Managing Finances in Nonprofit Human Service Organizations

FINAL DRAFT

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ABSTRACT

The nonprofit sector has undergone considerable structural and financial changes since the 1960s. Political changes and an environment of declining resources have led nonprofit human service organizations to develop strategies to diversify their funding streams to protect themselves from environmental uncertainties. These changes have altered the ways that nonprofits are developed, administered, governed, evaluated, and sustained. This review maps the current knowledge base on nonprofit financial management and identifies implications for research and practice.

KEY WORDS: Nonprofit human service organizations, financial management, shared decision-making, philanthropy, fundraising.

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Introduction

The nonprofit sector makes a substantial contribution to the national economy and employs an estimated nine percent of the national labor force (Salamon, 2002; Young & Steinberg, 1995). As self-governing bodies, nonprofit human service organizations are established for public purposes and are exempt from federal income taxes (Boris, 2006). Unlike the for-profit and public governmental sectors, nonprofit organizations are often dependent on several sources of revenue to fund their service delivery, advocacy, and/or community-building programs (Young, 2007). Since the 1960s, political and economic changes have structurally and financially altered the nonprofit sector. An environment of declining financial resources has led nonprofits to develop alternative funding strategies that have changed the ways that nonprofits are developed, administered, governed, evaluated, and sustained.

Executive directors and governing boards make decisions that influence the financial stability of their organizations. These decisions relate to securing diverse funding sources, developing internal controls to balance the budget, and using management information systems to monitor services. The increasingly important role played by philanthropy, mounting accountability requirements, and competition among for-profit and nonprofit providers have contributed to changes in human service nonprofits and led to the development of new staff positions responsible for financial resource generation and information management. This review draws upon the literature to map the current knowledge base on nonprofit financial management in order to identify emerging themes and trends for their research and practice implications.

The review is presented in four primary sections, beginning with an overview of nonprofit finance and funding diversification. Nonprofit organizations are increasingly seeking to diversify their revenue streams in order to protect themselves from political, social or economic environmental changes that can influence their funding. The second section of this review addresses how nonprofits develop and balance their budgets and how shared-decision making between the Executive Director and Board of Directors help a nonprofit develop and maintain financial security. The next section identifies the types of resources that nonprofit organizations seek in order to secure a diverse revenue stream and generate funding to cover operational expenses. The paper concludes with a research agenda that seeks to address the themes identified in this review and generate new knowledge for practice and research.

Overview and Funding Diversification

While most nonprofits seek to diversify their revenue streams, they often have little control over their funding sources. Unlike public agencies, nonprofit services are not publicly mandated and financed (though they may have contracts to provide mandated services) and unlike businesses, nonprofits rarely have access to consumers who are able and willing to pay the full costs of services (Gronbjerg, 1993). While nonprofits have funding flexibility, they also experience considerable vulnerability to changes in external funding priorities. As a result, nonprofit leaders must continuously engage in building relationships with a variety of funding sources, each with its own set of priorities and expectations.

Political and economic changes over the past five decades have structurally and financially altered the nonprofit sector. In the 1960s and 1970s public sector funding for the delivery of nonprofit human services expanded greatly through the allocation of federal, state, and local funds. However, in the 1980s the Reagan administration introduced a period of massive retrenchment that reduced government funding for a variety of human service programs and radically altered government-supported nonprofit service delivery. In the 1990's, the devolution of federal authority and accountability to state and local agencies along with increased contracting requirements placed additional pressures on the nonprofit sector. Growing demands for service in the latter decades of the 20th century coupled with decreases in funding and changes in regulations contributed to the demise of many nonprofit organizations (Menefee, 1997).

Not only has the external environment influenced the financial stability of nonprofits, but it has also increased the accountability expectations for nonprofits to address public and private funding requirements. These expectations have led nonprofits to develop new systems related to fundraising, resource generation and information management. Nonprofit managers have developed new ways of thinking about the financial management and the need to adapt their organization to changing and increasingly competitive environment (Golensky & Mulder, 2006). One approach to building the capacities of nonprofits is to diversity their funding streams.

Building Capacity by Diversifying Funding

The relationships between nonprofit organizations and their funding sources change over time, as social and economic trends influence some funders more than others (Froelich, 1999; Gronbjerg, 1993; Randolph, 1979). Nowhere is this more evident than in the changing financial relationship between nonprofits and government. For the latter half of the 20th Century, the public and nonprofit sectors engaged in a complex and mutually dependent partnering for the delivery of publicly funded human services. Although the nonprofit sector has historically relied on several sources of revenue, the availability of government contracts offered a steady stream of funds that ultimately shifted the attention of nonprofits away from fundraising and other revenue sources (Gronbjerg, 2001). For example, in the early 1980s government grants were the primary funding source for over half of the nonprofit human service organizations surveyed (Gronbjerg, 1993).

