Money Matters: The Structure, Operations and Challenges of Nonprofit Funding

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Abstract

This paper is based on analysis of various sources of data pertaining to the financial status of nonprofit organizations in the United States and to the activities of institutions and individuals who provide funds to those organizations. The paper begins with a general overview of the flow of funds within the nonprofit sector in the U.S., including primary fund sources, intermediary players, and the final 501(c)(3) recipients of funds. It then presents a typology of nonprofit organizations based on functional activities rather than program areas. Indicators of financial capacity for nonprofit organizations are established and then used to assess the relative financial health of the sector’s functional segments. The role that scale plays in determining nonprofits’ access to and use of funds is addressed. The paper then looks briefly at the use of bonds and debt. It concludes by assessing and questioning how well the nonprofit funding market functions.

Document Development

This paper presents the results of the initial phase of what was anticipated to be a multi-phase project exploring the structure and functioning of the market for nonprofit funding. It is based on research completed by The Bridgespan Group between September 2001 and January 2002 and conducted in consultation with Jed Emerson. Jed Emerson and Paul Carttar wrote the paper with the help of senior staff of The Bridgespan Group. The document is the joint product of their labors.

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The Bridgespan Group works to create sustained impact on the nonprofit sector through improved strategic decision-making and organizational effectiveness. The firm pursues this goal through two primary approaches: consulting engagements with a broad array of high-potential nonprofits intended to have significant direct
impact on their capability and performance; and selected activities aimed at systematically distilling and disseminating Bridgespan’s knowledge for the benefit of other nonprofit managers and sector participants.

The paper’s baseline data and analysis were the product of significant work by research teams in The Bridgespan Group’s Boston and San Francisco offices. Key contributors from The Bridgespan Group to this paper include: Jeffrey Bradach, Susan Colby, Renee Berman, and Carolyn Spaht. Dara Pauker assisted in the preparation of this document.

Given the breadth and complexity of this topic, as well as the considerable thought, research, and writing already in existence, the Bridgespan Group convened an Advisory Committee to support the research and writing process. Both the research and this paper were reviewed by and commented on by members of the Committee. Their advice and criticism contributed significantly to the progress of the research and the development of the final draft.

The Committee consists of the following individuals:

- Shari Berenbach
- Luther Ragin
- *Calvert Foundation*
- *F.B. Heron Foundation*

- Bill Ryan
- Allen Grossman
- *Hauser Center, Harvard University*
- *Harvard Business School*

- Clara Miller
- Ed Skloot
- *Nonprofit Finance Fund*
- *Surdna Foundation*

The authors hope that this paper will be used by a broad cross-section of individuals from academia, nonprofits, foundations, government and business. For this reason, we have assumed no familiarity with concepts of finance or existing academic research. While some may find the following presentation overly simple in its framing of highly complex issues, our intent is to make the document and the
research and analysis on which it is based as accessible as possible to the widest possible readership.

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Key Findings

- Funds totaling approximately $900 billion flow to nonprofit organizations annually, based on 1998 data. Of these funds, more than 60% come from fees and payments made directly in exchange for services;

- Despite their high profile, private foundations provide less than 2% of the funds flowing into the sector each year. Combined with community foundations, corporate foundations, and supporting public charities (for example, United Way), they still provide less than 3%;

- Of the approximately $70 to $80 billion in debt capital provided to the sector, over 98% is sourced from commercial institutions, which tend to apply "for-profit" standards of creditworthiness to qualifying borrowers;

- The relative financial capacity of nonprofit organizations varies significantly by functional category, even when the data are adjusted for scale;

- The financial benefits of increasing scale are not uniformly linear within each functional category, and, in fact, appear to vary substantially within certain functional categories;

- Segments of the nonprofit sector having relatively high financial capacity attract 80% of the sector’s total funding but consist of only 6% of the total number of organizations. We believe this is a product of both scale and functional category economics.

These findings are explored more deeply in the pages that follow.
Introduction

Each year, reports are published that document the funding activities of the nonprofit sector. Some forms of contributions increase, others decline. Some organizations raise more funds, others go out of fashion and confront new challenges in securing adequate resources to meet their needs. Taken together, these reports constitute a significant body of work, and they have taught us a great deal about the trends that characterize the flow of funds through the sector.¹

Recently, some analysts have begun to look at these resource flows through a new lens, one that focuses on contributions, cash, and debt not as a form of charity, but as a type of capital with its own terms and structure. From this perspective, the funds supporting the work of the nonprofit sector constitute their own distinctive funding market.² Proponents of this approach have developed a number of conceptual frameworks to describe how nonprofit organizations might figure as players in such a funding market. But to date they have stopped short of engaging in a detailed, quantitative analysis of how this market is structured and how its resources are allocated.

¹ A bibliography is included as an appendix to this paper. The authors of this document would like to thank those who have previously written on this topic. The reader is directed to the appendix for further readings.

² This paper uses the phrase “nonprofit funding market” to refer to the market within which nonprofit organizations seek and receive financial support from a variety of donors, as well as from contracts, government grants and other sources. Other papers and books use terms such as the Nonprofit Economy and Social Capital Marketplace to describe the same idea. The reader is directed to the bibliography in the appendix for additional reading regarding these terms and approaches. We make use of nonprofit funding market since we feel it will have the greatest clarity for the largest group of readers.
This paper, and the research on which it is based, attempt to add to the frameworks others have developed. In particular, we sought to answer two fundamental questions.

First,

“How is the nonprofit funding market structured?”

And second,

“How well does that market structure function?”

The first question is the subject of Part I, which presents highlights of the analysis conducted in the project. To address this question, in the following pages we will:

- Present information about the number and type of players in the nonprofit funding market;
- Describe a typology of nonprofit players in which they are categorized by functional activity; and
- Explore the amount and form of the funds that move among these players.

The second question is the subject of Part II, in which we consider how effective the structure and form of this funding market are in meeting the needs of those who seek resources to create social impact and value for society as a whole. As our analysis to date cannot be said to have resolved such a subjective question, Part II consists primarily of interpretations of the actual data.

Before we begin the presentation of our facts, findings and conclusions, however, a few critical observations are in order:

- From a financial perspective, one of the more confusing aspects of the nonprofit sector relative to the private sector is the ambiguity surrounding the meaning and use of certain terms, particularly ones like “revenue” and “capital” that have very precise, technical, accounting definitions. The confusion appears to have two main roots. First, the practical differences between the sectors often strain the normal usage of the terms, as when large private donations to nonprofits—which have the feel of “capital”—are
made to support routine operations and, therefore, should actually be considered “revenue.” Second, accounting rules, particularly as laid out in pronouncements like FASB 116, can also create seemingly anomalous results, as when large grants made to support a building project—and therefore clearly “capital” in the common sense—must be booked as annual “revenue” in the year in which the grant commitment is received.

In order to minimize misunderstanding, therefore, we want to be clear about how we are using these critical terms. For purposes of this paper, we will use the following definitions:

- “Revenue” will refer to money provided to nonprofit organizations in direct exchange for a specific product or service. Examples would include fees paid to nonprofit hospitals for patient care, tuition payments made to private colleges, government contracts for provision of counseling services, annual dues for membership in a nonprofit health facility, or purchases of books from an advocacy organization.

- “Capital” will refer to any money, whether debt or non-debt, provided to a nonprofit organization in support of its work, whether earmarked for programs, general operations, or physical expansion. Examples would include bequests, contributions from the United Way, weekly donations to a church, building fund gifts to one’s alma mater, or commercial bank lines of credit.

- “Funding” or “funds” will refer to any money provided to nonprofits, whether otherwise considered to be revenue or capital.

While the subject of this paper is overwhelmingly broad, its actual objectives are quite narrow: to use actual data to establish a fundamental fact base regarding key aspects of the nonprofit funding market and to test a number of core assumptions about its workings. Although the body of factual information available on the nonprofit sector is extremely limited, we were able to develop a set of data from nonprofit organizations’ financial reports and other sources that enabled us at least to progress toward that goal. Given that most if not all of the issues addressed here have been considered
and explored by other authoritative participants in and observers of this market, we did not expect the analysis to generate profound new insights per se. Rather, we hoped that by bringing objective data and information to bear, we would add clarity to existing debates and raise new questions for future investigation.

- The focus of this paper is the flow of charitable funds within the United States, not globally. Our data is drawn from a variety of information compiled on and reported by domestic nonprofit organizations, and it was specifically culled to remove U.S.-based organizations whose focus is primarily international. While this paper may have implications for those operating in the civil sector the world over, we urge readers to remember that the analysis pertains only to fund flows that originate, and for the most part remain, within the United States.

- The data on which most of our analysis is based comes from financial information provided by nonprofit organizations to the Internal Revenue Service (IRS). The Urban Institute’s National Center for Charitable Statistics (NCCS), which collects this data and makes it publicly available, derives its information from two primary sources:
  - Form 1023, reported in the Business Master File of Exempt Organizations (BMF)
  - Form 990, reported in the Statistics of Income (SOI) Files.

- The benefit of using this source is that it represents, in our judgment, the most reliable data currently available to researchers that is in any sense
“apples to apples” across the full range of nonprofit organizations in the U.S. That said, it clearly has a number of limitations, which are explored at length on the NCCS website.

- The essence of the problem lies in a universal truth: the information that any database contains is only as good as the information that is entered into it. The nonprofit sector is a large and varied place, and the same diversity that contributes to its richness extends to the financial data its constituents provide to the IRS, the single agency requiring general financial reporting of nonprofit organizations that has any consistency and regularity. In some cases, staff members completing the IRS’s 990 may not know how to fill out the form correctly, which can create unintentional misrepresentation. In others, questions arise because reporters are using different allocation methods to address similar issues (for example, fundraising and administrative costs). And for a few, the misrepresentation may be intentional, as reporters knowingly emphasize program costs and minimize administrative or fund-raising costs in an effort to look as good as possible in the eyes of potential funders. Whatever the explanation, the result is data that are less robust in terms of integrity and comparability than researchers would wish. Efforts to address this issue by standardizing reporting practices are underway. But for the time being, at least, the assumption that the nonprofit sector generates valid data is precisely that, an assumption, and we note it as such along with the limitation it forces on our analysis.

