

**DRAFT – NOT FOR QUOTATION**

*The Market Transformation of Nonprofits and Philanthropy*

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## Introduction

Nonprofit organizations draw on several different major sources of income, including government funding, earned income and philanthropy. The degree to which nonprofits depends on these sources varies widely from country to country, from one field of activity to another, and even among nonprofits in the same fields of service. The Johns Hopkins Comparative Sector Project has documented this variation for a cross-section of countries and fields of activity and classified countries and fields into three categories: fee-dominant, government-dominant and philanthropy-dominant (Salamon, Sokolowski and Associates, 2004).

While the substantial variations in income mix among nonprofits are clear, widely acknowledged and beginning to be understood (see Young, 2006), variations in the patterns of income support for nonprofits over time appear, at first blush, to be less dramatic. The major gross temporal change, in the United States at least, is that philanthropy is becoming a smaller proportion of the mix, having shrunk from approximately half of nonprofit budgets in 1964 to a third in 1976 to under 20% today (Weisbrod, 1998; Nonprofit Sector in Brief, 2007). On the other hand, government funding, which is commonly believed to be shrinking as a result of changes in social policy such as government tax cuts and welfare reform, has actually increased its share of nonprofit sector support over time, to more than a third of all nonprofit revenue today (Smith, 2006; Salamon, 2002). In contrast, earned income support for nonprofit organizations (from fees and commercial ventures), popularly thought to be increasing its share of nonprofit income over time as a result of the growing “commercialization” of the sector (Weisbrod, 1998) has, in aggregate terms, not really changed much. For example, Salamon (2002) reports that the sector’s share of fees and charges rose from 46% to 47% of revenues between 1977 and 1997.

Of course, these aggregate trends in sector financing mask different patterns of change within parts of the nonprofit sector. For example, government support for nonprofits in health care rose from 32% to 42% of revenues between 1977 and 1997 while share of revenues from fees in social service nonprofits rose from 13% to 28% in those same years. However, with a few such exceptions, the aggregate numbers for

nonprofits do not reveal revolutionary changes in nonprofit finance, except for the fact that the sector has grown quickly, outgrowing its philanthropic base, and managing to keep apace through government support and earned income growth.

The real changes in nonprofit finance have come *within* the gross categories of earned income, government funding and philanthropy. Indeed, in each income category trends point to increasingly market-oriented structures and practices and perhaps a convergence in the forms of income support. In the sections to follow we describe these changes, ultimately paying the most attention to the shrinking category of philanthropy for several reasons. First, it remains possible that philanthropy will begin to regain its prominence in nonprofit finance over time, albeit in different forms. (Hopes for a large part of future intergenerational transfers of wealth going into philanthropy persist; see Havens, O’Herlihy and Schervish, 2006). Second, many of the most fascinating and revealing changes in form are occurring within the category of private giving. Third, despite its shrinking share of nonprofit income, philanthropy (and volunteering) remains the spiritual heart of the sector – driving its decision making and disproportionately influenced by donors, especially major individual philanthropists and large corporate and foundation funders.

The forgoing analyses of income sources beg the question of why these changes – dubbed as a “market transformation” - are taking place. The penultimate section of the paper considers some underlying factors, including changes in the overall economy, technology, and government policy, and a maturing of the nonprofit sector. We conclude with some thoughts on what these changes could mean for the effectiveness of philanthropy in coming years, and potential strategies for philanthropy and nonprofit institutions to address the changes now taking place.

### **Changes in Government Funding**

Some 31% of the revenues of nonprofit organizations in the U.S. are provided directly by government (Rushton and Brooks, 2006). However, only 9% of nonprofit revenues now come in the form of government grants (Nonprofit Sector in Brief, 2006). The contrast in these figures reflects a definitive trend from government grants, which entail minimal accountability requirements, to fees, contracts and other forms of market-

based governmental payments. According to Smith (2006) this transition began in the 1960s in conjunction with major increases in government funding for community based programs, health care, arts and culture and other services, which required government to increase its capacity to monitor these expenditures. With the advent of managed care arrangements in social services and health care, government contracts also became more performance-oriented, tying payments to specific measures of service provision. Moreover, with the growth of government insurance programs such as Medicare and Medicaid, and various other consumer subsidy programs in housing and other areas, government funding increasingly took the form of reimbursements, vouchers or fees paid for services rendered to specific clients and consumers. In some cases, the forms of payment influenced the character of services in important ways. For example, rapid increases in health care spending through Medicare and Medicaid and parallel slowing of traditional social services grant spending led to a transformation of services such as care for the elderly from social service to medical modes of provision (Smith, 2002).

