

THE Nonprofit QUARTERLY



Nonprofits & Democracy: *A View from the Current Century*

AND:

Nonprofits, Taxation & the Public Trust

Suarez, Castillo, and Pratt *on* the New Demands on Nonprofits
in a Pluralist and Equitable Democracy

NPQ Policy Position *on* PILOTs

Delaney and Pratt *on* Nonprofits and Taxes

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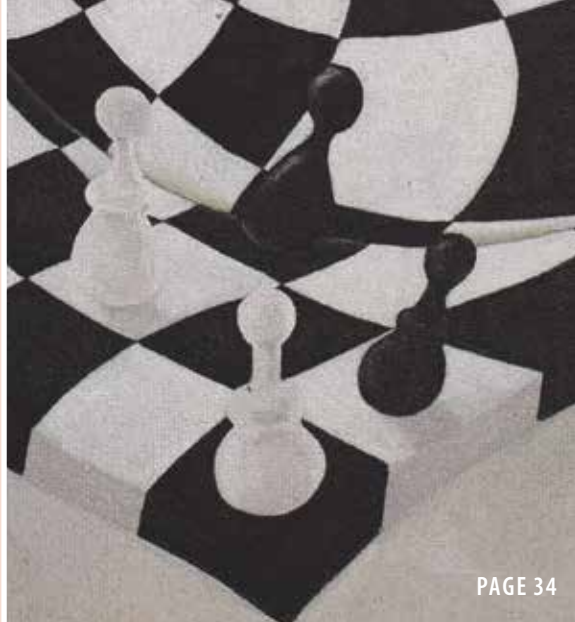


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by Aaron Tanaka

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Welcome

DEAR READERS,

This season's two main topics—one understanding the link between a healthy, engaged democracy and the nonprofit sector, and the other reviewing the local, state, and federal proposals to tax nonprofits—are deeply related. They are both intricately connected to the public's expectations of nonprofits—expectations that assume a values base that is partially memorialized in law and regulation but with plenty of room left for individual nonprofits to violate public trust. These violations accrue back to the whole sector in the form of public skepticism. Are we really who the public thinks we are? The mitigating force it hoped we would be? Or are we as capable of being unfair, self-serving, superficially driven, and greedy for money and power as any other sector? If so, we can expect to lose as much faith as other sectors have. Rob Atkinson, in a paper presented at the Third Annual Conference of the New York University School of Law Program on Philanthropy and the Law in 1991, neatly summarizes the expectations:



I think the charitable exemption reflects not only a desire to promote the helping of others, but also a healthy agnosticism about how that help can best be given, a willingness on the part of the majority to promote minority conceptions of the good of others. That, ultimately, is what we are asking our fellows to promote when we defend the charitable exemption. To persuade them, we may have to show more than that we are helping others by our own lights; we may have to point to the minor metabenefits that fall outside Grand Theory, and we may have to assure them that we are mindful of meta-harms like racial discrimination. In fairness, too, we must tell them how much helping others our way will cost. On this issue, economics will have much to tell us. But whether we assume those costs will depend, ultimately, on what kind of society we want to live in. That, I'm afraid, we will have to decide for ourselves.

With the nonprofits and democracy section, we confront the limitations of representation in our country's democracy, and consider what it will take to carry an agenda of equity into that larger system. We explore this sector's purpose vis-à-vis democracy, and advance some new thinking based in older principles about how to enter the sphere of public governance in a way that embeds social change in practice.

Regarding the nonprofits and taxes section: Every so often, a reader raises a hue and cry when *NPQ* takes an explicit position on a contentious policy or practice question. Readers: we do that! We have never purported to be “objective” reporters of the “facts” (nor believe objectivity in journalism exists). So, here is a warning to those who like their reporting free of opinion: in this cluster, we introduce *NPQ*'s position on how nonprofits ought to respond to proposals to tax the tax exempt, and we advance two proposals of our own—one of which some readers may find quite surprising.



The Nonprofit Whisperer

There are no absolutes regarding whether or not nonprofit mergers are a good idea—but they are never a simple undertaking. Mergers are costly, take a lot of preparation, and should only be contemplated after alternative options for strategic alliances have been studied. If you are considering a merger, the Nonprofit Whisperer advises, “Start with the value-add questions, particularly: Will this enhance our impact and delivery on mission? Are there ways to restructure other than a merger that might get us to the same or nearly same result?” Such questions will help keep you properly oriented as you explore the landscape.

DEAR NONPROFIT WHISPERER,
What are your thoughts on nonprofit mergers? Have you seen successes? Failures? Do you think not worth the time and money? A smart strategy to serve the community better?

*Interested in your feedback—thanks!
 Wondering*

Dear Wondering,
 This is an “all depends.” Mergers should really only occur after other options for strategic alliances (described in the final paragraph, below) have been explored and/or if there is a mission imperative. That said, heavily governmental contracting and third-party payer organizations have “market” pressures on them to become more viable—by building contract-heavy organizations that achieve a certain level of “scale.” This notion of scale may be driven by the idea of integrating linked services to constituents, but is often also justified by an effectiveness argument about achieving

critical mass and, by implication, cost effectiveness in administrative functions. But there is also likely a measure of consideration in there of establishing a stronger negotiating position with local government by becoming a big player.

Mergers are extremely costly, so organizations should analyze the return on investment alongside analyzing the mission benefit and impact on end users, as well as other “value-add” types of questions. This type of preplanning should be led by a seasoned consultant who does not have skin in the game regarding the outcome of whether a merger takes place or not. Besides enormous amounts of time discussing the merger, there can be costs associated with a consultant for guiding the process, along with expert support to integrate technology, human resources, communications, and financial and fund development. Attorneys are always involved, since (to paraphrase merger expert David La Piana) a merger involves dissolution of one nonprofit into another or dissolution of both

corporations into a new corporation.¹

If a partner has been identified, ensure that there is a values/culture match, or at least enough common ground to do the hardest work of the merger—which is actually post-paperwork and technical integration—and that there is a cultural alignment of the newly formed staff.

Merging is such a large undertaking that making sure to research the topic and to talk to nonprofits that have experienced successful mergers will be an important step. Your local philanthropies, particularly the community foundation and local nonprofit management association (if your region has one), will be able to provide resources and direction. And there is a growing amount of literature in the field about mergers that can help you learn more: from La Piana’s guide *The Nonprofit Mergers Workbook*² and Thomas McLaughlin’s *Nonprofit Mergers and Alliances*³ to research on successful mergers, such as the 2016 report *Mergers as a Strategy for Success*, by Donald Haider, Katherine

Cooper, and Reyhaneh Maktoufi,⁴ and articles like the *Nonprofit Quarterly's* "How to Save A Nonprofit: The Care Steps Required in Mergers and Acquisitions," by Bhakti Mirchandani.⁵

Before considering a merger, though, have the organization go through an exercise to surface the "why"—again. Start with the value-add questions, particularly: Will this enhance our impact and delivery on mission? Are there ways to restructure other than a merger that might get us to the same or nearly same result? Some examples of alternatives could include thinking about joint programming, shared staff, and shared space with like-minded organizations; creating a "management support" organization that provides all the administrative back-office supports to more than one organization (thereby creating

efficiencies); or using an established fiscal sponsor to provide administrative supports ranging from financial management and human resources to insurance umbrellas and even, in some cases, governance. These options are all spelled out in La Piana's workbook.⁶

NOTES

1. David La Piana, *The Nonprofit Mergers Workbook: The Leader's Guide to Considering, Negotiating and Executing a Merger* (St. Paul, MN: Fieldstone Alliance, 2000), 7.
2. Ibid.
3. Thomas A. McLaughlin, *Nonprofit Mergers and Alliances*, 2nd ed. (New Jersey: John Wiley and Sons, 2010).
4. Donald Haider, Katherine Cooper, and Reyhaneh Maktoufi, *Mergers as a Strategy for Success: 2016 Report from the Metropolitan Chicago Nonprofit Merger Research Project*

(Metropolitan Chicago Nonprofit Merger Research Project, 2016).

5. Bhakti Mirchandani, "How to Save a Nonprofit: The Care Steps Required in Mergers and Acquisitions," *Nonprofit Quarterly*, August 15, 2018, nonprofitquarterly.org/2018/08/15/how-to-save-a-nonprofit-mergers-acquisitions/.

6. La Piana, *The Nonprofit Mergers Workbook*.

THE NONPROFIT WHISPERER has over thirty years of experience in the nonprofit sector, serving variously as nonprofit staff and board member, foundation staff member, and nonprofit management consultant.

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THE Nonprofit QUARTERLY

Nonprofits and Democracy: **A View** *from the Current Century*

The relationship between nonprofits and democracy is far from firm.

As the articles in this cluster suggest, whether from a conceptual/theoretical standpoint, an historical standpoint, or a practical standpoint, nonprofits and democracy at best represent a less than fully formed alliance rooted in an historically problematic system of principles. Until we fully interrogate what “democracy” should look like and how the sector should design itself accordingly, this relationship—taken for granted by so many—will remain uncertain, if not meaningless.

THIS CLUSTER OF ARTICLES ADDRESSES ONE OF the most important conversations *NPQ* has seen repetitively circulate over the decades that we have been involved in the sector, around the question, “exactly *what* is the relationship of nonprofits to democracy?” Are nonprofits really essential venues for the development of our civic and democratic agency, and places where we can develop robust collective efforts for shared public benefit? Or, have they lost that distinction over the years?

The articles collected here address the question from a number of vantage points. Elizabeth Castillo acknowledges and names the many different theories of sectoral purpose that exist;

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these emerge from a variety of academic disciplines and together make little sense as threads of a whole cloth. But her main argument is for a coherent sectoral purpose that honors what the public really needs from this sector *uniquely*. She suggests that to truly embrace our identity as agents of democracy, we need to attempt a conceptual shift that acknowledges power and resource exchanges more explicitly.

Jon Pratt discusses the core democratic idea that is still reflected in many nonprofits when they are first started, but which has to compete for space as those organizations mature and become larger and more formalized. Pratt names the lures that seduce many organizations away from their focus on collective action for collective good, and suggests that we need to take a close look at the sector as it currently exists and consider how it might be redeveloped to serve those original purposes.

Cyndi Suarez discusses the challenges involved in nonprofits attempting to more seriously take on the role of being active agents of democracy, even as the necessity of real racial inclusion is finally being actively addressed in our so-called democratic institutions. Suarez outlines the challenges involved, not in trying to retake what many see as a devolved system of discourse but rather in trying to build what might finally be inclusive democratic systems and institutions. This will involve a recasting of our narratives and a disrupting of behaviors that subjugate. Suarez suggests that to be agents in

such an exciting endeavor, nonprofits and philanthropy must also look to their own modes of behavior, interrogating themselves more stringently.

These various strands of thinking are all corelevant in any number of situations on the ground, but a study by Megan Ming Francis on the NAACP and its early relationship with a white-dominated funding group stands out as illustrative of the obstacles we create to our own effectiveness when we do not keep these long-standing problems top of mind. The short version of the story is that the NAACP was drawn off its collectively conceived course by a funder in a way that Francis believes can be traced through to the current day. She calls this process “movement capture,” and names the dynamic as a serious threat to grassroots democratic action. “Why does the protection of black bodies from private and state-sanctioned violence remain an unmet challenge for civil rights groups committed to racial equality?” she asks, in a *Law & Society Review* article titled “The Price of Civil Rights: Black Lives, White Funding, and Movement Capture.” A key but under-recognized reason, she contends, is directly connected to this coopting.

We hope that this group of articles has the effect of reenergizing readers around the essentially powerful position the sector could hold in helping to craft the future of this country. We trust readers will keep this conversation progressing apace!

A Cult *of* Democracy— Toward *a* Pluralistic Politics

by Cyndi Suarez

IN THE UNITED STATES AND GLOBALLY, THERE IS much concern about both the devolution of democracy and the resurgence of racism and xenophobia. There is a sense that things are breaking down and the world no longer makes sense. But these challenges are intertwined and what are actually dying are the dominant narratives undergirding them. The bold-faced resurgence of some of their most extreme characteristics, while very dangerous, is also a testament to this final battle.

In 2019, as white supremacists balance entitled anger and outsized fears—deciding it is time to be more explicit (again) about the underlying goal of domination through an outright offensive for a white ethno-state, fearing the rise of people they consider different—we are still hailing too many firsts: the first black woman, the first gay,

CYNDI SUAREZ is a senior editor at the *Nonprofit Quarterly*. She is author of *The Power Manual: How to Master Complex Power Dynamics* (New Society Publishers, 2018), in which she outlines a new theory and practice of power. Suarez has worked as a strategy and innovation consultant with a focus on networks and platforms for social movements, and her studies centered on feminist theory and organizational development for social change.

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Even though many
wonder why democracy
looks the way it does
today, for some of those
who study democracy,
it comes as no surprise.

the first Muslim, the youngest. These leaders are running and winning because things are increasingly not working for more and more voters. Inequality has risen. Most people can't afford to cover basic needs like food, housing, education, and healthcare. And the earth is dying. The overarching task now is to construct a new narrative.

FIRST POINT: We urgently need a new narrative.

Democracy has been broadly defined as “a government in which the supreme power is vested in the people and exercised by them directly or indirectly through a system of representation usually involving periodically held free elections.”¹

Even though many wonder why democracy looks the way it does today, for some of those who study democracy, it comes as no surprise. Many, like Chantal Mouffe, professor of political theory at the Centre for the Study of Democracy at the University of Westminster, are calling the current state of democracy in the West a “populist moment.”

In her new book, *For a Left Populism*, Mouffe argues that this moment has been brought to us by the centrist policies of neoliberalism, which sought to hide conflict and different political interests in the midst of increasingly plural democracies with a “blurring of the frontier between right and left.”²

Mouffe contends that the rise of right wing populism reflects a break in the story as non-elite whites seek to recoup what they perceive as decreasing political and economic power. She proposes what she frames as a new democratic project for our times—the left needs to offer a democratic alternative that also *overlaps* with the political interests of the excluded “other.”

To do this, we must center what Mouffe calls “the *affects* of democracy.”³ Our identities are comprised in large part by the groups with which we identify; in other words, our identities are built upon our emotional connection to other people. The new narrative must take into account that politics is not only what we think, but what we feel. The left, she says, must focus on offering new political identities that support pluralism.

SECOND POINT: The new narrative is about the deepening of democracy; to enact it, we must evolve identities that not only make us think but also care about the collective.

Where Mouffe goes wrong is in her admittedly controversial claim that pluralistic democracies must engage as legitimate all of the demands made by its populace, even the xenophobic. While “these will be fought with vigor,” the “right to defend those ideas will never be questioned.”⁴ Instead, she argues, we must focus on the democratic aspirations that exist across perceived political differences.

Mouffe makes the mistake many liberals make when she assumes a level playing field.

Michael G. Hanchard, Africana professor at the University of Pennsylvania and director of the Marginalized Populations project, in his new book, *The Spectre of Race: How Discrimination Haunts Western Democracy*, describes how, rather than being new, Western democracy has always contained multiple regimes based on difference, known as racial democracies or ethno-regimes. The problem is that they are also unequal.

An understanding of this submerged history and its forces may lead us to conclude that this populist moment of mobilization against elites is also yet another half loop in the cycle of Western democracy that seeks to subordinate a portion of the social body for the benefit of the political elite, which in the West has been historically defined racially as white. Hanchard, having taken the time to understand this submerged narrative, starts not with an unexamined assumption but with a studied claim: that the practice of Western democracy has been one in which, from the beginning, “difference, figured as race, was rendered politically salient.”⁵

For Hanchard, tracking the organizing effect of race on the development of Western democracy hinges on the distinction between the *ethos*, or ideals, of democracy and the *ethnos* (the prevailing idea about who is the “highest, typical human being” in a nation) of its institutions and practices.⁶

He traces the concept of ethnos back to classical Athens, considered the font of Western

democracy, where “Slavery was rationalized as a necessary institution that allowed citizens to fully participate in civic life without material constraints.”⁷ Aristotle articulated the tension this produced for the legitimacy of the developing institution of democracy. Hanchard notes, “Contrary to many of his peers, Aristotle questioned the justification for slavery and was concerned about its corrosive effects upon both the slaves and citizens in classical Athens.”⁸

Ethnos shows up as a claim of racial homogeneity and superiority in heterogeneous societies; it articulates difference (gender, geographic origin, race, culture), and then creates political institutions and practices to manage this difference in order to secure privileged access to social resources for a political elite.

The dual nature of Western democracy was embraced and further articulated by the main colonial powers in their day-to-day management of the colonies and responses to the anticolonial movements they engendered. Hanchard outlines this arc for us when he writes, “The most robust, long-standing democratic polities in the contemporary world—France, Britain, and the United States—have been housed in societies that have profited from slave labor, empire, and colonialism.”⁹

Hanchard’s main claim is that Western powers didn’t just shape racialized peoples and colonized regions; this history of racism and colonization also shaped Western democracy.

In the colonies, where whites were physically outnumbered, the political elite developed racialized divide and conquer tactics. Hanchard explains, “Tactics devised and utilized to manage subject populations in a colonial territory, or even within the metropole, became part of the strategies of containment in the domestic sphere in the post-World War II period, evidenced in the following areas of governance: immigration, policing, and counterterrorism policies, and in the monitoring of dissent.”¹⁰ He concludes, “The legal, juridical, and institutional empowerment of citizens has been dynamically related to limiting second class citizens or prohibiting non-citizens from access to citizenship, as well as certain key economic and political institutions.”¹¹

From its inception, Western democracy has always been a balancing act of inclusive institutions and practices for those deemed legitimate and a different exclusive set for the illegitimate. Hanchard notes Hannah Arendt’s observation on the problem: “Racism deliberately cut across all national boundaries, whether defined by geographical, linguistic, traditional or any other standards, and denied national-political existence as such.”¹²

Thus, not only are ethno-regimes not level playing fields, inequality is a consistent feature of ethno-regimes in that their institutions and practices *produce* inequality.

The logic behind this approach is that the more difference is acknowledged in politics, the more elites consider politics to be impossible. In practice, it turns out that the opposite is true: the less difference is acknowledged, the more the need for politics. Hanchard brilliantly outlines the massive project that it was (and is) to create dual (or triad—citizen, second class citizen, and noncitizen) regimes. The resources required to sustain it are vast and widespread.

The *Atlantic*’s Ibram X. Kendi writes about the effort put into these regimes in the United States: “trace the issues rending American politics to their root, and more often than not you’ll find soil poisoned by racism.”¹³ Kendi spells out how racism affects the very rules of democracy.

Those people of color not imprisoned or deported are robbed of their political power by other means . . . In the old days, before the Voting Rights Act, states and counties suppressed voting by men and eventually women of color through property requirements, literacy tests, and poll taxes—while tacitly condoning employer intimidation and Ku Klux Klan violence. Now states and counties suppress voters through early-voting restrictions, limits on absentee and mail-in ballots, poll closures, felon disenfranchisement, and laws requiring voters to have a photo ID.

Voters of color who can’t be kept from the polls are herded into districts where their ballots, in effect, don’t count . . .

From its inception,
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Clearly, in the United States, the project of deepening democracy needs to overlap with the project of centering anti-racism. This, in spite of everything, is actually not controversial.

