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The Resilient Sector: The State of Nonprofit America

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When three hijacked planes crashed into the World Trade Center and the Pentagon on the morning of September 11, 2001, the police, fire, and military organs of New York City, Washington, D.C., and the U.S. government were not the only entities to respond with heroism and élan. The events of that horrific morning also triggered a spirited response from the vast, uncharted network of private voluntary institutions that forms the unseen social infrastructure of American life. In small towns and large cities, from the Florida Keys to northernmost Alaska, people rushed to offer assistance. In part, the responses were spontaneous and unstructured. But in far larger part, they were organized and orchestrated, mobilized by the vast assortment of organizations and institutions that compose what is increasingly recognized as a distinct, if not wholly understood, sector of our national life known variously as the nonprofit, the charitable, or the civil society sector.

Like the arteries of a living organism, these organizations carry a life force that has long been a centerpiece of American culture—a faith in the capacity of individual action to improve the quality of human life. They thus embody two seemingly contradictory impulses that form the heart of American character: a deep-seated commitment to freedom and individual initiative and an equally fundamental realization that people live in communities and consequently have responsibilities that extend beyond themselves. Uniquely among American institutions, those in the nonprofit sector blend these competing impulses, creating a special class of entities dedicated to mobilizing *private initiative for the common good.*

The terrorists who crashed civilian jetliners into unarmed buildings on that fine September morning did not, therefore, assault a nation without the capacity to respond. That capacity extended well beyond the conventional and visible institutions of government. It embraced as well a largely invisible social infrastructure of private, charitable groups and the supportive impulses to volunteer and give that it has helped to nurture.

And respond it did. Within two months, individuals, corporations, and foundations had contributed $1.3 billion in assistance to a wide array of relief efforts. Blood donations alone were estimated to have increased between 250,000 and 400,000 pints in the wake of the disaster.[1] Some of the institutions involved in mobilizing this response were household words—the Red Cross, the Salvation Army, and United Way. Others were established but less-well-known institutions like the New York Community Trust, the Community Service Society of New York, the Chicago Mercantile Exchange Foundation, and many more. Still others were created especially to deal with this crisis—the September 11 Fund, the Twin Towers Fund, Trial Lawyers Care (to assist victims with legal issues), and the Alaska Culinary Association (to benefit families of restaurant workers killed in the World Trade Center collapse). Altogether, some 200 charitable organizations reportedly pitched in to help directly with the relief and recovery effort in New York alone, and countless others were involved more indirectly. According to one recent survey, an astounding 70 percent of all Americans made some kind of contribution to this response.[2]

Revealing though this episode has been of the remarkable strengths of America's "third," or nonprofit, sector, however, it simultaneously revealed the sector's limitations as well. Private voluntary groups, though highly effective in mobilizing individuals to act, are far less equipped to structure the resulting activity. In short order, the fragile systems of nonprofit response were severely challenged by the enormity of the crisis they confronted in the aftermath of September 11. Individual agencies, concerned about their autonomy, resisted efforts to coordinate their responses, either with each other or with government authorities. Individuals in need of assistance had to navigate a multitude of separate agencies, each with its own eligibility criteria and targeted forms of aid. Inevitably, delays and inequities occurred; many individuals fell through the slats, while others benefited from multiple sources of assistance. What is more, misunderstandings arose between the donors, most of whom apparently intended their contributions to be used for immediate relief, and some agencies, most notably the Red Cross, that hoped to squirrel the funds away for longer-term recovery, general institutional support, and other, less-visible, disasters down the road. What began as an inspiring demonstration of the power of America's charitable community thus became a demonstration of its shortcomings as well.

In this, the story of the nonprofit sector's response to the crisis of September 11 is emblematic of its position in American life more generally. Long celebrated as a fundamental part of the American heritage, America's nonprofit organizations have suffered from structural shortcomings that limit the role they can play. This juxtaposition of strengths and limitations, in turn, has fueled a lively ideological contest over the extent to which we should rely on these institutions to handle critical public needs, with conservatives focusing laser-like on the sector's strengths and liberals often restricting their attention to its weaknesses instead. Through it all, though largely unheralded and perhaps unrecognized by either side, a classically American compromise has taken shape. This compromise was forged early in the nation's history, but it was broadened and solidified in the 1960s. Under it, nonprofit organizations in an ever-widening range of fields were made the beneficiaries of government support to provide a growing array of services—from health care to scientific research—that Americans wanted but were reluctant to have government directly provide.[3] More than any other single factor, this government-nonprofit partnership is responsible for the growth of the nonprofit sector as we know it today.

During the past twenty years, however, that compromise has come under considerable assault. At the same time, the country's nonprofit institutions have faced an extraordinary range of other challenges as well—significant demographic shifts, fundamental changes in public policy and public attitudes, new commercial impulses, massive technological developments, and changes in lifestyle, to cite just a few. Although nonprofit America has responded with creativity to many of these challenges, the responses have pulled it in directions that are, at best, poorly understood and, at worst, corrosive of the sector's special character and role.

Despite the significance of these developments, little headway has been made in tracking them systematically, in assessing the impact they are having both generally and for particular types of organizations, and in getting the results into the hands of nonprofit practitioners, policymakers, the press, and the public at large. This book is intended to fill this gap, to offer an overview of the state of America's nonprofit sector, and to identify the changes that might be needed to promote its long-term health. To do so, the book assembles a set of original essays prepared by leading authorities on key components of the American nonprofit scene and on the key trends affecting their evolution. The result is the first recent integrated account of a set of institutions that we have long taken for granted, but that the Frenchman Alexis de Tocqueville recognized more than 175 years ago to be "more deserving of our attention" than any other part of the American experiment.[4]

This chapter summarizes the basic story that emerges from this assessment. Given the diversity of America's nonprofit institutions and the multitude of forces impinging on its various parts, this is no mean task. From my perspective, however, a dominant, if hardly universal, impression clearly emerges from the separate brush strokes of analysis offered in this book's chapters. Fundamentally, it is an impression of *resilience*, of a set of institutions and traditions facing enormous challenges but also important opportunities and finding ways to respond to both with considerable creativity and resolve. Indeed, nonprofit America appears to be well along in a fundamental process of "reengineering" that calls to mind the similar process that large segments of America's business sector have undergone since the late 1980s.[5] Faced with an increasingly competitive environment, nonprofit organizations have been called on to make fundamental changes in the way they operate. And that is just what they have been doing.