The shift from government grant programs to contracts and demand-side subsidies paid in the form of fees and reimbursements, is not the whole story of government support for nonprofits, however. Gronbjerg and Salamon (2002) document a host of targeted tax expenditure and government loan programs that have emerged in recent years, including low income housing and child care tax credits, medical expense tax deductions, student loans, and many others. These authors estimate that at the federal level, such programs increased by 123% between 1990 and 2001, reaching a value of more than 315 billion dollars. Furthermore, nonprofits garner indirect support as a result of general tax deductions that citizens receive when they make charitable donations to charitable nonprofit organizations. Rushton and Brooks (2006) estimate that these deductions cost government an estimated \$37.2 billion in forgone tax revenues in 2002, roughly one-fifth of direct government funding of nonprofits.

In general, the dramatic shifts from government grants to market-based forms of direct payments to nonprofits, and the growth of indirect tax subsidies that help consumers and tax payers to purchase services directly from, or donate to, nonprofit organizations, highlight the transformation of government funding in the U.S. towards a market-based model of support. Increasingly government can be seen as a frugal

purchaser of nonprofit services itself, a subsidizer or insurer of services selected by individual consumers, or a supporter of decentralized funding of nonprofit organizations through the marketplace of philanthropic giving. The era of relatively unencumbered government grant support has been supplanted by a complex array of market-based government financing instruments.

Similar developments are occurring in other countries as well. Certainly reforms in welfare state policies in the United Kingdom and elsewhere in Europe, beginning in the 1980s, led both to a change in the form of support to nonprofits, from grants to contracts, as well as to increased levels of government contracting out of public service provision to nonprofit and other private organizations (Anheier and Salamon, 2006). More recently, a new emphasis in Europe on “social enterprise” as a way of engaging private organizations to address issues such as work integration and child care, has replaced direct government service with contractual support of various kinds of private organizations, for specific projects and programs (Borzaga and Defourny, 2001; Nyssens, 2006). In these instances, at least, government support of nonprofits has become more of a business proposition than a pure subvention of charitable activity.

### **Earned Income**

Earned income has long been a mainstay of nonprofit organizations in the United States (James and Young, 2006). And while the degree to which these organizations depend on earned income has not changed dramatically in the past few decades, the forms and practices associated with this source of income are shifting in two important ways. First, imposing fees for services is becoming more widely accepted, even for services traditionally provided without charge. Second, there is growing emphasis on new earned income-based ventures, both those that are unrelated or only partially related to an organization’s social mission, and those that use the market place in new ways to address those social missions.

Reliance on fees is growing fastest in fields that have historically been less dependent on fee income, including social services, the arts and civic organizations, as compared to other nonprofit fields such as education or health care where reliance on fees has traditionally been high (Salamon, 2002). Thus, reliance on fee income is becoming

more widespread, with nonprofits seeking out new possibilities for charging fees as well as trying to derive more income from services already supported in whole or part by fees. The decision to impose a fee where none has been previously charged involves a number of considerations including revenue potential, impact on mission, and influence on the culture of the organization (Oster, Gray and Weinberg, 2004). It is becoming understood, for example, that charging for services can have both positive and negative impacts on mission. On the positive side, fees can mitigate stigma associated with consuming “charitable” social welfare services such as transportation for senior citizens or help from a neighborhood health or legal clinic or tutoring program. Fees can also help to allocate use of congested services such as visitation to museums in peak vs. off-peak hours. And fees can screen out users who might otherwise be tempted to consume services frivolously. Fees can also generate new revenues that can be used to extend the capacity of a nonprofit to serve more people. With an appropriate pricing structure, nonprofits can often employ fees to enhance their resources and mission impacts without excluding people who need their services or alienating donors who may have philosophical objections to commercial revenue or may perceive that their help is no longer required. And service fees can be “bundled” into subscriptions and memberships that encourage people to consume mission-related services such as performances by contemporary artists or health enhancing exercise and nutrition programs, which they may not otherwise have sought.

