-based organizations.[7]

II. Strategy #1: Transforming the Notion That Nonprofits Should Not Behave Like Businesses

Interestingly, nonprofit leaders posit that one of the largest obstacles to strengthening their organizations is not structural but conceptual. The participants of NYCEDC's roundtable and others interviewed for this paper call for revolutionizing the way we perceive the role of nonprofits in society. In 2013 nonprofit activist Dan Pallotta delivered a provocative TEDTalk, which garnered 3.5M views and criticized the "two separate rulebooks" that govern the actions of nonprofits and their private sector counterparts.[8] Pallotta argued that societal limitations placed on nonprofits—such as equating frugality with morality and rewarding nonprofits for how little they spend rather than for what they accomplish—hinders these organizations in accomplishing their missions. The vast scope of the problems tackled by nonprofits in reducing poverty, eliminating disease, etc. requires an enlarged—and unfettered— response that is more commensurate to the tasks at hand. In his TEDtalk Pallotta urged: "Let's change the way we think about changing the world."[9]

In his book, *Uncharitable: How Restraints on Nonprofits Undermine Their Potential*, Pallotta provides five specific misperceptions about nonprofits that he advocates overturning.

Here's how he explains the first misperception, which relates to compensation:

> We have a visceral reaction to the idea of people making a lot of money helping others. Interestingly, we don't have a visceral reaction to the idea that people should make a lot of money *not* helping other people. It gives a stark, mutually exclusive choice between doing well for yourself and your family and doing well for world.[10]

In addition to hypocrisy surrounding compensation, Pallotta faults the restrictions placed on nonprofits in advertising. While for-profit entities devote significant portions of their budgets to advertising and public relations, nonprofit organizations are expected not to advertise, "unless the advertising space and airtime is donated."[11] Because donors "want to see their money spent directly on the needy," advertising efforts are discouraged, despite the fact that raising the profile of nonprofits would likely result in attracting even more donations and involvement from the community.[12] Pallotta goes on to list three additional hindrances, including the pressure 1) to avoid taking risks; 2) to complete projects in an unreasonably accelerated amount of time; 3) and to succeed without having the advantage of raising capital. The historical statistics in this regard support Pallotta's thesis: since 1970, 46,136 private sector businesses have crossed the $50M annual revenue threshold, while only 144 nonprofits have achieved the same distinction during that time period.[13] During an interview for this paper, one nonprofit executive shared that some of her colleagues made the decision to stop using the word nonprofit altogether because it seemed to contradict the very real needs they had in raising funds.[14] She said that they transitioned from referring to their organizations as nonprofits to for impact organizations.

The nonprofit theater scene in New York City provides an excellent case study for how nonprofits can successfully adapt to competitive, for-profit marketplaces. In 1961, when the first association for nonprofit theaters was founded, there were only 23 regional theaters involved, but now that number has ballooned to nearly 2,000 member theaters.[15] New business models and creative financing mechanisms—such as not-for-profit self-financing, enhancement funding, and collaboration funding—in addition to federal support from the National Endowment of the Arts have caused nonprofit theaters to flourish. In 2007 over half of the new shows that debuted on Broadway had first originated in nonprofit theaters.[16] The New York City nonprofit theaters present a promising model for other nonprofit entities seeking to adapt and remake themselves in the current competitive economic environment.

However, advocating that nonprofits should adopt modern business practices to enhance their work does not mean these new approaches should overwhelm their missions. Nonprofits, like New York City's theaters, are socially driven enterprises. While solid finances are necessary for these institutions to stay afloat, their real purpose "involves much more than simply making money."[17] As the Associate Dean of Performing Arts Services at the University of North Carolina at Charlotte, Dean Adams, explained, "the challenge has always been to balance the economic necessity to get audiences in the door with the mission to create meaningful work for the community and its local artists. Ideally, both happen simultaneously.[18] Accordingly, assertions that the challenges nonprofits confront can be resolved only by assuming a more business-centric mentality or implementing more monetary incentives and goals, underestimate the complexity of the problem.[19] The ultimate success of nonprofits should be measured not only on financial health but on success in achieving their mission objectives.[20] Perhaps the term "for impact organizations" appropriately emphasizes the importance of the latter in balancing between these two measures of success.

Economic development agencies should actively work with the nonprofit community to transform outmoded perceptions of what it means to be a nonprofit. Using their influence, these agencies can help the public realize the vital import nonprofits have to state and local economies and can help create an environment—especially in the funding arena—where nonprofits are free to pursue new paths of action. This is the first step in instigating a comprehensive strategy to take full advantage of nonprofit resources.

