

Seizing the Day: Opportunity in the Wake of Crisis— An Interview with Lester Salamon

by the editors

Nonprofit Quarterly: Over the past 10 years, what economic changes have taken place in the sector, and how important have they been?

Lester Salamon: Over the past 15 or 20 years, there have been massive changes in the economics of the nonprofit sector and in the economic approach of the sector. First, there has been enormous growth in nonprofit employment and expenditures at a rate that has exceeded the growth rate of the GDP [gross domestic product] of the country by a substantial margin. Fueling this growth have been social and demographic shifts that have increased the market for nonprofit services and expanded government entitlement spending in fields where nonprofits operate.

To cite just two of these entitlement programs, Medicaid and Medicare pump more money into the nation's nonprofit organizations than most of

the major foundations combined. Their reimbursement policies have profound implications for what significant portions of the nation's nonprofits can do, yet nonprofits are not effectively represented in the arenas that shape these policies.

Finally, I would emphasize the greatly expanded need for investment capital as opposed to operating income for the sector. This has been another sleeper issue in the sector.

NPQ: Why investment capital?

LS: Like other organizations, nonprofits increasingly need capital for new technology, for strategic planning, and for new facilities to respond to increases in demand for their services, including increases that result from changes in public policy. Where there are areas of growth in the needs that nonprofits serve—particularly where those needs either can be financed privately or financed through various government programs—nonprofits are at a disadvantage unless they can find access to investment capital. Historically, the playing field has been uneven. It's uneven because nonprofits don't have access to the equity markets, they can't

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issue stock, which essentially is free capital. They can't do so because they can't offer dividends to their investors. So nonprofits have no access to an important source of investment capital, and this makes it hard for them to respond to surges in demand.

NPQ: *What's going on with revenue from fee-for-service activities?*

LS: It continues to grow. It is the single largest source of revenue growth in the sector overall and spreading into ever-wider portions of the sector. I think that will continue. It is important to realize, however, that fee income from core nonprofit services is not the same as income from unrelated businesses or closely related ones (e.g., entrance fees at museums versus sales of replicas of museum works).

Many people see business income as an important future growth area. I'm much more dubious about that. It's just very hard to start and operate a separate business as opposed to coming up with a fee structure for an existing core service. How the current economic crisis will affect nonprofit fee income is anyone's guess, of course. But in this economic climate, it will likely be harder for nonprofits to operate outside businesses than to stick to their knitting and market their core services to paying customers.

NPQ: *Is there a relationship between the need for investment capital and fee-for-service endeavors?*

LS: Sure. You can't bring in fee-paying customers unless you have the facilities to reach and serve them, which requires capital. Similarly, it's hard to attract investment capital without a sustainable source of income. There has been considerable growth of nonprofits in the suburbs that seems related to serving fee-paying customers. But generally speaking, for-profits are able to do that faster and more extensively. This economic crisis could

lead to the withdrawal of for-profits from a lot of these markets, and that could create interesting opportunities for nonprofits.

A lot of for-profits have been able to generate capital for expansion by developing financial models that show continuing, escalating returns. It's now harder to convince investors of those returns. A reduction in social spending may thus trigger a contraction of the for-profit presence in many human-service fields. This could shift the balance back in favor of nonprofits, which do have access to some forms of capital that for-profits don't.

NPQ: *Such as?*

LS: Such as tax-exempt bonds or wealthy individuals who want to build a facility and name it after themselves. The whole structure of the return models that for-profits use can come crashing down on them when reimbursement rates change, causing stock valuations to plummet and private investors to bail out. We've seen this happen in a lot of fields. And in some, for-profits have turned to shady dealings to survive. More commonly, they just pull out of the field. Nonprofits tend not to do that; they stay the course. This has been an argument for why we should be concerned about growing for-profit competition in certain fields because nonprofits are more reliable providers. If the populations being served are vulnerable and can't easily adapt to having a new provider come along, in these markets it's not good public policy to encourage for-profit involvement.

NPQ: *What about changes in philanthropy?*

LS: Our infrastructure has been too fixated on the philanthropy side of things. That's a comfortable ideological place to be, to be bringing philanthropy in, to be assertive on philanthropy, and certainly some see the sector almost exclusively in these lights. That's been a blind spot. The center of organizations has become a bit more concerned

about government as a funding source, but there was a period when every budget would be analyzed from the point of view of its impact on nonprofits, and that has not been a popular thing to do politically. So some of the key sector organizations have shied away from it.

NPQ: *Why?*

LS: I suspect that there are people on boards of nonprofits and on boards of the infrastructure organizations who don't want to be in the posture of supporting tax increases or growth of government, which has not been a popular political position.

NPQ: *Who advocates for government budgets?*

LS: To the extent that it's done, it's by the sector-specific fields, but even there I don't see it as terribly proactive. Often where it occurs is when the sector plays defense and when there are threats of massive cuts. One of the points that I've made over and over is that there should be an active nonprofit presence in the decision making surrounding Medicare and Medicaid reimbursements.