With limits of government funding, nonprofits sought to diversify funding as a way to protect themselves from political and economic uncertainty related to the loss of a contract (Benefield & Edwards, 1998; Rosentraub, 1991). However, it is not always clear how to reduce the dependence of nonprofits on government contracts in favor of other financial resources in the community. Funding diversification requires high levels of management efforts to seek, secure, and oversee multiple grants, contracts, and donations (Gronbjerg, 1991). Nonprofit organizations have often invested in consultants and fund development staff to facilitate diversification.

The initial step in diversification is to involve the organization's Board of Directors in financial planning and resource identification, a set of activities that voluntary boards sometimes fail to appreciate when it comes to reducing an organization's financial vulnerability by advising, fundraising, pledging personal contributions and building connections (Gibelman, Gelman, & Pollack, 1997; Hodge & Piccolo, 2005; Tyminski, 1998).

Fundraising is clearly one approach to diversifying an organization's revenue stream. While fundraising is not new to the nonprofit sector, raising funds from private donors has become an increasingly competitive process (Thornton, 2006). As volunteers, Board members and development committees are certainly involved in fundraising efforts but cannot be expected to devote substantial time and energy to fundraising. Therefore, nonprofits are establishing staff positions devoted to resource development which can be costly in the form of competitive compensation packages (Lindahl & Conley, 2002). This requires nonprofits to make a substantial financial commitment in order to expand their sources of revenues.

Another approach to diversifying an agency's revenue stream is to access foundation resources. The most prominent philanthropic grant-making resource in the nonprofit sector is the foundation; in essence, a nonprofit organization that exists to allocate funds to other service producing nonprofits (Lenkowsky, 2002; O'Neill, 1989). Foundations are often built upon an endowment with a particular grant-making program or mission, including financial support to increase the infrastructure capacities of human service organizations (Gronjberg, Martell, & Paarlberg, 2000; Prewitt, 2006).

Philanthropies are as diverse as nonprofit human service organizations and include: 1) community foundations that exist on the invested donations of many donors and serve specific localities (Carman, 2001), 2) private foundations endowed by one source, typically a wealthy family (Ostrower, 2007), and 3) corporate foundations supported by annual profits that can be deducted as charitable contributions from their corporate taxes and allocated to nonprofits that have a direct connection with the corporation's line of business (O'Neill, 1989).

Nonprofits often use foundation grants to develop innovative programs and alternative service delivery methods (Netting, Williams, & Hyer, 1998). While some foundations develop requests for proposal (RFP), others invite nonprofit organizations to approach them with a program idea. If the idea meets the foundation's mission and goals, they may provide multiyear start-up funding to support the implementation of a creative new endeavor. Multiyear funding can provide nonprofits with a buffer from the volatility of shorter term funding in order to develop a program over time (Ebaugh, Chafetz, & Pipes, 2005).

The long-term survival of a nonprofit can be enhanced by organizational structures and systems that address the following challenges: lack of staff training opportunities, high rates of turnover, lack of access to technology, insufficient financial support for fundraising positions, and technical assistance needed to help nonprofits build capacity and promote independence (Light, 2004). Unrestricted grants can provide resources to support operations, promote capacity development, and generate self-sufficiency, especially when other funding sources come with fiscal constraints that exclude support for administrative costs (Gronbjerg, Martell, & Paarlberg, 2000; Mandeville, 2007). This type of flexibility enables nonprofits to use foundation dollars where they need it most, unlike government funds which often require that funds be spent in specific ways.

Financial support from foundations relies on the cultivation of relationships within the local community. A shared concern about a local population creates an opportunity for nonprofits to develop relationships with foundations. Other benefits include fewer reporting requirements and lower administrative costs as compared to government grants (Gronbjerg, 2001). However, foundation funding also brings many challenges, including unique funding priorities, screening processes, and oversight responsibilities that require nonprofits to respond to different grant-making processes (Gronbjerg, Martell, & Paarlberg, 2000). For example, is there a match between the mission of the foundation and the mission of the nonprofit and does the nonprofit have the capacity to meet the funder requirements. Foundations differ considerably in their philosophies and practices concerning accountability and effectiveness (Ostrower, 2007). Even the most minimal foundation requirements can add to the already overwhelming task of managing multiple funding sources that support nonprofits.