III. Strategy #2: Pursuing Opportunities to Promote Colocation Among Nonprofits

Given that occupancy costs typically constitute the second largest line item in most nonprofit budgets, real estate is a particularly impactful area for economic development agencies to contribute. In places like New York City, where the rental market is hyper-competitive and property values are high, nonprofits face real hardship finding and paying for real estate. The recent exit of the cultural icon, Galapagos Art Space, from Brooklyn is evidence of this reality. In response to this challenge, the trend of establishing "colocation spaces" for nonprofits is increasingly gaining traction. Colocation spaces, if owned and operated by a nonprofit entity, have the advantage of being exempt from property taxes. Colocation centers are especially beneficial to "startup" nonprofits, which allow funds previously allocated for rent to be used on boosting the program development and overall capacity of new nonprofits.[21] They serve as a kind of incubating space during these pivotal stages of early organizational development.

Yet the benefit of colocation to startups—and to more established organizations—is more extensive than just early cost savings. Researchers have found that colocation "enhances nonprofit organizations' professional work environments and service delivery, promotes shared services," and decreases nonprofits' administrative burden by assuming tasks like, "property management, public safety, and related management."[22] Executives, freed up from the obligations of these administrative duties, are able to focus on other priorities. Furthermore, the benefits of colocation extend even broader, flowing "directly to the community as the centers become dynamic hubs where residents can meet and organize."[23] These kind of attractive built environments, symbolizing the value and quality of the organization, develop into recruitment tools for funders, volunteers, and board members.[24]

There are extraordinary and innovative examples of colocation spaces sprouting up throughout the country. Recognizing the constraints posed by occupancy costs, the Marin Community Foundation in Novato, CA purchased three buildings to house its grantees: one for youth programs, one for justice-oriented work, and another for children and family services.[25] The Foundation created a separate entity called MarinSpace to operate the three buildings and to educate other area nonprofits about occupancy issues. The Hannah Foundation in Detroit converted a former hotel into a center for organizations that focus on serving low-income senior citizens.[26] The Nonprofit Village in Rockville, MD is a 10,000 square foot facility that is leased to full capacity and currently provides office space to 17 different nonprofits.

While it is clear that the colocation model holds promise for cultivating nonprofit growth, what can economic development agencies do to scale up these efforts? One of the greatest assets most city governments have at their disposal is real estate. Development agencies can strategically draw upon these land resources to facilitate the creation of nonprofit centers. For example, New York City partnered with Chashama to establish 50,000 square feet of studio space for emerging artists in the Brooklyn Army Terminal in Sunset Park.[27] City agencies can also partner with commercial real estate professionals, who understand and support the needs of the nonprofit sector, to identify opportunities for nonprofits seeking office space.[28] One government official in New York City suggested establishing colocation centers in each of the city's boroughs that would focus on specific programmatic areas.[29] This intentional strategy of linking and collocating social service providers—including, when appropriate, relevant local government agencies—would result in better coordination of services and help facilitate new synergistic partnerships.

IV. Strategy #3: Facilitating Other Means of Collaborating With Nonprofits and the Private Sector

The third aspect of this comprehensive strategy to increase the capacity of nonprofits focuses on facilitating more general collaboration within the nonprofit sector and with private sector entities. Historically, nonprofits have faced criticism for working in isolation, showing limited interest in partnering with outside organizations except in "opportunistic" cases.[30] Further, some advocates have pointed to the recent proliferation of the number of nonprofits, instances of duplication of organizational efforts and geographic overlap as real threats to the sustainability of the sector.[31] A large body of literature suggests that collaboration, defined as "what occurs when different nonprofit organizations work together to address problems through joint effort, resources, and decision-making and share ownership of the final product or service," confers significant benefits to nonprofits, some of which have already been touched on in the discussion on colocation.[32] The "collaborative advantage" includes expanded "social and intellectual capital, improved innovation, more funding, greater staff retention, improved service provision, greater success at advocacy, and increases in general organizational effectiveness."[33]

Cooperation among nonprofits has particular impact on the financial capacity of nonprofits. Researchers have discovered that the nonprofits that are most financially vulnerable are least likely to enter partnerships, which is unfortunate since coalition-building seems to correlate with financial success.[34] A 2011 study of 200 nonprofit leaders in San Francisco, CA found that "collaboration was essential to receiving government funding and resulted in more financial support from government sources."[35] Funders view collaboration as an indication of the strength of a nonprofit and a measure of its ability to carry out its proposals. However, it is important to note that the ways in which nonprofits collaborate varies greatly. For example, universities, hospitals and philanthropic foundations—given their size and financial resources—are likely to partner in systematically different ways than other sorts of nonprofits.[36]