When the Supreme Court stripped federal preclearance from the Voting Rights Act in 2013, it removed one of the last antiracist policies from federal law.¹⁴

How can those positioned as illegitimate engage democratically across difference—especially while legitimizing xenophobia, as Mouffe proposes we do—when the very act triggers the white polity to erode their democratic rights? Instead, as Hanchard demonstrates, “many aspects of social inequality have political roots.”¹⁵ Contrary to Mouffe’s assertions (and her goal of building pluralist democracies), not only is xenophobia not compatible with democracy, in a system where racism has served as an actively silent design principle for exclusion, it must be actively named and designed against.

Kendi concludes,

[O]nly an embrace of antiracism can save the union. Antiracist ideas are built on the bedrock of racial equality. They recognize that any observed disparities between groups are the product not of hierarchy among races but of racist systems that create and perpetuate inequities. Antiracist policies seek to close the gaps in rights, resources, and opportunities that racist policies have opened and maintained.¹⁶

THIRD POINT: Racism is an actively silent design principle for exclusion in Western democracy, and deepening democracy requires actively designing against it.

Clearly, in the United States, the project of deepening democracy needs to overlap with the project of centering anti-racism. This, in spite of everything, is actually not controversial. A recent study—by Ian Haney López, author of *Dog Whistle Politics: How Coded Racial Appeals Have Reinvented Racism and Wrecked the Middle Class*, and Anat Shenker-Orsorio, author of *Don't Buy It: The Trouble with Talking Nonsense about the Economy*—found that “Democrats can prevail by telling a story that ties together race and class, calling out the right’s exploitation of racial anxiety as a tactic to divide and distract.”¹⁷ Stories like this one:

No matter where we come from or what our color, most of us work hard for our families. But today, certain politicians and their greedy lobbyists hurt everyone by handing kickbacks to the rich, defunding our schools, and threatening seniors with cuts to Medicare and Social Security. Then they turn around and point the finger for our hard times at poor families, Black people, and new immigrants. We need to join together with people from all walks of life to fight for our future, just like we won better wages, safer workplaces, and civil rights in our past. By joining together, we can elect new leaders who work for all of us, not just the wealthy few.¹⁸

Using focus groups, studies from four states, and an online national survey of 2,000 adults, Haney López and Shenker-Orsorio found that stories like this that address both race and class together beat right-wing stories and “standard left-of-center, race-neutral” ones.¹⁹ They note, “Overt mentions of race outperformed colorblind statements in rebutting conservative talking points.”²⁰ They conclude,

Here’s the secret: The race-class message describes racism as a strategy that the reactionary rich are using against all people. By moving away from conversations about racial prejudice that implicitly pit whites against others, the race-class message makes clear how strategic racism hurts everyone, of every race. It signals to whites that they have more to gain from coming together across racial lines to tackle racial and economic injustice than from siding with politicians who distract the country with racial broadsides.²¹

Hanchard observes that “the exclusion of certain populations from participation in a polity [is] based on superficial differences that are perceived as irreconcilable.”²² And this is the dominant narrative that wants to die. Luckily, many in the United States appear to be ready for a bigger politics, if we can only step up to the challenge. The new narrative is about universalizing democracy. We do need to develop new

political identities, Mouffe is right about that. These need to help us manage what Hanchard identifies as the “first form of inequality”—perceptual discrimination.²³

FOURTH POINT: The drama in the story, the hero's challenge, is to overcome the negative affects of political differences with a bigger narrative in order to universalize democracy across acknowledged difference.

Luckily, much has already been done to guide and anchor such efforts. For example, at the levels of rights, any legitimate, pluralist democracy should seek to comply with the Universal Declaration of Human Rights,²⁴ which includes additional articles from the International Convention on the Elimination of All Forms of Racial Discrimination, starting from the assumption that “the existence of racial barriers is repugnant to the ideals of any human society.”²⁵

In terms of institutions and practices, French political thinker and historian Alexis de Tocqueville's description of key elements of the democratic character of the U.S. associations that proliferated in the 1800s are often recalled in efforts to remember our earlier forms. They align along the following:

- Structures for deliberation
- Processes for transparency and accountability
- Stewards of rules and procedures
- Practices that ensure access and leadership development
- Products that capture shared practices²⁶

As for political identity, the *Atlantic's* Yoni Appelbaum, in a recent series on democracy, writes of that earlier time, “Democracy had become the *shared civic religion* of a people who otherwise had little in common. Its rituals conferred legitimacy regardless of ideology.”²⁷ (Italics mine.) He concludes, “There is no easy fix for our current predicament; simply voting Trump out of office won't suffice. To stop the rot afflicting American government, Americans are going to have to *get back* in the habit of democracy.”²⁸ (Italics mine.)

Hanchard does us the favor of clarifying this narrative when he writes,

Alexis de Tocqueville, a commentator on democracy in the United States, did not consider the Indian question or the Negro question to have significant import for the practice of United States democracy. [Gunnar] Myrdal and [Gustave de] Beaumont [Tocqueville's friend who accompanied him on his journey to the United States], on the other hand, perceived racial discrimination of *US African Americans* as a clear barometer of democracy.²⁹ (Italics mine.)

Like Tocqueville, Beaumont wrote about democracy in the United States, including the central role of race, but his writing never became popular.³⁰ This is, perhaps, not surprising. Hanchard points out,

Democracy is only one form of political rule that has tolerated, in fact benefited from, inequality, but it is also the only form of political rule for which inequality poses challenges to its ideological legitimacy.³¹

Hanchard points to Latin American political theorist Guillermo O'Donnell—whose political thinking acknowledged the plurality of Latin American societies (which developed democracy from a history of colonial rule and authoritarian regimes)—as someone whose work may have something to offer toward the expansion of Western democracy at this moment. He describes O'Donnell as someone who “understood the installation of democratic institutions and practices as neither immanent nor cyclical but the result of political mobilization against authoritarian, oligarchic, and other forms of nondemocratic rule.”³²

Further, O'Donnell understood the political identities that enact these regimes. Hanchard writes, “Antidemocratic politics and social inequality produced social and political behaviors and cultures of arrogance among elites, on the one hand, and subservience and resignation among popular groups, on the other.”³³

“Democracy is only one form of political rule that has tolerated, in fact benefited from, inequality, but it is also the only form of political rule for which inequality poses challenges to its ideological legitimacy.”

This is the new democratic project—rising to the challenge of pluralism, democracy beyond political regimes, beyond the bounds of state politics to everyday life.

Countering these suggests potential axes for new, pluralistic political identities.

In *The Quality of Democracy*, O'Donnell concludes,

Today, efforts to win citizen rights are coupled with pressures for the democratization of the state and social opportunities. The people living in these countries—more than the theoreticians—have discovered that democracy must be seen as a permanent, day-to-day conquest and an order that is perfectible through citizen action.³⁴

Given Western democracy's history of political exclusion, O'Donnell identifies *agency* as a "grounding factor of democracy," connecting "democracy, human development, and human rights."³⁵ For him, political identity orients around the human being as agent. "The enacting of agency requires the universalistic attainment of at least some basic rights and capabilities."³⁶

O'Donnell takes into account contestation, or conflict, in democratic practice, and highlights the need for what he called "an enabling institutional milieu for the struggles usually needed in order to inscribe need-claims as effective rights."³⁷ Thus, pluralistic democracy is not given, but asserted—constantly enacted by people who practice acting as if they had rights.

This is the new democratic project—rising to the challenge of pluralism, democracy beyond political regimes, beyond the bounds of state politics to everyday life. We need to stop harking back to some better days of democracy and think about what we have to move forward to, observing the artifacts that need to be carried forward and envisioning the ones that have not yet been realized.

Democracy must be held more dear than fear or hatred of difference.

FIFTH POINT: The bigger narrative must help create a shared civic religion, at every step, day after day—a cult of democracy.

We need to move beyond uniting the left as a response to the so-called united right. As my friend and organizer Nijmie Dzurinko recently posted on Facebook, "The task is not to unite the left. The task is to unite the bottom." To unite the

bottom, we must actively design against political exclusion.

How does our sector serve as a nourishing field for the building of a pluralist democracy, especially when we have our own ways of constructing and managing the "other"? How do we, to use Hanchard's frame, contribute to making our society less ethnocentric and more ethos-centric? (Hint: We can start with our own organizations.) How do our own institutions and practices serve as the playing field for democratic decision making and shape political identities that enact pluralism?

Many like to think of these as different projects, but they are not. Civil society is the training ground for democracy—to think otherwise is a blind spot in our work for social justice. Our main job is to guard against inequality in the political regime and in our organizations. But we should go further—we should be able to harness difference. Humans are part of nature and nature doesn't have a problem with diversity. In fact, it thrives on it, and we should too.

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A New Theory *of* U.S. Nonprofits *in a* Democracy Gone Awry

by Elizabeth A. Castillo

A RECENT PANEL SESSION AT A CONFERENCE OF scholars reminded all present why this sector is more defined by what it is *not* than what it *is*. Members of the panel had been invited for their knowledge of social and political history and their understanding of the sector as it now exists.¹ The session was fascinating for its tracing of the theories of purpose that have been applied to the sector; at the same time, it reinforced the need for a more unifying central theory.

This article shares exploratory research on new ways to think about the emergence and

trajectory of the nonprofit sector. It also considers how these perspectives might help us to better understand the democratic nature of the sector and its unique role in democracy as a locus for constant improvement on what is—with the best interests of both the commons and the margins in mind.

The Importance of Theory to the Nonprofit Sector

Some readers may wonder why nonprofit theory matters when there is so much work needing to be done on the ground. While there are many reasons why theory is useful and why getting it right is vital, here I focus on the three reasons with the most impactful consequences for people in the sector.

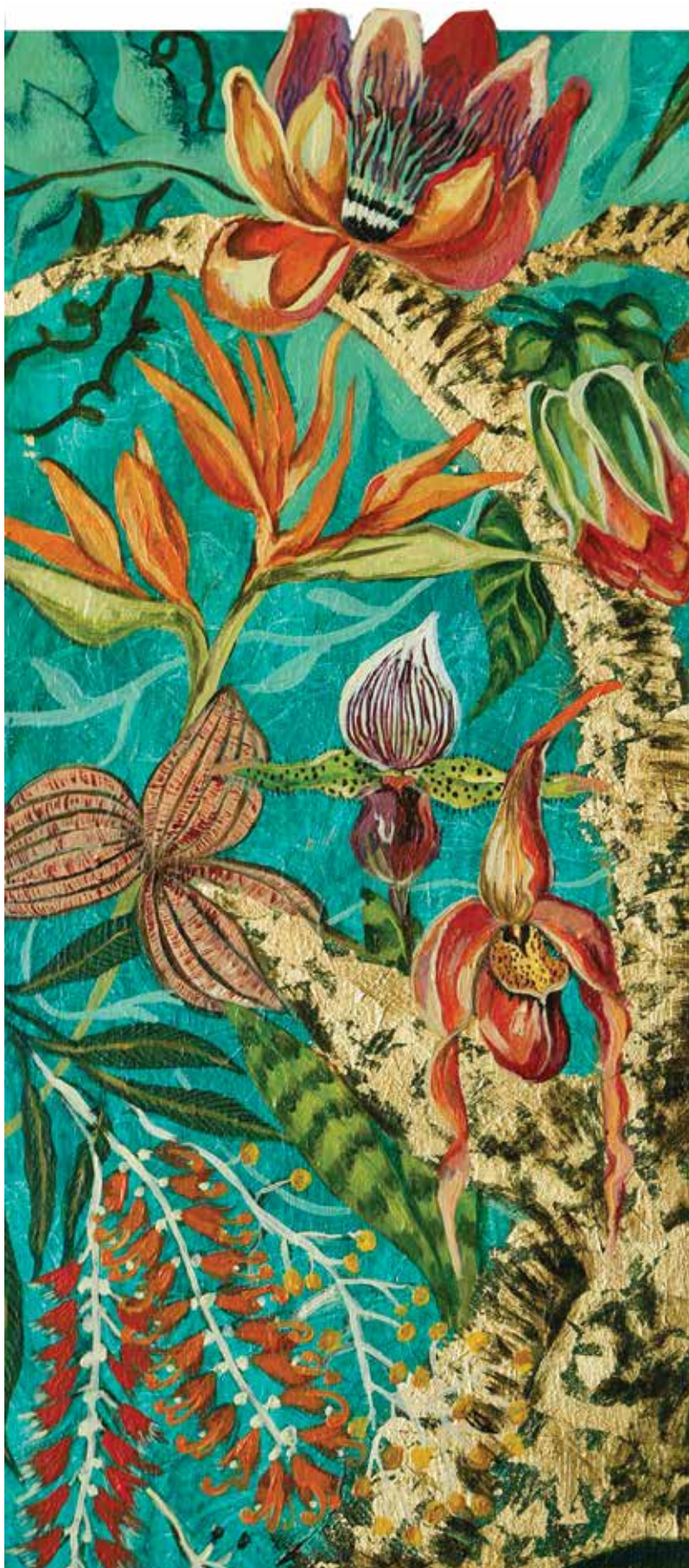
First, like all institutions, *philanthropy and the nonprofit sector rely explicitly and implicitly on conceptualizations to guide their choices and actions*. Explicitly, this shows up as formalized logic models and theories of change that undergird resource investment decisions and policy choices. When logic models are based on inaccurate conceptualizations, we should not be surprised when the policies and programs developed from them fail. Here, theory is no longer academic—it has real impact on the people nonprofits serve. Further, we all operate with implicit

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mental models of how the world works. A multidisciplinary and critical approach to building theory helps to surface assumptions that lead to errors. For example, had people critically examined the assumptions behind the practice of using indirect cost rates as a proxy for organizational effectiveness (a practice based on economistic management theories like transaction costs²), that misinformed trend might never have gotten off the ground. However, many people uncritically accepted that a theory from the business realm would be equally applicable to the non-profit sector.

Second, *theory enables us to recognize and make sense of complex patterns*. It allows non-profit organizations to get a bird's-eye view of the operating landscape rather than stumbling along at street level. It also helps justify things that leaders know intuitively but may be hesitant to implement because they run counter to market logic. An example is investing in professional development for employees. While economistic theories rationalize cost/benefit approaches to decision making and dispute the value of investing in employees, employee engagement theories provide empirical support for the wisdom of employee development, because it sets off a cascade of increasing returns to the employee and the organization.

Finally, *theory impacts how our world gets structured*. When the Ptolemaic view of planetary motion was replaced by Nicolaus Copernicus's model, which in turn was surpassed by Kepler's, Newton's, and Einstein's models, these new understandings didn't change how the planets moved. In contrast, social science theories generate a double hermeneutic: a two-way action effect, where theories guide our actions and those resulting actions shape the world—often in ways that become self-fulfilling. For example, economistic management theories make assumptions that people are self-serving and opportunistic and therefore must be monitored closely. However, substantial evidence shows that such attempts to reduce the autonomy of workers through control and surveillance actually make workers less, not more, trustworthy. Rather than questioning the theory, the



Perhaps most important, nonprofit theory must attend holistically to power dynamics. Rather than relegating the study of power to political scientists, both scholars and practitioners must learn to see power as a current that runs through—and shapes—all aspects of organizations and systems.

results are used as evidence that even stronger controls are needed. Similar patterns can be found in criminal justice, school discipline, and child development.

Challenges of Building Nonprofit Theory

Thinking back on the presentations at this panel as a whole, a few themes stand out—especially, the problem of multiple levels of analysis; the need for interdisciplinary thinking; the central role that subjective factors (e.g., values, identity, norms) play in shaping the sector; and the importance of accounting for context and power relations. (See sidebar on pages 24–26 for summaries.) Regarding multiple levels of analysis, virtually all the scholars touched on the interdependent and embedded nature of the sector. For example, it is challenging to assess organizational impact, in part because it arises from the interactions between an organization, its partners, the policy environment, and individual stakeholder contributions. This is a thorny problem for researchers, who are trained to isolate parts of a system so as not to confound results of their causal models. While this reductionist approach works well in the physical sciences, in the social sciences it leads to the omission of essential information (e.g., interaction effects across levels) needed to understand the phenomenon being studied.

Similarly, academics have been trained to discount subjective aspects of a phenomenon and stick to what is “objective” and measurable. Increasingly, however, scholars recognize that reality is co-constructed and therefore requires methods that can accommodate subjectivity as part of the dynamics being studied. Potential remedies to both the multilevel and subjectivity problems include using complexity science approaches³ such as process studies,⁴ multilevel analysis,⁵ multilevel modeling,⁶ and computational science (e.g., agent-based modeling)⁷ to capture and account for expressive and legitimating aspects of sector dynamics (such as values and norms, as well as systemic effects like emergence and self-organization). A complexity science approach is necessarily interdisciplinary, because no single discipline

alone can understand a complex system. Like a cubist painting depicting many aspects of an object simultaneously, scholars from different fields must collaborate with practitioners to understand the interdependent nature of nonprofit organizations and civil society.

Perhaps most important, nonprofit theory must attend holistically to power dynamics. Rather than relegating the study of power to political scientists, both scholars and practitioners must learn to see power as a current that runs through—and shapes—all aspects of organizations and systems. Work in progress by Eva Witesman and Curtis Child offers a promising approach;⁸ they are using institutional analysis to decipher how factors such as biophysical and material conditions, participant diversity, community attributes, and laws and governance rules shape organizational forms and options for action.⁹ Critical theory similarly attends to boundary spanning, mutual influence, and non-market norms such as care—all hallmarks of the nonprofit sector often marginalized by market logic.¹⁰

Conventional Nonprofit Theories—Borrowing from Other Disciplines

In their presentation, Megan LePere-Schloop and Rebecca Nesbit explained that nonprofit studies in many ways is an amalgam of disparate and often conflicting theories derived from multiple disciplines over various time periods. This mishmash creates a certain amount of chaos in public understanding, regulation and advocacy, and practice. Similar to the parable of the blind men and the elephant, nonprofit theories may seem contradictory because they highlight a particular aspect of the sector (e.g., service delivery, voice and advocacy, collaboration) rather than the gestalt. Theories may also appear to conflict because they focus on different units of analysis (e.g., individual, organization, civil society). Additionally, many theories used in the sector were borrowed from other fields. Thus, they may rely on invalid assumptions.

It is time for the nonprofit sector to start questioning the economic suppositions that guide how organizations are managed and resource

investments are made. One reason that market logic became dominant is that business and management theories offered a cohesive narrative about how the world works (e.g., competition, trickle-down benefits). The nonprofit sector has failed to develop its own cogent narrative, primarily because we do not yet have clarity about the way complex social dynamics work. The scholars on this panel outlined some ways these impediments might be overcome. By paying attention to theory building, we can reorient the world to humanistic management practices and create an economy that works for all.