Sometimes the imposition of fees can be treacherous – witness the outcry faced by the Salvation Army when it tried to charge fees for extended stays in homeless shelters (Associate Press, 2003). In addition, implementing fee generating programs can tax the culture of a nonprofit organization, pitting traditionalists against business-types who may not see eye to eye on various decisions. However, the increasing realization by nonprofits that fees have an important place in the support of mission-related services and in the overall financing of nonprofit operations is an important factor in the movement towards charging of fees for formerly free services.

A related phenomenon is the seeking of new service ventures capable of generating earned income for nonprofit organizations. There are several strands to this development as well. One strand is based on the realization that nonprofits often have

under-utilized assets or core competencies that are capable of generating additional income without undermining their social missions. Thus, museums, arboreta and university campuses are often good places to hold private receptions for weddings, graduation parties, or seminars and conferences for other organizations. Gift shops in art museums and hospitals or university book stores can actually enhance the educational or cultural experience while generating new income. More controversially, many nonprofits have trusted brand names that they can leverage through appropriate corporate partnerships that generate streams of new licensing, commission or royalty-type earned income. Thus, the American Heart Association can provide its seal of approval on foods it deems healthy, and the American Cancer Society can have its logo appear in advertisements of pharmaceutical companies that produce tobacco patches. Care must be taken to avoid relationships that can damage a nonprofit's reputation; but often, such arrangements actually enhance mission impacts through greater exposure of the organization's messages, as well as generation of additional revenues for its programs.

The undertaking of commercial ventures by nonprofits blends seamlessly into the contemporary social enterprise movement in the United States. In a social enterprise venture, a nonprofit organization tries to utilize the marketplace to address its mission more effectively than it could otherwise, while generating earned income as well (Young, 2007). However, not all social enterprise ventures earn a profit nor must they necessarily do so. For example, a restaurant or bakery operation that employs ex-offenders, or members of otherwise challenged groups, in order to prepare them to participate in the labor market may not be able to compete with for-profit firms in the same industries unless it is subsidized. However, such enterprises still use the discipline of the marketplace, including appropriate pricing of products and services, to simulate conditions and design programs that allow them to address their social missions in new and effective ways.

In sum, new developments in earned income generation by nonprofits, including the imposition and creative use of fees income, and new earned income ventures and social enterprises, are noteworthy not only because they maintain nonprofits' reliance on fee income but also because they increasingly use market mechanisms to address their social missions in more effective ways.

## **Philanthropy**

Of all sources of support for nonprofit organizations, philanthropy (giving of money or time) comes closest to the voluntary, charitable heart of the sector's mission and value system. Yet even in this domain, the nature of support and the practices for engaging philanthropy are becoming more market-oriented. This transformation manifests itself in numerous ways including the tying of donations to private benefits, greater donor control over the uses of gifts including donor choice in federation giving, donor advised funds in charitable foundations, the framing of fund raising appeals as purchases of charitable output, the framing of giving as social investment rather than charity, greater competitiveness among foundations, and the integration of giving and volunteerism programs into the mainstream market strategies of corporations.

It is increasingly understood that giving and volunteering are not purely "altruistic" activities and are motivated by multiple factors, including self-interest and private benefit (Vesterlund, 2006, Leete, 2006). Indeed, recent research suggests that donors are motivated as much or more by private benefits of giving (including feelings of personal satisfaction) than by the impacts they may have on the public good or charitable output. What is striking in the way philanthropy and volunteering are now practiced in the U.S., is the degree to which the concept of private benefit is now central to resource development. Mancur Olson (1965) pointed out years ago that one way to overcome the free rider problem associated with voluntary support of a public good was to provide "selective incentives" in the form of private benefits. This approach has become common practice in fund raising campaigns, ranging from the offerings of gifts and discounts for donations to public broadcasting to the naming of programs and facilities in hospitals, universities and arts institutions, in honor of major donors.

Another approach has been to "package" charitable output so that donors feel they are personally responsible for increases in charitable output. Thus, homeless shelters "sell" Thanksgiving dinners for their clientele and international relief organizations invite donors to "adopt" children and follow their progress over time. In general, Tuckman and Chang (2006) note that nonprofits have become increasingly creative over time in commercializing their outputs so that donors feel they are buying something for their money.