In addition to within-sector collaboration with other nonprofits, many nonprofit organizations are pursuing cross-sector partnerships with for-profit firms. These partnerships can provide a level of support and funding that may not otherwise be possible. For example, the NEW Center in Ann Arbor, MI, a nonprofit resource center that provides assistance to 4,000 nonprofits annually, recently joined with the Zingerman's Community of Businesses, to provide leadership training to nonprofit executives.[37] Zingerman's has agreed to provide sponsorships for nonprofit leaders interested in participating in the company's highly regarded ZingTrain business programs. While this relationship between the New Center and Zingerman's formed organically, economic development agencies can strategically seek out these opportunities to bring together nonprofits and corporations. Capitalizing on its power as a convener, development agencies can assemble various players and set agendas that foster an exchange of resources and talent.

Interestingly, the various leaders in the New York City nonprofit community, who were interviewed for this paper, focused less on cross-sector partnerships and more on within sector collaboration.[38] Interviewees highlighted strategies that empowered nonprofits to work together to achieve mutual desired outcomes. For example, the NYCEDC helped facilitate "group purchasing" for nonprofits through Essena, which offers discounts on various goods and services.[39] They also referenced the value of the Mayor's Office and other government entities convening nonprofit stakeholders together for regular meetings, as was done several years ago with the Strengthening the Nonprofit Sector Taskforce. Apparently, a number of successful initiatives arose from joint efforts through the Taskforce, including the Health and Human Services Accelerator.[40] More of these coalition-building iniatives should be pursued by economic development agencies in the future given the tremendous benefit they provide to the nonprofit sector.

V. Strategy #4: Bolstering the Role of the "Nonprofit Liaison" Within Local And State Governments

States and localities committed to promoting best practices in advancing the economic growth of nonprofits have opted to establish a "nonprofit liaison" position within the executive branch of government. The liaison aims to "tap the expertise, creativity, and local economic impact of the nonprofit community" and acts as a third party in "tackling persistent problems that add costs and complicate otherwise effective government nonprofit-relations."[41] States like New York, Michigan, and Connecticut, as well as cities like Newark and Denver, have created liaison positions with astonishing results. In Michigan the liaison brokered $100M of investments from private sources that were aligned with public sector priorities; in Newark, the liaison helped facilitate contributions of $26.2M to nonprofits from both private and public entities; and, in Denver, the Office of Strategic Partnerships secured $32.7M for nonprofits and contributed to the expansion of the programs serving the city's youth by 25%.[42]

Having this bridge between the nonprofit world and government is immensely useful. Given the newness of the role, New York State's liaison is still in the process of exploring how to best take advantage of the position, especially in terms of reaching nonprofits in New York City. However, the liaison's work should be complemented by a network of other individuals assigned to serve as the points of contact in government agencies. For instance, NYCEDC could appoint an advocate who works specifically with nonprofits, as has been the case in the past.[43] This individual could act on behalf of nonprofits in pursuing issues like those mentioned by the attendees of NYCEDC's recent roundtable: resolving situations in which the guidance provided by different government agencies is in conflict, i.e. Vendex, or advocating to include nonprofit entities in the programming of the City's Department of Small Business Services (SBS).[44]

VI. Strategy #5: Improving the System Of Government Procurement

One of the most significant avenues whereby the government interacts with nonprofits is through funding nonprofit services. To the extent that state and local economic development agencies can improve the government procurement process—by expanding opportunities to secure funding, by addressing what is termed the "nonprofit starvation cycle," and by resolving bureaucratic inefficiencies that plague the system—nonprofits would benefit in dramatic ways. According to a study conducted in 2011, over one third of the revenue from 501(c) 3 organizations was derived from government contracts and grants.[45] This includes approximately 350,000 contracts and grants with 56,000 different nonprofit entities worth over $137 billion.[46] Intriguingly, studies show that public funding is more instrumental to the creation of new nonprofits than private funding; generally, the private investment required to found a new nonprofit is five times as high as it would be with public contracts or grants.[47] This is because government funding affords long-term stability for programs and promotes standard practices that help demonstrate the health and sustainability of nonprofits to other stakeholders and potential funders.[48] While economic development agencies may not have the ability to support nonprofits directly with extensive financial assistance, they can help facilitate an improved procurement process so that the impacts of other government resources are fully leveraged.