What is involved here, moreover, is not simply the importation of "business methods" into nonprofit organizations, although that is sometimes how it is portrayed.[6] While nonprofits are becoming more "business-like," the business methods they are adopting have themselves undergone fundamental change in recent years, and many of the changes have involved incorporating management approaches that have long been associated with nonprofit work—such as the emphasis on organizational mission, the ethos of service to clients, and the need to imbue staff with a sense of purpose beyond the maximization of profit. In a sense, these longtime nonprofit management principles have now been fused with business management techniques to produce a blended body of management concepts that is penetrating business and nonprofit management alike.

Like all processes of change, this one is far from even. Some organizations have been swept up in the winds of change, while others have hardly felt a breeze or, having felt it, have not been in a position to respond. What is more, it is far from clear which group has made the right decision or left the sector as a whole better off, since the consequences of some of the changes are far from certain and at any rate are mixed.

Any account of the "state of nonprofit America" must therefore be a story in three parts, focusing first on the challenges and opportunities America's nonprofit sector is confronting, then examining how the sector's institutions are responding to these challenges and opportunities, and finally, assessing the consequences of these responses both for individual organizations and subsectors and for nonprofit America as a whole. The balance of this chapter offers such an account. To set the stage, however, it may be useful to explain more fully what the nonprofit sector is and why it deserves our attention.

What Is the Nonprofit Sector and Why Do We Need It?

The nonprofit sector is a vast and diverse assortment of organizations. It includes most of the nation's premier hospitals and universities, almost all of its orchestras and opera companies, a significant share of its theaters, all of its religious congregations, the bulk of its environmental advocacy and civil rights organizations, and huge numbers of its family service, children's service, neighborhood development, antipoverty, and community health facilities. It also includes the numerous support organizations, such as foundations and community chests, that help to generate financial assistance for these organizations, as well as the traditions of giving, volunteering, and service they help to foster.

More formally, we focus here on organizations that are eligible for exemption from federal income taxation under Section 501(c)(3) of the tax code, plus the closely related "social welfare organizations" eligible for exemption under Section 501(c)(4) of this code. Included here are organizations that operate "exclusively for religious, charitable, scientific, or educational purposes" and that do not distribute any profits they may generate to any private shareholder or individual. Alone among the twenty-six types of organizations exempted from federal income taxation, the 501(c)(3) organizations are also eligible to receive tax-deductible contributions from individuals and businesses, a reflection of the fact that they are expected to serve broad public purposes as opposed to the interests and needs of the members of the organization alone.[7]

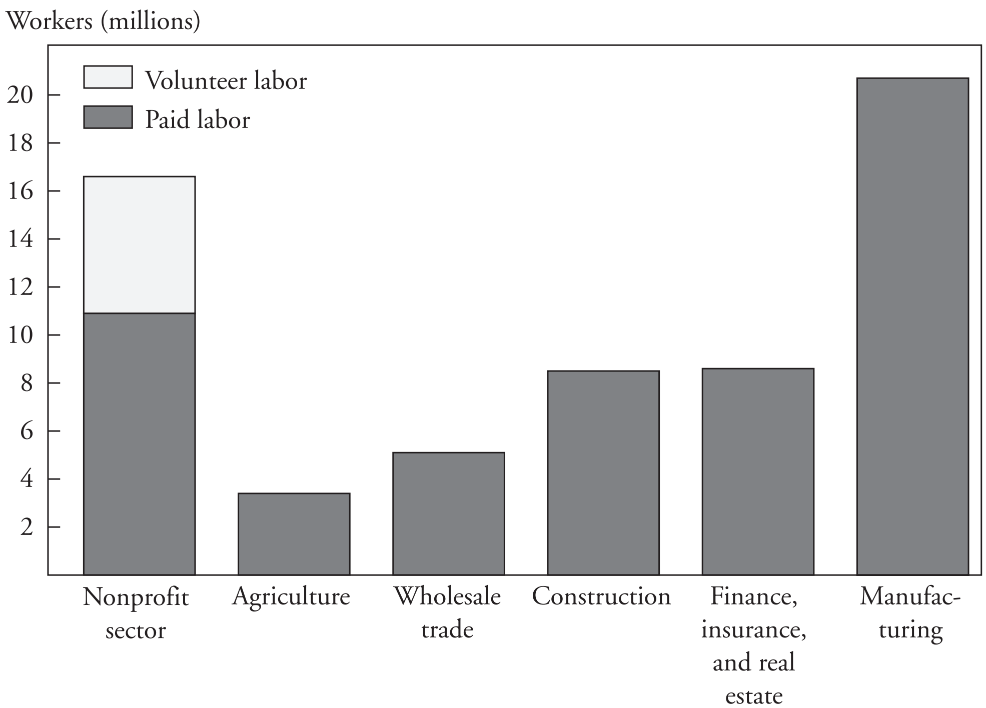
Scale

No one knows for sure how many such nonprofit organizations exist in the United States, since large portions of the sector are essentially unincorporated and the data available on even the formal organizations are notoriously incomplete. A conservative estimate puts the total number of formally constituted 501(c)(3) and (c)(4) organizations at 1.2 million as of the mid-1990s, including an estimated 350,000 churches and other religious congregations.[8] As of 1998, these organizations employed close to 11 million paid workers, or over 7 percent of the U.S. work force, and enlisted the equivalent of another 5.7 million full-time employees as volunteers.[9] This means that paid employment alone in nonprofit organizations is three times that in agriculture, twice that in wholesale trade, and nearly 50 percent greater than that in both construction and finance, insurance, and real estate, as shown in figure 1-1. With volunteer labor included, employment in the nonprofit sector, at 16.6 million, approaches that in all branches of manufacturing combined (20.5 million).[10]

Most of this nonprofit employment is concentrated in three fields—health (43 percent), education (22 percent), and social services (18 percent). With volunteers included, the distribution of employment changes significantly, with the religious share swelling to 23 percent and health dropping to 34 percent (figure 1-2).