3 Issues related to the integrity of nonprofit organizations’ financial data are discussed in depth on the NCCS website http://www.nccs.urban.org/guide.htm. To confirm its own understanding of these issues and the soundness of its methodology, members of The Bridgespan Group communicated directly with staff at the NCCS.
• The relative financial capacity of nonprofit organizations is one of the central issues this paper explores. To pursue this issue, we needed both a way to measure financial capacity and a way to compare organizations within the sector in terms of that capacity. Both these challenges are discussed at greater length in the paper; but we want to underscore them here.

As readers will be aware, organizations in the nonprofit sector are traditionally categorized according to the program areas, or domains, in which they work (environment, for example, or social services). Because our objective was to compare nonprofit organizations in terms of their financial capacity, however, as opposed to their operational capacity or perceived ability to achieve impact, we chose to depart from tradition and categorize the organizations in our data set on the basis of their functional activities and relative funding intensity.

With respect to measurement, we needed to determine appropriate indicators of financial capacity that would enable us to surmount the sector’s data deficiencies and make consistent, valid comparisons across its diverse universe of organizations. While the authors appreciate keenly the myriad limitations of relying on any specific metric for this purpose, we believe that, in the words of the Chinese proverb, “a long journey must begin with a single step.” In this instance, the first step ultimately led us to choose two metrics, which are discussed at greater length hereafter:

- The ratio of an organization’s fund balance to its annual revenues, which helps us understand the adequacy of its long-term financial resources; and

- The ratio of an organization’s annual surplus to its annual revenues, which helps us understand the adequacy of its short-term financial resources.

In each case, these calculations were made using NCCS data for the latest single year then available (1998), and, therefore, present a “snapshot” of the sector at a particular time. Mindful of the vagaries of nonprofit accounting and reporting in any given year, our belief (and our bet) is that
factors that would be quite problematic if the focus of our analysis were individual organizations will tend to be neutralized when the focus is on aggregations of nonprofits in broad functional categories as it is here.

With these “capital caveats” in mind, we now turn to our data and analysis.
Part I: Analysis
The Nonprofit Funding Market: Tracking Fund Flows

Chart 1 titled, “Market map of funding flows, 1998” presents an overview of the nonprofit funding market. The chart tracks the sector’s funding flows in fiscal year 1998 (the latest year available) from fund sources through intermediaries to the practitioners who apply these funds in pursuit of their missions. The numbers on the practitioner side are taken from tax reporting forms submitted to the IRS. The numbers for funding sources and intermediaries come largely from other information sources.4

FUNDING SOURCES

Beginning on the left-hand side of the chart, we see that the funds injected into this funding market totaled an estimated eight hundred and forty-eight billion dollars ($848B)5. Of this sum, $774B was provided in the form of payments either directly to nonprofit organizations or to nonprofit financial intermediaries. In that sense, this could be thought of as the total funding “knowingly” provided to the nonprofit sector. The remaining $74B represents an estimate of the money invested in for-profit institutions that ultimately made its way to nonprofits in the form of loans.

4 Sources Include: Nonprofit Almanac (Independent Sector 1997); Giving USA (1999); CDFIs Side by Side (NCCA 1999); Foundation Giving Trends (Foundation Center 1999); The PRI Directory (Foundation Center 2001); Fidelity CGF Annual Report (2000); United Way Annual Report (2001); NCCS Database of IRS 990 forms; Securities Data Corporation; National Council of State Housing Agencies; TBG Interviews.

5 This figure is lower than that often cited in other studies. This is due to the fact that we have removed foundations from the category of nonprofits in order to better segment the funding market and understand what funds are actually available to the practitioner community. Foundations and other intermediaries are included in the middle box. The final figure of $881B also differs from other sources since we have taken endowments and non-U.S.-facing organizations out of the recipient column.
While it is important to recognize the existence and magnitude of these funds, the primary focus of this paper is the $774B that sources intended to direct to the nonprofit sector.

The $774B knowingly provided to nonprofits, consists of four major components, the largest of which is private payments and fees. These accounted for $334B of the funds that flowed into the market and include direct payments for services such as hospital fees, program related revenues, private tuition, and membership fees. Hospitals and institutions of higher education were the largest beneficiaries of this fund source. It is important to note that while these fees are “revenues” generated from services the organization provides, as opposed to “capital” contributions, they nevertheless contribute to an organization’s capital base to the extent that they generate surpluses, that is, pools of cash that can be drawn upon by management to support other needs of the organization.\(^6\)

Second largest in size are payments from the different levels of government, which in 1998 totaled some $285B. As with private payments and fees, the vast majority of this amount is composed of various forms of “revenue,” for example, contract payments from state and local governments for social services and federal payments to hospitals under the Medicare and Medicaid programs. A relatively small amount would constitute “capital” as defined above.

Next largest, at $147B, is individual giving, all of which would be considered charitable “capital” under our definition, as these funds are donated in support of the nonprofit’s mission-related work and not in exchange for a particular service or product. Of this total, approximately $24B was contributed to what we are considering to be nonprofit financial intermediaries (see below), while the remaining $123B went directly to operating nonprofits, i.e. “practitioners.” Finally, some $8B was donated to nonprofits by corporations, $6B as direct donations and $2B as contributions to corporate foundations.

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\(^6\) An organization’s capital base or “capital structure” is best understood as consisting of the liabilities and assets that appear on its balance sheet, at least in the long-term.
Individual contributions to commercial banks and investment houses comprise the remaining external source of the sector’s funds and totaled an estimated $74B in 1998. These are distinct from other nonprofit sources of funds in two critical respects. First, the “investors” who provided money to these institutions did so out of financial rather than charitable motives, with the full expectation of receiving all of the principal back, plus interest. Second, they did not necessarily have any idea that the money would find its way to nonprofit enterprises rather than for-profit businesses. All of this amount would be considered “capital” under any definition.

FINANCIAL INTERMEDIARIES

Moving to the right, we come next to the sector’s financial intermediaries. As traditionally defined, there are many types of intermediaries in the nonprofit sector. For the purpose of this paper, however, we are interested in understanding intermediaries solely with respect to their role in the flow of funds within the nonprofit funding market. The term “intermediary” as used here refers to organizations whose primary function is to serve as a conduit for resources from funding sources to nonprofits providing direct, technical, or support services. Although any of these institutions might make some limited number of purchases of goods or services from nonprofit organizations, these would be inconsequential relative to the funds provided to nonprofits in basic support of the institutions and their missions. Consequently, these funds can be considered “capital” as previously defined.

Foundations are included in this category, rather than classed with fund sources, because the majority are the creations of corporations or ultra-high net worth individuals, who are the true sources of the philanthropic funds. In practice, therefore, they function as a form of funding intermediary between individual and corporate donors and the nonprofit practitioners that ultimately receive the funds. That said, it could easily be argued that at least perpetual private foundations (i.e., those that have survived the original donor) should be considered funding sources in their own right, given that disbursement decisions are often independent of the original individual’s intent. For convenience, however, we have chosen to keep all private foundations together in a single category.
Segregating foundations in this way highlights an important point:

Of the $774B in funds provided to nonprofit organizations by all sources, only $24B came through nonprofit financial intermediaries. In percentage terms, these figures are even more striking: all foundations, including both private and community, provided less than 3% of the total funds flowing to nonprofit organizations.

Nonprofit intermediary capital managers include the following:

- **Private Foundations** (such as family foundations and general purpose foundations), which had an asset base of $327B, received an inflow of $16B and contributed $15B in funding outflows to the nonprofit sector.

- **Supporting Public Charities** (such as the United Way), with an asset base of $10B, inflows of $4B, and outflows of $4B.

- **Community Foundations**, with assets of $23B, inflows of $3B, and outflows of $2B.

- **Corporate Foundations**, with assets of $13B, inflows of $3B, and outflows of $2B.

- **Community Development Financial Institutions**, with assets of $5B, inflows of $1B, and outflows of less than $1B.

- **National Donor Advised Funds**, such as the nonprofit charitable gift funds created by large investment managers like Fidelity and Schwab, with assets of $2B, inflows of $1B, and outflows of less than $1B.

Together, these nonprofit financial intermediary organizations received a total of $27B in capital inflows in 1998 and re-directed $24B to nonprofit organizations seeking capital in the market place.

As noted previously, various for-profit financial intermediaries provided approximately $74B in debt capital to the nonprofit sector. Of this, commercial banks provided an estimated $50B in funds to nonprofit organizations. Approximately $24B more came from institutional investors in the form of directed debt assumed by individual nonprofit institutions, chiefly tax-exempt bonds. As noted above, while these funds flow directly from banks and investors into the
practitioner community of 501(c)(3) organizations, we do not include them in the analyses that follow because of their distinctly commercial financial nature. To indicate the different status of these funds, we connect them to the practitioner community on the market map with a dashed line.

PRACTITIONERS

At the far right-hand side of the map, we come to the practitioner community, which consists of those nonprofit organizations that ultimately receive and use these funds to create various kinds of social value. To underscore what we said above, in this analysis, practitioners are the subset of nonprofit, 501(c)(3) organizations that perform services “on the ground,” that is, services other than the re-granting of funds. Defined in this way, the secular practitioner community received a total of $703B in fiscal year 1998, while religious organizations received $68B. These numbers reflect funds received in the form of private payments and fees, individual donations and government grants, as well as contributions from intermediaries.

In addition to the funds received from outside sources, the practitioner community generated $110B internally. This money is derived from investments, interest returns, and other cash flows resulting from the sound management of existing funds under practitioners’ control.