Although foundation funds can reduce some of the financial vulnerability of nonprofits, there is some cause for concern about the influence of foundations. In order to reduce their dependency on government funding, nonprofits have turned to private foundations for grant support, failing to recognize that both government contracts and foundation grants are dependent on the economy (e.g., income from foundation investments) and the political environment (e.g., changing government priorities). In addition, foundations and donors today are more engaged in the grant making process and expect higher levels of involvement in the organizational life of their grant recipients (Ostrander, 2007). The combined impact of increasing involvement of foundations and government in the lives of nonprofit organizations has led to questions about mission drift, ownership of services, and financial dependency (Froelich, 1999; Ostrander, 2007).

In summary, the array of revenue streams are highlighted in figure 1. In addition, it is important to note that the diversification of funding streams involves a process of shared decision-making between the executive director and the board of directors related to strategies for developing and balancing budgets as noted in the next section.

Balancing the Budget and Shared Decision Making

Nonprofit financial management involves the control and planned use of resources in a manner that is designed to further the organizational mission while also being in compliance with the law, professional ethics, and community standards (Lohmann, 1980). Balancing revenues with expenditures includes accounting, budgeting, cash management, debt management, and risk management (Coe, 2007). These processes are used to produce financial statements that describe the agency’s resource base over time, how the financial resources were used in the past, and how the organization expects to use them in the future (Strachan, 1998).

The successful balancing of revenues and expenditures involves financial planning (Lohmann, 1980). The annual budget is the organization's financial plan that can be built as a line-item budget, a program or project-specific budget, and/or a zero-based budget (Coe, 2007, Kettner, Moroney, & Martin, 1999; Lohmann, 1980). The budget is a projection of future expenditures in relationship to expected revenues and serves as a guide for both managers and board members to monitor and control the expenditures throughout the year (Coe, 2007). The budget is essentially a planning and communication tool for the Executive Director to regular4ly monitor budget compliance and for the governing board to identify and monitor agency priorities (Coe, 2007).

A realistic financial plan for a nonprofit organization needs to be flexible and responsive to internal and external pressures. Because nonprofits, by definition, do not exist to make a profit, managers struggle in their attempts to 'break even' within the context of their budgeting process (Lohmann, 1980). The concept of breaking even is being challenged today by the need to generate excess revenues over expenses to support the long-term survival of the organizations through the use of endowments and for-profit enterprise.

Nonprofit human service organizations are accountable to many different stakeholders including funders, clients, and community members. Each of these stakeholders has different definitions of accountability and effectiveness (Elkin, 1985). In some cases, an organization may be accountable to different funders for different programs and each of these contracts may have different accounting and reporting requirements. Diverse accountability requirements require tracking and monitoring systems to comply with these requirements and generate necessary reports. From a fiscal perspective, this is often accomplished with limited administrative resources.

The process of accountability includes end-of-the-year audits of all financial transactions over the previous year in the form of financial reports to funding sources (Coe, 2007). Financial audits also provide the basis for future budgeting with regard to the organization's financial condition, statements of expenses, and statements of revenues (Coe, 2007). In addition to financial accountability, nonprofits are increasingly required to report on nonfinancial aspects of their service delivery with respect to client outcomes. As a result, nonprofits are expected to respond to two accountability goals, one concerned with service outcomes and the other with financial management (Lohmann, 1980; Tinkelman, & Donabedian, 2007).

Political and economic changes in the environment and competition between organizations can alter funding patterns and increase the financial vulnerability of nonprofits (Crittenden, 2000; Hodge, & Piccolo, 2005). The financial state of an organization depends upon the stability and adequacy of its resources and on the capacity of management to withstand fluctuations in revenue (Tuckman & Chang, 1991)

Assessing Financial Health and Developing Internal Controls

In addition to developing and adhering to the budget, attending to external forces that influence the organization's finances, and ensuring compliance with all accountability requirements, the Executive Director and Board of Directors are also responsible for assessing the financial health of the organization. Unfortunately there are few established processes for measuring the financial performance and health of nonprofits (Ritchie & Kolondinsky, 2003). Assessing financial health includes revenues and expenditures, assets and liabilities, accumulated surpluses, and efficiency measures (Greenlee & Tuckman, 2007).

One way for the Executive Director and Board to evaluate the agency's financial health is to develop a monitoring system that includes early warning signs related to the organization's susceptibility to financial problems and the need for strategies to address them(Greenlee & Tuckman, 2007; (Trussel, 2002). A nonprofit is considered financially vulnerable if it has more than a twenty percent reduction in its fund balance during a period of three consecutive years (Greenlee & Trussel, 2000; Trussel, 2002).