The degree to which nonprofits rely on government revenue varies considerably by sector, with nonprofits focused on arts, culture, and humanities the least likely to depend on these sources and social service nonprofits the most likely to receive government aid. Table 2 below, based on a national, stratified sample of random charitable institutions that reported $100,000 or more in expenses on IRS Form 990, provides a further description of which types of nonprofits draw upon government funding.[49]

While this investment in nonprofits—of all sectors—is key to their sustainability, there are serious problems with how government funding is administered. According to the same study cited previously, nearly 40% of nonprofits reported "a decline in local and state

Table 1. Nonprofits with Government Contracts and Grants

Dollar Amount of Contracts and Grants

Type of Organization	Number	Percent	Mean ($)	Median ($)	Total ($ millions)	Percent
Arts, culture, and humanities	7,189	12.9	152,074	33,600	1,081	0.8
Education	3,828	6.9	1,392,814	157,034	5,223	3.8
Environment and animals	2,359	4.2	560,871	101,800	1,306	1.0
Health	6,729	12.1	5,586,483	545,082	36,448	26.5
Human services	29,483	52.9	2,826,338	387,732	80,565	58.6
Other	6,114	11.0	2,203,786	274,688	12,769	9.3
Overall	55,702	100.0	2,543,870	250,000	137,392	100.0

Source: Urban Institute, National Survey of Nonprofit-Government Contracts and Grants (2013).
Notes: Figures are based on nonprofit organizations included in the sampling frame. Missing or not applicable answers were excluded.
Percentages may not sum to 100 because of rounding.

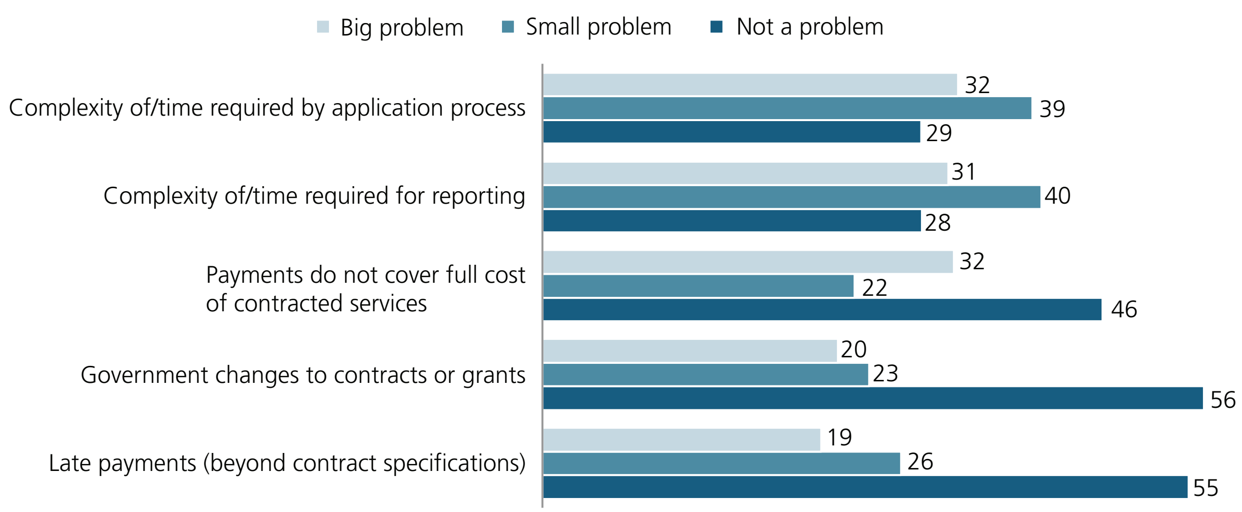
government funding" and "nearly half of the organizations reported that they experienced limitations on the percentage of government funds that could be used for program and organization administrative costs."[50] Additionally, a further study by the Urban Institute found that government contracts to social service nonprofits often fail to cover the full costs of services, meaning these entities have to make up the difference by "reducing their level of services, raising additional funds, or reducing staff."[51] While this trend was exacerbated recently during the Great Recession, the reduction in government funding seems to be a long-term phenomenon.