Nature as a New Conceptual Model

Could our theoretical impasse stem from building our theories on egocentric rather than ecocentric foundations? Looking at how nature organizes may open up new horizons for insights on phenomena such as resource flows, exchange processes, organizing, and cooperation across multiple scales. A starting point is thermodynamics. For example, biologist Harold Morowitz asserts that “the flow of energy through a system acts to organize that system.”¹¹ As a system experiences positive feedback (recursion), it sometimes reaches a threshold that can generate a qualitative change in state, leading to reconfiguration of the system. The phase transition of water turning to steam when boiled is one example. Such transformations occur as a way to enhance energy flow by creating a new channel between environmental inputs and outputs. What if we considered the emergence of the nonprofit sector and hybrid organizations as the development of qualitative state changes (phase transitions) that occur as a way to release the buildup of energy?

In a similar vein, ecologist Howard Odum’s maximum power principle posits that nature self-organizes in ways that expand degrees of freedom so as to produce increasingly higher qualities of energy.¹² His early analysis of energy flow in ecological systems found that nature passes on only a small portion of the energy from one trophic level to the next.¹³ Initially, Odum was surprised by this, seeing it as energetically inefficient. However, with further analysis he came to understand that nature was not wasting energy

but rather storing it for future use. He found that some of the remaining energy was distributed to the environment in ways that could be reclaimed later to benefit both an organism and its environment.

For example, trees’ fallen leaves are processed by microorganisms, providing nourishment for them while at the same time enriching the soil in which the trees grow. How might this model be useful for thinking about civil society as a storage substrate that can be drawn upon in the future as needed? The maximum power principle suggests that organisms optimally process energy by balancing trade-offs—namely, the tension between maximizing energy conversion and minimizing the time it takes to convert the raw material into energy. Prevailing designs balance these trade-offs in ways that contribute to power maximization of the system in which the organism is embedded.¹⁴ A bio-inspired framework can also be informed by developmental systems theory. For example, Gilbert Gottlieb’s theory of probabilistic epigenesis hypothesizes that an organism’s development is a process of bidirectional coaction—a two-way causal process where, for example, the environment shapes the developmental potential of the organism while the organisms’ actions also shape the environment.¹⁵ This in turn expands or constrains potential trajectories for the organism and future generations of the organism’s lineage.

As these three examples suggest, adopting a functional approach to sector analysis may open up new theoretical horizons. Progress in theory building is often stymied because of initial failure to construct adequate definitions and descriptions.¹⁶ By focusing on function, both in terms of its biological definition (*what something does, what results that action produces*) and its mathematical definitions (*the process or relational association between members and sets, or the relational association between an input and an output according to some rule*), we can help move our descriptions from abstract to concrete. Additionally, such an approach can reduce semantic confusion. For example, words such as *welfare* have different meanings depending on one’s political leanings. Even if operationalized clearly, words carry interpretive baggage.

The nonprofit sector has failed to develop its own cogent narrative, primarily because we do not yet have clarity about the way complex social dynamics work.

My preliminary analysis suggests that the form of an organization relates to the type of exchange it employs, the degrees of freedom it develops for itself and others, and the extent to which it distributes resources back to the environment for its own future benefit and that of the systems in which it is embedded.

A functional approach transcends these issues.

Finally, evolutionary biologists consider functions to be mechanisms for fitness (the ability of an organism to survive and reproduce). A bio-inspired framework grounded in the functions of exchange (how an organism gets resources from the environment) and metabolism (how the organism processes resource inputs and disposes of those processed materials) can lay the foundation for new understanding. For example, symbiosis (e.g., parasitism, commensalism, mutualism) could be used as a model to understand organizational forms as a continuum rather than as static types. Similarly, the Millennium Ecosystem Assessment's framework is another promising model.¹⁷ It outlines four core functions of an ecosystem in terms of supplying human needs: *provisioning* (providing resources that help humans survive, such as clean air, water, and material goods); *supporting* (processes that make provisioning possible); *regulating* (actions that dampen or amplify supporting and provisioning processes); and *cultural* (e.g., spiritual, aesthetic, educational, recreational, and meaning making).¹⁸ My preliminary analysis suggests that the form of an organization relates to the type of exchange it employs, the degrees of freedom it develops for itself and others, and the extent to which it distributes resources back to the environment for its own future benefit and that of the systems in which it is embedded.

Implications for Democracy

While these bio-inspired ways of thinking about the sector open up new prospects for building theory, it's also worth considering what they could mean for governance and civil society. Democracy rests on the notion of popular sovereignty—that is, a government's authority is derived from the people who agree to be governed in exchange for protection and promotion of their well-being and rights. In a liberal democracy, these rights include individual freedoms like self-expression, voluntary association, and political participation. Governmental abuse of authority is kept in check through rule of law—the collective agreement to use principles rather than personal whims to guide decision making. These principles are

typically spelled out in a constitution. Everyone—including the government—is supposed to be subject and accountable to these laws. Key aspects of rule of law include equality before the law, checks and balances on the use of power, and transparency (e.g., that people know the rules of the system, that judicial processes follow those rules). A benefit of this principles-based approach is that—if followed by all, and if the principles are in fact equitable—it produces stability and predictability for both the society and its members.

However, democracy is not self-maintaining nor inherently equitable. It is therefore subject to destabilization. To prevent this requires ongoing attention to ensuring freedom, equality, and social cohesion, the conditions under which democracy flourishes. In the United States and other countries, democracy is threatened by social polarization (the erosion of trust and cooperation) and regulatory capture (lawmaking guided by special interests rather than the common good, usually in nontransparent ways).

How might a bio-inspired approach to theory building help address these perils? A starting point is that an ecologizing approach to theory provides a clearer definition of *power* (the rate at which energy is transferred). This in turn helps us to recognize that what we typically refer to as power is actually *control*—the ability to decide the way something will happen.¹⁹ This distinction is important, because in the public domain, the ability to control requires a narrowing of vision that “must destroy or ignore some information in order to facilitate the collecting, processing, and comprehending of other, more purposive information.”²⁰ Such selective vision increases the potential for manipulating people within the system.²¹ As a rule of law becomes beholden to special interests instead of principles, and people are acculturated to value a means (money) rather than an end (individual and collective well-being), these special interests increase their capacity to exert even greater manipulative control over people. Besides the obvious moral concerns this presents by reducing popular sovereignty and autonomy, this type of control also puts the society at risk practically. This is because it reduces access to information needed to guide

If an ecological lens helps us to understand these dynamics (e.g., why reduced autonomy threatens democracy), what can it tell us about potential solutions? The answer is twofold. First, nurturing democratic governance requires policies that expand degrees of freedom, because this increases the system's access to information and enhances its information-processing capacity. This in turn expands the system's *evolvability*—its capacity to leverage randomness in ways that generate more options for adaptive solutions.²² A capabilities approach is a policy foundation that can expand a society's generative capacity by activating latent potential.²³ Since all people have inherent talents but much remains dormant due to systemic failures of structural inequality and poverty, designing inclusive policies to develop everyone's capacities (for example, through learning, creativity, physical well-being) is a way to substantially increase the capacity of the society. These benefits then create a stronger foundation for future generations' capabilities development. Additionally, developing capabilities enhances capacity for self-regulation,²⁴ over time reducing the amount of legislative control required.

What role can the nonprofit sector play in promoting these shifts? While there are several, I'll focus on three. First, the pluralism for which the sector is known²⁶ provides the diversity that is essential to increase the information-absorption and information-processing capacities of the system (society).²⁷ Functionally, the sector serves as an innovation incubator that tests potential solutions for how cooperation can be

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If an ecological lens helps us to understand these dynamics (e.g., why reduced autonomy threatens democracy), what can it tell us about potential solutions?

SYMPOSIUM HIGHLIGHTS

Limits of Current Theories

Richard Steinberg noted that one of the most widely accepted theories for explaining the emergence of the nonprofit sector is the three-failures theory.²⁹ It seeks to answer two questions. The first is values-based (normative): *What activities are best conducted by what kind of actor?* The second is facts-based (positive): *Why are some activities conducted by particular kinds of actors?* Rather than a stand-alone theory, three-failures theory—as Steinberg explains it—is a hybrid of other theories. These include *public goods theory*,³⁰ which posits that nonprofits emerge as a result of market and government failures to produce needed collective goods; *voluntary failure theory*,³¹ which hypothesizes that philanthropic insufficiencies give rise to markets and government; and Hansmann's contract failure³² and overexclusion theories,³³ which claim, respectively, that nonprofits arise when it's costly to obtain truthful information about the quality or quantity of a needed service, or when for-profit firms exclude nonpurchasers unnecessarily.

Steinberg also described elements of theory building and the difference between a theory and a framework. He explains that frameworks are an attempt to give structure to a collection of ideas. They are often the starting point for theory development. However, frameworks are generally too abstract and wide in scope to produce testable propositions about a phenomenon. Restricting attention to a portion of the framework, however, narrows focus sufficiently to develop propositions that can be tested empirically. The data produced by that testing then refutes or lends support to the propositions that make up a theory.³⁴

The framework Steinberg is developing begins by considering whether sectors or actors should be the starting point for nonprofit theory building. Both choices offer advantages and disadvantages. Actors include individuals, organizations, networks, and kinship structures like families. These agents can act alone or jointly. In contrast, a sector perspective starts by making distinctions between for-profit, nonprofit, and government (public) sectors based on their structural features, which then produce differing behaviors in certain environments. Distinctions that can be made to identify sector properties include ownership, the right to distribute profits, and the right to use coercive power. Combining these produces sectoral combinations, such as hybrids, partnerships, and linked ownership forms like subsidiaries and conglomerates that have interlocking governance.

Problems that Steinberg has identified with current theories include the omission of households and families,³⁵ networks,³⁶ and other informal groups. Further, the three-failures theory does not attend sufficiently to operating contexts such as premarket societies, failed states, and

dictatorships. For example, autocratic states sometimes value nonprofits because they attract resources and provide public goods, yet these nonprofits also present potential threats to the power, legitimacy, and ideology of autocrats.³⁷ Other lingering questions include whether legal or functional structure is the right criterion for making distinctions. He also noted that sector labels are associated with beliefs about comparative advantages of each, so we must attend to normative and symbolic meanings that affect how scholars categorize activities of sectors.³⁸ Additionally, current categories do not distinguish between subsectors. For example, the category of "private sector" does not distinguish between proprietorships, jointly owned firms, social ventures, and worker-owned versus investor-owned businesses.³⁹ Similarly, the category "nonprofit sector" does not make distinctions between commercial/donative or trust/corporation forms. Finally, there is the matter of how to judge comparative advantage of the various theories. One possibility is to use instrumental norms (standards that advance achievement toward an end).⁴⁰ Examples of such norms include social efficiency (comparing social benefits to social costs), Pareto optimality (balancing resource allocation trade-offs in ways that optimize payoffs among participants), or social welfare optimality (collective decision making that promotes stable social ordering). Another option is to use legitimating norms (values-based standards). These include expressive goals (practices that give voice to identity and beliefs) and affiliative goals (striving to promote group harmony and sense of belonging).⁴¹ There is also a question of how we should categorize nonprofit organizations that have morally questionable missions, such as those that seek to violate the sovereignty of others (e.g., religious conversion, social marketing) or that exclude certain groups of society.⁴²

The Need for a New Paradigm

James Mandiberg proposed that the limitations being discussed may indicate that we are in the midst of a paradigm shift. He reviewed Thomas Kuhn's three-phase model of paradigm formation.⁴³ He described the first phase as being *pre-paradigmatic*, where many explanations emerge and compete but none is considered dominant. The second phase, called *normal*, sees one explanation becoming dominant even though it doesn't explain everything (and the anomalies it doesn't explain tend to be disregarded/viewed as unimportant). The third phase, called *revolutionary*, sees an increased focus on those exceptions and stimulates a return to many competing explanations.

Mandiberg then outlined the anomalies that the three-failures theory does not address. For example, he noted that diverse economic activity

predates the notions of formal markets, contracts, and government. Like the other scholars, he observed that it also does not account for economic activity generated through the informal economy, household labor, or “dead capital” —assets not easily bought, sold, invested, or valued.⁴⁴ He further noted that many types of organizations reflect an intersection of the three sectors. For example, benefit corporations and mutual organizations such as credit unions can be seen as hybrids of for-profit and nonprofit organizations. Likewise, similar economic activity can be found in two or three of the subsectors, such as healthcare and social services. Sector incorporation has also become more of a strategic than a natural choice, with organizations increasingly adopting complex organizational forms to meet their strategic objectives. As an example, Mandiberg shared the case of a Japanese farm that includes: a privately owned vineyard with workers paid collectively; a nonprofit residence school serving people with developmental disabilities; and a for-profit winery and restaurant owned by the families of the school’s residents.

Mandiberg’s presentation then turned to factors that may be eroding the three-sector norm. These include neoliberalism and its outsourcing of service provision via nonprofit and for-profit organization contracting; the growth of social enterprise; the success of nonconforming economies, such as Chinese military-owned for-profits; changing social and cultural norms placed on organizations; and globalization, because the three-failures theory doesn’t sync with many non-Western contexts.

New Directions: Identity-Based Theories

A key takeaway from the presentations overall is that conventional notions of three sectors and organizational forms and motivations no longer provide sufficient explanatory or predictive power. New theories are needed that can account for different political contexts, coevolution and coproduction, and engagement with constituencies toward stewardship of the commons.

To address these gaps, Julie Langer presented Organizational Identity Orientation as a framework that can potentially explain such anomalies.⁴⁵ At the organizational level, this theory asks, *Who are we in relation to our stakeholders?*⁴⁶ This conceptual model posits that organizations generally see themselves in one of three ways: individualistic, interdependent (relational), or collectivistic. Five analytical dimensions operationalize these in practice.

The first dimension is *locus of an organization’s self-definition*. This means that organizations may see themselves as a stand-alone entity separate from others (individualistic); as interconnected with partners (interdependent); or as part of a larger, impersonal whole (collectivistic). A second dimension is *traits and values*. Individualistic organizations distinguish themselves from other organizations by using superlatives (e.g., “the best”). Interdependent organizations see themselves as connected dyadically to certain others (e.g., a “caring partner”). Collectivistic organizations

define themselves in terms of a larger, more impersonal group or cause. A third dimension is *relational motivation*. This can range from self-interested (individualistic), to benefiting others (interdependent), to prioritizing the welfare of the greater collective (collectivistic). A fourth dimension is *comparison referent*—to whom and how the organization compares itself. Individualistic organizations make comparisons with other organizations. Interdependent organizations compare themselves to a standard. Collectivistic organizations compare themselves to other groups. A fifth dimension is *social value potential*. This can range from seeking to maximize wealth and efficiency (individualistic), to increasing interpersonal understanding and valuing empathy and dependability (interdependent), to generating solidarity and valuing virtues of conscientiousness and fairness (collectivistic).

Langer is currently working on building theory in this area by developing a quantitative measurement model of organizational identity orientation using the five dimensions and three categories to determine how organizational members across different sectors define this aspect of identity. Besides sector analysis, she will also look at factors such as industry type and services that an organization provides, to see if these help explain her empirical findings.

Philanthropy as a Form of Moral Action

Michael Moody began by reminding participants that high-level theory should explain *why* and *what*, not *how*. Questions our nonprofit theories should answer include: *What is this form of action? Why does it exist? and Why do actors choose this form over others?* Effective theories should simultaneously account for both universality and cultural/historical variation; diversity of activity and expression; and anomalies. Ideally, a high-level theory is interdisciplinary, accessible to practitioners, and affirmative.

Moody argued for using *philanthropy as a form of moral action* as the *what*. He operationalized philanthropy as “private, voluntary action intended for the public good,” cautioning that *private* does not mean *asocial*. Because philanthropy (moral action) is dynamic, it likely must be studied as a process—that is, as a form of social action—rather than conceptualized statically through the lens of sector-dependency. For example, he illustrated that philanthropy can be seen as a human response to the human condition, motivated by a vision of “good.” He argued that this framing accommodates philanthropy across diverse activities, in all sectors, and acts as both means and ends.

Moody also sees moral action as an expression of moral imagination that shapes a moral agenda. He asserted that we are essentially moral entrepreneurs who affect others and the public through our voluntary goodness, stating that while not all moral action is philanthropic, all philanthropic action is moral. Further, philanthropy is always cultural in its expression, because it is shaped by cultural and historical understandings

of objectives (means) and goals (ends). It also has both ideal (i.e., perfect, ultimate) types of action, as well as mutable ones that represent cultural expressions change.

Seeking feedback on this exploratory work, Moody outlined some possible critiques and asked for comments from the audience. First, is this conceptualization too donor-centric? Second, is it too microfocused on moral entrepreneurs rather than on the system in which they operate? Third, does it privilege democracies over other political contexts? And fourth, how might this “form of action” theory lead to testable hypotheses?

The Interdisciplinary Nature of Nonprofit Theories

Rebecca Nesbit and Megan LePere-Schloop are working to develop a framework and methodology that categorize how various disciplines contribute to nonprofit research (e.g., sociology, political science, and economics) and what units of analysis they address.

For example, political science questions that inform nonprofit theorizing at the macro level (society and the sector) include: How does the sector fit into larger political systems and/or the political economy? How do nonprofits shape political processes and their outcomes? Why are some goods and services provided by governments and others by nonprofits? Political science theories that inform these questions include the market model of democracy, pluralism, and civil society and the state.

Questions at the meso level (networks, coalitions, communities, and organizations) include: How do nonprofits work in tandem or in conflict with other actors to shape activity at different stages of the policy process? What political roles do individual nonprofit organizations play? Here, nonprofit scholars employ political science theories like political contestation, advocacy coalition framework, and nonprofit political roles (e.g., advocate, service provider, watchdog, policy formulator).

At the micro level (individuals), nonprofit scholars examine questions such as: How do nonprofits shape individuals’ political attitudes, knowledge, and behavior? For insights, they draw from theories such as political behavior (attempts to influence, or escape the influence of, others); political and social capital (power and relational resources); political socialization (the shaping of values and beliefs); associationalism (voluntary democratic self-governance of society);⁴⁷ and political evaporation (apathy about public affairs and discourse).⁴⁸ Besides creating a framework to classify major theories of the sector, identify disciplines they draw from, and articulate the types of questions they seek to answer, LePere-Schloop and Nesbit’s work will also advance nonprofit theory building by illuminating assumptions that lie beneath each discipline’s conceptual models. This should yield insights into the nature of the contradictions and identify ways they might be reconciled to advance theory and enable more robust empirical testing of theoretical propositions.

The Emergence and Hybridization of the Nonprofit Sector

Rikki Abzug presented an overview of the history and prehistory of the sector, beginning with clans, kingdoms, and sects (pre-500 CE), and moving to the Roman Empire (circa 500 CE); medieval joint-stock companies (1300s); English charitable uses, trading companies, and colonies (1600s); and the emergence of the distinction between the public and private sectors (1800s). She then outlined some reasons for the growing confusion about how many sectors exist and what constitutes and defines each sector—for example, business (for-profit); government (public); nonprofit (NGO); informal, underground, and black market; familial, reproductive, and household; and religion. To make sense of how these categories relate, she presented a matrix overlaying the categories both vertically and horizontally, proposing that their intersections offer new explanatory insights. For example, socialized health- and childcare can be seen as the intersection of the household and government sectors. Corporate foundation giving can be seen as the intersection of the nonprofit and for-profit sectors.