In sum, we see that in 1998 a total of $774B was provided from a variety of fund sources, with an additional $70B to $80B flowing in to the sector in the form of various debt offerings.

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7 This figure comes from the Nonprofit Almanac and was not based on The Bridgespan Group’s analysis of 990 data. The actual figure may be higher than this, since many religious institutions do not complete or file 990s.
PRACTITIONER FUNDS BY DOMAIN

Drilling into the practitioner arena, we will look first at how these funds were divided among the sector’s various domains.\(^8\) (See Chart 2, “Practitioner revenues by domain, 1998.”) In 1998, the total $813B of funding available to secular, direct-service 501(c)(3) organizations was allocated as follows:

<table>
<thead>
<tr>
<th>Domain</th>
<th>Total Funds</th>
<th>Number of Organizations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health</td>
<td>$408B</td>
<td>41,000</td>
</tr>
<tr>
<td>Education</td>
<td>$268B</td>
<td>102,000</td>
</tr>
<tr>
<td>Human Services</td>
<td>$59B</td>
<td>76,000</td>
</tr>
<tr>
<td>Arts</td>
<td>$25B</td>
<td>54,000</td>
</tr>
<tr>
<td>Public, Social Benefit</td>
<td>$18B</td>
<td>23,000</td>
</tr>
<tr>
<td>Environment/Animal Welfare</td>
<td>$4B</td>
<td>10,000</td>
</tr>
<tr>
<td>Mutual Membership Benefit</td>
<td>$1B</td>
<td>1,000</td>
</tr>
<tr>
<td>International &amp; Foreign Affairs</td>
<td>$1B</td>
<td>1,000</td>
</tr>
<tr>
<td>Other/Unknown</td>
<td>$30B</td>
<td>94,000</td>
</tr>
</tbody>
</table>

The disparity between the top two recipients and the rest of the sector is striking. Health care and education received the lion’s share of the funds, 50% and 33%

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\(^8\) Domain categories are taken from the National Taxonomy of Exempt Entities (NTEE), along with major categories from the Nonprofit Almanac. The more detailed NTEE codes as well as the IRS codes were later used to organize group categories by function (see the next section).

\(^9\) While these figures represent the number of organizations listed in the Business Master File (BMF) of the Nonprofit Center for Charitable Statistics Database, they may not represent the number of organizations actually active within the sector. In The Charitable Nonprofits, Bowen et al. engage in an analysis of how many organizations listed in the BMF are actually no longer active, but are still listed as a non-filer (an organization under $25,000 in annual revenue) and are therefore counted in the total number of organizations in the sector. Please refer to this work for more on the topic. Additional research on the life-cycle of organizations in the nonprofit sector would be useful. Such inquiry would explore how the sector “terminates” underperforming organizations and whether there is anything comparable to the way in which an effective for-profit market holds underperforming companies to account by putting them out of business.
respectively. By contrast, human service and arts organizations (the next largest recipients) received only 7% and 3% of the sector’s revenues respectively.

The data in this chart and the market map prompt a number of observations. Before examining them, however, we want to point out an important shift in perspective: When we move from the market map to the distribution of funds among nonprofits, we also move from talking about the source of the sector’s funds to the form those funds take on entering a practitioner’s funding structure. This applies whether we look at the distribution of funds by domain, as we do here, or by function, as we do in the next section.

This shift in perspective is important, because ultimately we want to understand what practitioners can do with their funds and not simply how much was given to them. For example, two organizations may each receive 100% of their funding from individuals. But if one receives the funds in the form of private payments and the other as contributions, the implications for their cost and capital structures as well as their need for funding may be quite different. The former, it appears, has a business model that allows it to generate its own revenues; so if it can cover the full costs of generating those revenues—which is often a big if—it can use the remainder however it likes. The latter, by contrast, seems to be wholly dependent on donations, which may, or may not, come with strings attached.10

Although at this point we simply want to present the data, readers should be aware that this question of form and function is a key issue, since many observers believe that a lack of “fit” between the two is a central element in the nonprofit funding market’s inability to fully meet the needs of those operating within it. It may help the reader to think of this as the difference between a flow of funding (which is income) and a stock of funding (which is assets). While this paper begins by addressing current flows of funding, the focus of the discussion does shift to stocks of funding from time to time, as readers will see.

10 The information sources on which the NCCS database is built do not differentiate between restricted and unrestricted funds.
Removing foundations from the set of players normally viewed as funding providers highlights the fact that the sector’s primary funding sources are individuals (60%) and government (30%). Of the 60% of funds contributed by individuals, 70% is in the form of private payments and fees, while 30% is direct donations. Of that 30%, 40% to 60% is donated to religious organizations.
Chart 1: Market map of funding flows, 1998

* Numbers in parentheses indicate assets

Note: Bank, institutional investor and CDFI inflows into nonprofits are not reflected in the Practitioner total. Private Payment & Fees and Government figures are allocated percentages of $619B. Private Foundations are comprised of Independent Foundations and Operating Foundations. Practitioner category does not include 501(c)4s.

Source: National Center for Charitable Statistics Database of IRS filings; Nonprofit Almanac (Independent Sector 1997); Giving USA (1999); CDFIs Side by Side (NCCA 1999); Foundation Giving Trends (Foundation Center 1999); The PRI Directory (Foundation Center 2001); Fidelity CGF Annual Report (2000); United Way Annual Report (2001); United Jewish Communities Annual Report (1999); Securities Data Corporation; National Council of State Housing Agencies; United States office of Management and Budget; The Chronicle of Philanthropy; Interviews by The Bridgespan Group.
Chart 2: Practitioner revenues by domain, 1998

Note: Does not include 501(c)(4)s ($37B) or religious organizations ($68B); Other includes membership dues and assessments, interest, dividends, net rental expenses, other investment income, gains from sale of assets and inventory, income from special events, and miscellaneous other income.

Source: NCCS IRS database tables Business Master File (BMF) and Statistics of Income (SOI)
BeyondDomains: Toward Understanding the Funding Requirements of Nonprofits

The information presented thus far helps us understand how funding moves through the nonprofit sector. In the remaining sections of Part I, we will focus on the forces that are influencing this flow. Before turning to this subject, however, we want to draw attention to the typology we have created to categorize the sector’s myriad organizations and explain why we thought such an experiment in categorization would be useful.

As Clara Miller has pointed out, a nonprofit’s need for capital is more likely to be determined by its life cycle, size, and the businesses in which it engages than by the program area in which it works.\textsuperscript{11} To put the same thought in somewhat different terms, organizations working in the same domain do not necessarily share the same challenges in terms of their funding structures and needs.

To illustrate, consider an environmental advocacy group and a nonprofit land trust. Traditionally the two organizations are placed in the same domain, “environment,” yet the differences in their funding structures and funding needs are striking. While the advocacy group spends the vast majority of its funds on engaging elected officials, the land trust spends its money on acquiring acreage. The former also requires little in the way of hard assets, while the latter is almost entirely defined by its hard assets. In fact, viewed from the perspective of its asset base and funding development options, the land trust has more in common with an affordable housing developer than it does with the environmental advocacy group, while that

\textsuperscript{11} Miller, Clara, “Capital Structure Counts: The Business Roots of Capacity at Nonprofits,” The Nonprofit Finance Fund, 2002. The monograph series is part of NFF’s Comprehensive Capitalization Initiative, which focuses on researching and understanding the appropriate allocation of assets required for the successful operation of a nonprofit business. Further information on NFF and the Comprehensive Capitalization Initiative, as well as links to the monograph series can be found at www.nonprofitfinancefund.org.
group, in turn, more closely resembles other advocacy organizations working in disparate domains such as health or education.

This example and others like it led us to experiment with the creation of a new typology for categorizing nonprofit organizations, which was based on a simple, intuitive hypothesis:

*Organizations of similar size sharing similar functions are likely to have similar funding needs and a similar capital structure.*

The typology of nonprofit organizations presented in Chart 3, “Categories of practitioners,” was developed to allow us to test this hypothesis as we pursued our analysis. We acknowledge that this particular set of categories remains substantially untested and that our choices are sure to provoke many probing and difficult questions. However, we also hope that readers will give this typology the benefit of the doubt, recognizing that it represents only a first and experimental step in defining a more robust framework for understanding nonprofits’ funding needs.

To create the typology, we used a two-step process. First, we looked at the practitioner organizations in our database individually, to understand how they classified themselves (by virtue of their primary activity code). Then, we sorted those activities into eight basic categories and grouped the nonprofit organizations accordingly. For example, organizations included in the alliance/advocacy category are issue-based groups working to raise awareness and influence policy, typically at a regional or national level. Environmental groups and organizations focused on educational reform are among its constituents. The eight categories were then arrayed in a spectrum from left to right according to their hypothetical level of asset intensity (defined as the amount of hard assets required to execute the organization’s strategy).
Of the eight functional categories, only one, institutional services, required further sub-division. As noted in Chart 3, the organizations in this category all require some sort of physical facility in order to deliver their services. Beyond this commonality, however, the segment is so large and so diverse that further refinement was essential. As a result, we created the four subcategories shown in Chart 4, “Segmentation of institutional services”: Higher education, Hospitals, Privileged beneficiaries, and Remaining institutional services.
Chart 3: Categories of practitioners (1)

We examined the practitioners through the lens of the activities in which they engage rather than the domain of the sector (e.g. environment, education) that they represent. Our hypothesis is that the activities that the organizations perform, rather than their domain, drive their cost structures and capital needs.