It is a phenomenon, however, that involves not only government funders—local, state and federal—but also private philanthropic organizations and corporate donors. At the center of the debate is the concept of the nonprofit starvation cycle, which relates not just to government funding generally but to the amount of overhead costs specifically permitted in these types of grants and contracts. The nonprofit starvation cycle, according to the literature, leaves nonprofits so "hungry" as the result of under-investment in organizational infrastructure that "they can barely function as organizations—let alone serve their beneficiaries."[52] There are three elements in this cycle, which serve as a kind of negative feedback loop: first, the trend starts with unrealistic expectations from funders about the expenses related to running a nonprofit; second, nonprofits, then, feel pressure to "conform to funders' unrealistic expectations;" and, lastly, nonprofits react by skimping on overhead and underreporting their expenditures to funders and on tax forms, which then perpetuates the skewed expectations that initiated the cycle.[53] The data is startling: the average overhead costs for nonprofits have dropped by 2.5% in the last twenty years.[54] It is worth noting that the size of the nonprofit typically determines the level of overhead, with very small and very large organizations requiring the lowest percentages.[55]

In New York State, the issue of rate of government reimbursement for overhead expenses has surfaced recently because of Executive Order 38, which Governor Cuomo signed into law in 2012. As of 2015, the Executive Order is in full effect, and the regulations limit the percentage of organizational overhead paid for by state funds to 15%[56] This is not an unreasonable amount (most nonprofits report overhead levels of below 30%), but strategies designed to boost the impact of the independent sector should account for the "hallowing out" effect that can occur for organizations which—because of the nature of their work—have high overhead rates.[57]

In addition to intervening on behalf of nonprofits on overhead reimbursement, economic development agencies should concentrate on increasing the bureaucratic efficiency of the procurement process. Various types of red tape—such as overly burdensome reporting requirements, delays in payments, and unexpected cost escalations—pose serious challenges for nonprofits. The participants in NYCEDC's roundtable spoke directly to these concerns, complaining that some of required paperwork was "tedious and rigid" and prohibited "new models of thinking and operating," while cost delays "ended up costing their organizations significant amounts of money."[58] While New York City benefits from some of the country's most progressive laws requiring prompt contracting and payments to nonprofit contractors, those laws are seldom enforced with 92.5% of the state's contracts completed late.[59] On the national level, the Urban Institute's 2012 study included an illuminating graph, which is reproduced below, that highlighted the main buerocratic inefficiencies of concern to nonprofits throughout the country.

Figure II. Key Problems Reported about Government Contracts and Grants



Source: Source: Urban Institute, National Survey of Nonprofit-Government Contracts and Grants (2013).
Notes: Figures are based on nonprofit organizations included in the sampling frame. Missing or not applicable answers were excluded.
Percentages may not sum to 100 because of rounding.

While problems in government procurement are pervasive, there are simple and relatively painless strategies that economic development organizations and other government partners can employ to help address these issues. Here are five such approaches: First, launch electronic document vaults for storage and safekeeping of documents pertaining to nonprofits that are commonly requested by government agencies. New York, Connecticut, Illinois, and Maryland have implemented this innovative tactic with great success.[61] Second, follow the lead of the federal government through Grants.gov and create a transparent and accessible platform for sharing information about funding opportunities.[62] Third, simplify and standardize reporting requirements, so that federal, state and local government entities are consistent in what they demand of nonprofits. Part of this process involves standardizing definitions of "frequently used terms and standard accounting budget categories," so that all levels of government are on the same page.[63] Fourth, implement regulations requiring prompt payment of contracts and ensure those regulations are properly enforced. Lastly, collect and report on data related to government grants and contracts to monitor progress on these issues and to compare treatment of nonprofits with similarly situated for profit entities.[64] Collectively, these strategies would greatly improve the ease with which nonprofits can benefit from government funding, thereby strengthening the sector and, by extension, the economy.

VII. Strategy #6: Expanding the Human Capital Capacity of Nonprofits

The nonprofit community faces a significant resource deficiency in human capital, a deficit that economic development agencies and private sector partners are especially equipped to help address. Failure to address this problem will result in a continual weakening of the sector. Nonprofits confront challenges at every level of the human capital pipeline: recruitment, retention, and retirement. In terms of recruitment, nonprofits often cannot afford to compete in the "bidding war for top talent," meaning they often "lose out to the public and private sector."[65] Thus, the only type of personnel nonprofits can recruit—who are still qualified—are what one nonprofit executive called the "do gooder" types, who are few and far between.[66] Symptomatic of this is the common practice among nonprofits of requiring potential employees to first serve as unpaid interns.