Abzug then outlined a few other ways to make sense of the origins of the sector. From an economic perspective, she presented a progression that showed a primary sector (agriculture, mining, natural resources) giving rise to a secondary sector (manufacturing, engineering, construction), making possible a tertiary sector (service industries), quaternary sector (education and research), and quinary sector (high-level decision makers like government and industry, and perhaps the emergence of global elites). From an historical-political perspective, she used the United States as an example to show how tariff and tax legislation from the 1800s to the present day yields insights into the invention and evolution of the nonprofit sector.

Abzug closed by illustrating how differing analytical approaches produce different insights. For example, a continuum perspective on organizational forms starts with traditional nonprofits and progresses to those with earned income activities, then social enterprises, on to socially responsible businesses and corporate social responsibility, and ends with traditional for-profit businesses at the opposite end of the spectrum. Conversely, a multiple-sectors perspective—using Venn diagrams inspired by Kim Alter, Jack Quarter, and Laurie Mook—shows how the social economy can be understood as a combination of the public sector, private sector, and civil society organizations. Where these sectors overlap gives insight into the different forms of the social economy. For example, public benefit nonprofit organizations represent the intersection of civil society organizations and the public sector; social enterprises can be seen as the intersection of civil society organizations and the private sector; and community economic development can be seen as the intersection of all three sectors.

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Nonprofits *as* Agents *of* Tension *and* Democracy

by Jon Pratt

NONPROFIT ORGANIZATIONS ARE FREQUENTLY lauded as essential contributors to a functioning democracy, but what does that actually mean? In what ways do nonprofits help express the democratic impulses of liberty, autonomy, and self-determination?

In its purest democratic form, every nonprofit would sprout from an independent community concern or idea, born around a kitchen table, exhibiting a shared commitment of some sort. This image is, of course, no longer alone in the larger landscape of nonprofits, but it is the basic mold to which public expectations and aspirations attach: nonprofits as the embodiment of a task taken on collectively to improve society—a task that, in the doing, does not benefit the organizers above all those to whom benefits are meant to flow. This notion is attached both to the “commons” (those things we need to make communities whole, happy, and prosperous) and to the creation of a pluralistic democracy (that is, a democracy that can be fair to the parts, however marginalized, and to the whole).

Here we must stop for a moment to acknowledge the complexity of other theories about the

purposes of the sector. These are reviewed in Elizabeth Castillo’s article (in this cluster), where she argues for a return of focus to the sector’s most essential function as a venue for collective action that can keep us at pace with the ethics of a changing world, in which the seats of power need—as always—to be challenged.

Cyndi Suarez’s article, also in this cluster, provides a frank view of the barriers to pluralistic democracy that nonprofits have been unable to knock down and have even, at times, been accused of propping up—as in the longstanding critique of this sector as a self-serving “nonprofit industrial complex” and the recent critiques of philanthropic practices that undermine public self-rule. These criticisms attach particularly to the uses of nonprofits to fulfill government intentions, and to the “doing to” or “doing for” rather than “doing with” mentality that pervades a good part of the service sector. Practice habits that neglect engagement and the common generation of common goals

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One key test for free persons in a democracy is whether they are allowed to start and operate an organization that expresses a collective interest and energy.

detract from the energy, power, and—one might conclude—basic ethos and democratic nature of the sector. These practices may flow from conditions set by revenue sources and from obedience to bureaucratic order¹ and legitimacy, as argued later in this article, but they can also undermine the sector's influence and efficacy.

In a practical sense, the democratic nature of nonprofit organizations is demonstrated daily throughout the world when regular citizens express their interests and values by deciding what organizations to associate themselves with—and even perhaps how and when to form them, how to manage and govern them, and what risks to take or sacrifices to make in pursuit of a common goal. These expressions of grassroots democracy represent an almost universal aspiration: in most countries, there are groups of like-minded individuals who choose to join together to undertake public projects, forming associations larger than friends and family but smaller than the state—from community arts and youth sports to environmental advocacy and coin collecting.

But various political regimes react differently to these independent nodes of self-governance. The most open societies present few barriers to forming new organizations, while authoritarian regimes regularly restrict the formation, operation, and funding of voluntary organizations.² However, even in political environments that see these organizations as good and necessary expressions of civic life, there is a set of real-politik limitations that can make the work of such organizations messy, frustrating, compromised—and frequently undemocratic.

The dissonance between the democratic ideal of free associations and the lived reality of funding restrictions and government controls is the U.S. nonprofit sector's existential dilemma: its reason for being—free expression—is constantly tested.

What Grounds the Sector as a Core Aspect of a Democracy?

In democratic societies, adults are considered competent to make a wide range of decisions about their own lives—especially the right to

participate in the selection of their representatives for self-government. The ability to be sufficiently knowledgeable to participate in self-government requires some access to a free press and being able to meet and talk with fellow citizens about common concerns. The rights of free people to form associations, organize meetings, develop petitions, and confront government is recognized throughout the First Amendment to the U.S. Constitution and codified in the Universal Declaration of Human Rights.³

One key test for free persons in a democracy is whether they are allowed to start and operate an organization that expresses a collective interest and energy.

Governments' Mixed Feelings about Organizations in Their Midst: How Free Should Nonprofits Be?

The Universal Declaration of Human Rights represented a worldwide consensus that successful democracies should allow a robust set of nonprofit (or nongovernmental) organizations to provide opportunities for their citizens to do things together that they could not do alone. The growth of organizations in more than two hundred countries confirms that there is an almost universal interest on the part of the public in forming such associations, but governments differ on what they are willing to tolerate in that realm.

Governments generally have an affinity for organizations that promote civic peace—whether it is earthquake relief, performing arts, or health and education—but many have less patience with organizations that seek to influence the workings of government. The ability of associations of regular citizens to serve as an intelligent check on abuses of power assumes a substantial degree of freedom—a role often not particularly welcomed by those in power.

This tension inherent in the relationship between nonprofits and the U.S. government has always been acknowledged. In *Democracy in America*, Alexis de Tocqueville posited that forbidding some types of associations and allowing others would confuse people and inhibit the use of associations, but could be justified by the need for order:

I do not believe that a nation is always so much a master as to allow citizens the absolute right to associate in political matters, and I even doubt that there is any country, in any period, in which it would not be wise to set bounds for freedom of association.⁴

But he also admitted that there would be a cost to restricting the right of association: “If to save the life of a man one cuts off his arm, I understand it; but I do not want someone to assure me that he is going to show himself as adroit as if he were not one-armed.”⁵

Resource Dependency and Democratic Expression

While principles of self-government, free will, and autonomous collective action are at the heart of forming nonprofit organizations, there is an inevitable reality check when organizers are forced to confront how they will finance these enterprises. This existential dilemma facing nonprofit organizations has been addressed before in the *Nonprofit Quarterly*, including the following observation:

The way an organization handles decisions about funding sources sets in motion an ongoing chain of consequences, further decisions, and compromises about what the organization will and will not agree to do. Throughout the history of nonprofits, major changes in size, direction, and strategy (and even new names and purposes) are more commonly due to shifts in revenue than to changed intent.⁶

In an ideal world, nonprofit organizations would be simple agents of democracy, animating the popular aspirations of people in their community. The reality ends up being more complicated, presenting a dilemma familiar to political parties and candidates: how do you finance your campaign and keep your soul?

Not Your Great-Grandparents’ Nonprofit Sector

Since Tocqueville, in 1835, chronicled the early American appetite for forming voluntary associations of all types in *Democracy in America*, several things have changed. There are more formal structures and regulations surrounding

these organizations, and the types of organizations have been evolving over time. One essential change in organizational form since that time has been the abandonment of membership organizations as the dominant form, with organizational leaders elected by a general membership, often at public annual meetings. The vast majority of U.S. nonprofit corporations now task current board members with selecting their successors.

The democratic spirit and willingness to attend meetings of chapters of national organizations is now dwindling; at the same time, there are twelve million men and women who have chosen careers in full- and part-time nonprofit work that expresses their values and interests. Two million Americans now serve on nonprofit boards of directors in deliberative, decision-making roles to set the direction and budgets of their organizations (and this number is just for the nonprofit organizations that have at least one employee).⁷

For these working charities (in which the nonprofit workplace can be seen in important ways as comparatively desirable and distinct from business and government workplaces), the workforce is growing, the wage gap with government and business is shrinking, and management and the workforce is majority female.⁸ Many of these organizations are managed differently from business and government, are closer to the community, are more participatory, and as a result can be slower to make decisions and less financially driven.

In the 1960s, young Americans were encouraged not to just drop out of the system but to work to change it—and many sought ways to live out their values in their work life. An important difference between the voluntary groups of the 1800s and the nonprofit organizations of the new millennium is that these new organizations are primarily local—incorporated at the state level, with local boards and primarily local funding.

The Black Lives Matter and #MeToo movements are not structured along the lines of previous generations of membership organizations, but they share their ambitions to build participation and influence society. The knowledge of how to *combine*—how to join with others and get something done—is what Tocqueville called

In an ideal world, nonprofit organizations would be simple agents of democracy, animating the popular aspirations of people in their community. The reality ends up being more complicated.

Open societies require venues for individuals to exercise their rights. Nonprofit organizations naturally fill this role—particularly when they act in ways that engage the ideas, energy, and speech of members of their community.

the “mother science” of democracy.⁹ Currently in the United States, this knowledge of how to form new nonprofits and seek funding is widely shared and is a worthwhile contribution to grassroots democracy—as substantial as the Moose, Eagles, and Freemasons were in their day.

Imperfect Organizations for Imperfect Democracy

Open societies require venues for individuals to exercise their rights. Nonprofit organizations naturally fill this role—particularly when they act in ways that engage the ideas, energy, and speech of members of their community. While generating and preserving resources encouraged by tax exemptions is useful to support this work, the participatory role of nonprofit organizations in a democratic society is better seen as rooted in the First Amendment and the Universal Declaration of Human Rights rather than in the tax code.

In a world that needs more of what nonprofits can do, most communities hold a measure of untapped people energy, compassion, and support. When these organizations are able to stay true to this democratic calling, they are well positioned to build relationships and understanding—and achieve their potential as effective, responsive, and influential voices in concert with their constituencies.

NOTES

1. Under state nonprofit corporation statutes, officers and board members must act in accordance with duties of care, loyalty, and obedience—with this last duty requiring compliance with all laws, codes, and tax requirements affecting nonprofit organizations.
2. The International Center for Not-for-Profit Law's Civic Freedom Monitor provides up-to-date information on issues affecting civil society around the world, and its U.S. Protest Law Tracker is a compilation of new laws—proposed, passed, or rejected—that could potentially restrict the right to peaceful assembly across the United States.
3. In 1948, the United Nations adopted the Universal Declaration of Human Rights as an essential foundation for freedom, justice, and peace in the world, including five articles that bear directly on the role

of voluntary associations in a democracy: Article 19—“Everyone has the right to freedom of opinion and expression; this right includes freedom to hold opinions without interference and to seek, receive and impart information and ideas through any media and regardless of frontiers.” Article 20—“(1) Everyone has the right to freedom of peaceful assembly and association. (2) No one may be compelled to belong to an association.” Article 23—“(4) Everyone has the right to form and to join trade unions for the protection of his interests.” Article 27—“(1) Everyone has the right freely to participate in the cultural life of the community, to enjoy the arts and to share in scientific advancement and its benefits.” Article 30—“Nothing in this Declaration may be interpreted as implying for any State, group or person any right to engage in any activity or to perform any act aimed at the destruction of any of the rights and freedoms set forth herein.”

4. Alexis de Tocqueville, *Democracy in America*, trans. and ed. Harvey C. Mansfield and Delba Winthrop (Chicago: University of Chicago Press, 2000), 500.

5. Ibid.

6. Jon Pratt, “Analyzing the Dynamics of Funding: Reliability and Autonomy,” *Nonprofit Quarterly*, June 21, 2004, nonprofitquarterly.org/2004/06/21/analyzing-the-dynamics-of-funding-reliability-and-autonomy/.

7. Author's calculation, from median number of 15.3 board members for nonprofit organizations in 2014 (as described in Ruth McCambridge, “BoardSource's Board Governance Index: Is Your Board ‘Normal’?,” *Nonprofit Quarterly*, January 27, 2015, nonprofitquarterly.org/2015/01/27/nonprofit-board-governance-boardsource-index/), multiplied by the number of reporting public charities (210,723 organizations in the National Center for Charitable Statistics 2015 full 990 dataset of public charities).

8. *The White House Project Report: Benchmarking Women's Leadership* (New York: The White House Project, Fall 2009), 77. The report notes that in 2005, women in the nonprofit sector made up “nearly 75 percent of the 8.4 million employees.”

9. Tocqueville, *Democracy in America*.

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The Multidimensional Landscape *of* Nonprofits *and* Taxes

“Nonprofits are by no means tax negative (or even tax neutral),” writes Jon Pratt, within. So why do proposals to tax the tax-exempt continue to pop up like a game of whack-a-mole? As Ruth McCambridge asserts, the answer lies in the preponderance of large and wealthy organizations that refuse to pay their fair share toward the well-being of the communities they live in and/or benefit from, and organizations that violate the trust of their stakeholders—behaviors that break the sector’s sacred contract with the public and risk causing an unbridgeable rift.



NPQ HAS LONG COVERED ATTEMPTS BY VARIOUS levels of government to impose taxes (and fees) on nonprofits. Because we all pay taxes at the local, state, and federal level, these proposals are myriad, but they are connected by type and justification. This makes them relatively easy to address on a practical level, *if*:

1. A network that understands the flow among the various levels—and which can mobilize quickly on a local or state level—exists to do so.
2. The sector does not protect elements that violate the “contract” between the public and itself. These “elements” tend to be larger organizations that are viewed as not just providing insufficient public benefit but, further, as not placing public benefit first, as they are meant to do.

NPQ has long distinguished itself from most of the rest of the nonprofit infrastructure by not viewing every attempt to hold nonprofits accountable on this last point as an incursion on the whole body. We recognize that some behaviors violate the expectations that the public has, and that if we let those behaviors become extreme, then the basic contract that maintains our credibility and trust position with the public is abridged. The issue, then, is to make the distinctions—and this sorting is not always easy, nor is it ever without controversy. Both points highlight recommendations elaborated on further down—one for philanthropy and the other for policy—based on *NPQ*’s study of the issues over the years; and this group of articles should be read overall as a position statement vis-à-vis how nonprofits should be orienting themselves around those issues.

In this cluster, Jon Pratt provides an on-the-ground analysis of the financial realities of nonprofit tax contributions to the public, emphasizing that those contributions are robust even with the benefits of tax exemption. Ruth McCambridge examines the controversial proposals to tax nonprofits, and outlines *NPQ*’s position with respect to the recommendations; and Tim Delaney talks about the complexities surrounding how nonprofit tax policy is formed.

NPQ takes positions on a couple of issues related to the earlier points. These are:

- The nonprofit sector *needs* the one network that addresses nonprofit tax policy proposals as they appear across geographical boundaries: the National Council of Nonprofits (NCN), a network made up of nonprofits and nonprofit associations throughout the United States. We believe its current funding level to be well out of proportion—very low in relation—to its strategic importance, and we are taking a position, as longtime observers of the nonprofit infrastructure, that a pool of philanthropic money should be developed to build the organization to reasonable and even robust scale. (The same is true for the individual state associations involved in nonprofit tax policy.) (You may note that *NPQ* and NCN do not always agree on policy issues—see Delaney, within—but we believe that their capacity is critical to the sector.)
- The sector should not resist but rather should encourage generous payment in lieu of taxes (PILOT) arrangements among the very large nonprofits—mostly the “eds and meds”—that for some communities unreasonably shrink their tax bases. These organizations should also acknowledge and honor the nonprofit “promise” in the nonprofit/public contract more generally.

This group of articles is by no means an exhaustive treatment of nonprofit taxation proposals, but it begins to try to clarify some of the crucial issues in our advocacy in that regard. As we write this, Senator Chuck Grassley has asked the IRS for the results of its monitoring of nonprofit hospitals’ compliance with community benefit requirements. *NPQ*’s stand is that, in order to support the nonprofit sector’s position in the public trust, these kinds of monitoring efforts are necessary and should be supported rather than viewed as a threat.



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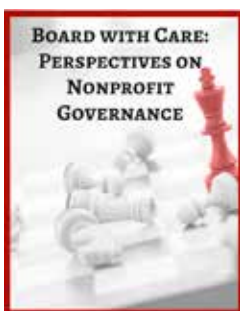
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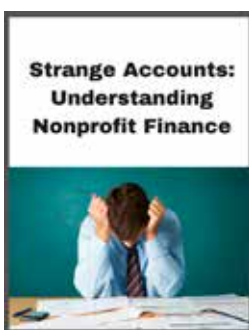
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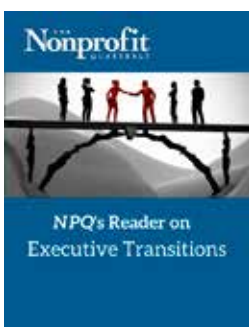
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The True Story *of* Nonprofits *and* Taxes

by Jon Pratt

FROM THE OUTSIDE, IT CAN LOOK LIKE THE NON-profit sector, because it is tax exempt, does not contribute to government tax bases at all. That one-sided view wildly misses how this part of the economy works even at the most basic level.

It is true that in 2015, U.S. nonprofit organizations benefited from somewhere in the neighborhood of \$137 billion in tax preferences from exemptions and deductions—but at the same time, they sent approximately \$243 billion to various government entities in the form of taxes, tax withholding for others, and fees.

In other words, even though they are sometimes considered to be an essentially “tax-free” sector of the economy, nonprofits clearly have deep involvement on both sides of the ledger: as a tax expenditure, in the sense of forgone revenue, and as taxpayers and tax collectors, making substantial contributions to government revenues through tax collection from nonprofit employees and activities. This side of the ledger is not often examined, so this rough estimate is offered as a clarification that nonprofits are by no means tax negative (or even tax neutral).

The two charts that follow capture nonprofit tax activity in 2015 across a vast array of U.S. jurisdictions—federal, state, and local—in a variety of tax transactions. The IRS reported that charities held over \$3.8 trillion in assets and received

\$2.9 trillion in revenue during that tax year.¹ These projections are my initial effort to quantify (in a necessarily gross estimate) the national value of charitable nonprofit benefits and obligations across the various taxing systems.

Charitable organizations’ exemption from federal and state corporate income taxes has been the most visible charitable tax benefit, but the actual value of the corporate income tax exemption is probably less than imagined due to the lower net margins of income over expenses among nonprofits. The projected benefit of this part of the exemption will shrink further, to \$20 billion in

Tax type	Value of exemption/ deduction (billions)
Federal individual income, charitable contribution deduction	\$44.4 ²
Federal corporate income tax exemption	\$36.7 ³
State and local property tax exemptions	\$12.5 ⁴
Nonprofit private activity tax-exempt bonds	\$14.0 ⁵
Federal estate tax, charitable deduction	\$8.2 ⁶
Federal corporate income tax, charitable deduction	\$5.8 ⁷
Federal Unemployment Tax Act (FUTA) exemption	\$5.0 ⁸
State corporate income tax exemption	\$4.9 ⁹
State sales tax exemption	\$4.4 ¹⁰
State inheritance or estate taxes, charitable deduction	\$1.6 ¹¹
TOTAL value of U.S. charitable exemptions and deductions	\$137.3 billion

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2018—with the marginal federal corporate income tax rate reduced by the 2017 Tax Cuts and Jobs Act, from 35 percent to 21 percent.