<table>
<thead>
<tr>
<th>Asset intensity: High</th>
<th>Description</th>
<th>General activities:</th>
<th>Specific organizations:</th>
</tr>
</thead>
</table>
| **Asset building & development** | • Purchase and holding of assets such as land for public-serving purpose or transfer of ownership for purposes other than individual assistance | Wildlife preservation | Fifth Street Highrise Inc.  
Lawrence Area Nonprofit Housing Corporation  
Save Our Rivers  
The Florida Keys Land Trust |
| **Institutional services** | • Direct provision of public welfare or enrichment services, including both essential or nonessential human needs  
• Service provision requires a physical plant/structural institution and is thus highly asset-intensive  
• Includes hospitals, higher-ed organizations, and privileged beneficiaries | Training centers | West Georgia Early Childhood Center  
Little Acres Daycare  
Concho Free Clinic  
Boys and Girls Club |
| **Provision of cultural assets/services** | • Design, development, testing, manufacturing and marketing of product/services with some cultural value  
• Protection and sharing of organizational/community assets for public benefit  
• Relatively high asset intensity | Public television/radio/printing  
Theater, performing arts  
Literary activities/outreach  
Commemorative events | Blue Ridge Broadcasting Corp.  
New York City Ballet  
Buffalo Historical Society  
Project Literacy  
Writers Workshop Inc. |
| **Individual economic assistance** | • Provision of money or other financial instruments to individuals to meet basic ongoing or temporary needs  
• Non-monetary support supplied to satisfy basic human needs  
• Asset intensity similar to that of typical financial institutions | | Scholarship providers  
Mutual insurance  
Workman's compensation organizations  
Pension and retirement funds  
Food service, emergency financial/other assistance |

Note: Religious organizations and 501(c)(4)s are not included here; categorization is based on the activity code that an organization listed as its primary activity on IRS Form 990.
Chart 3: Categories of practitioners (2)

<table>
<thead>
<tr>
<th>Asset intensity: Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counseling, training and advisory services</td>
</tr>
<tr>
<td>Research</td>
</tr>
<tr>
<td>Alliance/advocacy</td>
</tr>
<tr>
<td>Local community building</td>
</tr>
</tbody>
</table>

**Description:**
- **General activities:** Any type of counseling, training, or advising of individuals/groups/organizations, regardless of subject matter.
- **Inpatient or outpatient services:** Groups may take place in a facility, but typically smaller in size (and thus less asset-intensive) than institutional services.
- **Vocational counseling:** May engage in social action, educational or cultural activities, but with an emphasis on sharing interests.
- **Hairdressing:** Typically locally-based and locally-focused.
- **Scientific research:** May require a facility, but typically low asset intensity.
- **Environmental advocacy:** Groups brought together by shared interests, background, beliefs.
- **Economic development:** May engage in social action, educational or cultural activities, but with an emphasis on sharing interests.
- **Typically locally-based and locally-focused.
- **Very low asset intensity.

**Specific organizations:**
- **Counseling, training and advisory services:** Hazelden, Family Guidance Center, Cabrini-Green Youth & Family Services, Community Services for the Mentally Disabled, Jewish Support Services for Adults with Mental Illness.
- **Alliance/advocacy:** Issue-based groups that work to raise awareness and influence policy, regardless of issue.
- **Typically have a regional or national focus.
- **Less of a grassroots emphasis than local community building.
- **Local community building:** Groups brought together by shared interests, background, beliefs.
- **Typically locally-based and locally-focused.
- **Very low asset intensity.

Note: Religious organizations and 501(c)(4)s are not included here; categorization is based on the activity code that an organization listed as its primary activity on IRS Form 990.
Chart 4: Segmentation of institutional services

<table>
<thead>
<tr>
<th>Institutional services</th>
<th>Description:</th>
<th>General activity examples:</th>
<th>Specific examples:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher education</td>
<td>- Institutions of higher learning, whose primary focus is on education, including those extensively involved in research&lt;br&gt;- Service provision requires a physical plant/structural institution and is thus highly asset-intensive</td>
<td>- Higher education institutions&lt;br&gt;- Undergraduate colleges&lt;br&gt;- University or Technical Institutions</td>
<td>- Stanford University&lt;br&gt;- Harvard University</td>
</tr>
<tr>
<td>Hospitals</td>
<td>- Institutions providing health care and both general and specialized health services&lt;br&gt;- Service provision requires a physical plant/structural institution and is thus highly asset-intensive</td>
<td>- Hospitals&lt;br&gt;- Primary care facilities&lt;br&gt;- Specialty hospitals&lt;br&gt;- Group health practices</td>
<td>- Acadia Hospital Corporation&lt;br&gt;- Akron General Medical Center</td>
</tr>
<tr>
<td>Privileged beneficiaries</td>
<td>- Organizations providing for non-essential human needs that can rely on beneficiaries for a substantial and reliable influx of capital&lt;br&gt;- Service provision requires a physical plant/structural institution and is thus highly asset-intensive</td>
<td>- Museums&lt;br&gt;- Amateur sports leagues&lt;br&gt;- Sport training facilities/camps</td>
<td>- Pac-10&lt;br&gt;- Tech Museum of Innovation</td>
</tr>
<tr>
<td>Remaining institutional services</td>
<td>- Direct provision of public welfare or enrichment services&lt;br&gt;- Service provision requires a physical plant/structural institution and is thus highly asset-intensive</td>
<td></td>
<td>- Little Acres Daycare&lt;br&gt;- Conejo Free Clinic</td>
</tr>
</tbody>
</table>
Defining Financial “Capacity” in the Nonprofit Funding Market

The central question in analyzing the nonprofit funding market is whether that market is meeting the needs of the players involved. Are nonprofits able to develop adequate funding structures to support their activities? Do they receive adequate funding infusions? In a word, what financial capacity do the nonprofits in this market place possess?

In this context, when we describe an organization’s having adequate “capacity,” we are referring solely to the state of its financial wherewithal. We recognize there are many other important aspects of an organization’s performance such as its ability to achieve the impact it seeks, the soundness of its operations, and the health of its culture. These dimensions are not our focus here, however. Accordingly, we define an organization as having sound financial capacity if it is able to secure an adequate and flexible supply of funding.

INDICATORS OF FINANCIAL CAPACITY

We chose to assess the financial capacity of nonprofit organizations by looking at two indicators. The first is the “fund balance,” which reflects funds accumulated by or committed to an organization over a number of years. A fund balance is the nonprofit equivalent of owners’ equity, and reflects the value at a given point in time of an organization’s “net assets,” including accumulated surpluses, committed grants or bequests, and permanent endowment funds. As such, it is indicative of an organization’s long-term supply of financial resources. In order to create a simple normative measure of an organization’s long-term capital adequacy, it is presented in this paper as a multiple of total annual revenue.

The second indicator, the organization’s operating surplus, is also presented as a percentage of total revenue. The presence of an operating surplus speaks to both the short-term adequacy and flexibility an organization enjoys with respect to its funding supply. For a nonprofit, the surplus, at least in very broad terms, is
equivalent to its “profit” in a given year and thus, potentially, the amount of funds it can spend in a manner of its own choosing. We say “potentially,” because the surplus can include funds that remain in restricted accounts. It is important to note that the designation “nonprofit” or “501(c)(3)” does not mean that an organization cannot have funds left over at the end of the year. Rather, it means that those funds cannot be paid out as profits to the benefit of individuals. Consequently, it is possible for nonprofit organizations to have an operating surplus—even a sizable surplus—at the end of the year.

We recognize that many in the sector may disagree with our second indicator, because they consider it sound management to end the year with a zero surplus so as not to discourage future contributions. Indeed, there are likely to be instances of such management in our data set. Nevertheless, we maintain that a zero surplus represents a precarious financial position for any organization, even if it is the result of a deliberate funds management strategy.

It is important to note that there are many other potential measures of a nonprofit organization’s financial capacity than these, including the amount of its restricted versus unrestricted funds, the percent of its revenue that is self-generated, and its ability to access debt. Although we will discuss some of these measures hereafter, we did not use them as primary indicators for two reasons. First, our objective was to assess capacity across the sector, and some indicators, such as earned income, almost by definition vary by functional category. Second, the difficulty of isolating certain data prevented some metrics, like restricted versus unrestricted funds and access to debt, from being used.

WHICH SEGMENTS HAVE STRONG FINANCIAL CAPACITY, WHICH DO NOT?

To carry out our analysis of financial capacity, we first divided nonprofit organizations into three groups. Small organizations were defined as those with less than $10M in annual revenue. Large organizations were defined as having revenue between $10M and $60M. And very large organizations were defined as those with over $60M in annual revenue. Ten million dollars may seem an
arbitrary cut-off point for a sector in which slightly more than 80% of the organizations have revenues of one million dollars or less. But since the NCCS database (the SOI), which we used for the analysis, includes all organizations larger than $10M, but only a sample of those smaller than $10M, we needed to use the larger cut-off point to maintain adequate sample sizes once we had divided the nonprofit universe into the functional categories previously described.

We then went through a series of steps to identify the segments of the nonprofit sector that are most financially at risk: that is, those that are most in need of funding. This process resembled peeling an onion. We began with the full universe of secular practitioner 501(c)(3) organizations and sequentially stripped off those with the highest levels of financial capacity, beginning with the sector’s two largest functional categories, hospitals and higher education, both of which are part of institutional services.

As we noted earlier, both health care and higher education are massive relative to all the other functional categories, so the analysis would be skewed if they were not isolated and analyzed separately. However, we also hypothesized that the nonprofit organizations in these categories would function similarly to comparable for-profit institutions. Using the metrics described earlier, relative fund balance and surplus, we analyzed the performance of nonprofit and for-profit hospitals and found this to be the case. Ironically, while virtually identical, both showed significant financial weakness, reflecting the fundamentally weak state of institutional healthcare finance. In contrast, while the availability of for-profit comparisons is obviously quite limited, nonprofit institutions of higher education demonstrated very strong levels of relative financial capacity.

The next cut was intended to identify size-related segments across functional categories that taken as a whole appeared to have relatively high levels of financial capacity. Our hypothesis here, which was also borne out with analysis, was that very large organizations (that is, those with annual revenues over $60M) from any functional category would tend to appear relatively strong when compared with those already determined to have high financial capacity (that is, institutions of higher education).
Finally, we looked at and isolated functional categories that appeared to have high financial capacity within the entire category. At that point, having identified relatively strong functional categories, we were left with the segments that appeared to be in greatest need of funding—the ones whose financial capacity looked precarious. These were the segments that would merit further investigation to understand their funding structures more deeply and to identify strategies for improving their status and increasing their impact.