The financial oversight of nonprofit organizations received considerable public attention as a result of publicized cases of fraud and misdirected funds (Gibelman, Gelman, & Pollack, 1997). Since nonprofits are dependent upon their external environment for financial resources, these cases have had serious implications for nonprofit organizations (Martin, 2001). In an increasingly complex funding environment, nonprofits must demonstrate their capacities to manage with integrity a system of internal controls to oversee the receipt and disbursement of funds (Graham, 2008; Martin, 2001). Internal control systems provide a framework for: 1) identifying and analyzing the organization's risks, 2) establishing policies and procedures to ensure that management directives are carried out, 3) developing communication and information systems that enable staff to carry out their responsibilities, and 4) developing monitoring systems to oversee control performance (Graham, 2008). Developing such a system requires that nonprofits allocate significant human and financial resources for the development and management of an internal control system (e.g., training staff, documenting procedures, and monitoring processes).

Shared Decision Making

The financial management of a nonprofit organization involves shared decision-making between directors of nonprofits and their boards about how to generate, allocate, and evaluate the impact of financial resources (Golensky & Multer, 2006). Nonprofit boards play an instrumental role in establishing and overseeing the organization's financial policies and procedures, including fiscal policies, developing financial plans and budgets, generating resources and fundraising, and selecting and evaluating the executive director (Harris, 1993; Holland, 1998;Ingles, 2000; Widmer, 1993; Wolf, 2007).

Board members help to build and sustain community relationships by lending credibility that enhances access to political and financial resources (Callen, Klein, & Tinkelman, 2003; Saidel & Harlan, 1998). Board members also contribute directly through donations and fundraising that draws upon their own social networks. Well-connected board members can contribute significantly to the fiscal performance and overall effectiveness of an organization (Bradshaw, Murray, & Wolpin, 1992; Brown, 2007; Callen, Klein, & Tinkelman, 2003; Hodge & Piccolo, 2005). As a result, the strategic recruitment and selection of high-value board members is vital to effective financial management, fundraising, legal council, public relations and organizational planning and administration (Gibelman, & Demone, 2002; Wolf, 2007).

In the context of shared decision-making, the process of diversifying funding sources includes the risks associated with compromising the agency’s mission by responding to the priorities of its funding sources (Golensky & Mulder, 2006; Gronbjerg, 1993; Hall, 1987; Jones, 2007; McBeath & Meezan, 2006; Ostrander, 1989; Richter & Ozawa, 1983; Saidel & Harlan, 1998). The market, the political climate, and increasing competition for resources are all factors that influence financial decision-making for nonprofit organizations (Hughes, 2006). Each source of funding brings with it a series of strategic opportunities and contingencies that must be recognized, understood, and managed by boards and executive directors (Gronbjerg, 1993; Richter & Ozawa, 1983).

Fundraising

One set of decisions that nonprofit leaders and governing boards share are the decisions related to building the organization's fundraising capacity. To secure a diverse set of resources, nonprofits need to continuously identify and secure both institutional and individual philanthropic resources, often done by hiring a new staff position responsible for resource generation and fundraising.

Increasingly, nonprofits are diversifying their revenue streams by seeking foundation grants and gifts from charitable donations (Smith, 2002). With 90% of US households making an annual donation to a nonprofit organization (Vesterlund, 2006) and 12% going to social welfare organizations (Brooks, 2004), it is clear that these donations are based on many different reasons from providing resources for less fortunate populations to finding avenues for altruistic involvement.

Nonprofit fundraising is all about building relationships with individual donors who continue to donate money and goods from year to year, including large cash donations and in-kind gifts such as buildings, artwork, and automobiles that nonprofits can convert to money (Gray, 2007; Lindhal & Conley, 2002; Thornton, 2006). Although individual donations may appear small, the total amount of funds raised over ten or twenty years can represent a very important asset for the organization (Wolf, 2007).

The goal of most fundraising plans is to increase donations each year as well as the number of annual donors by maximizing the organization's visibility and credibility and examining community support for the organizational mission (Benefield & Edwards, 1998). Board member involvement in developing and implementing the fundraising plan is essential to develop ownership because people often give to people. The extent to which the board members are out in the community and asking for donations within their social networks makes a fundraising plan that much more successful (Wolf, 2007).