The retention of nonprofit employees is equally problematic given the lack of resources available for salary raises and staff development. One scholar even prioritized retention over recruitment, conjecturing, "the true crisis is not a lack of bodies to fill nonprofit jobs; rather, it is the deficit of investment in current nonprofit people and the systems that support them.[67] In a 2012 study of social justice nonprofits in Oakland, CA, 63% of nonprofits set aside professional development budgets of $500 or less, and 55% of emerging nonprofit leaders thought they must leave their organizations "to advance their careers."[68] These trends are extremely detrimental since cultivating staff talent over time and benefiting from the institutional knowledge that longtime staff provide are key elements in sustaining organizations.

In regard to retirement, there are a host of challenges revolving around the current bottleneck created by nonprofit executives, who are continuing to work and have rejected the "golden years" version of retirement.[69] The bottleneck affects opportunities for less senior staff, and nonprofits are already voicing concerns about the leadership gaps that will exist once the executives do retire in the next several years.[70] On top of this, according to the Oakland survey, only half of social justice nonprofits offer retirement plans to their employees, which could be a reason why nonprofit employees are choosing to retire later.[71]

With the aim of rectifying these human capital deficiencies among nonprofits, New York City has fostered professional development programs such as Greater NY that pairs nonprofit executives with business leaders. The business leaders serve as mentors and advisors to nonprofit executives in negotiating organizational challenges.[72] In the past five years, Greater NY has facilitated nearly 40 mentoring relationships, but, if increased funding and staff resources were allocated in the future, this program could be scaled up to a significant extent. Another resource in developing nonprofit staff should be the growing number of universities and colleges offering degrees in nonprofit management and philanthropic studies.[73] While not all nonprofit staff may be able to pursue these programs full-time, taking select courses in "human resources and financial management" or "external development skills, like fundraising, advocacy, and marketing," could benefit junior and senior staff alike.[74]

Lastly, human capital programs that seek to improve the quality and functioning of nonprofit boards should continue to be reinforced. Scholars have repeatedly found that actively engaged board members improve "the financial stability of nonprofit organizations."[75] There are a number of excellent examples of programs that serve as models for training boards. The NEW Center in Ann Arbor, MI offers regular courses toward this end, and BoardServeNYC has been successful in training and recruiting prospective board members for New York City nonprofits. Expanding the human capital capacity of nonprofits—by addressing the challenges in the recruitment, retention, and retirement pipeline and promoting professional development—constitute a central component the overall strategy in building up the independent sector.[76]

VIII.Strategy #7: Expanding the Financial Capacity of Nonprofits

The last—and perhaps most important—strategy pertains to addressing the fundamental constraint inhibiting the growth of the nonprofit sector: limited financial capacity. With a great deal of frankness, one of the NYCEDC's roundtable participants articulated the essence of the problem for most nonprofits:

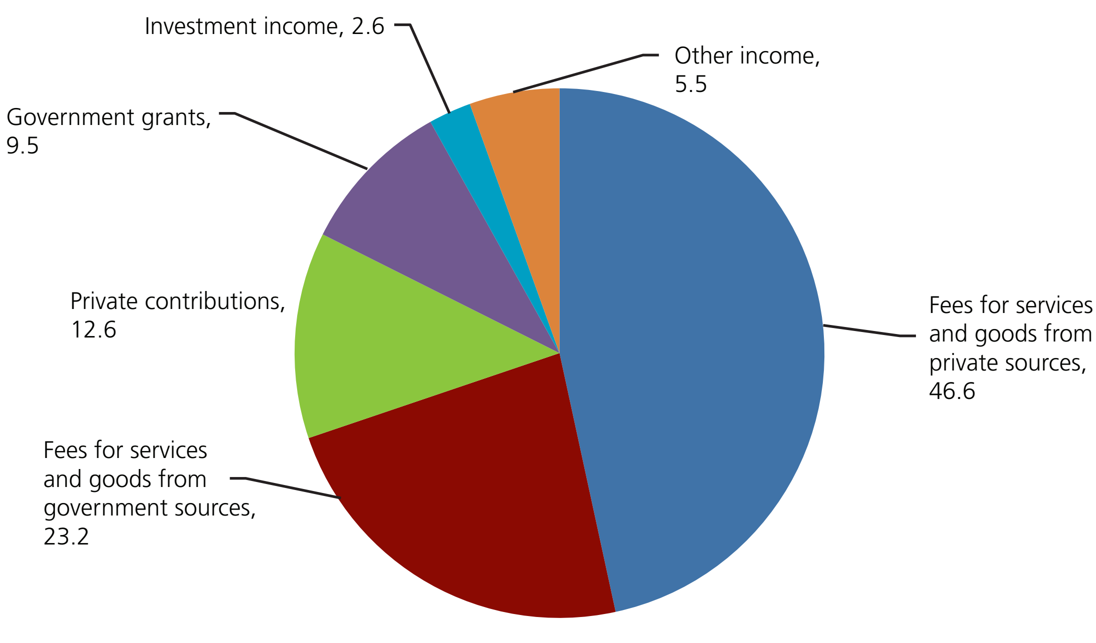
> We have to recognize that the expenses and revenues are not lined up. Nonprofit employees are mirroring their clients…[they are] just trying to live day-to-day. [They] cannot be thoughtful…they want to be creative, [but] do not have the time or money to figure out how to fix their model to operate in this new environment that has [dramatically] changed since 2008.[77]