These large categories disguise, however, the huge array of separate services and activities in which nonprofit organizations are involved. A classification system developed by the National Center for Charitable Statistics, for example, identifies no fewer than twenty-six major fields of nonprofit activity and sixteen functions—from accreditation to fundraising—in each. Each of the major fields

Figure 1-1. *Nonprofit Employment in Relation to Employment in Major U.S. Industries, 1998*

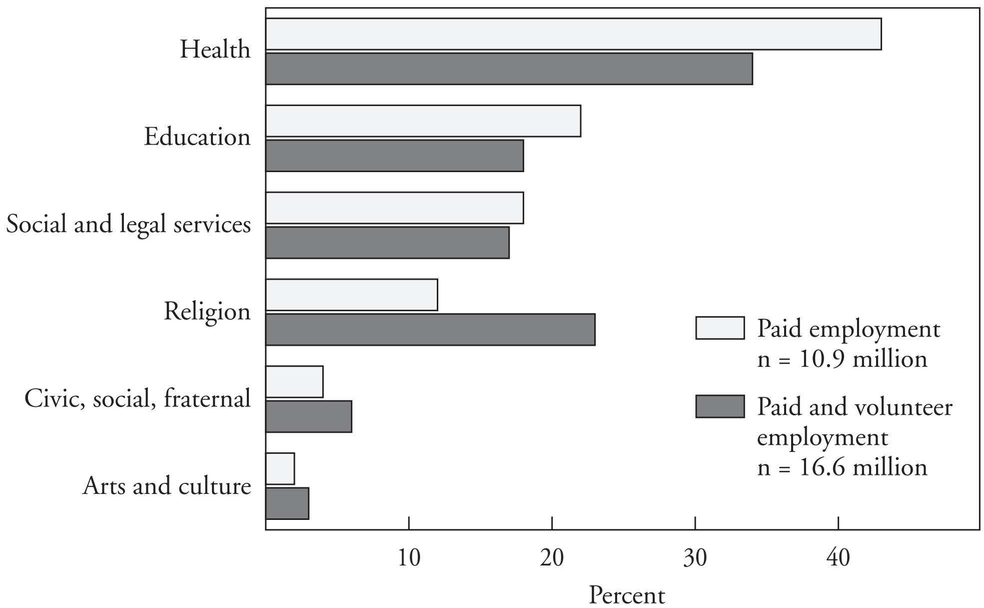


Source: Murray S. Weitzman, Nadine Tai Jalandoni, Linda M. Lampkin, and Thomas H. Pollack, *The New Nonprofit Almanac and Desk Reference* (San Francisco: Jossey-Bass, 2002), pp. 33, 23, 80; U.S. Census Bureau, *Statistical Abstract of the United States,* 120th ed. (Washington: U.S. Government Printing Office, 2000), p. 420.

is then further subdivided into subfields. Thus, for example, the field of arts, culture, and humanities has fifty-six subfields, and the field of education has forty-one. Altogether, this translates into several thousand potential different types of nonprofit organizations.[11]

Even this fails to do justice to the considerable diversity of the nonprofit sector. Most of the employment and economic resources of this sector are concentrated in large organizations. However, most of the organizations are quite small, with few or no full-time employees. Of the nearly 670,000 organizations recorded on the Internal Revenue Service's list of formally registered 501(c)(3) organizations (exclusive of religious congregations and foundations) in 1998, only about a third, or 224,000, filed the information form (Form 990) required of all organizations with expenditures of $25,000 or more. The remaining two-thirds of the organizations were thus either inactive or below the $25,000 spending threshold for filing.[12] Even among the filers, moreover, the top 4 percent accounted for nearly 70 percent of the reported expenditures, while the

Figure 1-2. *Distribution of Nonprofit Employment, Paid and Volunteer, by Field, 1998*



Source: Author's estimates based on data in Weitzman and others, *The New Nonprofit Almanac and Desk Reference* (San Francisco: Jossey-Bass, 2002); Virginia B. Hodgkinson and Murray S. Weitzman, *Nonprofit Almanac: 1996/97* (San Francisco: Jossey-Bass, 1996).

bottom 40 percent, with expenditures of less than $100,000 each, accounted for less than 1 percent of the total.[13]

Roles and Functions

Quite apart from their economic importance, nonprofit organizations make crucial contributions to national and community life.[14]

THE SERVICE ROLE. In the first place, nonprofit organizations are *service providers*: they deliver much of the hospital care, higher education, social services, cultural entertainment, employment and training, low-income housing, community development, and emergency aid services available in our country. More concretely, this set of organizations constitutes:

—Half of the nation's hospitals,
—One-third of its health clinics,
—Over a quarter of its nursing homes,
—Nearly half (46 percent) of its higher education institutions,
—Four-fifths (80 percent) of its individual and family service agencies,
—70 percent of its vocational rehabilitation facilities,

—30 percent of its daycare centers,
—Over 90 percent of its orchestras and operas,
—The delivery vehicles for 70 percent of its foreign disaster assistance.

While disagreements exist over how “distinctive” nonprofit services are compared to those provided by businesses or governments, nonprofits are well known for identifying and addressing unmet needs, for innovating, and for delivering services of exceptionally high quality. Thus nonprofit organizations pioneered assistance to AIDS victims, hospice care, emergency shelter for the homeless, food pantries for the hungry, drug abuse treatment efforts, and dozens more too numerous to mention. Similarly, many of the premier educational and cultural institutions in the nation are private, nonprofit organizations—institutions like Harvard, Princeton, Johns Hopkins, the Metropolitan Museum of Art, and the Cleveland Symphony, to name just a few. While public and for-profit organizations also provide crucial services, there is no denying the extra dimension added by the country’s thousands of private, nonprofit groups in meeting public needs that neither the market nor the state can, or will, adequately address.