A successful fundraising strategy incorporates several fundraising activities, including, direct mail, telephone solicitation, and special events. Direct mail campaigns are the most common annual fund appeal used by nonprofits (Benefield & Edwards, 1998). While direct mail solicitation letters are efficient in time spent and number of people reached, they often do not have substantial financial results (Sargeant & Kahler, 1999; Wolf, 2007). Telephone solicitation represents a more personal approach to fundraising, especially through the use of volunteers and board members. Telephone solicitation can be used to recruit new donors, solicit additional donations from previous donors, and convert donors to a more committed form of giving (Sargeant & Kahler, 1999). This approach has been shown to be an effective way for nonprofits to raise substantial donations (Wolf, 2007). Nonprofits also cultivate donor relations by contacting local businesses for in-kind donations or gift certificates for fundraising events. Special events provide nonprofits with a way to generate revenue and as a public relations vehicle to attract community attention as well as recruit new volunteers and board members (Gronbjerg, 1993). Board members and volunteers are often involved in the planning and implementation of special events that can also serve as important occasions to reward and entertain donors, volunteers, staff, and clients (Gronbjerg, 1993).

Another type of fundraising involves major gift solicitation with wealthy donors that often require significant investments of time but can be the most profitable revenue source for a nonprofit (Benefield & Edwards, 1998; Sargeant & Kahler, 1999). The first step in the planning process usually involves identifying and researching potential donors along with the preparation of a convincing case statement that identifies major needs, how a major gift could address the need, and how these needs correspond with the donor's philanthropic interest and history of philanthropy (Wolf, 2007). The second step involves a series of meetings with prospective donors to provide them with an opportunity to make a significant impact on the life of the organization (Polonsky & Sargeant, 2007).

Successful fundraising takes time and effort. Nonprofit human service agencies have often relied on managers, board members, special fundraising committees, and community volunteers to carry out an organization's fundraising plan. There is a growing awareness that nonprofit organizations may be able to generate larger fundraising revenues over time if they devote resources to establishing development and fundraising staff positions, especially since less than half of nonprofit organizations hire staff who are responsible for fundraising efforts (Rooney, 2007). Successful fundraising requires a multi-year commitment of staff and financial resources to support different types of fundraising activities (Benefield & Edwards, 1998).

There is a growing consensus that the nonprofit sector needs to shift its thinking about fundraising from the emotions associated with charity to investing in outcomes in order to promote organizational sustainability (Ralser, 2007). Potential funders are increasingly viewing philanthropy in terms of return on investment. This approach encourages nonprofits to re-conceptualize their niche in the market. The concept of a return on investment requires that nonprofit leaders develop new ways of thinking about their relationships with donors by viewing gifts as an exchange for his/her investment (Ralser, 2007). As a result, nonprofits need to generate information that is relevant to the donor's investment interests by documenting results related to the gift and thereby building the credibility to entice future investments.

In summary, shared financial decision-making needs to take into account the requirements of funding sources related to accounting for the use of financial resources as well as outcomes derived from the investment. Nonprofits need to continuously assess their capacity to adhere to funding requirements as well as build a donor base. This process requires an accurate calculation of the administrative costs associated with resource generation and monitoring.

Figure 1: Types of Revenues and Expenditures

Revenue Sources

Government Funding

- Federal, state, and local government funding that supports nonprofit human service organizations can range from 10-90% of the agency's annual budget (Martin, 2001).
- Multi-year contracts can provide considerable financial support for program operations and support for developing new services.
- The process of securing, administering, and adhering to the ever-growing requirements of public contracts can be challenging for nonprofits (Gronbjerg, 1993).
- These requirements call for program budgeting and outcome measurement that involve a significant level of professional expertise and a call for the hiring of accounting and program evaluation staff (Kettner & Martin, 1985; Smith & Lipsky, 1993).
- The extra costs associated with these management requirements can drain resources away from service delivery and over reliance on government funding can lead to fiscal crises when government spending is significantly reduced (Kramer, 1985; Gronbjerg, 1991; Rushton & Brookes, 2007).

Institutional Philanthropy

- Another source of financial support for nonprofit organizations is private and community foundations (Cordes & Sansing, 2007; Lenkowsky, 2002; O'Neill, 1989; Prewitt, 2006).
- Community foundations manage the resources of many different donors in the community and their missions are to address the needs of local communities (Carman, 2001; Prewitt, 2006).
- Private foundations (similar to community foundations)usually reflect an endowment created by a single source, such as a family or a corporation, based on certain areas of interest and allocate their funds locally, regionally, nationally, or internationally (Ostrower, 2007; Prewitt, 2006).
- Reductions in government funding has contributed to increased reliance on more flexible institutional philanthropy for developing programs, increasing capacity, and/or maintaining operations (Lenkowsky, 2002; Mandeville, 2007).
- Some foundations offer multiyear grants that enable nonprofits to overcome the volatility of shorter term funding (Ebaugh, Chafetz, & Pipes, 2005).
- As nonprofit organizations, foundations set their own funding priorities, criteria, screening processes, and accountability requirements (Gronbjerg, Martell, & Paarlberg, 2000; Ostrower, 2007).