Another popular mechanism for fund raising is the offering of “memberships” in charitable organizations. Such memberships are tied to benefits ranging from discounts for special exhibits or gift shop purchases to admission to special member events and opening nights. Over time, the very concept of membership in a nonprofit organization has become ambiguous, as some (traditional) memberships entail governing rights and privileges while others (of more recent vintage) are essentially nominal designations intended to stimulate donations. Steinberg (2006) makes the useful distinction between *member-serving* and *public-serving organizations with members*, the former charging dues that are essentially fees for services (bundled into membership packages) and the latter utilizing membership as a fund-raising device and coupling member payments (essentially donations) with selective private benefits. Since the latter benefits are usually estimated as small percentages of membership fee levels, most of the membership payments in public-serving nonprofits are deductible and treated like donations for purposes of taxation.

Because of the way data is reported, it is difficult to tell whether membership payments are increasing or decreasing over time. It is known that nonprofit associations, especially member-serving nonprofits, are becoming less reliant on dues per se, (Steinberg, 2006); however, the portion of member payments considered donations are not classified as dues for tax reporting purposes and hence not distinguished from other components of philanthropic revenue. Casual observation suggests, however, that gifts raised through membership programs constitute an increasing part of the revenue base of public serving nonprofits.

It is difficult to tell if nonprofits are gaining more leverage over their donations by coupling them to private benefits. The pressures seem to operate in both directions. For example, prestigious colleges and universities have historically applied preferential admission criteria for children of alumni who have been generous donors. And some of these institutions have exploited their athletic programs to leverage higher philanthropic contributions. For example, the Georgia Institute of Technology now requires individuals to make minimum donations to the university before they can be considered for preferred ticket packages to athletic events (Atlanta Journal Constitution, 2007). But donors too have increased their leverage to influence the way their gifts are used and the

character of the programs they choose to fund. For example, Peter B. Lewis was instrumental in choosing the architect for the management school building named for him at Case Western Reserve University, had his sayings inscribed on the lobby floor of the new building, and held other Cleveland charities hostage because of his dissatisfaction with the university (Hollander, 2003). The market-orientation of major gift philanthropy has been a two way street with a long tradition dating back to the robber barons of the 19<sup>th</sup> century. But with the acceleration of wealth creation in the 1990s, especially at the top end of the income distribution, major gift giving appears to have taken on a more transactional tone.

This tone has manifested itself in a number of interesting ways. One is the advent of venture philanthropy and the transformation of donors into “venture philanthropists”. A second, related, phenomenon is the proliferation of philanthropic foundations per se, a manifestation of donors’ desires to make their own choices and to control the use of their gifts, rather than accede to the decisions of existing philanthropic institutions. The number of grant making foundations doubled in the U.S. between 1975 and 2000, to more than 70,000 and much of this increase has taken place since 1990 (Prewitt, 2006; Havens, O’Herlihy and Schervish, 2006). The recent major gift of more than \$40 billion by Warren Buffet to the Gates Foundation is the exception to the rule, although even here Buffet will exert considerable influence over the use of his gift (Strom, 2007). A third phenomenon is the growth of donor-advised funds, set up within the context of community foundations, charitable federations, or more recently within charitable arms of major securities firms such as Fidelity Investments or Merrill Lynch. These latter funds are now among the largest charitable institutions in the U.S., though they are little more than a decade old.

These developments in major gift philanthropy mirror an earlier wave of innovations in the organization of annual giving in the U.S. including the emergence of “donor choice” in annual federated fund raising appeals such as United Way, and the advent “alternative funds” in areas such as the arts and the environment, all of which gained popularity in the 1980s and ‘90s because donors wanted more say about how their payroll deductions and other gifts were being allocated to alternative charitable purposes (Young and Brilliant, 2004)

Interestingly, greater market pressure is being felt at the top end of the foundation world as well. With the advent of the huge Gates Foundation, made even more intimidating by Buffet's recent gift, other formerly dominant large foundations such as Ford, Carnegie and Rockefeller, are consolidating and modernizing their operations so as to compete more effectively in their social impacts. This has taken the form of program consolidations, staff turnover, greater internal coordination and information sharing, and openness to new ideas and approaches, and use of new evaluation and measurement techniques (Strom, 2007).