THE ADVOCACY ROLE. In addition to delivering services, nonprofit organizations also contribute to national life by identifying unaddressed problems and bringing them to public attention, by protecting basic human rights, and by giving voice to a wide assortment of social, political, environmental, ethnic, and community interests and concerns. Most of the social movements that have animated American life over the past century or more operated in and through the nonprofit sector. Included here are the antislavery, women’s suffrage, populist, progressive, civil rights, environmental, antiwar, women’s, gay rights, and conservative movements. The nonprofit sector has thus operated as a critical social safety valve, permitting aggrieved groups to bring their concerns to broader public attention and to rally support to improve their circumstances. This advocacy role may, in fact, be more important to the nation’s social health than the service functions the sector also performs.

THE EXPRESSIVE ROLE. Political and policy concerns are not the only ones to which the nonprofit sector gives expression. Rather, this set of institutions provides the vehicles through which an enormous variety of other sentiments and impulses—artistic, religious, cultural, ethnic, social, recreational—also find expression. Opera companies, symphonies, soccer clubs, churches, synagogues, fraternal societies, book clubs, and Girl Scouts are just some of the manifestations of this expressive function. Through them, nonprofit organizations enrich human existence and contribute to the social and cultural vitality of community life.

THE COMMUNITY-BUILDING ROLE. Nonprofit organizations are also important in building what scholars are increasingly coming to call social capital—

those bonds of trust and reciprocity that seem to be crucial for a democratic polity and a market economy to function effectively.[15] Alexis de Tocqueville understood this point well when he wrote in *Democracy in America*:

> Feelings and opinions are recruited, the heart is enlarged, and the human mind is developed, only by the reciprocal influence of men upon one another . . . these influences are almost null in democratic countries; they must therefore be artificially created and this can only be accomplished by associations.[16]

By establishing connections among individuals, involvement in associations teaches norms of cooperation that carry over into political and economic life.

VALUE GUARDIAN.[17] Finally, nonprofit organizations embody, and therefore help to nurture and sustain, a crucial national value emphasizing individual initiative in the public good. They thus give institutional expression to two seemingly contradictory principles that are both important parts of American national character: the principle of *individualism*—the notion that people should have the freedom to act on matters that concern them—and the principle of *solidarity*—the notion that people have responsibilities not only to themselves but also to their fellow human beings and to the communities of which they are part. By fusing these two principles, nonprofit organizations reinforce both, establishing an arena of action through which individuals can take the initiative not simply to promote their own well-being but to advance the well-being of others as well. This is not simply an abstract function, moreover. It takes tangible form in the more than $200 billion in private charitable gifts that nonprofit organizations help to generate from the American public annually and in the 15.8 billion hours of volunteer time they stimulate for a diverse array of purposes.

Challenges and Opportunities

Despite the important contributions they make, nonprofit organizations find themselves in a time of testing at present. To be sure, they are not alone in this. But the challenges facing nonprofit organizations are especially daunting, since they go to the heart of the sector's operations and raise questions about its very existence.

Nonprofit organizations have generally responded energetically and creatively to these pressures. What is more, they have taken ample advantage of the opportunities they also enjoy. But the responses have been uneven and not without risks. It is therefore necessary to look more closely at these challenges and opportunities and at the way nonprofit organizations have responded to them.

Key Challenges

Fundamentally, nonprofit America has confronted six critical challenges over the recent past. From all indications, moreover, these challenge seem likely to persist—and in some cases to intensify—in the years ahead.

THE FISCAL CHALLENGE. In the first place, America's nonprofit organizations have suffered from a persistent fiscal squeeze. To be sure, that squeeze was relieved in part in the aftermath of World War II, and particularly during the 1960s, thanks to a significant infusion of government support. Although it is not widely recognized, the government efforts to stimulate scientific advance and overcome poverty and ill health during this period relied heavily on nonprofit organizations for their operation.[18] By the late 1970s as a consequence, federal support to American nonprofit organizations outdistanced private charitable support by a factor of two to one, while state and local governments provided additional aid. What is more, this support percolated through a wide swath of the sector, providing needed financial nourishment to universities, hospital, clinics, daycare centers, nursing homes, employment and training organizations, family service agencies, and many more. Indeed, much of the modern nonprofit sector as we know it took shape during this period as a direct outgrowth of expanded government support.

This widespread government support to nonprofit organizations suffered a severe shock, however, in the early 1980s. Committed to a policy of fiscal restraint, and seemingly unaware of the extent to which public resources were underwriting private, nonprofit action, the Reagan administration attacked federal spending in precisely the areas where federal support to nonprofit organizations was most extensive—social and human services, education and training, community development, and nonhospital health. Although the budget cuts that occurred were nowhere near as severe as originally proposed, federal support to nonprofit organizations, outside of Medicare and Medicaid, declined by approximately 25 percent in real dollar terms in the early 1980s and returned to its 1980 level only in the late 1990s.[19] Although some state governments boosted their own spending in many of these fields, the increases were not sufficient to offset the federal cuts. Nonprofit organizations in the fields of community development, employment and training, social services, and community health were particularly hard-hit by these reductions. Although the government's fiscal pressure significantly eased in subsequent years, the experience of the 1980s and early 1990s has left a residue of anxiety that new budget pressures are now reviving.

Not just the amount, but also the form, of public sector support to the nonprofit sector changed during this period, moreover. Where earlier government offered grants and contracts to nonprofit organizations and gave nonprofits the inside track, during the 1980s and 1990s government program managers were encouraged to promote for-profit involvement in government contract work, including that for human services.[20] More significantly, the use of grants and contracts itself gave way increasingly to forms of assistance such as vouchers and tax expenditures that channel aid to consumers rather than producers, thus requiring nonprofits to compete for clients in the market, where for-profits have traditionally had the edge.[21] Already by 1980, the majority (53 percent) of federal assistance to nonprofit organizations took the form of such consumer subsidies, much of it through the Medicare and Medicaid programs. By 1986 this stood at 70 percent, and it continued to rise into the 1990s.[22] In part, this shift resulted from the concentration of the budget cuts of the 1980s on the so-called discretionary spending programs, which tended to be supply-side grant and contract programs, while Medicare and Medicaid—both of them demand-side subsidies—continued to grow.[23] In part also, however, it reflected the ascendance of conservative political forces that favored forms of assistance that maximized consumer choice. The price of securing conservative support for new or expanded programs of relevance to nonprofit organizations in the late 1980s and 1990s, therefore, was to make them vouchers or tax expenditures. The new Childcare and Development Block Grant enacted in 1990 and then reauthorized and expanded as part of the welfare reform legislation in 1996 specifically gave states the option to use the $5 billion in federal funds provided for daycare to finance voucher payments to eligible families rather than grants or contracts to daycare providers, and most states have pursued this option.[24] In addition, another $2 billion in federal daycare subsidies is delivered through a special childcare tax credit. Nonprofit daycare providers, like their counterparts in other fields, have thus been thrown increasingly into the private market to secure even public funding for their activities. As a result, they have been obliged to master complex billing and reimbursement systems and to learn how to "market" their services to potential "customers."