Individual Philanthropy

- Individuals in the United States gave $184 billion to nonprofit organizations in 2002 and another $8 billion in charitable bequests (Rooney, 2007).

- Although the bulk of private donations and gifts go to educational and arts institutions (Odendahl, 1989), there is evidence that individual philanthropy plays an important role in funding human service organizations (Rooney, 2007).
- While most individual giving is local and related to community integration and opportunities to give, new forms of giving are emerging (e.g., giving circles of individuals who pool their donations and collectively allocate it) (Eikenberry, 2006; Jones, 2007).
- Individual donations allow for considerable discretion in how funds are used as well as the community legitimacy that this source of support creates for an organization (Ebaugh, Chafetz, & Pipes, 2005; Gronbjerg, 1993).
- While a major gift from a wealthy donor is the goal of most nonprofits, the efforts to secure such gifts are considerable (Gronbjerg, 1993; Sargeant, & Kahler, 1999).
- One of the challenges associated with major donors can be the disproportionate influence of a large gift on the organization's goals and mission (Ebaugh, Chafetz, & Pipes, 2005; Ostrander, 2007).

Earned Income

- Guo (2006) found that 43% of nonprofit social service agency income came from client fees and service charges in 1998 (James & Young, 2007).
- Nonprofit managers and boards struggle with defining appropriate fee systems for their service recipients, especially for low-income clients (Lohmann, 1980; Prochaska, & DiBari, 1985; Rubenstein, Bloch, Wachter, & Vaughn, 1985).

- Human service nonprofits are becoming increasingly involved in commercial activities to generate revenues such as selling services, pursuing commercial ventures, and marketing (Gronbjerg, 2001; James & Young, 2007).
- According to Salamon (1993), commercial income accounts for a larger share of growth in human service nonprofits than other income sources; however, these ventures can blur boundaries between for-profit and nonprofit goals and can ultimately contradict the agency’s mission (Bryson, Gibbons, & Shaye, 2001; Dart, 2004; Guo, 2006; Kramer, 1985).
- Social enterprise ventures are entered into for one or more of the following reasons: limited revenue streams, expanded demand for services, increased competition with nonprofits and for-profit organizations providing similar services, greater availability of corporate partners, and/or increased demands for accountability (Young & Salamon, 2002).
- While a social enterprise can help a nonprofit become self-sufficient, there is a risk of substituting profit-making goals for human service goals (Gibelman & Demone, 2002).

Investment Income

- Investment income can take the form of endowment, interests, dividends, rental property, and capital appreciation (Gronbjerg, 1993).
- Endowments can generate a steady source of income that requires less staff effort to manage and can provide part of a financial safety net during hard times (Bowman, Keating, & Hager, 2007).

In-Kind Income

- It is estimated that volunteer hours generate the equivalent to 1.68 million full-time paid employees, which represents $58.9 billion dollars (Preston, 2007).
- Although their labor is not paid and their contributions are not often valued in monetary terms, volunteers make important contributions to the operation of nonprofits (Mook, Sousa, Elgie, & Quarter, 2005) and can reduce fiscal pressures on an organization while also helping it meet its mission, vision, and goals (Brudney & Kellough, 2000).
- The successful recruitment, training, monitoring, and retaining of volunteers requires considerable staff time and energy in order to use the skills and talents of volunteers most effectively in meeting both the needs of the volunteers and the agency (Preston, 2007; Stebbins, 1996; Wolf, 1999).
- Reasons for volunteering include altruism, meeting people, learning about a field, developing professional contacts, gaining training or experience, and providing entry into a particular organization (Wolf, 1999). Managers must ensure that volunteers are held to the same set of standards as employees within the context of agency policies and procedures (Martin, 2001).
- Volunteer board members help nonprofits fulfill their missions, operate in accordance with the law, and make sound financial decisions (Preston & Brown, 2004).
- Board members bring expertise that is important for nonprofit survival (e.g., finance and law) and have the capacity to generate financial resources through their social networks (Brown, 2005; Iecovich, 2005; Inglis & Cleave, 2006; Preston & Brown, 2004).