This goes back to my previous point. It's such an enormous driver of everything in the sector. As Medicare and Medicaid move to a lowest-unit-cost-of-services reimbursement system, it becomes hard for nonprofits to do community organizing, to do advocacy, to have medical schools that do training and not simply delivery of medical care at the lowest-unit cost. So it potentially drives out of the sector all the things that make the sector unique and distinctive. If I were the nonprofit czar, I would have our major infrastructure organizations regularly monitoring everything that is done in Medicare and Medicaid and calling attention to the implications that changes have for nonprofit providers. This is just so critical.

But philanthropy has been stalled at the individual level for 15 years. It has certainly grown, but its growth has lagged behind the growth of per-

sonal income, and it has lagged behind the growth of the sector, so that it has actually shrunk as a share of the sector's revenues. So the question is how to kick it further ahead. Fortunately, there have been interesting developments here. One that I have focused on is the new investment emphasis of some funders—both individual funders and foundations—and the efforts to use philanthropic dollars to leverage private-investment dollars.

NPQ: *So you're talking about program-related investments, mission-related investments, and the like?*

LS: I think that is a hopeful development—or at least it has been. It's not clear what the meltdown in the private capital market will do to it. There's a whole set of promising vehicles at risk right now: the whole array of financial institutions and requirements associated with community reinvestment. So I think we're going inevitably to anticipate a reduction in the flow of those dollars.

All this puts pressure on state and local governments. State and local governments are the partners of the feds and the entitlement programs and have significant say over Medicaid—at least reimbursements—that has powerful impact on mountains of nonprofits, not just health; it's well into the social-service field (e.g., addiction management, mental-health counseling, and developmental disability). Over the past eight years, states have added lots of people to these programs, and many states have it in their power to reverse those decisions. So we may begin to see reductions in reimbursement rates, shaving off of certain groups of people that have gotten access. I think that people have to be super-vigilant to ensure that this doesn't happen. Because if it does, a crucial source of revenue will disappear.

NPQ: *That is, that advocacy would need to happen at the state level?*

LS: Yes, a lot of the decisions are at the state level. but I think it needs to be done federally, too.

NPQ: *Are other things at risk?*

LS: Some tax-advantaged giving could be at risk. The low-income bonds that states are allowed to issue that have a federal tax advantage to them could be shaved back.

NPQ: *If you could make three recommendations, what would they be?*

LS: I imagine a defense strategy and an offense strategy for nonprofits in the present economic environment. On the defense side, there are a number of policies at risk now that need to be defended, and defended aggressively, some of which I've mentioned already—like the Community Reinvestment Act, the special tax incentives for community development finance institutions, and tax provisions encouraging charitable giving out of individual retirement accounts.

But I also think that there are interesting opportunities in this environment for a strategy of offense for the sector if it can be entrepreneurial enough to grab them, which I think it can be. One of these is the housing crisis. If we come around to a sensible approach on the mortgage meltdown—which would be that the government somehow acquires mortgages and establishes an entity that will work out the bad mortgages—this could open an enormous opportunity for nonprofits to be the agents that work with people on the ground in communities to come up with decent workouts for their mortgages.

NPQ: *And in fact, the CDC [community development corporation] infrastructure is largely already there to do so.*

LS: It's exactly its presence on the ground that recommends it, because if this stays in Treasury

and proceeds along its current course, Treasury will hire a bunch of collections agents who will buy the loans at a low price and try to squeeze out a nickel from each dollar of loan value by foreclosing. They're not going to have the same incentive to keep people in housing as the nonprofit network would have. So that's a terrific opportunity. If \$500 million of the \$700 billion bailout fund (i.e., one fourteen-hundredth) were made available to networks of local nonprofits to work with families to rearrange their loan terms to more affordable rates, we could strengthen an important network of nonprofit organizations and move the country some distance out of our housing and financial mess. We're workout specialists; we know how to deal with communities and how to get a decent deal for them and for the government.

Then there will be fields in which for-profits will begin to disappear, to pull back—nursing home care, home-health care, things of this sort—where they're heavily leveraged and can't support operations. This will create opportunities for nonprofits to acquire facilities on the cheap if they can generate the capital.

And I have no doubt that there are entrepreneurial nonprofits out there that will figure out a way to do precisely this. We have some amazing institutions and amazing entrepreneurs in the nonprofit sector. I'm talking here about service and advocacy organizations. Many of them have become enormously effective and sophisticated enterprises—with far more complexity than our simplistic charity imagery would suggest. That message somehow hasn't penetrated the public consciousness. And it is not clear to me that the infrastructure organizations have done enough to get this message across. Perhaps this economic crisis, painful though it is, will provide an opportunity to do just this. It is an opportunity that the sector should seize.

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