Before turning to the charts that display the results of these analyses, we want to emphasize the fact that segments, not organizations, were the units of analysis. Consequently, when we say that a given segment can be considered to have relatively strong or weak financial capacity, we are not saying that every organization within that segment warrants the same classification. Segments that are relatively strong can still include organizations with weak financial capacity and vice-versa. Segments that we believe merit further analysis simply had a higher incidence of relatively weak organizations within them, thereby causing the segment as a whole to be classified as weak.

When we assessed the financial capacity of nonprofit segments composed of organizations with more than $10M in annual revenue, we found three sets that performed well on both measures, fund balance and operating surplus. The three are higher education, provision of cultural assets and services, and privileged beneficiaries. We then took these three segments and averaged their performance to create a benchmark of financial strength for large organizations. Charts 5 and 6 titled “Fund balance relative to revenue: Financially strong practitioner segments greater than $10M, 1998,” and “Surplus relative to revenue: Financially strong practitioner segments greater than $10M, 1998,” show the results. A similar process led to the identification of two segments of small organizations (those with less than $10M in revenue)—privileged beneficiaries and research—whose performance could similarly be used as a benchmark of financial strength for their nonprofit peers. These results are shown in Charts 7 and 8, “Fund balance relative to revenue: Financially strong practitioner segments less than $10M, 1998,” and “Surplus relative to revenue: Financially strong practitioner segments less than $10M, 1998.”
Equipped with these definitions of strong financial capacity, we then looked across the entire spectrum of practitioner segments, having first broken them out into two groups: those with operating budgets of more than $10M, and those with budgets less than that amount. The results of these analyses are provided in two summary charts (Charts 9 and 10), titled “Summary of fund balance, surplus and use of debt: Practitioner segments greater than $10M, 1998,” and “Summary of fund balance, surplus and use of debt: Practitioner segments less than $10M, 1998.”

On each of these charts, a dashed line separates the segments that we considered to be relatively strong financially from those with questionable financial capacity, which require further investigation. In order to create a consistent basis for comparing the segments, as well as to facilitate examination, we devised a five-level scale that allowed us to represent the numerical findings as uniform spheres. Segments with the strongest financial performance on either of the two measures are designated with a fully colored ball for that measure, while those with the weakest are designated with a blank ball. Levels of performance between the worst and best are designated with balls of increasing color, beginning with a quarter then a half then three-quarters. To be positioned above the dotted line, each segment needed to have a fully filled-in sphere for fund balance and at least a half sphere for surplus. Thus, segments that are financially “strong” can be said to perform well against the primary indicator of fund balance and at least reasonably well against the secondary indicator of surplus.

The summary charts give rise to several observations. The first is the generally poor financial capacity of the nonprofit sector. Among organizations with less than $10 million in annual revenues, nine out of the eleven segments were relatively weak, having at best a limited fund balance and limited or no surplus reserves available. The situation is better among larger organizations, which perform much better than smaller organizations on the primary dimension of fund balance. Yet even here, only three out of eleven segments fell into what could be called the truly “strong” grouping.
It is also notable that certain functional categories appear to be financially weak regardless of the size of the organizations under consideration.\textsuperscript{12} These include Asset Building and Development; Counseling, Training, and Advisory Services; Hospitals; and Remaining Institutional Services.

This finding raises the question of whether, given the current structure of the funding market, there are segments of the sector that are structurally weaker financially than others. Consider a social services agency that provides counseling to homeless people. Such an organization is unlikely to earn much in the way of revenue on its own and is highly likely to rely heavily on government contracts or foundation grants. But since it is also probable that those contracts and grants may come with tight restrictions on administrative reimbursement, the organization might not face any realistic prospect of achieving an operating surplus or positive fund balance.

As an aside, it should be understood that agencies in such circumstances may still have certain financial capacities that they are not fully exploiting, particularly relating to debt. For example, to banks assessing creditworthiness, government contracts are often viewed as a form of ongoing cash flow, which might then be used to support the repayment of debt or other financial obligations. Similarly, some bond underwriters consider social-service organizations such as psychiatric care facilities good lending candidates whereas others, like community arts programs, are not, because the former are thought to provide “essential” services.\textsuperscript{13} While these funds should not be viewed as a form of capital, since they are revenues received in exchange for services provided, such funding relationships may expand the financing options of nonprofit organizations.

\textsuperscript{12} Please keep in mind that we are addressing only those organizations with annual budgets of less than $60M, since those that are greater than that amount are by definition financially healthy.

\textsuperscript{13} The authors would like to thank Bill Ryan for drawing the concept of “essentiality” to our attention in his review of this paper.
Our final observations from these charts relate more broadly to the use of debt. While the numbers indicate a vast spread among organizations in their use of debt, it is clear that within each functional category larger organizations made greater use of debt than small ones. It is also clear that, as would be expected, the use of debt was closely tied to the actual activities or functions performed by the organization. Those nonprofits with an ability to pay back debt thanks to predictable cash flows were, inevitably, the greater users of debt to help diversify their access to the capital needed to both manage and grow their organizations. Furthermore, such organizations could be thought of as functioning as active players in the mainstream capital market where their scale allows them to secure financing at a level beyond that of their smaller nonprofit cousins.

Indeed, Charts 11 and 12, “Self-generated revenue versus use of debt for practitioner segments greater than $10M, 1998” and “Self-generated revenue versus use of debt for practitioner segments less than $10M, 1998,” show a strong correlation between the percent of self-generated revenue and the use of debt by both large and small organizations. The most natural explanation for this is that lenders are more willing to extend credit to organizations that can point to a history of “dependable” revenues coming from enterprises, fee for service, or other activities under the borrower’s control. Indeed, this correlation may be even stronger than our analysis shows, since our proxy for access to debt, which is an organization’s actual use of debt, probably understates the number of nonprofits that could borrow but choose not to.

The relationship between self-generated revenue and access to capital has implications for grantmaking foundations as well as lenders. Many foundations provide short-term support to organizations with the idea that over time they will become self-sufficient and be able to find new sources of funds to cover the operating expenses of programs originally launched with the foundation’s money. In truth, the data show that for certain types of nonprofits, it is extremely unrealistic to believe they will ever be able to achieve financial sustainability. While some of these organizations may have other areas with unexplored potential to generate earned income, grantmakers must realistically assess whether the prospect of financial sustainability is appropriate.
Stepping back from these numbers to the question of strong versus weak financial capacity and the mix of practitioners in the nonprofit funding market, the findings are arresting. As Chart 13, “Financial capacity mix of practitioners, 1998” makes clear, organizations with relatively high financial capacity (including hospitals, given their comparability to for-profit institutions) account for over 80% of the market’s total practitioner revenues. Yet those same relatively strong organizations (which also include institutions of higher education and organizations with over $60M in annual revenue) make up less than 6% of the total number of nonprofit organizations active in this market!
Chart 5: Fund balance relative to revenue: Financially strong practitioner segments greater than $10M, 1998

Three segments of large organizations (greater than $10M in revenue) are considered to have strong financial capacity; these segments define the standard of financial capacity for other organizations in our analysis.

Source: NCCS IRS Database, The Bridgespan Group Analysis
Chart 6: Surplus relative to revenue: Financially strong practitioner segments greater than $10M, 1998

The strong surpluses of these segments also provide a standard of financial capacity.

Source: NCCS IRS Database, The Bridgespan Group Analysis
Two segments of small organizations (less than $10M in revenue) are considered to have strong financial capacity; these define the standard of financial capacity for small organizations.

Source: NCCS IRS Database, The Bridgespan Group Analysis
Chart 8: Surplus relative to revenue: Financially strong practitioner segments less than $10M, 1998

While weaker than large organizations, the surpluses of these segments are strong relative to other segments.

Source: NCCS IRS Database, The Bridgespan Group Analysis

Based on the metrics of financial capacity, institutional services (other than privileged beneficiaries) and asset building and development appear to be the weakest segments.

<table>
<thead>
<tr>
<th>Segment</th>
<th>Fund balance</th>
<th>Surplus</th>
<th>Organizations using debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher education</td>
<td>High</td>
<td>High</td>
<td>93%</td>
</tr>
<tr>
<td>Privileged beneficiaries (institutional services)</td>
<td>Low</td>
<td>Low</td>
<td>73%</td>
</tr>
<tr>
<td>Provision of cultural assets/services</td>
<td>Low</td>
<td>Low</td>
<td>48%</td>
</tr>
<tr>
<td>Individual economic assistance</td>
<td>Low</td>
<td>Low</td>
<td>53%</td>
</tr>
<tr>
<td>Alliance/advocacy</td>
<td>Low</td>
<td>Low</td>
<td>57%</td>
</tr>
<tr>
<td>Local community building</td>
<td>Low</td>
<td>Low</td>
<td>57%</td>
</tr>
<tr>
<td>Research</td>
<td>Low</td>
<td>Low</td>
<td>53%</td>
</tr>
<tr>
<td>Counseling, training &amp; advisory services</td>
<td>High</td>
<td>High</td>
<td>64%</td>
</tr>
<tr>
<td>Hospitals</td>
<td>High</td>
<td>High</td>
<td>91%</td>
</tr>
<tr>
<td>Remaining institutional services</td>
<td>High</td>
<td>High</td>
<td>76%</td>
</tr>
<tr>
<td>Asset building &amp; development</td>
<td>Low</td>
<td>Low</td>
<td>80%</td>
</tr>
</tbody>
</table>

Source: NCCS IRS Database, The Bridgespan Group Analysis
Chart 10: Summary of fund balance, surplus and use of debt: Practitioner segments less than $10M, 1998