The economic activity generated by nonprofit organizations results in substantial collections and transfers of taxes and generation of fees. The vast majority of total federal revenues is collected through the individual income tax (49 percent in FY 2019) and Social Security and Medicare taxes (36 percent), compared to the 7 percent share coming from corporation income taxes. At the same time, nonprofit employees tend to receive only ordinarily taxed income as compensation, while for-profit employees may have access to equity participation, capital gains treatment, and other individual income tax preferences, lowering their effective rates.

Nonprofits are actively engaged in collection and transfer of taxes from their employees, an obligation with penalties of fines or imprisonment for failure to pay (including for board members!), and are required to pay a variety of taxes and fees to the federal, state, and local governments that are not subject to exemptions—adding up to \$280 billion in 2015:

Tax/Fee type	Value of taxes/fees collected (billions)
Federal individual income tax, employee withholding	\$115.2 ¹²
OASDI (Old Age, Survivors, and Disability Insurance) and Medicare, employer portion	\$49.4 ¹³
OASDI and Medicare, employee portion	\$49.4 ¹⁴
State individual income tax, employee withholding	\$26.5 ¹⁵
State unemployment insurance tax	\$1.1 ¹⁶
State sales tax collections	\$0.9 ¹⁷
Utility taxes/franchise fees	\$0.5 ¹⁸
Federal unrelated business income tax (UBIT)	\$0.3 ¹⁹
Private foundation excise tax	\$0.3 ²⁰
State unrelated business income tax (UBIT)	\$0.1 ²¹
Excise tax on excess executive compensation (new in 2018)	\$ 0
Excise tax on net investment income of private colleges and universities (new in 2018)	\$ 0
TOTAL taxes and fees transferred to government	\$243.7 billion

Further Thoughts on the Nonprofit Place in the Tax World

Nonprofits benefit financially from these tax preferences, so by extension they, as organizations, benefit from the public's expectation that they must truly benefit the public if they are accorded their special status. This can also translate into preferences for government to contract with nonprofits in certain subject areas, such as human services and child protection. Some of the most interesting qualitative and tax comparisons come from activity areas where nonprofits and for-profits compete for the same customers—hospitals, higher education, child care, nursing homes, home healthcare, student loans, low income housing, and so on.

Tax preferences can have a push and pull effect, encouraging particular types of activities. Nonprofits in English-speaking countries have the greatest tax preferences and also have the largest nonprofit sectors. In these countries, the signaling that these organizations are in large part not taxed can encourage charitable contributions and volunteering.

Like other parts of the economy, nonprofits jealously seek to guard their tax preferences (and who can blame them?), and often find themselves in a tug-of-war with different parts of state and local government that also are seeking revenues, as noted by Tim Delaney in “Nonprofit Tax Policy: A Game of Three-Dimensional Chess” (in this section of the magazine). Each side seeks to make its strongest arguments for its role as essential service in a battle of competing goods when it comes to sales and property tax exemptions. It's worth noting that units of government don't pay sales or property taxes either, and no one suggests taxing the police department to pay for the fire department (and no one has been able to make federal buildings pay local property taxes).

Another stress point can be found between for-profit businesses and nonprofits, both over UBIT and over property tax exemptions. Claims of unfair competition have been raised historically by the National Federation of Independent Business, resulting in a few line-drawing changes in UBIT applicability. Nonetheless, concerns over the substantial growth in the economic activity of nonprofits—some of it seen as essentially

Like other parts of the economy, nonprofits jealously seek to guard their tax preferences (and who can blame them?), and often find themselves in a tug-of-war with different parts of state and local government that also are seeking revenues.

commercial—have not risen as high on the business lobby agenda as they did in the late 1980s.

A simmering issue underneath the various tax conflicts is the sheer growth of the medical and higher education sectors. For much of the general public, these prosperous institutions do not look like charity cases marked by modest salaries, nondescript buildings, and substantial grassroots fundraising. As the medical field consumes a growing portion of the gross domestic product—and so long as nonprofit hospitals are 99 percent fee driven—other taxpayers could well wonder how that industry rates its special preference. When the property tax exemptions were written into most state constitutions (in the 1800s), the colleges and hospitals were just getting started—usually with religious roots, certainly of modest size. Those contentious funding mechanisms PILOTs (payments in lieu of taxes) may well gather support as a timely and sensible compromise for these large institutions.

NOTES

1. “Charities and Other Tax-Exempt Organizations, Tax Year 2015,” Internal Revenue Service publication 5331 (Rev. 12-2018), Catalog No. 72046Q. (Comprehensive IRS data on nonprofits after 2015 aren’t available.)
2. Projected forgone tax revenue from donors’ tax obligations from 2015 individual income tax charitable contribution deductions. Total charitable deductions of \$221.8 billion (IRS SOI [Statistics of Income] Individual Income Tax Returns, Line Item Estimates 2015), with an average effective individual tax rate for itemizing taxpayers of 20 percent. For itemizers, generally the higher the individual’s income, the greater the share of his or her deductions made up of charitable contributions—so the actual average tax rate avoided for charitable contributions may be higher.
3. Projected forgone tax revenue from 2015 corporate income tax based on 501(c)(3) net income of \$104.9 billion and 35 percent corporate tax rate (IRS SOI Nonprofit Charitable Organization and Domestic Private Foundation Information Returns, and Exempt Organization Business Income Tax Returns: Selected Financial Data, 1985–2015).
4. Projected forgone property tax revenue from 2015 state charitable property tax exemptions, extrapolated from total reported charitable property of

\$1.045 trillion in land, buildings, and equipment (IRS SOI, Table 3, Form 990 Returns of 501(c)(3)-(9) Organizations: Balance Sheet and Income Statement Items, by Code Section, Tax Year 2015). If 80 percent of this \$1.045 trillion value is subject to the property tax, and the average commercial property tax rate is 1.5 percent, the forgone property tax would be \$12.5 billion.

5. Projected forgone income tax revenue in 2015 from holders of \$102.4 billion in private activity tax-exempt bonds issued in 2015 by state and local governments for debt financing public benefit private projects, such as private universities, hospitals, affordable rental housing, funding and refinancing student loans, etc., on a tax-exempt basis under federal income tax laws (IRS SOI Tax-Exempt Private-Activity Bonds, Form 8038). (Author’s estimate.)

6. Projected forgone tax revenue from donors’ charitable deductions from 2015 federal estate tax, \$20.4 billion in charitable bequests made from estates exceeding the 2015 \$5,430,000 estate taxable threshold, 40 percent tax rate (IRS SOI, Estate Tax Returns Filed in 2015, Gross Charitable Bequests).

7. Projected value of federal corporate income tax, charitable deduction, based on \$16.7 billion in charitable contributions, 35 percent tax rate (IRS SOI, 2013 Corporation Source Book of Statistics of Income).

8. Projected value of exempted 2015 federal unemployment tax payments (FUTA rate of .06 applies to first \$7,000 of an employee’s payroll; 12 billion nonprofit employees) due to nonprofit FUTA exemption.

9. Forty-two states and many localities impose a tax on the net percent income of corporations, which may be a single rate or progressive within brackets. Projection applies an average 6 percent state corporate tax rate on net income across all charitable organizations to 501(c)(3) net income of \$104.9 billion.

10. Forty-five states collect sales taxes on purchases within their state, and local taxes are collected in thirty-eight states, ranging from 4 to 10 percent, with an average combined tax rate of 8 percent (Jared Walczak and Scott Drenkard, “State and Local Sales Tax Rates 2018,” Fiscal Fact No. 572 [Washington, DC: Tax Foundation, February 2018]). Charitable organizations can apply for an exemption from paying the sales tax in most states, but the process and eligibility vary greatly, and are rarely coexistent with 501(c)(3) status. (Author’s estimate, based on reported 990 functional

expenses typically subject to sales tax, including portions of meeting expenses, office expenses, and other expenses [IRS SOI Form 990 Returns of 501(c)(3)-(9) Organizations: Total Functional Expenses, by Code Section, Tax Year 2015].)

11. Fifteen states and the District of Columbia had estate taxes in 2015, with tax rates ranging from 9.5 percent (Tennessee) to 20 percent (Washington State) at the top end, with most at 16 percent. Projected \$1.6 billion forgone tax revenue from estates' charitable deductions from 2015 state estate taxes, based on \$9.9 billion in charitable bequests reported for these sixteen jurisdictions (IRS SOI, Estate Tax Returns Filed in 2015, Gross Charitable Bequests, by State of Residence).

12. Projected federal individual income tax employee withholdings for national nonprofit payroll of \$661.8 billion (IRS SOI, Salaries and Wages, Compensation of Officers and Other Persons, Table 3, Form 990 Returns of 501(c)(3)-(9) Organizations: Balance Sheet and Income Statement Items, by Code Section, Tax Year 2015); average federal tax withholding in nonprofit compensation ranges of 17.4 percent. (Author's estimate, based on IRS recommended withholding tables.)

13. OASDI and Medicare—employer portion based on payroll of \$661.8 billion. Federal Insurance Contributions Act (FICA) requires that employers make contributions to Social Security and Medicare out of every paycheck. The Social Security tax rate for employers in 2015 was 6.2 percent on income up to \$118,500 and the Medicare tax rate of 1.45 percent of all income levels. An estimated 3 percent of payroll was for individuals who exceeded the \$118,500 maximum taxable earnings. (Author's estimate.)

14. OASDI and Medicare—employee portion is equal to employer portion (6.2 percent on income up to \$118,500 plus the Medicare tax rate of 1.45 percent of all income levels).

15. Forty-three states have individual income taxes, thirty-three with graduated tax rates; projected total state income tax withholding is based on 4 percent of national nonprofit payroll of \$661.8 billion. (Author's estimate.)

16. Nonprofit organizations have the option of becoming direct reimbursers to pay unemployment claims, opting out of paying into state unemployment systems (under IRC §3303(e)), an option taken by most large nonprofit employers. This amount reflects the number

of nonprofit employers remaining in state UC systems. (You can find more on this at www.chooseust.org.)

17. When charitable organizations sell tangible goods or services that are subject to sales tax in their state, they are required to collect the tax and forward it to the state in the same way as businesses, unless the item is subject to an exemption. The list of items subject to sales tax varies widely by state, as do the lists of organizations or activities that qualify for charitable exemption. For example, almost every state has exempted Girl Scout cookies from sales tax, while many states allow fundraising events with time limits (such as limited to 30 days or less) to be free from collecting sales taxes.

18. A variety of federal, state, and local communications, utility, franchise and access taxes, and fees and charges can be applied to telephone, Internet service, and electrical and gas services, with no provisions for charitable exemptions. (Author's estimate is based on reported Form 990 functional expenses, including portions of information technology, office, and other expenses—IRS SOI Form 990 Returns of 501(c)(3)-(9) Organizations: Total Functional Expenses, by Code Section, Tax Year 2015.)

19. The 2015 unrelated business income tax (UBIT) payments by 501(c)(3) organizations were extrapolated by the author projecting 4 percent growth from 2013 tax payments (IRS Statistics on Income, Unrelated Business Taxable Income [Less Deficit], Unrelated Business Taxable Income, and Total Tax, by Type of Tax-Exempt Organization, Tax Year 2013).

20. IRS SOI, Excise Taxes for Year 2015 Reported by Charities, Private Foundations, and Split-Interest Trusts on Form 4720.

21. Most states impose a tax on nonprofits' unrelated business income, reflecting the state's corporate tax rate, but they can differ in how they apply it and what is covered. Projection applies an average of 6 percent state corporate tax rate on net unrelated business taxable income of \$1.9 billion (IRS SOI, Nonprofit Charitable Organization and Domestic Private Foundation Information Returns, and Exempt Organization Business Income Tax Returns: Selected Financial Data, 1985–2015).

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On Nonprofits, Taxation, *and the* Public Trust

by Ruth McCambridge



THERE HAVE BEEN many proposals floated at various levels of government to tax nonprofits, and most of them have not succeeded.¹ But some have—in particular, at the federal level, the recent taxing of extraordinarily high university endowments and extraordinarily high nonprofit salaries.² In this article, I try to draw out why, beyond the political circumstances of the moment, those proposals succeeded. Additionally, I suggest that while most attempts to impose taxes on

nonprofits should be resisted, there is one exception that requires some cooperation.

The One Spring from Which the Benefits, Requirements, and Resentments of Tax Exemption Flow

What can we make of the various waves of attempts to tax the tax exempt? Do they flow from a kind of callous disregard for the public good, or from disappointment with those who claim to serve that public good?

What happens to the way people think about nonprofits when Harvard University, sitting on top of the largest university endowment in the

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world—and known for its encroachment into certain lower income neighborhoods—decides that it is going to renege, year after year, on its payments in lieu of taxes (PILOTs) to the City of Boston?³ There is no correlation between the amount of land Harvard owns and does not pay taxes on, and the amount it contributes “voluntarily” to make up for that loss to the city and its residents.⁴ It alone, Harvard insists, is the judge of what it should be paying. (Of course, Harvard is not the only university to maintain such a stance; in New Haven, some call Yale “the plantation.”) And then there are the hospitals and other medical businesses. As I write this, a pharmaceutical company (also in Boston) is being tried in criminal court for multiple schemes to peddle opioids through doctors, and the same company has been accused of having too close relationships with nonprofit patient advocacy groups who subsidize those medications.⁵ What impressions of the sector are we left with when we hear this, or when we discover that a ballot-question campaign to lift the cap on charter schools is being financed by those who would be in a position to benefit from their management—and that the funds are being funneled through a nonprofit?⁶

Also in this city: a nonprofit health insurer took the money its customers paid in ever-increasing and impossible rates, and paid a departing executive (who left after leading the organization through a period of underperformance) more than \$11 million in severance.⁷ Later, the media surfaced the fact that the board members were additionally being paid high subsidies for showing up for a few hours a year, and that the possibility existed that the relationships among these actors were too interdependent to ensure that the organization was always acting in the best interests of its community.⁸

All this and more has happened in just one city, Boston, over the past few years.

So, am I surprised to hear that proposals to tax nonprofits are not just summarily dismissed by the right-minded? Was I surprised when Congress finally passed measures in the 2017 tax reform act that would essentially impose taxes on a few super-high salaries in the sector, and on

earnings from the highest of university endowments?⁹ Not in the least.

In fact, what surprises me is that nonprofits retain enough of a halo to engender both faith and disappointment among the public—but that speaks to an incalculably deep spring of trust and need on the part of the public. The need has to do with this sector’s holding of the responsibility for the shared means of collective well-being—the commons. Some of that responsibility lies with government, of course, but too often government fails at the job of protecting or even noticing the margins or the requirements of a fair, just, and free society in future generations; for that, we have the civil sector in which to organize ourselves.

Recently, I came across an excellent paper by Rob Atkinson, titled “Theories of the Federal Tax Exemption for Charities: Thesis, Antithesis and Syntheses,” in which the author posits that nonprofits are afforded exemption based in part on the general role they are seen as playing in society and the ways in which they are expected to behave.¹⁰ Some of those expectations are written into law—as, for instance, the nondistribution constraint, which is meant to reinforce the expectation that all earnings of the nonprofit are to be used toward its work rather than toward the enrichment of the few.

This guidance comes from the U.S. Tariff Act of 1913, which excluded public benefit nonprofits from paying federal income tax—the language reads that such organizations are exempt if “no part of the net income of which inures to the benefit of any private shareholder or individual.”¹¹ Thus, when salaries, or endowments with highly paid endowment managers, become too high, the public and representatives of the public may feel that the spirit of the exemption is being flouted. And, when the business being done by the organization flows through for-profit partners to enrich individuals, as was recently found to be the case at Memorial Sloan Kettering,¹² a violation is called—because in return for the tax exemption, the public wants to be assured that no one is using these organizations in a way that places his or her own individual interest above that of the public being served. Writes Atkinson,

Was I surprised when Congress finally passed measures in the 2017 tax reform act that would essentially impose taxes on a few super-high salaries in the sector, and on earnings from the highest of university endowments? Not in the least.

Nonprofits are fond of saying how much of our work is relationship- and reputation-based. . . . But the public evidently is capable of making the distinction among most nonprofits and the nonprofits (or nonprofit executives) that are enriching themselves in a way that is out of proportion to the public benefit they provide.

In the case of the charitable exemption, one intuition that we want our theories to explain is deeply held and not always clearly articulated. We are accustomed to thinking of the organizations in question here as virtuous in a way associated with the words “charity” and “philanthropy,” words related etymologically to the notion of selfless, other-regarding love. Moreover, we want an account of the charitable exemption in terms of that quality, an account that makes charity integral to the exemption, that shows the exemption to be tied to what makes the organizations charitable. A theory that does not make direct reference to this quality will disappoint us, even if it is elegant and internally consistent. We congratulate Laplace for moving the Unmoved Mover out of physics, but we are likely to be uncomfortable with theories that explain our intuitions about “charity” out of the charitable exemption.¹³

This assumption that nonprofits work to benefit the public in an overriding way is so deeply held that it is a fight we would have to work to lose; but, as suggested earlier, with enough carelessness over a long enough period of time, we certainly could begin to make a dent in it.

But Atkinson says that it is not only the assumption of good works that provides a general justification of tax benefit. He suggests that society also expects us to act in ways that are consistent with a certain cluster of values:

Bear in mind that we have looked thus far only at the kinds of good or service charities provide, ignoring any reasons for favoring charities based on the way they provide goods and services. We have, in other words, focused on the primary benefits charities provide, ignoring the metabenefits side of traditional subsidy theory. In this we are being faithful to the subsidy theory in its classic expressions. The asserted metabenefits of efficiency, pluralism, and diversity figured in more as rhetorical flourishes than as integral

components of an exemption rationale, sometimes as a broad normative defense of the nonprofit sector but never systematically as an explanation of its tax treatment.¹⁴

This appears to attach directly to the ability of this sector to promote civic and political behaviors consistent with a responsive and diverse society, and it is one of the more intriguing expectations the public has of us—and one of the most important. And Atkinson’s description of the responsibilities associated with that set of principles requires much of us in terms of observing the requirements of democracy:

I think the charitable exemption reflects not only a desire to promote the helping of others, but also a healthy agnosticism about how that help can best be given, a willingness on the part of the majority to promote minority conceptions of the good of others. That, ultimately, is what we are asking our fellows to promote when we defend the charitable exemption. To persuade them, we may have to show more than that we are helping others by our own lights; we may have to point to the minor metabenefits that fall outside Grand Theory, and we may have to assure them that we are mindful of metaharms like racial discrimination. In fairness, too, we must tell them how much helping others our way will cost. On this issue, economics will have much to tell us. But whether we assume those costs will depend, ultimately, on what kind of society we want to live in. That, I’m afraid, we will have to decide for ourselves.¹⁵

The Social Contract Is Ours to Break

Nonprofits are fond of saying how much of our work is relationship- and reputation-based, and this is as true for the sector as a whole as it is for individual nonprofits. But the public evidently is capable of making the distinction among most nonprofits and the nonprofits (or nonprofit executives) that are enriching themselves in a way that is out of proportion to the public benefit they provide—thus, the taxation of high salaries and endowments. In fact, even in localities, attempts

to retrieve either property taxes or payments in lieu of taxes generally focus on the largest institutions and institutions that occupy a significant portion of the property tax base. In these cases, the *Nonprofit Quarterly* feels that those institutions should voluntarily attempt to recompense the surrounding community for an agreed-upon proportion of what the institution would have owed in tax payments were they on the rolls. That money should not be figured in kind but added as cash to city revenue. Not to do so will continue to feed resentment based on perceptions of commonsense fairness.