Not only did government support to nonprofit organizations change its form during this period, but so did important elements of private support. The most notable development here was the emergence of "managed care" in the health field, displacing the traditional pattern of fee-for-service medicine. Medicare provided an important impetus for this development by replacing its cost-based reimbursement system for hospitals in the early 1980s with a system of fixed payments for particular procedures. Corporations, too, responded to the rapid escalation of health care benefits for their workers by moving aggressively during the 1980s to replace standard fee-for-service insurance plans with managed care plans that featured up-front "capitation" payments to managed care providers. These providers then inserted themselves between patients and health care providers, negotiating rates with the providers and deciding which procedures were truly necessary. By 1997, close to 75 percent of the employees in medium and large establishments, and 62 percent of the employees in small establishments, were covered by some type of managed care plan.[25] More recently, managed care has expanded into the social services field, subjecting nonprofit drug treatment, rehabilitation service, and mental health treatment facilities to the same competitive pressures and reimbursement limits as hospitals have been confronting.

Adding to the fiscal pressure nonprofits face has been the inability of private philanthropy to offset cutbacks in government support and finance expanded nonprofit responses to community needs. To be sure, private giving has grown considerably in recent years. Between 1977 and 1997, for example, total private giving grew by 90 percent after adjusting for inflation, roughly equivalent to the growth of gross domestic product. However, this lumps the amounts provided for the actual operations of charities in a given year with large endowment gifts to foundations, universities, and other institutions that are typically not available for use in a given year, as well as with gifts to religious congregations, most of which go to the upkeep of the congregations and clergy, as Mark Chaves shows in chapter 8 of this volume. When we focus on the private gifts available to support nonprofit human service, arts, education, health, and advocacy organizations in a given year, the growth rate was closer to 62 percent, still impressive but well below the 81 percent growth rate of gross domestic product.[26] Indeed, as a share of personal income, private giving has been declining steadily in the United States: from an average of 1.86 percent in the 1970s, down to 1.78 percent in the 1980s, and to 1.72 percent in the early 1990s. Especially distressing, as Virginia Hodgkinson notes in chapter 12, has been the disappointing rate of giving by the well-off, which has fallen considerably as a share of their income over the past decade or more, perhaps as a result of tax changes that lowered the tax rates of the wealthy and hence their financial incentives to give.[27] While giving as a share of personal income increased somewhat in the late 1990s, it did not return to its 1970s level; and the stock market sell-off and recession of 2000–02 have constrained its further growth despite the outpouring of support in response to September 11.

Although giving has grown in absolute terms, therefore, it accounted for only 8 percent of the growth of the nonprofit sector outside of religion between 1977 and 1997. As a share of total sector income, private giving actually lost ground, falling from 18 percent of the total in 1977 to 12 percent in 1997, and there is little evidence that this has changed substantially in recent years.[28] Indeed, many types of nonprofit organizations fear that September 11 may bring a decline in charitable support as resources are shifted to post-disaster relief and recovery.

THE COMPETITION CHALLENGE. In addition to a fiscal challenge, nonprofit America has also faced a serious competitive challenge as a result of the striking

Table 1-1. *Nonprofit and For-Profit Roles in Select Fields, 1982–97*

Field	*Percentage nonprofit* 1982	*Percentage nonprofit* 1997	*Percentage change in relative nonprofit share*
Employment			
Child daycare	52	38	–27
Job training	93	89	–4
Individual and family services	94	91	–3
Home health	60	28	–53
Kidney dialysis centers	22	15	–32
Facilities, participation			
Dialysis centers	58[a]	32	–45
Rehabilitation hospitals	70[a]	36	–50
Home health agencies	64[a]	33	–48
Health maintenance organizations	65[a]	26	–60
Residential treatment facilities for children	87[b]	68	–22
Psychiatric hospitals	19[a]	16	–16
Hospices	89[c]	76	–15
Mental health clinics	64[b]	57	–11
Higher education enrollments	96	89	–7
Nursing homes	20[b]	28	+ 40
Acute care hospitals	58[a]	59	+ 2

Source: U.S. Census Bureau, *U.S. Economic Census* (Washington: U.S. Census Bureau, 1999); Bradford Gray and Mark Schlesinger, chapter 2 of this volume, fig. 2-1; National Center for Education Statistics, *Digest of Education Statistics 2000* (Washington: Department of Education, National Center for Education Statistics, 2000), pp. 202–03, 209.

a. Initial year for data is 1985, not 1982.

b. Initial year for data is 1986, not 1982.

c. Initial year for data is 1992.

growth of for-profit involvement in many traditional fields of nonprofit activity, from health care and welfare assistance to higher education and employment training. This, too, is not a wholly new development. But the scope of competition appears to have broadened considerably in recent years, and in an increasing range of fields nonprofits have been losing “market share.” Thus, as shown in table 1-1, the nonprofit share of daycare jobs dropped from 52 to 38 percent between 1982 and 1997, a decline of some 27 percent. Similarly sharp declines in the relative nonprofit share occurred among rehabilitation hospitals, home health agencies, health maintenance organizations, kidney dialysis centers, mental health clinics, and hospices. In many of these fields, the absolute number of nonprofit facilities continued to grow, but the for-profit growth outpaced it. And in at least one crucial field—acute care hospitals—while the nonprofit *share* increased slightly, a significant reduction occurred in the *absolute number* of nonprofit (as well as public) facilities, so that the for-profit share of the total increased even more.