Nine out of eleven small segments appear weak based on their fund balance

<table>
<thead>
<tr>
<th>Segment</th>
<th>Fund balance</th>
<th>Surplus</th>
<th>Organizations using debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Privileged beneficiaries (institutional services)</td>
<td>⬤</td>
<td>⬤</td>
<td>32%</td>
</tr>
<tr>
<td>• Research</td>
<td>⬤</td>
<td>⬤</td>
<td>26%</td>
</tr>
<tr>
<td>• Individual economic assistance</td>
<td>⬤</td>
<td>⬤</td>
<td>32%</td>
</tr>
<tr>
<td>• Local community building</td>
<td>⬤</td>
<td>⬤</td>
<td>40%</td>
</tr>
<tr>
<td>• Provision of cultural assets/services</td>
<td>⬤</td>
<td>⬤</td>
<td>31%</td>
</tr>
<tr>
<td>• Alliance/advocacy</td>
<td>⬤</td>
<td>⬤</td>
<td>44%</td>
</tr>
<tr>
<td>• Higher education</td>
<td>⬤</td>
<td>⬤</td>
<td>66%</td>
</tr>
<tr>
<td>• Institutional services</td>
<td>⬤</td>
<td>⬤</td>
<td>57%</td>
</tr>
<tr>
<td>• Asset building &amp; development</td>
<td>⬤</td>
<td>⬤</td>
<td>77%</td>
</tr>
<tr>
<td>• Hospitals</td>
<td>⬤</td>
<td>⬤</td>
<td>63%</td>
</tr>
<tr>
<td>• Counseling, training &amp; advisory services</td>
<td>⬤</td>
<td>⬤</td>
<td>51%</td>
</tr>
</tbody>
</table>

Source: NCCS IRS Database, The Bridgespan Group Analysis
Chart 11: Self-generated revenue versus use of debt for practitioner segments greater than $10M, 1998

Self-generated revenue and use of debt are positively correlated; the more of its own revenue that an organization generates, the more likely the organization is to use debt.

Percent of organizations using debt

Source: NCCS IRS Database, The Bridgespan Group Analysis
Chart 12: Self-generated revenue versus use of debt for practitioner segments less than $10M, 1998

Similarly, for small organizations, self-generated revenue and use of debt are positively correlated.

Percent of organizations using debt

Self-generated revenue as a percent of total funding

Source: NCCS IRS Database, The Bridgespan Group Analysis

Segments with strong financial capacity represent 80% of practitioner market revenue, but only 6% of organizations.

<table>
<thead>
<tr>
<th>Segment</th>
<th>Practitioner Funding</th>
<th>Number of practitioners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Beneficiaries</td>
<td>$813B</td>
<td>403K</td>
</tr>
<tr>
<td>(Institutional Services)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research &lt;$10M</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product &gt;$10M</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Higher ed</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Large orgs &gt;$60M</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hospitals</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: NCCS IRS Database, The Bridgespan Group Analysis.
Note: Hospitals included based on comparative analysis of for-profit and nonprofit counterparts.
Size Matters: The Role Scale Plays in Access to and Usage of Funds

In exploring how each practitioner category makes use of funding, we expected to find that on balance, the larger an organization, the more diverse its funding base would be and the stronger it would be with respect to the indicators of financial capacity. When we looked at the data, however, we found that while this assertion holds for several categories, one category shows an “hourglass” scale effect and in several others no conclusions could be drawn about the effects of scale.

In the categories of Higher Education, Provision of Cultural Assets/Services, Remaining Institutional Services, and Hospitals—all categories in which hard assets such as buildings, equipment, and related items presumably play an important role—scale has a positive effect on the key indicators of financial capacity. For example, in the area of Higher Education, 91% of the organizations that had more than $10M in annual operating revenue also had a positive surplus. In contrast, only 50% of the organizations in the same category that had annual budgets of less than $10M ended the year with an operating surplus.

Similar differences in scale and funding options are also evident when we consider an organization’s use of debt as a function of its ability to generate revenue. Again, in the case of Higher Education, while approximately 74% of the revenue for both large (greater than $10M) and small (less than $10M) organizations was self-generated, only 66% of the smaller organizations made use of debt, whereas a full 93% of larger educational organizations chose to borrow funds.

Scale also had a significant positive effect on key financial indicators in the Privileged Beneficiaries (Institutional Services) category, which includes symphony orchestras, opera and ballet companies, as well as museums. Of those organizations with less than $10M in annual revenue 69% had positive fund balances, while 90% of those with budgets between $10M and $60M and 100% of those with budgets of over $60M had positive fund balances. Further, 60% of the organizations with less than $10M in annual revenue also had positive operating
surpluses, while 87% of those with annual revenues of $10M to $60M and 100% of those with budgets in excess of $60M had operating surpluses.

By contrast, in the category of Local Community Building, we found an hourglass distribution on indicators of financial capacity, with the weakest organizations occupying the middle of the segment. Of the organizations with budgets of less than $6M, 81% had a positive fund balance, while 96% of the organizations with budgets of $10M to $40M also had positive fund balances. While those numbers reflect relatively sound financial capacity, less than 73% of the organizations with budgets of between $6M and $10M were able to report positive fund balances.

In other areas, we could find no relationship between size and financial strength. Categories such as Counseling, Training and Advisory Services; Research; Asset Building and Development; Individual Economic Assistance; Remaining Institutional Services; and Alliance/Advocacy all had inconclusive findings. Further exploration of the relationship between size and financial capacity in these categories will require deeper analysis and the accumulation of new or additional data.

Finally, and unsurprisingly, for organizations with annual budgets in excess of $60M, the use of debt and the presence of fund balances were at levels that fell within the “strong benchmark” previously established. 14

What, then, are we to conclude from all this?

First, although we can observe characteristics that support the efforts of practitioners to grow their organizations, and we can identify some of the factors that allow organizations to continue to be at scale, the available data does not allow us to describe the factors that actually allow an organization to move to scale (assuming that is the goal of its leadership!). We do know the market does not

14 It should be noted, however, that very large organizations often do not maintain annual surpluses, since they tend to have extremely high fund balances upon which they can rely for cash flow and other support throughout the year.
have the capacity to consistently track and reward performance. As anecdotal observers, we also know that charitable grants and donations are often awarded in the absence of demonstrated impact. However, the inability to clearly define the specific drivers of scale is a critical issue that requires further research.

Second, even in the absence of further data, we can explicitly state one thing: when viewed in total, the available data clearly show that scale does matter. Across the functional categories, those organizations that tend to have the strongest financial capacity generally tend to be the largest.

Third, it would be wrong to extend that observation to assert that there is a direct correlation between organizational size and financial strength. It could well be the case that strong financial capacity itself is what drives scale—that financially sound, well-run organizations simply attract more funds than organizations that appear less healthy.

Finally, for certain types of nonprofit organizations having high levels of fixed assets, the benefits of being at scale are clear and compelling. In these cases, scale contributes very directly to an organization’s ability to achieve stronger financial performance, since the fixed costs can be spread over a larger activity base, thereby reducing the average cost of serving intended beneficiaries.

In addition to the research questions noted above, other questions related to scale deserve further inquiry and are noted in the “Epilogue” section of this paper. For now, we will turn our attention to another issue that touches on questions of scale: the use of debt to leverage the resources of the organization.

**Bonds and Debt**

When you look beyond the traditional sources of nonprofit support—grants, fees, and individual donations—the first alternative is debt. In an earlier section, we discussed the general question of access to and usage of debt as that was reflected in our data. Here we want to focus on two specific types of debt, Program Related Investments (PRIs) and bonds, in order to explore access and usage in greater depth.
Program Related Investments may be thought of as “simple” debt, in that they are below-market-rate loans made by lending foundations to nonprofit organizations or for-profit corporations attempting to create social value. In 1999, over $346M in PRIs were awarded to nonprofit organizations (see Chart 14, “Source of PRIs by foundation type, 1998 and 1999”). Private foundations accounted for over 90% of these investments, with the balance being provided by corporate and community foundations.

While the “grantor role” foundations play is relatively modest in relation to the total funding moving through the sector, the potential for foundations to leverage their assets by combining grants with PRIs would seem to be significant. However, the vast majority of foundations do not use this financing option to any extent, focusing instead simply on making grants. This suggests a noteworthy opportunity to increase the availability of a potentially powerful financing tool—below-market-rate loans made with patient capital—to practitioners who may be worthy but who otherwise lack access to debt.

While current recipients of these loans represent a wide array of domains, it is striking to note that only 15% to 20% of reported PRIs were earmarked for “operating revenues,” i.e., working capital, with the majority of funds being targeted to hard asset expenditures such as building, land acquisition, and related capital campaigns (see Chart 15 “Use of PRIs, 1998 and 1999”). Hard asset investments are important and appropriately financed with debt. However, the small percentage of debt used to finance other important operating activities underscores the limited options available to nonprofit organizations attempting to expand their sources of funding beyond grants and gifts.

Similar constraints apply with respect to the somewhat more complex instrument of fixed note debt, also known as tax-exempt bonds. On the whole, the providers of this type of debt are mostly mainstream for-profit banks and investment firms,
which tend to apply rigorous for-profit approaches to qualifying borrowers.\textsuperscript{15} As a result, it is hardly surprising to discover that tax-exempt bond financing is used primarily by large organizations, particularly those involved in health care, education, and housing—the very organizations lenders are likely to view as being most capable of repaying the debt (see Chart 16 "Number of municipal tax-exempt bonds issued and their volume, 1998").

As logical as this lending pattern is, however, it also leads us to wonder about the thousands of nonprofits that pay their bills successfully, year after year—thereby demonstrating the capacity to fulfill at least some, and perhaps greater, forms of debt obligations. Without the hard assets that can secure such debt, however, they may never satisfy the funding needs required to grow and take their social innovations to scale.