Venture philanthropy is an outgrowth of the entrepreneurial, high tech economy of the 1990s which created newly-minted billionaires interested in using some of their wealth for advancing social good. What distinguishes venture philanthropy from more traditional major philanthropy is the venture capital approach that many of these individuals have taken to charitable giving. In essence, instead of giving arms-length gifts they are involving themselves intimately in the operations of their recipient organizations, focusing not only on programs but on organizational capacity, presumably in for the long haul, and demanding measurements of performance and social impact such as social returns on investment (Letts, Ryan and Grossman, 1997; Kearns, 2006). Whether this will continue to grow as a model of philanthropy as these efforts mature over time is uncertain, but this movement has clearly influenced the philanthropy of many older foundations as well as the new wave of foundations established in the 1990s and early years of the 21<sup>st</sup> Century.

Donor-advised funds are an intermediate vehicle for donors who want more control over their charitable giving but who do not want the expense or restrictions placed on private foundations. Havens, O'Herlihy and Schervish (2006) note that these funds are sometimes referred to as "poor man's foundations" since they serve the same purposes of donor control and have followed a similar growth path. Although these funds date back to the 1980s and were pioneered by philanthropic federations and community foundations, they have been adopted by for-profit securities firms and grown spectacularly since the 1990s. While practices differ between the nonprofit and for-profit institutional settings of these funds, they have generally given donors much more discretion over the use of their gifts. Given the complexity of charitable choices, the

growth of individualized philanthropy has led to another type of phenomenon, Social Venture Partnerships and “giving circles” - resembling philanthropy cooperatives in which donors share information, pool their resources in some cases, and jointly deliberate on their charitable allocations (Havens, O’Herlihy and Schervish, 2006).

The notion of venture philanthropy derives naturally from the corporate sector where people think in terms of investments and returns. Moreover, over the last two decades, U.S. corporations themselves have reframed their charitable activities into components of overall corporate strategy (Burlingame and Young, 1996). This development has entailed several different thrusts including corporate volunteerism and cause-related marketing. Corporate volunteerism has become strategic in several respects. Corporations gain public relations and marketing benefits by having their employees work with charities, especially in highly visible activities such as home building or community clean up events. More fundamentally, corporations benefit by providing their talented young people with leadership and management experience through work on nonprofit boards and committees. A particular strand of corporate volunteerism is pro bono work by professional firms in law, accounting and other fields (Brudney, 2006). In this variation, corporate professionals gain valuable practice experience and public relations benefits for their firms in exchange for the specialized assistance they provide to charitable nonprofits. In all of these instances, corporate volunteerism is implicitly transactional, with clear benefits envisioned by both nonprofit and corporate partners to the arrangement.

Cause-related marketing and related forms of nonprofit-business partnerships have been growing and becoming more varied and sophisticated since the early 1990s (Louie and Brooks, 2006). Basically, these arrangements allow the profit-making corporation to associate itself with a charitable organization or cause in order to enhance its general public image or to promote specific products. In turn, the nonprofit may receive value in the form of enhanced visibility for its message through corporate marketing channels, in kind services in the form of expert assistance with business management functions, or cash in the form of various kinds of fees, royalty payments or grants. In all, U.S. nonprofits received some \$12 billion from corporations in 2002, approximately 5% of all monetary charitable contributions to nonprofits in that year. It is

difficult to estimate how much of this giving was truly transactional, but it is safe to surmise that virtually all of it was strategic in a general sense. At a minimum, corporations understand that business is better when their employees are productive and can live in safe and wholesome communities. So corporate philanthropy tends to be focused in communities where corporate offices are located and in institutions such as educational and cultural organizations that will benefit their employees, produce research, or graduate skilled workers who will advance enhance their productivity.

In all, philanthropy in the U.S. has taken a number of interesting turns in recent years, mostly in the direction of greater donor discretion and control, coupled with reactive strategies by nonprofits to package their missions and services in the form of worthy social investments and individualized donor benefits. One result is increased competition for philanthropic gifts among donors institutions and fund seekers alike. The “market” for philanthropy is no longer an abstract metaphor or idea; it has become a realistic description of how philanthropic giving now works.