The range of for-profit firms competing with nonprofits has grown increasingly broad, moreover. For example, the recent welfare reform legislation has attracted defense contractors like Lockheed-Martin into the social welfare field because it puts a premium on the information-processing and contract management skills they have developed as master contractors on huge military systems. Under many of these new arrangements, in fact, nonprofit providers are serving as subcontractors to for-profit firms hired by states or local governments to manage the welfare reform process. Even the sacrosanct field of charitable fundraising has recently experienced a significant for-profit incursion in the form of financial service firms such as Fidelity and Merrill Lynch, as Leslie Lenkowsky and Virginia Hodgkinson report in chapters 11 and 12, respectively, of this volume. By 2000, the Fidelity Charitable Gift Fund, established in 1991, had attracted more assets than the nation's largest community foundation and distributed three times as much in grants.[29]

The reasons for this striking pattern of for-profit success are by no means clear and vary from field to field. The shift in forms of public funding mentioned earlier has very likely played a role, however, forcing nonprofits to compete for subsidized customers in the marketplace, where for-profit firms have a natural advantage. The rise of health maintenance organizations and other "third-party payment" methods has had a similar effect, as Bradford Gray and Mark Schlesinger argue in chapter 2 of this volume, since such organizations emphasize price rather than quality or community roots in choosing providers, thus minimizing the comparative advantages of nonprofits. Technological developments have also given for-profit firms a strategic edge because technology puts a premium on access to capital and nonprofits have an inherent difficulty generating capital because their nonprofit status makes it impossible for them to sell shares in the equity markets. Nonprofits are therefore at a particular disadvantage in fields where rapid increases in demand or new technological innovations necessitate increased capital expenditures.[30]

THE EFFECTIVENESS CHALLENGE. One consequence of the increased competition nonprofits are facing has been to intensify the pressure on them to perform and to demonstrate that performance. The result is a third challenge: the effectiveness challenge. As management expert William Ryan has written, "Nonprofits are now forced to reexamine their reasons for existing in light of a market that rewards discipline and performance and emphasizes organizational capacity rather than for-profit or nonprofit status and mission. Nonprofits have no choice but to reckon with these forces."[31] This runs counter to long-standing theories in the nonprofit field that have emphasized this sector's distinctive advantage precisely in fields where "information asymmetry" makes it difficult to demonstrate performance and where "trust" is consequently needed instead. Because they are not organized to pursue profits, it was argued, nonprofits are more worthy of such trust and therefore are more reliable providers in such difficult-to-measure fields.[32]

In the current climate, however, such theories have few remaining adherents, at least among those who control the sector's purse strings. Government managers, themselves under pressure to demonstrate results because of the recent Government Performance and Results Act, are increasingly pressing their nonprofit contractors to deliver measurable results, too. Not to be outdone, prominent philanthropic institutions have jumped onto the performance bandwagon. United Way of America, for example, thus launched a bold performance measurement system in the mid-1990s complete with website, performance measurement manual, and video in order to induce member agencies to require performance measurement as a condition of local funding. Numerous foundations have moved in a similar direction, increasing their emphasis on evaluation both of their grantees and of their own programming.[33] Indeed, a new foundation affinity group, Grantmakers for Effective Organizations, has been formed, and a new "venture philanthropy" model is attracting numerous adherents.[34] The key to this model is an investment approach to grantmaking that calls on philanthropic institutions to invest in organizations rather than individual programs, to take a more active hand in organizational governance and operations, and to insist on measurable results.

The resulting "accountability environment" in which nonprofits are having to operate will doubtless produce many positive results. But it will also increase the pressures on hard-pressed nonprofit managers to demonstrate progress in ways that neither they, nor anyone else, may be able to accomplish, at least not without far greater resources than are currently available for the task. What is more, as Evelyn Brody shows in chapter 15, accountability expectations often fail to acknowledge the multiple stakeholders whose demands for accountability nonprofits must accommodate. The risk is great, therefore, that the measures most readily at hand, or those most responsive to the market test, will substitute for those most germane to the problems being addressed. That, at any rate, is the lesson of public sector experience with performance measurement, and the increased focus on price rather than quality or community benefit in third-party contracting with nonprofit health providers certainly supports this observation.[35]

THE TECHNOLOGY CHALLENGE. Pressures from for-profit competitors have also accelerated the demands on nonprofits to incorporate new technology into their operations. Indeed, technology has become one of the great wild cards of nonprofit evolution. Like the other challenges identified here, technology's impact is by no means wholly negative. As Elizabeth Boris and Jeff Krehely argue in chapter 9 of this volume, new information technology is increasing the capacity of nonprofits to advocate by reducing the costs of mobilizing constituents and connecting to policymakers and allies. This observation finds confirmation in Jeffrey Berry's careful analysis of the growing influence of citizen groups, which he attributes in important part to access to television news.[36] Technology is also opening new ways to tap charitable contributions. The September 11 tragedy may well have marked a turning point in this regard, since some 10 percent of the funds raised came via the Internet.[37]

Nonprofit education, health, and arts institutions are also benefiting from technological change. As Atul Dighe shows in chapter 16 of this volume, medical practice has already been transformed by new technology, but genetic engineering and the new field of bionics linking biosciences with electronics promise even more dramatic breakthroughs, making it possible to deliver medical services not only in one's home, but in one's body through the implantation of biosensors that can think and react. Digitization is having a similar effect in the arts world, as Margaret Wyszomirski points out in chapter 5 of this volume. Three on-site classical music websites are already in operation, providing live, streaming transmissions of orchestral concerts from around the world, and this is just the beginning. A project of the Mellon Foundation is digitizing the collections of hundreds of museums at a level of technical sophistication unmatched by anything even imagined before. Cultural institutions sit on vast stockpiles of cultural raw material that is potentially available for exploitation in the new digital era, and many institutions are taking advantage of the opportunities.