Expenditures

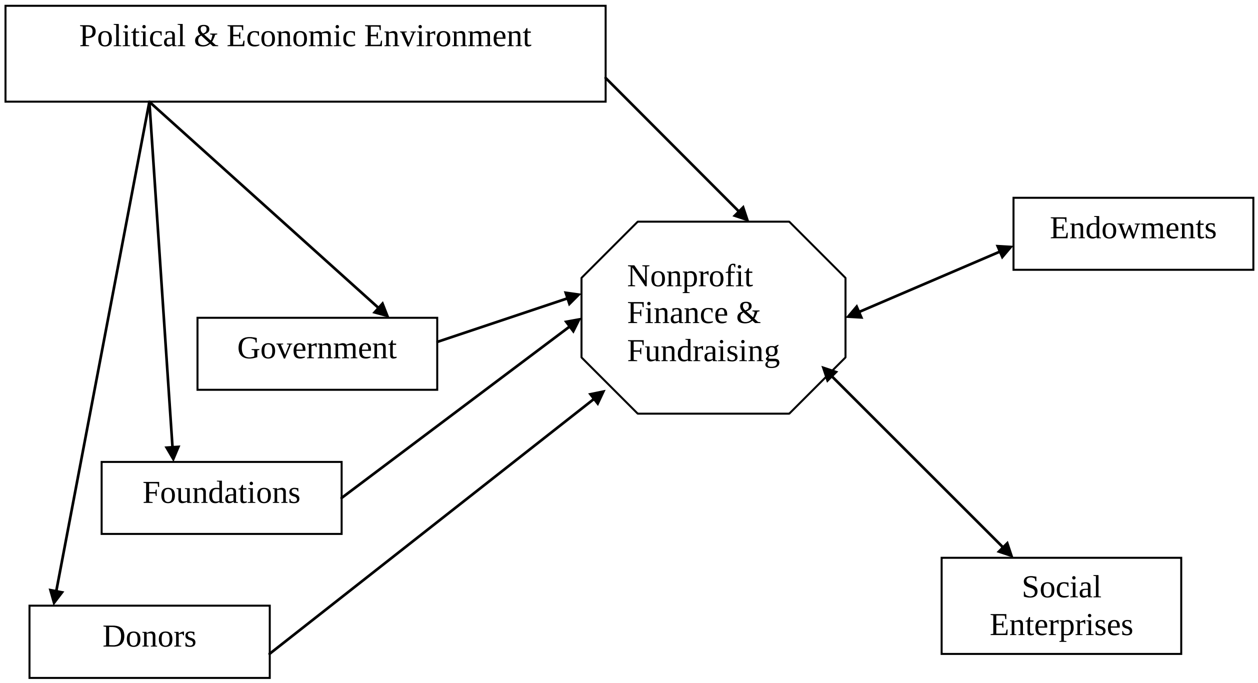
- Nonprofit expenditures include employee-related administrative expenses (e.g., salaries and benefits) and related operating expenses (e.g., rent or mortgage payments, utilities, insurance, and equipment) (Martin, 2001).
- Most nonprofits spend well over half of their annual budgets on personnel, especially since wages, benefits, conference travel, and training support need to be competitive with other organizations (Young & Steinberg, 1995).
- Other major administrative expenses relate to identifying measureable outcomes, designing systems to document progress, monitoring record keeping by staff, and reporting outcomes in ways that satisfy a multiplicity of funders (Elkin, 1985; Smith & Lipsky, 1993).
- Beyond operating expenses related to facilities (e.g., rent or mortgage) and maintenance, there are significant equipment costs associated with computer systems, software, network security, and communications (Hoshino, 1981; Mutschler & Hoefer, 1990; Velasquez & Lynch, 1981).
- Other operating expenses include transportation, office supplies, printing, and fundraising events (Sargeant & Kahler, 1999).

Implications for Research and Practice

The nonprofit sector differs from public and for-profit sectors in that it has unique access to specific types of funding sources but at the same time it has less control over these funds. The external factors of policy changes or changes in the economy can significantly affect the financial stability of a nonprofit organization. The financial landscape of the nonprofit sector underwent enormous shifts and changes in the later decades of the 20th Century that led to a growing interest in the survival and independence of this sector. While nonprofit organizations advocate for a greater influence over the policies that affect their funding, they have very little control over the decision-making processes of funders. As nonprofits seek to gain greater control over their finances in order to manage within changing environments, they are developing endowments, establishing social enterprises, and developing fundraising plans campaigns.