### **What is driving the Market Transformation of Philanthropy?**

The market transformation of philanthropy over the past two decades or more is a complex and multifaceted phenomenon with no simple or singular explanation. The usual suspects – changes in welfare state policies, revolutions in technology, expansion of an increasingly entrepreneurial economy, and the shear growth of the nonprofit sector over the past four decades – are all important influences that must be acknowledged. As governments have both increased their scrutiny of public services delivered through private auspices, and devolved financial and administrative responsibilities to local jurisdictions and to the private sector, philanthropy has had to acknowledge its new levels of accountability and become more transparent, responsive and demonstrably effective. As electronic technologies became more varied, accessible and powerful, offering vastly increased capacities for information access and greater ease of creating new, individualized vehicles for giving, philanthropic institutions have had to respond to the new realities of donor influence and control. And as the economy generated greater wealth, particularly at the top of the income distribution, new market-like forms have been introduced into the culture of giving and new levels of competitions for support and

philanthropic leadership have emerged, affecting existing and emerging pools of charitable funds as well as anticipated future intergenerational transfers of wealth. The fact that, proportionally speaking, philanthropy has become a smaller part of nonprofit sector financing over the past few decades has only exacerbated competition in the philanthropic market place, because gifts and grants remain a valued though increasingly scarce resource for nonprofit support. Finally, with the rapid growth of the nonprofit sector itself, giving has become a more complex challenge, requiring donors to have better information about thousands of new charities, leading to changes in methods and behaviors both among nonprofits seeking support and donors seeking to allocate their funds.

A Maturing Sector? Another facet to the market transformation of philanthropy is that, despite its deep historical roots in the U.S., the nonprofit sector, including its philanthropic core, is relatively young in terms of its formalization, self-recognition and internal organization (Hall, 2006). As a result, until recently, many of its management and organizational practices have been relatively primitive, improvised, adaptive, informal, borrowed or idiosyncratically aligned with bureaucratic structures and professional imperatives in specialized areas such as education or social work. This situation has changed substantially since the crises of the 1960s and '70s when foundations were called to account by the U.S. Congress and challenged on alleged abuses of accumulated private wealth and power. By the 1980s, the sector had begun to organize itself, develop an identity and establish collective institutions such as Independent Sector and the Council on Foundations, and was becoming the focus of serious study and managerial education in a number of universities. This newly minted sector infrastructure and self-awareness has burgeoned since the early 1990s arguably helping nonprofits to take more nuanced and sophisticated approaches to their management, planning, service delivery and resource-related decision-making. Thus, advanced business-like practices that may have been more commonplace in other sectors because of their earlier development have emerged more recently in nonprofits and philanthropy. These include strategic planning, entrepreneurial approaches to new opportunities and problems, competitive market strategies including branding and analysis of market niche, program and organizational evaluation, human resource

performance appraisals, application of marketing methodology to service provision and fund development, cost-benefit analysis, outsourcing and contracting practices, borrowing and financing techniques, business planning, risk assessment, and applications of other professional techniques designed to assess competitive advantage, calculate economic impacts and returns on (social and financial) investment, and so on. Along side the diffusion of these practices into the nonprofit sector has been the development of university programs and a new industry of management consultants and management support organizations that have formalized, extended and adapted this knowledge to the specific circumstances of nonprofit organizations.

One must consider, therefore, the possibility that philanthropy is just playing catch-up in a world where its presence has become more critical and visible, and where that recognition has set it barreling down a path towards more deliberate and effective development and management of its resources. This explanation has both a bright and a problematic side to it. The problematic side is that as philanthropy matures and adopts modern ways of transacting its economic business, it forces nonprofits to become more and more like business or government, putting at risk some of their individuality, creativity, spontaneity and special values such as collegiality, solidarity, cooperation, service and innovation. The bright side, however, is that if genuine maturing is taking place, rather than simple imitation of developments elsewhere in the economy, then changes in philanthropy can occur in ways that are sensitive to the peculiarities and uniqueness of nonprofit organizations and their special functions in society. This seems a credible possibility, given that the new infrastructure of the sector is indeed relatively customized. To a substantial extent, new university programs have developed their own theories and approaches to nonprofit sector governance, management, and finance, and have not simply borrowed from public administration or business management. Moreover, new codes of practice and institutional guidelines and principles are being formulated on their own terms without excessive reliance on business or government models or norms, by organizations ranging from Independent Sector, to the Association of Fund Raising Professionals to the Nonprofit Academic Centers Council.