But enticing as the opportunities opened by technological change may be to the nation's nonprofit institutions, they pose equally enormous challenges. Most obvious, perhaps, are the financial challenges. As one recent study notes, "Information technologies are resource intensive. They entail significant purchase costs, require significant training and upkeep, and yet become obsolete quickly."[38] Because of the structural disadvantages nonprofits face in raising capital due to their inability to enter the equity markets, however, the massive intrusion of new technological requirements into their work puts them at a distinct disadvantage vis-à-vis their for-profit competitors. We have already seen the consequences of this in the health maintenance organization industry, where the lack of capital following the discontinuation of government funding led to the rapid loss of market share to for-profit firms, which were better able to capitalize the huge investments in information-processing equipment required to manage the large risk pools that make managed care viable. Similar pressures are now at work in the social services industry, where managed care is also taking root.

Not only does technology threaten to alter further the balance between nonprofits and for-profits, but also it threatens to alter the structure of the nonprofit sector itself, advantaging larger organizations over smaller ones. This is due in part to the heavy fixed costs of the new technology. Already, concerns about a "digital divide" are surfacing within the sector, as survey after survey reveals the unequal distribution of both hardware and the capacity to adapt the hardware to organizational missions.[39] Although initially stimulating competition by giving even small upstarts access to huge markets, information technology also creates "network effects" that accentuate the advantages of dominant players.[40] Significant concerns have thus surfaced that e-philanthropy will allow large, well-known national nonprofits to raid the donor bases of local United Ways and operating charities and that information technology more generally will give exceptional advantages to large nationally prominent agencies in the competition for business partners, government funding, and foundation grants.

But the challenges posed by technology go far beyond financial or competitive considerations. Also at stake are fundamental philosophical issues that go to the heart of the nonprofit sector's mission and modes of operation. As Wyszomirski shows in chapter 5, such issues have surfaced especially vividly in the arts arena where the new technology raises fundamental questions of aesthetics, creative control, and intellectual property rights. Similar dilemmas confront educational institutions that are tempted by the new technologies to "brand" their products and package them for mass consumption, but at the risk of alienating their professorate, losing the immediacy of direct student-faculty contact, and giving precedence to the packaging of knowledge rather than to its discovery. How these technological dilemmas are resolved could well determine how the nonprofit sector evolves in the years ahead.

THE LEGITIMACY CHALLENGE. The moral and philosophical challenges that American nonprofit organizations are confronting go well beyond those posed by new technology, however. Rather, a serious fault line seems to have opened in the foundation of public trust on which the entire nonprofit edifice rests. This may be due in part to the unrealistic expectations that the public has of these institutions, expectations that the charitable sector ironically counts on and encourages. Also at work, however, has been the strident indictment that conservative politicians and commentators have lodged against many nonprofit organizations over the past decade. The central charge in this indictment is that nonprofit charitable organizations have become just another special interest, regularly conspiring with government bureaucrats to escalate public spending and doing so not so much out of real conviction about the needs being served as out of a desire to feather their own nests. Heritage Foundation president Edward Fuelner put this case especially sharply in 1996, criticizing charities for urging Congress to expand social welfare spending, while themselves "feeding at the public trough."[41] Entire organizations have been formed, in fact, to "dehalo" the nonprofit sector in this way, charging that a "new kind of nonprofit organization" has emerged in recent years "dedicated not to voluntary action, but to an expanded government role in our lives."[42] To remedy this, advocates of this view rallied behind the so-called Istook amendment, which sought to limit the advocacy activity of nonprofit organizations by prohibiting any nonprofit organization receiving government support from using any more than 5 percent of its *total* revenues, not just its public revenues, for advocacy or lobbying activities.

Similar challenges to the legitimacy of nonprofit organizations have arisen from critics who take nonprofits to task for becoming *overly* professional and thus losing touch with those they serve. This line of argument has a long lineage in American social science, as evidenced by the brilliant analysis by historian Roy Lubove of the professionalization of social work, which led social workers away from social diagnosis, community organizing, and social reform toward a client-focused, medical model of social work practice.[43] More recently, critics on the left have charged nonprofit organizations generally with contributing to the over-professionalization of social concerns. By redefining basic human needs as "problems" that only professionals can resolve, these critics contend, this over-professionalization alienates people from the helping relationships they could establish with their neighbors and kin.[44] By embracing professionalism, nonprofit organizations destroy community rather than building it up, the critics note. On the right, critics have been equally derisive of the professionalized human service apparatus, charging it with inflating the cost of dealing with social problems by "crowding out" lower-cost alternative service delivery mechanisms that are at least as effective.[45]

These sentiments echo loudly in the Bush administration's 2001 proposal to privilege "faith-based charities" in the distribution of federal assistance. A principal appeal of this idea is the prospect of replacing formal, professionalized nonprofit organizations with informal church groups staffed by dedicated volunteers. This reinforces a quaint nineteenth-century image of how charitable organizations are supposed to operate, an image that competitive pressures, accountability demands, and technological change have made increasingly untenable.

Coupled with a spate of high-profile scandals in the early 1990s, these criticisms seem to have shaken public confidence in charitable institutions. Surveys taken in 1994 and 1996 find only 33 and 37 percent of respondents, respectively, expressing "a great deal" or "quite a lot" of confidence in nonprofit human service agencies, well behind the proportions expressing similar levels of confidence in the military and small business (see table 1-2).[46] This improved considerably in the late 1990s, perhaps as a consequence of the perceived success of welfare reform. Yet, even at this latter date, while a substantial majority of respondents agreed that "charitable organizations play a major role in making our communities better places to live," only 20 percent "strongly agreed" with this statement. And only 10 percent were willing to agree "strongly" that most charities are "honest and ethical in their use of donated funds." All of this suggests that America's nonprofit institutions are delicately balanced on a knife-

Table 1-2. *Public Attitudes toward Charitable and Other Organizations in the United States, 1992–99*

	1992–96			*1999*	
	Percent expressing a great deal or quite a lot of confidence			*Percent expressing confidence*	
Institutions	*1992*	*1994*	*1996*	*A great deal*	*A great deal or quite a lot*
Youth development	48	47	50	33	72
Human services	37	33	37	29	68
Religious organizations	47	50	55	32	61
Private higher education	49	48	57	23	59
Military	49	49	54	22	57
Small business	46	53	56	16	55
Health organizations	40	36	39	15	43
Local government	24	23	31	9	33
State government	19	21	26	8	31
Federal government	18	19	23	8	27
Major corporations	19	22	24	7	29

Source: Independent Sector, *Giving and Volunteering in the United States, 1999* (Washington: Independent Sector, 1999), pp. 3, 5.

edge of public support, with most people willing to grant them the benefit of the doubt, but with a strong undercurrent of uncertainty and concern.[47] As a consequence, a relative handful of highly visible scandals—such as the United Way scandal of the early 1990s, the New Era Philanthropy scandal of the mid-1990s, or the Red Cross difficulties in the wake of September 11—can have an impact that goes well beyond their actual significance.