As a foundation for developing research and practice implications, Figure 2 was developed to capture the financial landscape of nonprofit human service organizations as it relates to government contracts, foundation grants, and private donations within the context of the political and economic environment. Developing different revenue streams requires nonprofits to make initial financial investments that can lead to greater financial security over time.

Figure 2: The Financial Landscape of Nonprofit Human Service Organizations



Building a Research Agenda

This review represents an attempt to map the current knowledge base of nonprofit financial management in order to identify major themes and the following research agenda:

- **Revenues:** While the literature describes the nature of diversification, there is little research on *how organizations successfully reduce their dependence on a single funding source*. Research on the effects of diversification on services and organizational operations can be informed by addressing the following questions:
  - What types of strategies and processes do both large and small nonprofits use to successfully diversify their revenue sources?
  - Are human service nonprofits developing diversification strategies that take into account political and economic uncertainties (e.g., social enterprise and fundraising programs to reduce dependence on grants and contracts)?
  - How do human service nonprofits approach the development of their own endowment programs?
  - What is the relationship between board composition and promoting the diversification of funding streams?
- **Expenditures:** Despite the considerable attention given to the advantages and disadvantages of enhancing revenue streams, *there is less information available about the nature of nonprofit expenditures , especially the role of administrative overhead* (Lohmann, 1980). Given the limited information about the nature of administrative costs, it is important to expand our understanding of this aspect of nonprofit financial management by addressing the following questions:
  - How do nonprofit leaders monitor and assess expenditures?

   - How do nonprofit organizations adequately build resources into their budgets to cover additional administrative costs associated with funding requirements?

- **Accountability:** Accountability warrants further investigation in terms of the costs associated with accountability systems and the challenges created when each revenue stream has its own unique reporting requirements. *As both public and private grant making organizations make more accountability and evaluation demands on their grantees, nonprofit organizations are responding by either developing monitoring systems that are unique to each funding source or searching for new ways to handle diverse reporting requirements.* Since many nonprofits have yet to integrate their financial performance indicators with their service effectiveness indicators, further research is needed to address the following questions:
   - What strategies do human service nonprofits use to efficiently respond to multiple reporting requirements?
   - Do Executive Directors and board members discuss these strategies prior to applying for new funding sources and how do they budget for complying with the increasing number of requirements?
   - What types of data management and evaluation systems do nonprofit human service agencies use to respond to both financial and programmatic accountability requirements?
- **Foundations**: With the accumulation of wealth in the United States in recent decades, there has been a growth in philanthropy and foundation awards granted to human service nonprofits (Gronbjerg, Matell, & Paarlberg, 2000; Lenkowsky, 2002). Some foundations are paying more attention to strengthening the capacity of nonprofits by providing capacity building grants but it is not clear how long they can be sustained given the changing political and economic forces outside of the nonprofit sector. At the same time, there is evidence that

the nonprofits are growing increasingly dependent on foundation grants and that a *three-way partnership is emerging in the delivery of human services in which an inter-dependent relationship is forming between public agencies contracting for human services, the nonprofits delivering services, and the foundations providing funds for innovative services, infrastructure enhancement, and organizational capacity building.* Little research has been done to examine the impact of capacity building grants or the dependence of nonprofits on foundation grants. Further research needs to be guided by such questions as:

- How do nonprofits perceive foundation funding and what efforts do they put in place to secure these funds?
- Are nonprofits seeking foundation grants primarily to address service delivery issues or are they pursuing philanthropic resources as a way to strengthen organizational capacity?
- How do foundations select organizations to receive capacity building funds and how do nonprofits conceptualize this form of support? Who decides which organizational areas are targeted for capacity building and how do nonprofits and foundations collaborate on these projects?
- What are the fiscal and programmatic outcomes of capacity building funding?

- **Fundraising:** *Nonprofits are increasingly seeking to diversify their revenues by generating their own income through attracting charitable donations through fundraising efforts.* Some nonprofits hire consultants to help develop a fundraising plan, others create development positions specifically for attracting and securing private funders and still others rely on board member and volunteer fundraising activities. While fundraising is viewed as an important way to generate private donations, there needs to be more research on how the nonprofit human service community raises funds, which fundraising strategies work best for different types of organizations, how community donors are cultivated, and how resources are allocated for the costs of fundraising. Future research could address the following questions:

- How do human service nonprofits approach their fundraising efforts? Are resources invested in developing a fundraising strategy?
- What the relationship between fundraising activity and financial outcomes applied to different types of nonprofits (e.g., size, clientele, location, etc.)?

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