If the latter scenario plays itself out, the market-transformation of philanthropy will have a special flavor, adapting the forms of market participation of other sectors, but

retaining sensitivity to the ultimate goals, values and purposes of philanthropic endeavor. However, there are other, more homogenizing forces at work as well.

Institutional Isomorphism. DiMaggio and Powell (1983) first adopted the term “institutional isomorphism” to connote the observation that over time economic institutions that interact with one another tend to become more alike. According to this idea “..an organization mirrors and incorporates the larger social structure of which it is a part...Organizational change is seen as a response to shifts in the ideology, professional standards, and cultural norms of the field or sector in which an organization is situated” (Powell and Friedkin, 1986, p.181). While sociological in its derivation, this theory is connected to ideas in economics as well. Intense competition, for example, often forces competing organizations to become more alike in order to survive. Moreover, dependency on particular sources of funding, regulatory oversight or political influence, can induce an organization to mirror its benefactors and antagonists in order to deal more effectively with them.

Applying this perspective to philanthropy reveals a number of homogenizing tendencies: As government adopts market-oriented practices such as competitive outsourcing, favoring contracts over grants, substituting demand side consumer-based vouchers, tax credits and reimbursements for direct funding of nonprofit organizations, and as nonprofits adapt to these practices by becoming more adept at evaluation, financial management and control, consumer responsiveness and market analysis, it is logical for philanthropy to follow suit, partly to strengthen nonprofit capacities to adapt to the new public sector environment and also because philanthropic institutions must themselves respond to the new public sector exigencies in order to justify the privileges granted to them by government and in order to respond to government regulations and reporting requirements.

Similar tendencies occur on the private market side of the nonprofit sector environment. Corporations wishing to partner with nonprofits to enhance their own public relations and marketing strategies help transform corporate philanthropy into a strategic exercise. Newly wealthy high technology entrepreneurs-turned-philanthropists bring a new market culture to their charitable endeavors, such as beliefs that everything worthwhile should be able to make a profit. New market-based social enterprises

compete with traditional nonprofits, inducing the latter to reframe their efforts as social ventures, report on their financial sustainability as well as their social returns to investment, and imitate the survival techniques of their competitors. Financial profitability becomes a dominating criterion of success, sometime squeezing out broader measures of social impact.

In sum, the nonprofit sector is not an “independent” sector. As less than 10% of the overall economy, it is inevitably integrated and homogenized into the broader fabric of business and government. And when the latter become more market-like in their practices and characteristics, philanthropy and nonprofit organizations tend to follow suit. This is not necessarily a bad thing or even an entirely new phenomenon. The institutional isomorphism that may drive this process derives in part from overall social norms that can be constructive. As described by Robbins (2006), the Ancient Greeks may have had some insights that apply to us today (p.16):

“Compelling Greek philosophical precepts also required great men to make constant performances of generosity to the city. These gift acts showed an elite’s determined progress towards the humane ideal of self-betterment....Competitive patrons used conspicuous civic donations to display the perfection of their distinctly liberal souls. The public came to expect this generosity – which even included the application of private fortunes towards defense and other government operations – from the self-improvement efforts of the wealthy....These donations also enabled city fathers to display an endearing solicitude for public welfare, earning them popular sympathy upon which they could later draw to advance themselves in civic affairs....”

Salutary or otherwise, an increasingly business-like, public and private, culture and context has inevitably affected philanthropy as it has every form of nonprofit organizational support. Most notably, philanthropy has undergone a market-oriented transformation in several ways. Whether this represents a maturing of philanthropy in a manner that can preserve its distinctiveness and enhance its impact, whether it represents a homogenization that suppresses that distinctiveness, or indeed whether it can even co-opt society’s overall market transformation for the common good, is yet to become clear.