HUMAN RESOURCE CHALLENGE. Inevitably, fiscal stress and public ambivalence toward the nonprofit sector have taken their toll on the sector's human resources. Experts in the child welfare field, for example, have recently identified "staff turnover" as "perhaps the most important problem" facing the field, citing "stress, . . . overwhelming accountability requirements, and concern over liability" as the principal causes.[48] As Shepard Forman and Abby Stoddard show in chapter 7, similar problems afflict the international relief field due to the explosion of complex humanitarian crises that blend enormous relief challenges with complicated political and military conflicts.

Especially difficult has been the recruitment and retention of frontline service workers for whom salary, benefit, and safety issues are particularly important, but retention of managerial personnel has also grown increasingly problematic. One study of graduates of public policy programs reports, for example, that the proportion of these public-spirited young people who take their first job in nonprofit organizations doubled between the early 1970s and the early 1990s. However, the nonprofit sector's retention rate for these personnel has declined over time, with more turning to the for-profit sector as an alternative.[49] Of special concern is the turnover of talent and burnout at the executive director level. Executive directors who came into the field to pursue the social missions of their agencies find themselves expected to function instead as aggressive entrepreneurs leading outward-oriented enterprises able to attract paying customers, while retaining the allegiance of socially committed donors and boards, all of this in a context of growing public scrutiny and mistrust. According to one recent study, a surprising two-thirds of the executive directors in a national sample of nonprofit agencies were in their first executive director position, and over half of these had held the job for four years or less. Although most reported enjoying their job, a third indicated an intention to leave it within two years, and even among those likely to take another job in the nonprofit sector, only half indicated that their next job was likely to be as an executive director.[50] As Wyszomirski reports in chapter 5, leadership recruitment has become a particular challenge in the arts field, where the vacancy rate for art museum directors hit a fifteen-year high in 1999.

SUMMARY. In short, nonprofit America has confronted a difficult set of challenges over the recent past. Fiscal stress, increased competition, rapidly changing technology, and new accountability expectations have significantly expanded the pressures under which these organizations must work, and this has affected the public support these organizations enjoy and their ability to attract and hold staff.

Opportunities

But challenges are not all that nonprofit America has confronted in the recent past. It has also had the benefit of a number of crucial opportunities, many of which seem likely to persist. Four of these in particular deserve special attention.[51]

SOCIAL AND DEMOGRAPHIC SHIFTS. In the first place, recent social and demographic shifts have created new demands for nonprofit services and new prospects for attracting the personnel these organizations will need. Included among these shifts are the following:

—The doubling of the country's elderly population between 1960 and 2000 and the prospect that there will be four times as many elderly Americans in 2025 as there were in 1960,

—The jump in the labor force participation rate for women, particularly married women, from less than 20 percent in 1960 to 64 percent in 1998,[52]

—The doubling of the country's divorce rate since the 1960s and the resulting sharp jump in the number of children involved in divorces,[53]

—A fivefold increase in the number of out-of-wedlock births, from roughly 225,000 in 1960 to more than 1.25 million per year by the mid-1990s,[54]

—The doubling of refugees admitted to the United States, from 718,000 between 1966 and 1980 to 1.6 million during the next fifteen years.[55]

Taken together, these and other sociodemographic changes have expanded the demand for many of the services that nonprofit organizations have traditionally provided, such as child daycare, home health and nursing home care, family counseling, foster care, relocation assistance, and substance abuse treatment and prevention. What is more, the demand for these services has spread well beyond the poor and now encompasses middle-class households with resources to pay for them, a phenomenon that one analyst has called "the transformation of social services."[56] Indeed, the acceleration of modern life and the pressures on two-career families have led, as Dighe notes in chapter 16, to the "outsourcing" of key aspects of family life, from child daycare to tutoring and party arranging. Since nonprofit organizations are actively engaged in many of these fields, they stand to gain from this trend.

Equally important is the emergence of what Dighe, following demographer Paul Ray, calls the Cultural Creatives, a growing subgroup of the population that now numbers as many as 50 million people.[57] Cultural Creatives differ from both "Moderns" and "Traditionalists," the two other dominant population groups in America, by virtue of their preference for holistic thinking, their cosmopolitanism, their social activism, and their insistence on finding a better balance between work and personal values than the Moderns seem to have found. Although they have yet to develop a full self-consciousness, Cultural Creatives are powerfully attracted to the mission orientation of the nonprofit sector and could well help to resolve some of the sector's human resource challenges.

THE NEW PHILANTHROPY. Also working to the benefit of the nonprofit sector is a series of developments in private philanthropy. The first of these is the *intergenerational transfer of wealth* between the depression-era generation and the postwar baby boomers that is anticipated over the next forty years. Estimated to range anywhere from $10 trillion to $40 trillion or more, this wealth accumulated in the hands of the depression-era generation as a consequence of their relatively high propensity to save, their fortuitous investment during the 1950s and 1960s in relatively low-cost houses that then escalated in value, and the stock market surge of the 1980s and 1990s, which substantially boosted the value of their investments.[58]

A second development is the *new wealth* created by the dot-com economy and other powerful economic trends and policies during the 1980s and 1990s, substantially increasing income levels at the upper end of the income scale. Between 1979 and 1992, for example, the share of the nation's wealth controlled by the top 1 percent of households climbed from 20 percent to over