Most nonprofits have less than three months of cash on hand, yet nonprofits that do generate savings are seen as less deserving funding candidates, leading to perverse incentives for long-term sustainable financial practices.[78] There is no consensus about how to measure the financial health of a nonprofit, but, generally, scholars utilize a series of financial ratios to approximate the ability of a particular nonprofit to secure funding from the government and other sources, grow over time and endure periods of financial hardship.[79] Some scholars differentiate between the term *financial stability*, which is defined as "organizational survival generated from reduced volatility in revenue streams" and *financial capacity* that relates to the "resources that give an organization the wherewithal to seize opportunities and react to unexpected threats," though the two concepts are interrelated and often are applied interchangeably.[80]

As to be expected, the financial needs of smaller nonprofits are distinct from large anchor institutions. In fact, research suggests it is more difficult for small nonprofits to raise funds and to connect to potential donors, which also makes them more vulnerable. But the majority of nonprofits are small, as nearly 90% of nonprofits have budgets less than $250,000.[81] Accordingly, the solutions developed by economic development agencies to promote the sector's financial stability and capacity should be tailor-made to the unique challenges confronting small institutions—which are the majority—and adapted to accommodate the different needs of larger institutions.

Further, as part of this strategic development, it is helpful to examine the specific types of funding that sustain nonprofits. The main sources of financial support for nonprofits include: fees for goods and services from private sources, fees for goods and services from public sources, private philanthropic contributions, other government grants, and several other smaller categories of other funding types. The following pie chart depicts how much revenue is generated from each source.[82]

Figure III: Nonprofit Revenue Sources



Source: "2014 State of the Nonprofit Sector Survey Results: Charting a New Path for Nonprofits"

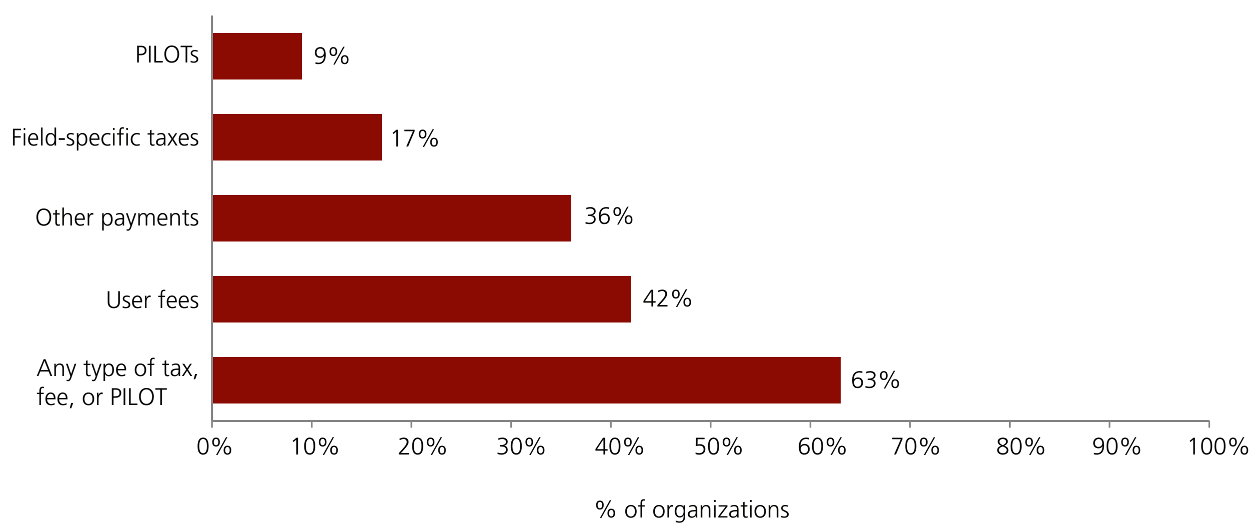
It is helpful to examine, also, what is notably missing from the top categories of funding: loans and capital from traditional sources like banks, which are readily available to private sector entities. While some types of nonprofits, like hospitals, have successfully convinced banks of their fitness to take on debt, hospitals benefit from stable revenue streams and large scale fee for service transactions that most other nonprofits do not have.[83]