NOTES

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Nonprofit Tax Policy— A Game *of* Three- Dimensional Chess

by Tim Delaney

THIS IS THE STORY ABOUT THE ONE THING THAT all charitable nonprofits share—connection to nonprofit tax policy—and how it comes about. This is not the story of sausage making, like the legislative process, but about how nonprofits, networked together, promote their common interests and distinct missions.

The process for developing nonprofit tax policy is not particularly complicated—other than that it gets formed in uncoordinated yet interconnected ways that influence each other, inside a giant, multihub, decentralized system of local, state, and federal governments, spread across the legislative, executive, and judicial branches. To put it another—more “simplified”—way, the formation of nonprofit tax policy is a bit like playing three-dimensional chess, in that tax policy proposals can spread horizontally (from state to state or from one local government to another) and vertically (from federal to state to local and back again) and diagonally (from one branch of government to another).

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To illustrate one of the many challenges that nonprofits face when dealing with nonprofit tax policy, consider the government side of this multi-dimensional chess game. The federal government alone has many thousands of decision makers shaping tax policies affecting nonprofits. These officials are located throughout the legislative, executive, and judicial branches, making uncoordinated choices as they establish, implement, enforce, and interpret elements of those tax policies. It's not only Congress and the president, but also the U.S. Department of the Treasury, including the Internal Revenue Service; the Office of Management and Budget; the U.S. Department of Justice; and dozens of other departments, agencies, and bureaus—interpreted and enforced further by 663 federal district court judges, thirteen circuit courts, and the U.S. Supreme Court. For variety, you can then add similar officials strewn across the fifty states and the District of Columbia, plus nearly ninety thousand local governments (counties, municipalities, school districts, and special districts).

Given the large number of people playing this chess game, it's important to recognize three facts. First, while at times the intent of such officials is

to alter existing tax policy relating to nonprofits, it is also true that they often focus on entirely different objectives without ever considering the impact on nonprofits, which can quickly become unintended collateral damage. The reality that legislation, rules, and court cases affecting nonprofits often aren't labeled "nonprofit tax policy" means that nonprofits must be ever vigilant.

Second, there is not one universal "nonprofit tax policy" about which the chess players are aware; rather, there are large numbers of tax policies that affect nonprofits. Even something as simple as sales taxes (should nonprofits have to pay and/or collect them?) varies widely across the states.

Third, one cannot assume that all nonprofits are of one mind regarding "nonprofit tax policy." With more than 1.4 million 501(c)(3) organizations registered with the IRS, that fact should not be surprising—but it's often forgotten.

Unfavorable tax policies—whether intentional or not—can limit, severely restrict, or even eliminate the ability of nonprofits to advance their missions. Yet no single nonprofit has the capacity to monitor or respond to tax proposals throughout

the country that might harm the work of the sector. That is why staying on top of nonprofit tax policy requires a networked approach.

Tax Policy Is a Power Game

It would be comforting if tax and other public policies were made rationally, based on logic and irrefutable facts. For instance, utilitarians—both classical (Jeremy Bentham, John Stuart Mills) and modern—would have policy makers conduct a cost-benefit analysis to identify what laws (including tax laws) would promote the greatest benefits and do the least harm. Applying this view, calculations could be made on how increasing this element and altering that one on the Rubik's Cube of tax policy should deliver a particular result.

Occasionally, it can work that way. But at the end of the day, tax policy is an exercise of power. Some interest group (a business, industry, unit of government, economic or political class, and the like) simply wants more money. Does it have enough power to alter tax policy? If its desire for more money is strong enough, a political tug-of-war between the status quo and those

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The Cornerstone of Nonprofit Tax Policy

In simplest terms, formal nonprofit tax policy can be traced back more than four hundred years, when Parliament enacted the Charitable Uses Act of 1601.* Before then, certain activities to benefit other people with emotional, spiritual, and material comfort were sometimes deemed worthy of being exempt from taxation. But what got treated as exempt varied, as determined by different ecclesiastical courts, which tended to uphold gifts for pious and charitable purposes, thus reducing the taxes collected while increasing the power of churches. So Parliament stepped in to regulate in a more systematic manner.

Europeans brought that concept, including the Act's preamble, to North America. Even before the United States was established, entities now considered to be nonprofits were treated that way, such as Yale College (1701) and the nation's first lending library (founded by Benjamin Franklin in 1731). Later, state constitutions and statutes exempted charities from taxation. Today, section 501(c)(3) of the federal tax code is based largely on the Charitable Uses Act of 1601.

*Specifically, the preamble to the Charitable Uses Act of 1601 identified the types of items that would not be taxed: "[...] the relief of aged, impotent, and poor people; the maintenance of sick and maimed soldiers and mariners; schools of learning; free schools and scholars in universities; the repair of bridges, ports, havens, causeways, churches, sea banks, and highways; the education and preferment of orphans; the relief, stock, or maintenance of houses of correction; marriages of poor maids; support, aid, and help of young tradesmen, handicraftsmen and persons decayed; the relief or redemption of prisoners or captives; and the aid or ease of any poor inhabitants covering payments of fifteens, setting out of soldiers, and other taxes." (As quoted in Nuzhat Malik, "Defining 'Charity' and 'Charitable Purposes' in the United Kingdom," *International Journal of Not-for-Profit Law* 11, no. 1 [November 2008]: 37.)

[T]he power game frequently takes precedence over logic, the ethics of cost-benefit analyses, regular processes, and/or fundamental fairness on matters concerning tax policy issues. This places a heavy burden on the nonprofit sector to be present in tax debates at every level of government.

wanting more money will ensue—regardless of whether “more money” in a given case is for the common good or for special interests. It’s about who has sufficient power to win the tug-of-war.

It started that way in 1601, when England’s ruling class—seeing “their” tax revenues and attendant power being taken by religious institutions—exerted power to secure the Charitable Uses Act. It continues through modern times. The federal Tax Cuts and Jobs Act that passed in December 2017 provides three graphic examples of how the exercise of power fueled by desire for more money can override everything else when tax policy is involved.

1. The Republican majorities in the House and Senate developed and passed the most comprehensive rewrite of the federal tax code since 1986, without a single hearing for public input and without a single supporting vote from the Democratic minority in either chamber. (Note: Not the first case of one-sided congressional action. For example, Democrats passed the Affordable Care Act without a Republican voting in support. The point here is not to ascribe blame but to show—with a recent example—that those who hold power can and will bypass procedural fairness and logic to achieve what they want.)
2. Lobbyists for corporate America and the wealthy demanded “more money” for their clients in the form of cuts in corporate and individual income taxes. To slightly counterbalance the revenue the federal government would lose by cutting those taxes, the chair of the House Committee on Ways and Means at the time, Representative Kevin Brady (R-Texas), needed to create or increase taxes on other items. He did that in part by imposing a 21 percent unrelated business *income* tax on nonprofits for their *expenses* providing parking and transit passes to their employees. The concept of imposing an income tax on outflow of expenses is baffling, but the chairman did it because he had the power to get more money for corporations and the wealthy. (He has since agreed—after intense lobbying—that this parking and transit provision should be repealed.¹)

3. The House majority stuck language into its version of the bill regarding an issue that had already been defeated (and was opposed almost universally by charitable nonprofits, houses of worship, and foundations): evisceration of the long-standing Johnson Amendment, which protects nonprofit nonpartisanship. Had they prevailed, partisan elites would have flooded churches and charities with about \$20 billion in dark money—not only to secretly influence elections but also to provide about \$7 billion in tax relief via charitable tax deductions to those making hidden political donations, according to calculations by Congress’s Joint Committee on Taxation. Fortunately, that language did not get through the Senate, so the protections of the Johnson Amendment remain firmly in place.

The lesson of each of these examples is that the power game frequently takes precedence over logic, the ethics of cost-benefit analyses, regular processes, and/or fundamental fairness on matters concerning tax policy issues. This places a heavy burden on the nonprofit sector to be present in tax debates at every level of government and monitor tax proposals in every branch of government. This sounds quite daunting, but coordinated and cross-informed action has proved successful, as can be seen below.

Horizontal Migration of Policy Proposals

Proposals for tax policies affecting nonprofit operations often migrate horizontally, moving from state to state and local government to local government. Sometimes that happens when two jurisdictions share a common border (and perhaps media markets); other times, however, identical proposals appear in noncontiguous jurisdictions.

Proposals Jumping from State to State

In 2011, new governors in Hawai’i and Michigan limited charitable giving incentives in their states because they wanted more money for their priorities.² In Hawai’i, the Democratic governor wanted more money to fill a state budget deficit he inherited, so he called for a cap on the amount

The Math of Charitable Deductions

When tax laws allow people to deduct from their reported income some or all of the amount they gave to charity, those people pay taxes on a lower amount. Consequently, the government receives less revenue via taxes. The reverse is true as well: if policy makers reduce or eliminate the deductibility from reported income of money that taxpayers contributed to charity, then those taxpayers will have higher reportable incomes and pay more in taxes, generating more revenue for the government. The same applies at both the state and federal levels.

of itemized deductions taxpayers could claim, which would also have the effect of limiting deductions for charitable donations. In Michigan, the new Republican governor, wanting more money to replace revenue the state would lose when he cut corporate taxes, targeted three tax credits that had proven successful as incentives for increasing charitable giving in the state.

While their intentions differed, the results were the same: research showed that contributions to charitable organizations fell precipitously in both states. In Hawai'i, the new tax policy brought in almost \$12 million in new revenues for state government to use, but charitable donations dropped by about \$60 million, according to the Hawaii Community Foundation. In Michigan, many people still donated to the work of food banks, homeless shelters, state colleges, and community foundations, yet without the tax credits to incentivize giving more, contributions to support the work of those nonprofits dropped that year by approximately \$50 million.

That's the bad news. The good news followed two years later.

In 2013, the nonprofit community in Hawai'i—led by the Hawai'i Alliance of Nonprofit Organizations—presented evidence to state officials proving that the cap on itemized deductions for charitable giving brought the state only one dollar for every five lost for use in communities.

The data and advocacy helped persuade lawmakers to carve out charitable deductions from the caps, thus reinstating the full incentive for taxpayers to claim itemized charitable deductions.³

Within weeks, a spate of legislative proposals to reduce charitable giving incentives popped up in several more states, including Oregon, Minnesota, Kansas, and North Carolina. That's when the power of a distributed network shines—this time in two important ways. First, information about this type of recurring threat is circulated throughout our networks of state associations of nonprofits and state policy allies, putting everyone on alert to identify similar proposals. While policy people always try to spot potentially harmful legislation, knowing that there's been an outbreak of similar bills sharpens the senses—like with people who live in Tornado Alley: it's one thing to be generally aware, and quite another when the tornado warning gets issued.

Second, the states that first encountered the problematic legislation shared what they saw and heard with the network, allowing each incident to be treated like a focus group or case study. Tapping into lessons learned in both Hawai'i and Michigan, the Nonprofit Association of Oregon identified a particular flaw in the proposal there and, working with nonprofits in that state, defeated legislation that would have included charitable donations in a proposed cap on itemized deductions. Oregon, in turn, added its insights, as did the Minnesota Council of Nonprofits, nonprofits in Kansas, and the North Carolina Center for Nonprofits when they defeated limitation legislation in their states. And as similar legislation has popped up in the years since then, everyone in the network has been able to tap into the experiences of colleagues. There is no cookie-cutter approach; each state association of nonprofits adds its own “accent” to materials, addresses any unique twists, and mobilizes its own networks of contacts and skills. Yet having access to that data bank of peers' insights has proven to be quite valuable (roughly \$50 million of contributions saved annually per state that prevailed) to the work of charitable nonprofits and the individuals and communities they serve.

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During and in the aftermath of the 2008 Great Recession, local governments were reeling. Many shared the same problem: they needed more money. A number opted for the same solution: seek to expand their tax base by including previously tax-exempt charitable nonprofits.

The nonprofit community needs such a network to counterbalance the variety of networks of government officials and the intricate networks of the business sector. One way in which tax proposals travel horizontally is through those networks. Government officials attend a variety of national or regional conferences and convenings of their peers, where they exchange ideas and learn about what has been tried elsewhere. These peer groups (such as the Council of State Governments, National Governors Association, National Conference of State Legislatures, National Association of Counties, National League of Cities, and many others) host meetings quarterly or semiannually. Given the rash of attempts by noncontiguous states in 2013 to reduce charitable giving incentives, it's likely that at an event someone shared information about the Hawai'i and Michigan experiments, and people from Oregon, Minnesota, Kansas, and North Carolina heard about the concept and tried to import it to their states.

Tax Ideas That Commonly Spread among Local Governments

During and in the aftermath of the 2008 Great Recession, local governments were reeling. Many shared the same problem: they needed more money. A number opted for the same solution: seek to expand their tax base by including previously tax-exempt charitable nonprofits. Here's a sampling of approaches.

Direct Property Taxes on Charitable Nonprofits. In New Orleans, the mayor called on Louisiana's legislature to amend the state's constitution and allow the city to directly tax the property of charitable nonprofits (but legislators refused, after hearing from the Louisiana Association of Nonprofit Organizations and other nonprofits). Commissioners of Allegheny County, Pennsylvania, voted unanimously to impose a property tax assessment on nonprofits, only to have the county executive veto the tax because it violated the state constitution. Jurisdictions acting less transparently conjured ways to evade state laws that exempted nonprofit property from taxation by inventing approaches

like "bed occupancy taxes" for select categories of nonprofits—that is, imposing a fee for every bed occupied by sick patients in nonprofit hospitals, students attending nonprofit universities, and residents of nonprofit nursing homes.

Many localities determine whether a particular nonprofit-owned property is tax exempt based on its use. For instance, some municipalities push for audits of local "eds and meds" to determine if, and how much of, their property is being used to operate profit-making business endeavors. Similarly, every few years we see a trend of local tax auditors suddenly rejecting long-standing exemptions, which forces individual nonprofits to spend resources to challenge the changed assessment administratively or in court, or nonprofits to respond collectively in different ways.

Payments in Lieu of Taxes. Every state has a law—a constitutional provision, a statute, or both—that exempts charitable property from taxation when used in pursuit of charitable purposes. Those laws are part of the social compact that traces back to 1601. Some municipalities, recognizing that legal limit on their power, have turned to a device called "payments in lieu of taxes," or PILOTs. In their friendly form, PILOT agreements are negotiated between a municipality and certain nonprofits—usually larger institutions with larger footprints, such as universities and hospitals. Common arguments from the host city of the larger nonprofits are that the fates of the city and nonprofit are intertwined, or that the city has to hire extra police or fire services to accommodate the added demands. Larger nonprofits often point to the state laws exempting property, all the added tax revenues that the nonprofit produces as an employer and purchaser of goods, the reduced costs of government that result, the unique community benefits provided by the nonprofits, and the higher property values and tax base attributable to the institutions. After negotiations, an understanding is reached.

Occasionally, situations become more heated, and municipalities demand "voluntary" payments. Some cities have resorted to not

issuing zoning variances or special-event permits, while at least one city has sent simulated property tax bills to dozens of the largest nonprofits demanding “voluntary” payments of up to 25 percent of an imaginary tax liability and then, with all the subtlety of a scarlet letter, publicly posting the names of nonprofits that paid and those that did not.

Here’s another way that a nationwide network of nonprofits provides value. Different state associations of nonprofits noticed pieces to a puzzle that, when put together, revealed a trend: occasionally, a local elected official would make assertions that “More than half the city’s property is tax exempt!” The official would then demand that nonprofits “pay their fair share.” But by having access to multiple data sets provided by the state associations, we were able to discern a pattern: too often, the politicians’ assertions were distorted, a cherry-picking of data. While true in many instances that more than half of a city’s property was exempt from taxation, the vast majority of that property was owned by local governments in the form of streets, schools, parks, airports, and of course, city hall, plus tax-exempt properties owned by the state government (e.g., highways, administrative offices, perhaps state capitol grounds) and the federal government (e.g., post offices, court buildings, maybe military bases, and more). It turned out that in most cases charitable nonprofits owned a comparatively small amount of property. Subsequently, after a few officials in different places were challenged publicly for making the misleading statements, this tactic largely stopped.

Vertical and Diagonal Migration of Policy Proposals

When policy ideas move horizontally, they almost always are made willingly, such as when a city proactively borrows an idea from another city’s experiment, or when a state imports a revenue-generating or cost-cutting idea from another state. But when policy decisions are made vertically between levels of government, they are often reactive in nature, such as states having to react to federal changes. And those vertical migrations are often diagonal as well,

such as a U.S. Supreme Court decision causing state legislatures and executive branches to respond.

Proposals Flowing from Federal to State

The federal government moves like a giant elephant: with each policy step it takes, it shakes everything beneath it. That’s especially true in the tax arena because of the often interlocking nature of tax policy. Recent and upcoming actions by all three branches of the federal government mean that nonprofits must be engaging in tax policy debates happening in the states.

Congress. With the Tax Cuts and Jobs Act of 2017 (TCJA) now in place, it’s tempting to believe that the only things left for nonprofits to do are try to amend it and comply with it. But the 2017 federal tax law pushed a lot of potential problems for nonprofits down to the states, including in the following and other ways:

- *Conformity.* Most states base part of their state income tax law on the federal Internal Revenue Code. Post-TCJA, each state now has a choice: Does it make changes to conform, or should it decouple its laws? Either way, states are reopening their tax codes to make accommodations. Whenever a legislative body starts to make changes to a tax code, there will be new winners and losers—sometimes by design of lawmakers but other times because of error. For example, in 2018, Vermont repealed its charitable deduction and replaced it with a less beneficial and capped tax credit—all in the name of conforming to the new federal tax law. In Kentucky, the legislature amended sales taxes and inadvertently expanded the tax to admissions to nonprofit fundraising events.
- *UBIT on Parking and Transit Benefits.* A specific example of conformity concerns the new 21 percent unrelated business income tax (UBIT) on nonprofits for the expenses they incur providing parking and transit passes to employees. Several states have had laws that automatically conform to federal law and impose parallel state taxes. In New York, for instance, the state tacks a 9 percent tax on

The federal government moves like a giant elephant: with each policy step it takes, it shakes everything beneath it. That’s especially true in the tax arena because of the often interlocking nature of tax policy.

One of the great hallmarks of the American form of government is federalism. As Supreme Court Justice Louis Brandeis famously observed, states serve as laboratories and can try “novel social and economic experiments without risk to the rest of the country.” That’s true with respect to tax policies, too.

anything on which the federal government imposes UBIT. Last year, state associations of nonprofits in New York and North Carolina sprang into action and secured legislation decoupling their states’ UBIT laws relating to parking benefits to employees.