## **Implications for Policy and Practice**

The market transformation of philanthropy has a number of important implications for the practice of philanthropy, for the strategies of nonprofit organizations, and for the structures that link philanthropy to operating nonprofits. The salient fact of modern philanthropy is that it is becoming more fragmented, decentralized and market-driven. While the Bill and Melinda Gates Foundation, with more than \$30 billion in assets even before the Buffet gift, and other mega foundations in the double digit billions such as Ford, Getty, Robert Wood Johnson and the Lilly Endowment, control a highly disproportionate share of foundation assets and grant making, and clearly exert leadership in particular fields of endeavor, the philanthropic sector as a whole is becoming less cohesive and potentially less influential because it speaks with more diverse and divergent voices, because donors do not coordinate their efforts to a significant degree, and because philanthropy is shrinking as a proportion of overall support for the nonprofit sector. Indeed, as previously noted, the major foundations that have now been dwarfed by the Gates Foundation are beginning to react to this new environment by trying to focus their own efforts more tightly and set more stringent priorities for themselves.

A counterbalancing consideration, of course, is that diversification and fragmentation also potentially enhance innovation and creativity, producing more new ideas for addressing social issues and problems. Not surprisingly the widely diverse initiatives and projects of the largest American donors in 2006 outnumber the tally of donors themselves, and the purposes of many of their gifts (to their foundations) are yet unspecified (Chronicle of Philanthropy, 2006) Moreover, one can argue that this is as it should be – that philanthropy is individualistic and should not be held to an overall standard of effectiveness. Nonetheless, if decentralizing trends continue, fewer individual sources or even clusters of philanthropy, nor the philanthropic sector overall, will have the opportunity to be truly influential unless there are structural changes in the system as a whole. In particular, if philanthropists – foundations large and small as well as significant major individual donors who operate through donor advised funds, planned giving arrangements and other means - do have common goals and intentions for societal improvement – in areas such as poverty, social justice, public health, environmental conservation or world peace - they will need to think about organizing themselves in

ways that advance their broad interests and causes more effectively. Perhaps that is the most important lesson of Warren Buffet's recent decision to join forces with the Gates Foundation; nonetheless, the general trend is basically in the opposite direction.

One can roughly divide the world of philanthropy into two parts: major grant making foundations with their own program agendas and strategies, and individual donors and personal and family foundations that are basically shoppers, often with particular preferences or ideas, in search of worthy philanthropic investments. (For a more nuanced, taxonomy of foundation identities, see Young, 2001). The former foundations can be understood as nonprofit organizations with well articulated social missions and goals which choose to outsource their programs to grantees rather than execute and manage them themselves. Their grantees can in turn be understood as agents for carrying out the social missions of their foundation benefactors. These benefactors are the philanthropic actors that should be most concerned with organizing themselves around their social agendas because the missions and strategies behind these agendas are in their own hands rather than those of their grantees.

Alternatively, donors in the second category must depend on the effectiveness of operating nonprofits to formulate compelling missions, communicate their messages and carry out their promised agendas effectively. That more sources of philanthropy are falling into this category over time has important implications for operating nonprofits that seek their support. In particular, operating nonprofits must become more skilled in marketing themselves, crafting their messages and differentiating their programs from other grant seekers, and searching for donors whose interests and preferences match their own. Thus, on this supply side of the philanthropic market, there is also room for new structures to enhance the efficiency and effectiveness of philanthropy. Institutions that can reliably and competently investigate the worthiness and effectiveness of alternative nonprofit grantees as prospective philanthropic investments and provide this information to potential donors, much in the way that investment houses do for venture capitalists in the business sector, could have an important new role in the future. (This is an idea favored by John C. Whitehead, former CEO of Goldman Sachs, and a major civic leader – personal conversations) Existing investigative rating and informational services such as the Wise Giving Alliance, Charity Navigator or Guidestar now address this function

only superficially, offering very simplistic ratios, checklists of best practices, and rudimentary descriptions of alternative charitable giving opportunities. As philanthropy continues to decentralize, a declining proportion of donors will have the capacity to effectively evaluate potential philanthropic investments. As a result, the nonprofit sector will require more of the kind of self-regulatory infrastructure that the business sector has developed over the last century – namely quasi-markets for capital (read charitable) investment. Would this be yet another case of institutional isomorphism, with nonprofits imitating business once more, or would it be a necessary maturing of philanthropy and the nonprofit sector on its own terms? These are perplexing issues facing philanthropy and nonprofits in the U.S. and elsewhere in the years ahead.

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