Economic development agencies can play a role in diversifying the types of funding accessible to all types of nonprofits. Agencies can assist with the creation of earned income ventures, bridge gaps between banks and nonprofits, so that debt becomes a more readily available funding tool, and, as a third measure, they can help nonprofits conduct long-term financial planning.[84]

Lastly, taxation of nonprofit entities is a growing concern for implementing a comprehensive strategy to augment the financial capacity of the sector. As state and local governments become more strapped with their own financial situations, they have begun to pursue innovative methods for enlarging the tax base to include nonprofits by charging utility fees and negotiating PILOTS (Payments In Lieu Of Taxes). In the state of New York, for example, Nassau County recently mandated a "water use fee" for "tax exempt public and nonprofit water and sewer users," and the City of Schenectady is planning to implement a "curb fee" to cover road services, which is calculated based on the amount of property fronting the road, regardless of whether the property is tax-exempt or not.[85] The Johns Hopkins Nonprofit Listening Post Project conducted a nationwide survey to determine the extent to which nonprofits were affected by these new forms of taxation. 358 nonprofits were questioned. Respondents were asked to distinguish between "field-specific taxes" like admission charges or bed taxes; "other payments" like property or sales tax, "user fees" for utilities such as water, sewer, or garbage; and, lastly, "PILOTS," which are mainly levied on large nonprofits. The figure below demonstrates the responses from nonprofits, including the fact that 63% of organizations surveyed were charged some sort of tax despite being designated tax-exempt.[86]

Johns Hopkins also conducted interviews in this survey, which revealed confusion among nonprofit executives on the seemingly contradictory nature of these policies. One representative from a nonprofit theater declared, "It's odd to think of making payments to the very governments whose agencies support us with grants."[87] Other individuals were more pointed in their criticism, like this executive from an elderly housing and services agency: "PILOTs are an inappropriate way for municipalities to attempt to cover their own shortfalls at the expense of other organizations which are serving the community, and should be strongly opposed and discouraged."[88] Accordingly, in crafting state and local budgets, government officials would be wise to recognize the potential pitfalls of taxing and charging fees to nonprofits, though these measures may be necessary in certain cases. Generally, this form of taxation is found to be inefficient given that nonprofit funding stems in large part from government contracts and grants. Economic development agencies can advocate on behalf of fair tax policies that do not adversely impact nonprofits.

Figure IV: Share of Responding Organizations Reporting Various Types of Fees and Taxes (n=351)



Source: The Johns Hopkins Nonprofit Listing Post Project Government Taxation Sounding, 2010

IX. Conclusion

Nonprofit institutions are often undervalued for the contributions they make as engines of local and state economies and sources of employment. Economic development organizations should develop comprehensive strategies that account for the unique needs of nonprofits and facilitate opportunities to grow the sector. There is no simple, catchall solution, for the issues confronting nonprofits are complex. The Executive Director for New York City's Center for Economic Opportunity said quite plainly: "There is no 'secret sauce' to strengthening and developing the capacity of nonprofits."[89] However, best practices for leveraging the economic impact of nonprofits include the following seven approaches: 1) transforming perceptions that nonprofits should not act like businesses; 2) pursuing colocation opportunities for nonprofits; 3) facilitating collaboration among nonprofit entities and between the independent sector and the private sector; 4) bolstering the role of the "nonprofit liaison" within local and state governments; 5) improving the system of government procurement; 6) expanding the human capital capacity of nonprofits; and, lastly, 7) building up the financial capacity of nonprofits.

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About the Social Capital Desk

The Social Capital Desk aims at growing and strengthening the impact ecosystem in New York City for long-term economic growth and strong communities. We cultivate the conditions for mission-driven businesses to thrive; enable the broader business community to integrate financial objectives with social and environmental ones; and recommend regulatory and policy framework to accelerate social impact entrepreneurship and investing.

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