Executive Branch. The House and Senate majorities inserted a provision in the TCJA that many saw as designed to punish residents of “high-tax states” (which happen to be predominantly Democratic along the two coasts) by capping at \$10,000 the amount taxpayers can deduct for the state and local taxes (SALT) they paid. In response, Connecticut, New Jersey, and New York enacted laws essentially allowing their states’ taxpayers to “work around” the federal limit by making a “charitable contribution” equal to their tax liability to special state-created charitable entities. The workaround laws would enable the taxpayer to claim a state tax credit to cancel most of the state tax liability and also claim a 100 percent tax deduction on federal taxes. The Treasury Department then issued proposed regulations that would prevent the workarounds—and put into question the deductibility of scores of other special tax incentives, such as the North Dakota Endowment Fund Contribution Credit.

Supreme Court. In 2018, the Supreme Court reversed decades of precedence by ruling that states have the power to impose sales taxes on entities with a certain amount of economic activity in their state, even if the entity does not have a physical presence there. (See *South Dakota v. Wayfair*.⁴) By the end of this year, because the decision opens access to roughly \$23 billion in potential new sales tax revenues, every state will have modified its laws—whether by statutes or regulations. Any nonprofit that buys or sells anything over the Internet, now or in the future, has an interest in how this new state tax policy issue created by the Supreme Court gets resolved.

The states have never been of one view as to whether charitable nonprofits should be exempt from sales taxes. The majority view has been that charitable nonprofits are exempt from paying

sales taxes on their purchases. Many states also recognize a related exemption from having to collect, report, and remit sales taxes on items or services they sell. But what will happen to charitable nonprofits selling things online like magazine subscriptions, online marketplaces, ticket sales for events, online auctions, and more? In the past, nonprofits looked to their home state’s laws. But after the fifty states and the District of Columbia all change their laws in response to the *Wayfair* decision, which state’s sales tax laws will control? Might charitable nonprofits in some states continue to enjoy exemptions, while others selling items online suddenly face a multitude of additional taxing jurisdictions (there are more than three hundred in Colorado alone) with endless new registration, calculation, reporting, and payment requirements? As states craft new laws and systems, advocacy opportunities may arise to streamline processes and expand exemptions in your state. Or nonprofits could lose exemptions as powerful interests expand their tax benefits at the expense of nonprofits.

Proposals Jumping from State to Federal

One of the great hallmarks of the American form of government is federalism. As Supreme Court Justice Louis Brandeis famously observed, states serve as laboratories and can try “novel social and economic experiments without risk to the rest of the country.”⁵ That’s true with respect to tax policies, too: When federal officials were proposing to cap or limit deductions that would have reduced charitable giving, we at the National Council of Nonprofits shared with Congress and the White House (as well as with our colleague organizations that focus on the federal level) the insights our network gleaned in 2011 and 2013 about how the states—red, blue, and purple—were finding that capping or eliminating charitable giving incentives significantly undermined financial support for the work of nonprofits. We urged Congress then—as well as when it was preparing for the comprehensive tax reform that surfaced as the Tax Cuts and Jobs Act—to see the initial damage done in Hawai’i and Michigan. We also underscored how fiercely nonprofits responded in their states to protect

the charitable giving incentive against the threats to eliminate, cap, or reduce the various incentives. Fortunately, several in Congress recognized that charitable giving is not a loophole but a lifeline for the communities we all serve.

• • •

The United States has built the largest nonprofit sector in the world, due in part to the fact that federal and state governments have offered favorable tax treatment and charitable giving incentives for a full century. The complex battles over whether these tax laws still make sense in the same way will surely be with us for the next century.

The lessons learned and alliances built show that, for the most part, the nonprofit sector is prepared to engage in these tax policy struggles—living out the wisdom, often attributed to Thomas Jefferson, that “the price of Liberty is eternal vigilance.”

NOTES

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You First: Leadership for a New World

“Just Ask ‘What?’”

by Mark Light, MBA, PhD

“With practice,” asserts Mark Light, “you can become a pretty good coach.” While Light is not proposing that every nonprofit leader become a professional coach, he does suggest that adding some basic coaching tools to one’s toolkit is a sure-fire way to improving your management and leadership skills. But first, you must establish your coaching stand; get your coaching questions in order; and open your heart to curiosity.

HAD MY FIRST EXPERIENCE WITH LEADERSHIP coaching about twenty years ago, when my then-chair of the board suggested that I needed a coach, and should get one “soon.” The old saying about polishing the rough edges had come up in a conversation over breakfast. I recall joking, “Me? Rough edges?” or something along those lines. She didn’t smile. I got a coach and started polishing.

I have long been captivated by the whole idea of coaching. And why not, right? Everyone is on the lookout for ideas and tools that could be helpful to the causes we serve. And what could be better than a tool that executive coach William P. Ryan describes as a “short- or medium-term consultation aimed at helping a leader improve work performance by gaining more personal awareness and reflecting more deeply on decisions”?¹

Other definitions include Michelle Gislason and Judith Wilson’s, who describe coaching as a practice that “supports individuals to make more conscious decisions and to take new action.”² The

International Coach Federation (ICF) defines it as “partnering with clients in a thought-provoking and creative process that inspires them to maximize their personal and professional potential.”³ Ana Polanco and Susan Misra write that coaching “supports people in exploring their identity, wholeness, and evolution to a way of being in the world that engages more of their whole self.”⁴

The last word here comes from the “Dean of Coaching,” Sir John Whitmore, who asserts that coaching is all about “unlocking people’s potential to maximize their own performance.” And just how is this done? Says Sir John, “It is helping them to learn rather than teaching them.”⁵ Kinda gives you goosebumps, doesn’t it?

That first experience with coaching knocked my socks off; in fact, in 2008, I started my own coaching practice, and for a decade I have used coaching in my teaching practice with emerging nonprofit leaders. Like the coachees in Bill Ryan’s study of practices, coaching for my clients centered on, “How do I master this new role? What are my blind spots,

what are my gaps, what do I need to figure out to jump in and succeed here?”⁶ New or seasoned leaders—who doesn’t need this sort of support at whatever level they may be?

Let’s say that you agree and want to get started, but because three in four nonprofits have budgets of less than \$1 million and two in three have budgets of less than \$500,000, finding and paying for a coach is going to be a stretch.⁷ Well, consider doing it yourself by adding some basic skills to your repertoire as a leader and manager. With practice, you can become a pretty good coach. You’re probably already doing some variation of coaching anyway, even though you’re not calling it that.

Now, just to be clear, I’m not suggesting that you go out and become a professional coach. What I *am* suggesting is that you add some basic coaching tools to your practice of managing and leading others. As Kris Plachy (founder and CEO of Leadership Coach, LLC) observes, leaders must play five roles to be successful: leader, manager, mentor, trainer, and coach.⁸ So, when you’re

doing your next one-on-one with a direct report, discuss the big picture of where they're going within the organization's context, take a look at the progress they're making in getting there, perhaps share some of your own insights and experiences, maybe teach them a new skill, and then coach them to unlock their own power to learn.

Do keep in mind that unlocking the power to learn must be in balance with the needs of the organization. That's a delicate dance sometimes; symbiosis is desired, for sure, but the leader is ultimately the advocate for the good of the agency.

But first things first: you must clearly establish and articulate your coaching stand. A *stand*, according to Polanco and Misra, is "the intention with which an organization or individual approaches coaching . . . a higher purpose and commitment that a coach embodies in order to support the client's exploration of change, free from the coach's own experience."⁹ They identify three necessary commitments: "First, *coaches explicitly consider power and privilege* . . . Second, *coaches are mindful of multiple ways of knowing beyond the brain's problem-solving capabilities* . . . Third, and finally, *coaches are open-hearted*."¹⁰

So, how do you hold to your stand? Give it voice at the beginning of each session. I start each coaching session by discussing where I and my coachee come from in terms of privilege and power, and how this influences the way we communicate. We then talk about our own stories, and get clear on how we will work together. (You may have other elements that are important to your stand, such as confidentiality and other ethical issues like those in the ICF Code of Ethics.¹¹)

Now that you have your stand clear, you'll need to get your coaching questions in order. This is a snap, because most of

your questions will begin with the word "*What*." For example, 75 percent of the Coaches Training Institute's list of 116 powerful questions begin with "What," 17 percent with "How," 3 percent with "When," and 3 percent with "Where." No other words register, including "Who" and the dreaded "Why."¹² Nine of Sir John's ten powerful questions also begin with "What"; "Where" is the tenth.¹³

The great thing about beginning your coaching questions with "What" is that you want your coachee to be thinking and talking, and open-ended questions make that easier. This is very nearly impossible if you're leading with yes/no questions.

All you have to add now to the mix is your curiosity as your coachee's story develops. Curiosity is easy to engage—your coachee is telling a story, and you want to see where it's going. It's actually fun to do. For example: "What happened?" "Computer crashed." "What happened then? What's the impact? What will you do now? When will you do it?"

Obviously, you don't want to wander aimlessly in the land of "What"; you're coaching for a purpose, and that purpose is often about what the individual wants to do. Supporting "individuals to make more conscious decisions and to take new action" is about forward movement.¹⁴ Your first questions should help them get clear on what they want, and your last questions should address what they'll do to get it. We're not talking therapy here—we're talking about the future, and you can get a lot done in a handful of conversations.

Now that you have your stand and questions, get used to checking in once in a while to reflect back what you've heard. That helps you to both stay on track and correct any misimpressions. I usually say something like, "Let me see if I've got this right—the computer crashed

and everything shut down, yes?" This is reflective listening, which involves "two steps: seeking to understand a speaker's idea, then offering the idea back to the speaker, to confirm the idea has been understood correctly."¹⁵ In the process, you're actually helping coachees hear what they've just said, helping them to slow down a bit and engage their thinking brain. You don't need to make any interpretations or search for the underlying feelings; you simply pay attention to what you're hearing.

Successful coaching ultimately rests on your belief that people can make their own decisions. I remember all too well learning this as a volunteer mediator in small claims and juvenile court. When I was in training to become a mediator, I was often frustrated by what I thought were unfair agreements that appeared to benefit one party over another. But the mediation center was committed to the transformative approach, in which "[outcomes] that are reached as a result of party shifts toward greater clarity, confidence, openness, and understanding are likely to have more meaning and significance for parties than outcomes generated by mediator directiveness, however well-meant."¹⁶

This is all well and good—but again, you're the leader who is in the role of a coach when appropriate. Sometimes people can make their own decisions about what they want to do, and it lines up with where the agency is going, but sometimes those decisions will be antithetical to what the agency needs. At that point, you must step out of the coach role and into that of the leader, manager, mentor, and/or trainer roles.

In sum, first, make your stand loud and clear. Second, take the conversation to the coaching ER: open-ended **E**mpowering questions ("What?") to unlock potential, and **R**eflective listening ("Am I hearing you right?") to stay on track.

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Almost forgot—six of seven questions from executive coach and author Michael Bungay Stanier's best seller about coaching are . . . well, if you don't know the answer by now, just ask "What?"¹⁷

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Is Diversification of Revenue Good for Nonprofit Financial Health?

by Mark A. Hager and ChiaKo Hung

In two words, *it depends*. As the authors explain, “Strategy, expertise, history, commitment, cause, and revenue mix differ from case to case, with a million different permutations.” Thus, “Study your own case, think through the ramifications, talk to everyone involved, and make your best calls without paying undue attention to an overly simplified prescription.”

AS IN ANY FIELD, NONPROFIT MANAGEMENT has its little truisms: Boards make policy and staff members carry it out. Hire an independent facilitator for strategic planning. Always thank your volunteers. One of the most often-quoted truisms is that *nonprofits should seek as much diversity in their revenue streams as possible*. Turns out that some truisms are truer than others, and anybody handing out absolute rules is probably trying to sell you something. There’s no substitute for understanding the ins and outs of an issue and then smartly applying them to your own situation. What blossoms in one situation might crater in the next.

The basic principle sounds good: depending on one primary source of income can be risky, especially if that source begins to head south, so it makes sense to hedge your bets—right? Indeed, the decree that more types of revenue—or more *revenue streams*—is always good has been around for a long time. Each revenue type (and source) comes with its own levels of reliability, constraints, and costs, and all may not align appropriately with the organization or its

stakeholders or other revenue sources. Many types of revenue streams may need a runway where they may cost more than they bring in for a period of time. Some need a different kind of organizational capacity than what exists. Some may draw you off course or create reputational issues. Some revenue streams might soften with the economy, while others do not.

Examples of this kind of complexity are everywhere. Picture a thrift shop that lives and dies purely on individual contributions, which we might call a *concentrated* portfolio. In contrast, the homeless shelter across the street may also rely substantially on individual contributions but also benefit from a foundation grant, county government sponsorship, and earnings from a social enterprise (a café staffed by shelter residents). We might say that the shelter has a *diversified* portfolio. And that’s always good, right?

Not always, no. Perhaps the government grant does not pay full costs of the service required to fulfill it, and therefore requires otherwise precious unrestricted money to supplement a

specific contract. And perhaps the social enterprise demands more than its fair share of staff attention—producing more angst than cash. The fact is that every revenue source requires some transaction costs: money, time, and attention. Every revenue source has its own level of restriction, from complete to none at all, and this affects autonomy and adaptability. The thrift store can do what it wishes with the money it makes within the confines of the nondistribution constraint—unless, of course, it loses money or operates on a very thin margin. Its revenue is not likely to decline with the economy—in fact, the opposite is true. All of these details about the nature and behavior of various revenue streams matter to the health of the overall operation, complicating the question of whether or not diversification is needed.

The decision to pursue additional revenue streams is a vital question of strategy for any nonprofit. So, you might not be surprised to learn that dozens of university faculty members who study nonprofit organizations have been studying the value of revenue diversification

for decades. But how useful has this been for practitioners? We reviewed all this research for a paper recently published in *Nonprofit and Voluntary Sector Quarterly*, and you might not be surprised to learn that the findings are messy and conflicting.¹ When we say that revenue diversification matters, what exactly are we saying it matters for? “Financial health” might mean revenues, or revenue growth, or volatility. It might mean assets, or asset growth. It might mean operating margin, or fundraising spending, or program spending, or even survival. Different researchers study different outcomes among different types of nonprofits in different places with different research methods, and **boom** they get different results and draw different conclusions. Sometimes revenue diversification is helpful to financial health, sometimes it makes no difference, and sometimes it is harmful. Given these conflicting results, it falls to you to figure out your situation for yourself.

Luckily, this rich thread of research has spawned a number of arguments about why revenue diversification might be helpful or harmful. That’s what we want to present for you here, so that you have what you need to make your own strategic decisions in your nonprofit organization. An important starting point is to dispel the notion that revenue diversification is uniformly (always, every time) a good thing. Sometimes it’s not. Turns out the pros and cons are about even on the revenue diversification question. Let’s dig in.

Pro: Flexibility

If you know anything about the revenue diversification arguments, you might call this the standard textbook declaration on the pro side. Maybe the future is going to be stable and predictable, and your one revenue stream will provide

the resources you need to pursue your mission. But the future is unknown! Two kinds of uncertainty threaten to upset the applecart at any time. One is large-scale environmental change: a hurricane, or a recession, or civil unrest could radically shift what you need or what you have coming in. The other is more personal: your revenue line could just dry up. Shifts in tax policy make people think twice about their charitable gifts, foundations change their giving priorities, governments move their contracts to your competitors, and social enterprises fail. We know these things happen, and it’s not hard to imagine them happening to us.

The argument, then, is that more (and ideally unrelated) revenue streams give us the *flexibility* to weather shifts of all kinds. If you get all your money from government contracts and that contract is terminated, you may be sunk. If you get half your money from government contracts and half from private grants, loss of the contracts is serious but not necessarily fatal. Revenue diversification can give you options when the ground shifts beneath you. We say it allows you to “hedge against uncertainty.”

Con: Risk and Vulnerability

Hager saves a little money each month: It grows in his savings account—not much, but it grows. Hung saves a little money each month: He invests it in mutual funds—sometimes the market produces big returns, and sometimes it cuts into his principal. Maybe Hung will end up with more savings than Hager after a few years, but Hager sleeps better at night.

Modern portfolio theory helps us think about how to balance our tolerance for *risk* with our desire for greater returns. The investment choices with the greatest potential for gains are the same ones with the greatest potential for loss. These same ideas apply pretty well

when making decisions about whether to pursue new revenue streams or not. Some revenue streams are more volatile or harder to maintain than others. Every time we pursue a new revenue option, we increase the complexity of our portfolio. We introduce risks that might cost us money in the long run—or at least a few nights of sleep.

Single-revenue streams, especially when the future is going to look much like the past, are safe and stable, just like savings accounts. However, the future is looking less and less like the past. Most of us now understand that we have to be prepared to adapt. Many read reliance on one revenue source as *vulnerability*, and, therefore, risk, and that makes good sense. But adding revenue streams adds complexity and new risks—ones that we often cannot fully calculate or appreciate as we enter into them.

Thus, diversifying requires at the very least a sober look at all the pros and cons of that particular income stream, including assessments of start-up costs, capital needs, and risks and consequences of worst possible scenarios. You may also need a special dashboard—or additions to your dashboard—so that the board can measure the costs-versus-benefits proposition. Without this forethought, you might end up in a worse financial position than if you chose not to diversify. The competence of your management team plays a big role here, and only you can gauge the likelihood that you will end up ahead.

Pro: Autonomy

The great advantage here is the freedom to call your own shots. *Having* money above what is needed for subsistence provides a lot of freedom, and *needing* money is a source of “constraint.” You have certainly seen examples of this: Private foundations do what they want, while their grantees have to toe the line.

Read any of the scholarship on revenue diversification, and there's a fair chance you will see references to "resource dependence," which means that money (or the ways to procure it) influences how organizations behave. Nonprofits that get all their money from government contracts—say, to provide mental health services for some part of their state—do not have much *autonomy*. The American Civil Liberties Union, with its recent huge influx of donor dollars, has a great deal of autonomy. The difference, again, is in the type of restrictions written into the type of revenue.

Revenue diversification has the potential to provide autonomy and all the advantages that come with that, since the nonprofit is not beholden to a single master. Whether many masters is better than one master is an open question, but diversification can provide freedom when one or another revenue stream places constraints on operations. The ability to call your own shots is essential; otherwise, nonprofits just vend services for the people holding the purse strings, and might stop representing their missions, boards, and broader stakeholder communities.

Con: Crowd-out of Private Donations

Crowd-out is one of those unanticipated problems that might come with—or might complicate—diversification of income streams. Put simply, *crowd-out* means that donors or purchasers might adjust their decisions due to their views on your other resource acquisition efforts. An example is the art museum attendee who declines to respond to a fundraising appeal because he believes his support obligation was met when he purchased the coffee-table book as he passed through the gift shop. Consequence: the museum cleared \$15 profit on the book purchase, but lost out on a \$150 donation.

Most of the research on crowd-out

focuses on the statistical relationship between government contracts and private donations. A mental health agency might strategize that a public fundraising campaign would provide it more latitude and autonomy, and even the ability to innovate. However, people may not be willing to contribute because they perceive the agency to be amply funded (by the government contracts) and therefore not in need of their contribution. Right or wrong, you can't blame the donor for making that leap.