As institutions with billions of dollars in assets created with the commitment to advance social impact and create social value, foundations might be the funding market players best positioned to address the apparent need for better access to debt. If so, there are a variety of steps foundations might consider, including changing the risk profile of organizations through the use of credit enhancements and other strategies of underwriting debt and/or providing secondary financial backing, engaging in direct lending, or working to expand the capital available through intermediary lenders like the Nonprofit Finance Fund, a national capital provider presently operating in several states.\textsuperscript{16}

\textsuperscript{15} Of the approximately $70B to $80B in debt provided to the sector, over 98\% is sourced from commercial institutions.

\textsuperscript{16} “A Funding Idea: Total Foundation Asset Management and the Unified Investment Strategy,” by Jed Emerson, explores ideas and strategies for how foundations can most effectively move to complement their grant making with additional funding support. That paper is available from the Publications Page at www.hewlett.org.
Chart 14: Use of PRIs by foundation type, 1998 and 1999

Private foundations provide over 90% of the program related investments (PRIs)

Note: Excludes PRIs less than $10,000; PRIs originated not outstanding; totals equals sum of 1998 and 1999 PRIs

Source: PRI Directory (the Foundation Center)
Chart 15: Different types of PRIs, 1998 and 1999

PRIs are mainly going to building renovation, equipment or capital campaigns, and working capital

Note: Excludes PRIs less than $10,000; based on a sample of 129 larger PRI funders; totals equals sum of 1998 and 1999 PRIs

Source: PRI Directory, published by the Foundation Center
Chart 16: Number of municipal tax-exempt bonds issued and their volume, 1998

Source: Securities Data Corporation (SDC); National Council of State Housing Agencies (NCSHA) Annual Report
Part II: Interpretation
How Well Does the Nonprofit Funding Market Function?

Thus far, this paper has been focused largely on analyzing how funds flow through the nonprofit funding market and how they are allocated within it. Now it is time to shift our attention to the second question: how well does this market structure function?

At the most basic level, markets of any kind are simply places of exchange between two sets of players, usually defined as buyers and sellers. In a capital market, those with capital to offer and those in need of capital exchange information of various kinds. Then, assuming the terms meet both players’ basic requirements, funds change hands—usually in exchange for a commitment to provide returns on the use of that capital at some future point in time. In a mainstream capital market, these returns are financial and consist of interest income and capital gains. In a nonprofit capital market, the returns are social.\(^\text{17}\) How to define them has been a central question for many in the nonprofit sector in recent years.\(^\text{18}\)

Capital markets evolve, in large part, because they provide a more efficient mechanism of exchange for the investor and investee than simply wandering the world, hoping to come together. Markets can provide standards, quality assurance, 

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\(^{17}\) Social returns are often defined as a broad set of returns that would include environmental, cultural and other value in addition to basic social value.

\(^{18}\) The movement toward “outcome funding” and ongoing discussions regarding “accountability” are both parts of this larger conversation and stand beyond the scope of this paper. For the funders’ perspective on some of these questions, the reader is encouraged to go to [www.geofunders.org](http://www.geofunders.org) as one starting place. Another source of extensive information on social return on investment methodology available to nonprofit organizations is [www.redf.org](http://www.redf.org).
and infrastructure to assist in the information exchange so critical to the positive transfer of capital. Thus,

The objective of a well functioning capital market
is to direct adequate quantities and types of capital in an efficient manner to the opportunities offering the highest potential risk-adjusted return.

CHARACTERISTICS OF A WELL-FUNCTIONING CAPITAL MARKET

Asked to define a well-functioning capital market, reasonable people could probably agree on four basic characteristics.

First, there must be an adequate supply of capital for investments promising a meaningful return. In practice, this means that organizations that perform well have access to an adequate supply of capital. Strong investment incentives, based on a fairly well-defined expected financial return, are in place for potential players. There are also relatively low barriers to entry and exit for potential investors.

Second, the capital available within the market must be flexible enough to meet the needs of the market's participants. Organizations have different capital needs at different points in their life cycle. A start-up will have different capital requirements than a mature organization, for example, and the market must be able to offer both players what they need (directly or through alliances). Given such conditions, an organization's sources of funds will tend to become more diverse over time as it evolves and demonstrates its value, with debt becoming an increasing counterpart to equity resources. Chart 17, “For-profit capital sources and benchmarks by life stage, 1998” presents a general framework for understanding how funds move through the for-profit capital market and how the organizations accessing those funds evolve within it. Obviously, however, there are no hard and fast rules governing how real firms function within this progression.

The third characteristic of an efficient capital market is that funds flow to the highest and best use. This fact acts as an incentive for investors, who will always seek the greatest return on their investment whether financial or social. You want to make financial investments in the “best” company, and you want to make philanthropic investments in the “best” nonprofits. For this to occur, the flow of
funds must be guided by solid information concerning investment opportunities. This means that there must be clear, well-accepted, and universally applicable measures of performance, which can be communicated to all players in a transparent manner. These measures, in turn, make it possible to maintain clear competitive benchmarks against which the market’s players can judge performance among competing investment opportunities. A market with insider trading and restricted information flow will benefit a small number of core players; but it will never achieve real efficiency nor provide maximum benefits for all who participate in it.

The fourth and final characteristic is that capital is allocated on a cost-effective basis. It does neither the investor nor the recipient any good if recipients are able to secure capital, but the cost of doing so exceeds the value of the capital received! So there must be low transaction costs, and basic information must be shared freely between and among various players in the market.

Given these four characteristics, how does the nonprofit funding market measure up? The reader should note that, because this section is concerned with decisions made in support of an organization’s mission, rather than with funds provided in exchange for specific goods and services, when we use the word “capital," we will be referring to its broader social definition as well as its financial accounting definition.

IS THE SUPPLY OF CAPITAL FOR NONPROFITS ADEQUATE?

It’s tempting to answer this question with a resounding “no," if for no other reason than the ease of identifying deserving nonprofits that lack sufficient funds to meet their needs. Yet the truth is that we have no objective basis for making that judgment. That said, however, it is also clear that the nonprofit capital market has a number of structural characteristics which tend to limit rather than expand the flow of capital. Participants in this market as well as many of its analysts have noted and documented these barriers for some time; but finding ways to overcome them remains a significant challenge.
To begin, “investor” motives in providing nonprofit capital are often ambiguous and difficult to discern. People engage in charitable giving for as many reasons as there are individual donors. Foundations, even those funding in the same area of interest, often pursue very different strategies and goals. Understanding donors’ motives can be confusing, not only for those attempting to secure capital to address new causes, but for old hands as well. And often, the investor herself may have a multitude of reasons for wanting to support a certain cause. All in all, it makes it difficult for the market to provide adequate capital when needs arise or to predict when funds will be available.

A second challenge in securing adequate funds is that this market has no equivalent to private ownership. As 501(c)(3) corporations, nonprofits are in a very real sense “owned by all.” This has led to the creation of a thriving nonprofit sector meeting the needs of many of our community members. But in part due to the absence of being able to offer something comparable to an equity position in a private firm, it can often be difficult for a nonprofit to secure adequate and diverse funds to meet its needs.

A third challenge for those raising nonprofit capital is that, with the exception of debt, there is no return of principal invested. Despite this fact, individual Americans are some of the most generous folks on earth, giving billions of dollars annually and asking nothing in return. At the same time, however, the absence of returns can create challenges for a nonprofit attempting to raise funds for special projects or an unpopular cause. In the for-profit market, as long as you can demonstrate a high probability of being able to return the funds with interest, you are likely to find someone to finance your enterprise. Unfortunately, even if your venture operates in a “questionable” area (such as producing land mines), you will be able to find players willing to fund it in return for the promise of getting a profit on the use of those funds. Nonprofits, then, suffer from a two-fold challenge of not being able to return the principal invested and not being able to distribute the profits earned from the use of those funds.

A final factor that may affect the availability of nonprofit capital is the lack of a defined exit strategy. From the recipient’s perspective, the absence of an exit strategy translates into uncertainty with regard to future financial support. A grant
may be renewed, or it may not. An individual gift of $5,000 received one year might turn into $500 (or $50,000) the next, or into nothing at all. In light of these uncertainties, developing a multi-year funding development strategy becomes difficult, if not impossible, for many nonprofits.

From the investor’s perspective, the consequences are different but no less problematic. The lack of an exit strategy creates uncertainty about whether funds will be building a future or simply addressing a short-term need. Without an exit option, donors have no way of knowing whether there will be others to whom they can “pass off” the investment. In addition, without an exit strategy in place, investors may commit to investing only a limited amount of capital; whereas if they knew that they could receive their principal as part of a larger exit-strategy option they might be more inclined to make longer and perhaps larger commitments.

While these problems have been discussed and debated often, especially with respect to foundation practices, the basic issue of when, whether, and how to exit a funding relationship is deserving of further study and analysis.19

DOES THE AVAILABLE CAPITAL MEET THE PARTICIPANTS’ NEEDS?

The second characteristic of an efficient capital market, meeting the needs of all the participants, also has some significant limitations in the nonprofit context. To begin with, public-charity status requires the receipt of “public support,” which may not always be to the nonprofit entity’s advantage. This can be especially problematic for organizations such as public-welfare and human-services agencies that are unable to generate user fees from their client base, thus limiting their options for revenue development and cash flow support.

Another limiting factor is the prevalence of restricted grants. As practitioners know so well, receiving funds is always a welcome event. Yet practically speaking, some

funds may be more welcome than others, because they can be used in whatever way management deems necessary. In this context, unrestricted or general operating support is often more helpful than targeted program grants; and similar logic can apply to the receipt of program service revenue, which may also be more flexible than many grants.

Last but hardly least, the fact that the sector has so few capital instruments severely limits the options available to nonprofits that want to diversify their capital structure.