Blind revenue diversification carries these kinds of unanticipated problems. Because the revenue streams are part of a portfolio, they can interact with and influence each other. In isolation, a given revenue stream has a certain potential for revenue gains. Taken together, those potentials may be lowered. If they are lowered enough, they may well not be worth pursuing or will need to be pursued in a more limited, experimental way.

Pro: Community Embeddedness

Community embeddedness refers to your street credibility. Do potential clients or patrons know about you? Do they see you as legitimate? Do potential collaborators think about you when opportunities arise? Embeddedness is one part visibility, one part credibility, and one part networking. Some people call it *social capital*—the more that key stakeholders see you as a player, the more embedded you are in the community. Not every nonprofit needs this kind of embeddedness in order to serve its mission, but many crave it nonetheless.

One important way that organizations interface with community is through their efforts to acquire resources. An organization with a prominent fundraising campaign might be well known among the part of the public that cares about its mission but invisible to foundations, other nonprofits, government, local

businesses, or the more general public. While diversifying revenue streams can have unanticipated downsides, a potential "extra" upside is exposure to new dimensions of the community. An organization well known to local grant makers might gain unique connections and increased reputation through the development of a social enterprise. Community connectedness might increase your penetration of mission, but community embeddedness might pay other benefits as well. For one, nonprofits with greater community embeddedness tend to live longer than more isolated nonprofits. Social capital pays, and revenue diversification can be a pathway to such embeddedness.

Con: Increased Administrative Costs

We mention risk and the potentials for crowd-out above, but the costs associated with (and capital required for) competently pursuing new revenue streams is too often overlooked by decision makers. If your organization has put time and effort into really good fundraising, that doesn't instantly translate into expertise in grantwriting, or investments, or sales. Expertise is one thing, but sunk and ongoing *administrative costs* in management systems are another. Contracting often carries the highest such costs, with administrative time required for application, monitoring, and reporting. A good fundraising program requires pricy software and a sustained effort. Earned-income ventures require products and physical spaces and bear the risk of market failure.

A nonprofit with a concentrated revenue portfolio can streamline its spending and maximize the resources it passes to programs. In contrast, diversification requires specializations and different administrative apparatuses across the various approaches. If administrative costs stray onto the sensibilities of donors, those donors might even reduce

their commitments to the organization. The increase in administrative outlays and the signals this may send to stakeholders are complexities that board members and other top managers do not always fully appreciate. Don't get us wrong: *we* think nonprofits should spend more on vital administration, including information technology, human resource management, and resource development. But the problem is that your patrons may not agree with that. As always, nonprofits have to balance their progress with the demands of those who hold the purse strings.

• • •

Can decades of academic research tell you whether you should diversify your revenue streams or not? Sadly, no: the results are mixed and difficult to sort out. However, what it can do is outline the issues you and your board should

consider when the question arises. Strategy, expertise, history, commitment, cause, and revenue mix differ from case to case, with a million different permutations. *It depends.* Study your own case, think through the ramifications, talk to everyone involved, and make your best calls without paying undue attention to an overly simplified prescription. Hopefully, flexibility, autonomy, and community embeddedness are around the corner.

NOTE

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"Is Diversification of Revenue Good for Nonprofit Financial Health?" draws on the NVSQ article, with permission.

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Reimagining the Economy: The Social Justice Enterprise

by Aaron Tanaka

Can you “do good while doing well?” asks Aaron Tanaka. “The risks to businesses and our communities are systemic and propelled by the concentration of wealth, the monopolization of industry and data, and the extraction of labor and the living earth in an insatiable race for profits. SJE offer an addition to the U.S. social movement ecosystem by articulating a proactive role for businesses to support and sustain grassroots change.”

Editors’ note: In this article, Aaron Tanaka, director of the Center for Economic Democracy and cofounder of the Boston Ujima Project, envisions a new approach for economic development that is centered on the concept of a “social justice enterprise”—an enterprise that, beyond the social enterprise of “doing good,” actively has social justice embedded in the DNA of the values of the business. This vision is being piloted on a small scale in Boston through the Boston Ujima Project, but holds promise to guide many efforts to rebuild the economy from the bottom up nationwide.

THE BELIEF THAT YOU CAN “DO GOOD while doing well” has entered the mainstream. Evidence of the trend ranges from the popularity of certifications like B Corp and the institutionalization of social enterprise as an academic field to the popular appetite for critiques of the concept—like that of Anand Giridharadas, in his best-selling book *Winners Take All*.¹ In fact, the idea that merely scaling these solutions can solve society’s most intractable problems is, at best, an incomplete theory of change. The most successful capitalist firms understand that competition within markets alone is a failing strategy. Politics and culture determine the winners of the economy, and the winners of the economy dictate politics and culture. Corporate allocations for lobbying, political action committees

(PACs), and advertising are examples of this logic at work.

The outcome of this system is a rigged competition in which social enterprises are up against Walmart, Amazon, and other monopolies of the modern era. Here, economies of scale are fortified by subsidies and tax breaks, trade policies and supply chain interventions, regulatory and contractual favoritism, and a myriad of other proverbial fingers on the scale.

Countervailing Capital

In a practical way, business associations of color and social enterprise alliances that engage in public policy advocacy actively seek to counterbalance the monopolistic market terrain. National networks like the American Sustainable Business Council, the Business Alliance

for Local Living Economies, and the U.S. Federation of Worker Cooperatives all propel these strategies.

Additionally, a growing number of grassroots organizations and social movement networks are putting their political weight behind a more radical subset of the social enterprise sector. Groups like the Restaurant Opportunities Center United and the National Domestic Workers Alliance have incubated worker-centered enterprises in the historically exploitative sectors of food service and care work. The Movement for Black Lives platform, the national Right to the City Alliance, and the New Economy Coalition have all articulated a vision for taking land out of the market by tapping into cooperative and community-owned real estate structures.

Often under the banners of new

economy, solidarity economy, economic democracy, and “Just Transition” strategies, these efforts advance specific private sector models that can exist in the capitalist economy while also subverting it. Movement Generation—based in Oakland, California—posits that “the heart learns what the hands do.” This formulation calls upon movement activists to “show, not tell” the possibilities for the future.

Building momentum from small, successful models, the social justice ecosystem builds our collective muscles for economic self-governance and leverages grassroots political power to win policy solutions that disrupt the “race to the bottom economy” in order to help grow alternatives. Rather than bending to the system, we bend the system to us.

Origins of Social Justice Enterprise

At a local scale, this approach is manifested through the Boston Ujima Project (Ujima), a nationally recognized economic democracy pilot launched in 2017. Ujima is a start-up business and finance ecosystem governed by Boston’s working-class communities of color that includes over two dozen local businesses.² Ujima’s ecosystem also includes the nation’s first community-controlled loan fund where every member has an equal vote on investment decisions, regardless of their personal financial stake.

Led by Boston’s grassroots organizations, Ujima is also creating a “Good Business Certification” to reflect the community’s demands for better policies, such as “Fight for 15” and “End the subminimum wage.” The “top tier” of Ujima’s Good Business Certification not only reflects the labor, ecological, and social standards that are expected from community-oriented companies, but also enrolls these firms as centers for building political power in a movement for racial, gender, and economic

justice. Ujima calls these businesses “social justice enterprises.” The idea is that SJEs operate in relationship with and supported by grassroots networks, while also playing a protagonist role in the political and cultural struggle for transformative change.

Contradictions of Capital versus Community

In the face of the dramatic deterioration of organized labor, the need to reconceptualize social movement strategy is palpable. With a reduction from 35 percent of the U.S. private sector labor force—at the height of the labor movement in the 1950s—to 10.5 percent today (and only 6.4 percent in the private sector),³ the labor movement has had to expand its efforts to improve the quality of jobs held by nonunionized wage earners.

SJE s offer a workplace organizing strategy focused on the 47.5 percent of the U.S. private workforce (as of 2018, 58.9 million people) employed in the small business sector.⁴ Like multinationals, small business owners can be responsible and fair employers—or not. But unlike big businesses, many small business owners are working-class people of color themselves, who own and operate companies in the same communities where they live. These owners occupy a contradictory class position, facing pressure to extract profits from their workers and environment, while connected personally with the economic and political interests of their communities and employees.

It is certainly true that some small business owners are “bad actors” and should be challenged through an array of well-tested legal and campaign strategies. But a large number of these family and community entrepreneurs not only see their enterprises as a vehicle for “giving back” but also have direct economic interests that are in

opposition to a multinational corporate agenda—and it is with this segment of community-oriented business owners that the social justice enterprise finds an opportunity to gain a foothold. SJE s seek not only to model structures and practices for the future of good business but also to leverage their political, cultural, and economic assets to create a more just society.

Ujima’s Three Pillars of the Social Justice Enterprise

1. Stakeholder Ownership and Control

SJE s voluntarily integrate operational and community stakeholders into their governance and distribute ownership benefits to those who produce value for the enterprise. Efforts to democratize ownership and control of the business unit should be seen as a central arena for contestation and innovation in the modern economy.

A. Stakeholder Ownership

A central feature of stakeholder ownership for any enterprise begins with distributing economic ownership to the employees whose labor is essential for the creation of enterprise value. For example, worker cooperatives are fully owned by employees, who each have an equal ownership stake. Employee stock ownership plan companies (ESOPs) permit either full or partial employee ownership of a firm. While some companies originate as worker-owned companies, many more become worker owned over time. For many businesses, the allocation of ownership to customers, community members, and vendors may also be appropriate.

B. Worker and Consumer Democracy

Workplace democracy is an essential feature of an SJE. In addition to

empowering employees with corporate governance and voice, SJE can engage with a range of stakeholders who are impacted by their operations and business decisions. SJE may reserve board seats for customers or community members, or recognize elected consumer or community councils with delegated powers or roles in decision making. SJE may also consider customer referendums or informal surveys to inform major corporate decisions that could impact those stakeholders.

C. Community Collective Bargaining

While democratic structures help anchor worker control over a firm, an SJE also embeds itself, where possible, into community-governed structures that establish business practices that reflect the values and interests of the broader community. In Boston, the Ujima Project's Good Business Certification enforces labor, operational, and marketplace standards that are democratically ratified and updated by membership of Boston's working-class residents of color. In the absence of community-governed structures, SJE can submit to other business standard and certification regimes—whether B Corp certification or industry-specific recognitions.

2. Social Impact and Community Benefit

SJE pursue inclusive living-wage employment, provide enriching goods and services, and adopt ecologically restorative business systems. This commitment to achieving community impact through business operations is embodied by the social enterprise movement that precedes the SJE. But SJE articulate more explicit expectations for labor rights and worker power as a constituent

feature. Though structures for stakeholder ownership and control ensure a degree of worker self-governance, proposals for workplace mediation and union neutrality institute a layer of employee protections through independent and parallel channels.

A. Workforce Inclusion and Labor Rights

With SJE, workforce inclusion is a central strategy for creating social impact and community benefit. In addition to hiring inclusive workforces, SJE can integrate best practices for guaranteeing labor protections into their operations. SJE commit to using third-party mediation services to provide workers with a forum to contest disciplinary actions or process grievances. SJE also partner with worker centers or worker service networks to offer labor rights education, workforce development resources, and other benefits to uplift the protections and resources available to employees.

B. Regenerative Business Practices

A central community benefit generated by SJE must be the regeneration of our natural ecosystems. Ecological practices begin with efforts to reduce environmental harm generated by “business as usual.” A regenerative enterprise, however, requires practices that not only do less harm but also repair and replenish the environmental systems upon which our economy and human life depend. Transitioning to 100 percent renewable energy, adopting zero-waste practices, incentivizing suppliers to adopt industry best practices, and implementing policies that actively contribute to the mending and regeneration of our ecosystems all reflect this distinction.

C. Positive Products and Service
As a business principle, SJE are committed to providing or producing goods and services that contribute to the well-being of customers, communities, and the planet. Businesses delivering products or services used for repressive or extractive purposes are disqualified as SJE, regardless of the ecological or labor benefits that accrue from their operations.

3. Worker and Community Power

The most distinct contribution of the SJE is to galvanize private sector assets to build grassroots political power in oppressed communities and communities of color. While social justice organizing has largely partitioned political power-building strategies to nonprofits, labor unions, and faith organizations, the SJE engages the small business sector as an essential force for building social movements. SJE offer new infrastructure to activate workers, owners, consumers, vendors, and investors to build independent political power and the capacity for grassroots governance.

A. Worker Organizing and Policy Advocacy

SJE support efforts to organize their workforces as educated and engaged actors for social change. SJE partner with social movement organizations to provide political development and civic engagement opportunities for employees on the job. The organizing ethic of an SJE centers the agency of workers to ultimately express and act on their own beliefs and interests.

B. Electoral Engagement and Mobilization

As private firms unencumbered by nonprofit 501(c)(3) rules, SJE offer infrastructure to advance electoral and political mobilizations in historically underrepresented communities. As labor unions decline, SJE seek to diversify the sources

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of working-class political power by retooling small businesses as sites for electoral engagement.

For example, businesses can offer paid time for employees to door-knock for candidates, or even bundle donations for aligned political campaigns. Retail and consumer-facing companies can serve as voter registration locations, sources for election information, and hubs for voter turnout efforts. SJE’s leverage private space for public mobilization.

C. Social Movement Infrastructure

As a new sectoral partner within a broader social movement ecology, SJE’s help resource frontline organizations and coalitions. SJE’s can help curb nonprofit dependence on charitable foundations and large donors. As oppressed communities organize to resist corporate extraction and state violence, SJE’s activate business owners to join as full agents and partners in the struggle for justice and democracy.

Pathways to Scale

SJE’s, in short, can help articulate a holistic and ambitious vision to transform small business to be a progressive force. As acknowledged, small social entrepreneurs are often already disadvantaged in the market. The ability to integrate many of these practices can be costly, time consuming, and even “bad for business.” Therefore, the proliferation of SJE’s requires an expanded orientation by grassroots organizations and unions—from one of protest and opposition to also include partnership and mutual accountability with local aligned businesses. SJE’s are positioned to model the future we seek while building a more democratic economy. The

risks to businesses and our communities are systemic and propelled by the concentration of wealth, the monopolization of industry and data, and the extraction of labor and the living earth in an insatiable race for profits. SJE’s offer an addition to the U.S. social movement ecosystem by articulating a proactive role for businesses to support and sustain grassroots change. Beyond “doing good while doing well,” SJE’s join the struggle against class, race, and gender-based oppression, leveraging their private assets for a more enduring public good.

NOTES

1. Anand Giridharadas, *Winners Take All: The Elite Charade of Changing the World* (New York: Alfred A. Knopf, 2018); and see Amy Costello, “Winners Give More, But Their Giving Reinforces Elite Power,” *Tiny Spark* podcast, *Nonprofit Quarterly*, September 25, 2018, nonprofitquarterly.org/2018/09/25/winners-give-more-but-their-giving-reinforces-elite-power/.
2. See “Boston Ujima Project,” Ujima Good Business Directory, indd.adobe.com/view/fb564986-c39a-4f5e-a7f6-3a201f3a0ed9.
3. Bureau of Labor Statistics, press release, “Union Membership (Annual) News Release,” January 18, 2019, www.bls.gov/news.release/union2.htm.
4. U.S. Small Business Administration Office of Advocacy, “2018 Small Business Profile,” accessed February 26, 2019, www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf.

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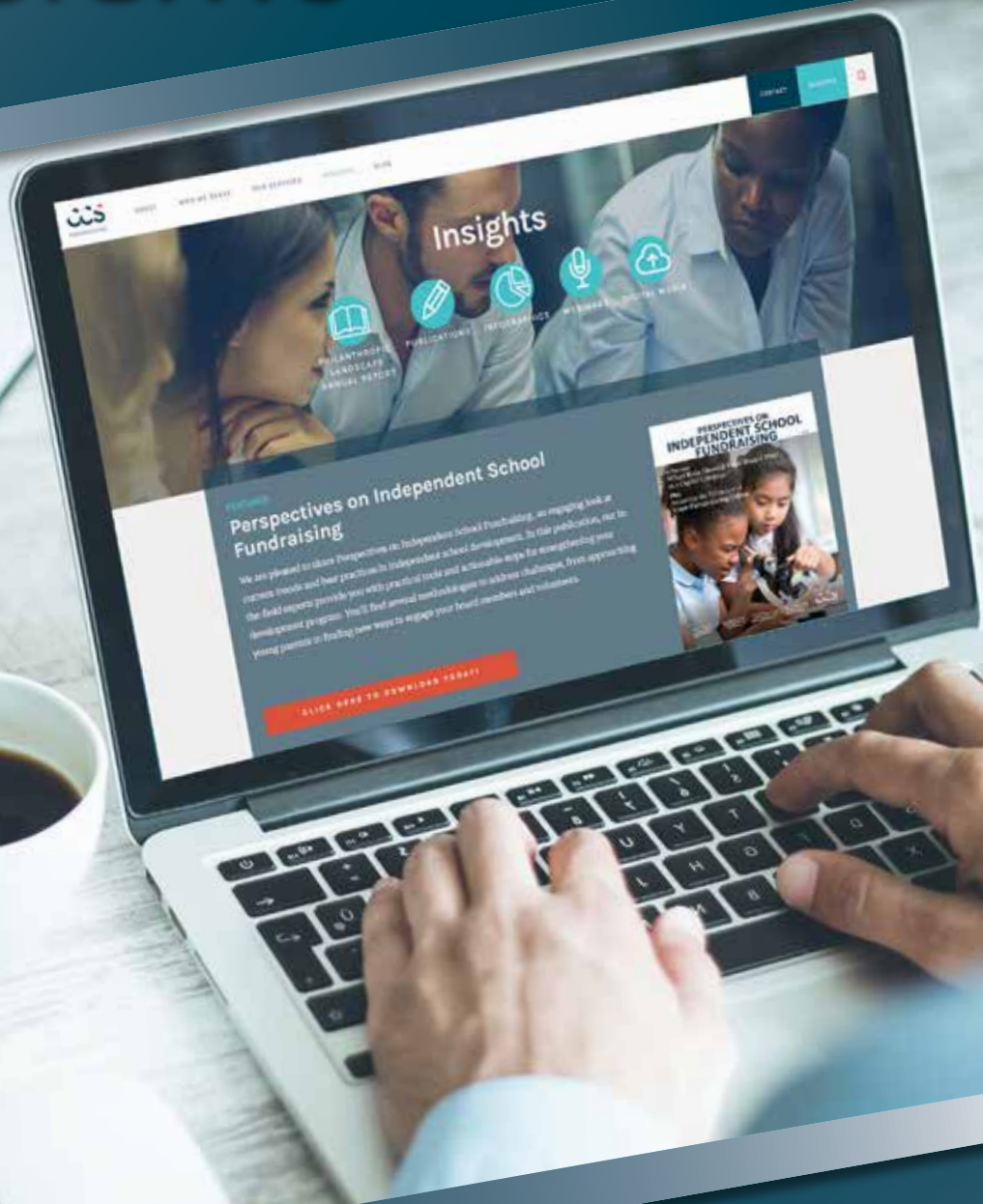
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