**DOES NONPROFIT CAPITAL FLOW TO ITS HIGHEST AND BEST USE?**

Of all the characteristics on which the nonprofit and for-profit markets for capital can be compared, this may be the most difficult to reconcile. Simply put, there is no “one best way” to define the highest and best use of funds in the nonprofit sector. Is the social impact of helping troubled youth greater than the impact of addressing global warming? Opinions differ. Are funds allocated to helping troubled youth better invested in early childhood education, after-school programs, or interventions with adolescents? Opinions differ again. And so it goes with respect to all the allocation choices social investors make.

Even more problematic, there is no objective data on which investors can rely. Measuring outcomes of many nonprofit programs is difficult if not impossible. Early childhood programs pursing the goal of healthy high school graduates will have to wait years to measure their results. Environmental groups working to protect a diversified ecosystem will have to wait decades to assess the effectiveness of their efforts. Factor in the challenge of assessing direct causality for any given program intervention, and the complexity grows even greater. In fact, the real question may not be whether social capital flows to its highest and best use but why anyone would imagine that it would.

And yet, the concern is real and important. The more investors in the sector strive to ensure their funds are flowing to the highest and best use (however they choose to define it), the greater the potential for impact. In this context, it’s useful—albeit disappointing—to look at two very broad pieces of data that tend to support the
hypothesis that nonprofit resources aren’t finding their way to opportunities with the greatest social impact.

The first has to do with the extreme concentration of dollars within the sector. As we noted earlier in this paper, a mere 6% of the sector’s organizations attract some 80% of the available resources. This well-funded segment includes hospitals, institutions of higher education, and cultural organizations of various kinds. Is this where 80% of the sector’s impact is generated? The answer is anybody’s guess. But the proposition that the other 94% of the sector’s organizations, which range from daycare centers and after-school programs to neighborhood health clinics and job-training programs, create only 20% of the sector’s impact—and deserve only 20% of its resources—seems open to question.

The second piece of data relates to the fluidity of the sector’s capital or, more precisely, the lack thereof. Both society’s needs and the performance of individual organizations change over time; and this dynamism is abundantly reflected in the for-profit funding markets. In contrast, the nonprofit market is remarkably static, with certain key players retaining dominant positions for years on end. In the ten years between 1990 and 1999, for example, seven of the top ten nonprofit organizations active in the U.S. maintained and, with one exception, grew their capital position relative to the market as a whole.

Only three new organizations (Fidelity Charitable Gift Fund, The Nature Conservancy, and The Boys & Girls Club of America) joined their ranks. During this same time period, however, only three of the top ten companies dominating the for-profit capital market at the beginning of the decade remained at the top by the end, and each of those companies actually lost market share. (See Chart 18, “Financial mobility of top ten nonprofits and top ten for-profits.”)

If the sector’s capital truly were being put to its best use we would expect to see more turnover among its top-tier organizations. While the picture would probably never be as dynamic as it is in the for-profit sector, it might include at least a few more new players moving into the market and attracting funds. What we seem to have instead, however, is a scenario in which organizations with good ideas and management develop a sound capital position and are then able to maintain it for years on end. Because these organizations consistently receive the lion’s share of
available funds, small- and middle-sized nonprofits with new ideas, addressing new social needs, may find it extremely difficult to move up the ladder of capital development. In sum, scale appears to be its own reward, with little apparent consideration of distinctions between the size of an organization’s impact and the quality of that impact.

ARE RESOURCES ALLOCATED COST EFFECTIVELY?

The last characteristic of an efficient capital market is that resources are allocated on a cost-effective basis. Although we cannot draw direct comparisons, in the for-profit sector the cost of capital (in the form of the interest rate) is clearly stated up front. Moreover, the transaction costs for both capital providers and recipients are tracked carefully and charged accordingly. By contrast, the nonprofit market has very high transaction costs for both sets of players. While the work of GuideStar makes an excellent start, it is simply not possible (yet…) to log onto the Internet and review the equivalent of a 10-K filing for a nonprofit organization or to download a “Morningstar Social Return on Investment Report” on a 501(c)(3). The lack of widely available, objective information requires each investor to do his own primary research—or simply to take the word of others when attempting to assess the viability of a given program initiative or intervention strategy.

The picture is equally murky with respect to the true costs of fundraising. The vast majority of nonprofit organizations have no system or mechanism in place to track the specific expenses incurred as a result of time spent by their executive directors and senior staff to generate funds. In fact, many nonprofits do not even report fundraising as a cost category within the 990. Consequently, any third-party efforts to make statements about “appropriate” levels of fundraising for nonprofits (either individually or in the aggregate) are largely useless. The available information simply does not allow us to engage in such analysis or draw such conclusions.
Chart 17: For-profit capital sources and benchmarks by life stage, 1998

<table>
<thead>
<tr>
<th>Life Stage</th>
<th>Average Revenues</th>
<th>Debt/Equity Ratio</th>
<th>Equity</th>
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<tr>
<td>Seed/Start-Up</td>
<td>&lt;$1M</td>
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<td>Owner’s equity, Friends &amp; family (private placement), Angel investors, Venture Capital</td>
<td>Banks/other Financial Institutions, Mortgages, Lines of credit, Accounts receivable financing, Trade credit, Small Business Administration loans</td>
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<td>Mezzanine</td>
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<td>Retained earnings, Mezzanine venture capital, Angel investors</td>
<td>Banks/other Financial Institutions, Mortgages, Lines of credit, Accounts receivable financing, Trade credit, Small Business Administration loans</td>
<td>Trade credit, Small Business Administration loans</td>
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<tr>
<td>Late Stage</td>
<td>$10-50M</td>
<td>0.5</td>
<td>Public issue of stock, Retained earnings, Investment and subsidiary income</td>
<td>Banks/other Financial Institutions, Mortgages, Lines of credit, Accounts receivable financing, Trade credit, Bridge loans, Leasing</td>
<td>Trade credit, Bridge loans</td>
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<td>Mature</td>
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<td>0.75+</td>
<td>Retained earnings, Secondary stock issues, Preferred stock and convertibles, Investment/subsidiary income</td>
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<td>Trade credit, Bridge loans, Leasing, Bond issues (single source and syndicated), Commercial paper</td>
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Seven of the top ten nonprofits remained the same from 1990-1999 while only three of top ten for-profits remained constant during the same period.

Note: Nonprofit rankings based on revenue and for-profit companies based on market capitalization

Source: Nonprofit Times; Fortune 500 Special Issues
Epilogue

All these considerations—from ambiguous investor motives, to a limited range of financial instruments, to a scarcity of data upon which to base decisions—combine to create significant and major inefficiencies in the nonprofit funding market. And if we are to view this as a “true” capital market, it then follows that these inefficiencies must be overcome, not only by those managing nonprofit organizations attempting to create change in our world, but also by those who would support and advance their efforts.

However, there is another question we might consider. Perhaps comparing the for-profit capital market and its four components of success directly to that of the nonprofit sector is a mistake. It could be argued that since the nonprofit market arose largely in response to the failures of mainstream markets, the benchmarks of performance and efficiency for the nonprofit market should be evaluated on the basis of other, yet to be determined criteria tailored to the needs and realities of this “social capital market.”

As Ed Skloot has observed, in many ways the inquiry into this “other” type of capital market is an emerging game wherein we understand some of the rules for how the game is played, but have yet to figure out all the rules, players, or equipment necessary for it to be played with the greatest level of performance and impact. While the authors of this paper made the effort to base our discussion on the existing available data, our interpretation of that data raises a number of issues and critical questions, including:

- If the concentration of wealth in the nonprofit funding market is as described, does that wealth benefit certain segments of society more than others? The data tentatively point to the fact that much of the sector’s wealth may go to

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20 The authors thank Shari Berenbach for her framing of these questions.
institutions whose services benefit a minority of our society. Additional exploration of this issue is called for.

- The effects of scale on the relative financial capacity of nonprofits are clearly powerful. That said, several critical questions should be explored further: What constitutes optimal scale for a nonprofit organization and how is it determined? What does it take to bring an organization to scale and how can the necessary ingredients be brought to bear? What is the role of the funding market in this process? How should the market be structured to best allocate funds in support of high-performing organizations that deserve additional resources to achieve optimal scale?

- While the percentage of funding emanating from private foundations is very small, their potential influence is not. Foundations can focus their resources in a wide variety of ways to achieve their goals. In the context of this discussion, what roles might foundations play to have the greatest impact on the ability of worthy organizations to prosper and, in particular, to achieve optimal scale?

- The role of commercial banking and finance institutions in providing capital to the sector should be further explored. Perhaps these services could be extended to the benefit of additional actors in the market. Deeper analysis of this part of the capital market would both assist our understanding of how that market is constituted as well as potentially assist in additional capital being made available to a broader part of the market.

- The fact is, while many nonprofit organizations are under-capitalized, the market does work quite well for a set of larger organizations able to combine both philanthropic and conventional capital. What, then, are the best strategies for extending this capital success to other nonprofit organizations meeting the needs of less advantaged segments of society?

Over the course of the previous pages the authors have presented an initial framework for understanding how funding moves through the nonprofit sector and advanced an array of questions with regard to whether and how the organization of these funds truly represents a funding market. In some ways, this effort may raise
more questions than it answers. Indeed, we hope it does and that in this respect our readers will feel the effort has been a success. It has been said that good research doesn’t attempt to answer every question, but rather makes the effort to present to the field an understanding of the next level of inquiry. Our hope that in presenting this analysis is that we have raised a new set of questions worthy of collective pursuit.
Part III: Appendices
Sources for Data Used in this Document

The analysis presented in this paper was drawn from a number of different sources, outlined in the following chart. In addition, the researchers consulted with individuals who had gathered and used some of the same data for their own research purposes to assure that our approach was consistent with generally accepted practices.
### Methodology notes

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Bibliography

The following bibliography lists readings and research on the nonprofit sector and, specifically, nonprofit finance that The Bridgespan Group found particularly helpful. It is not a definitive bibliography on either topic.

GENERAL


FUND SOURCES


**PRACTITIONERS**


