Dynamic times: Trends, opportunities, and progress in the Canadian nonprofit sector

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Executive Summary

The public looks to nonprofits to address pressing social problems that affect the everyday and future lives of citizens. According to management guru Peter Drucker, the nonprofit organization exists to bring about change in individuals and in society (6). However, as government continues to reduce its involvement and to cut budgets for social issues, individuals are taking the lead in creating social serving nonprofit organizations. Furthermore these organizations are fighting budget cuts by diversifying their revenues streams into other primarily “for profit” areas such as commercial services. This is changing the dynamics of the nonprofit sector with respect to the private and public sectors creating new opportunities and pitfalls. The importance of the nonprofit sector will only increase, as baby boomers move into their prime giving years, they are expected to bequeath or donate billions of dollars.

This report provides a big picture view of the nonprofit sector in Canada. Our objectives are:

- To appreciate the complexities and particularities (i.e. tax exempt status) of the nonprofit sector and its interaction with government and the private sector in Canada.
- To analyze the forces impacting the nonprofit sector and how they impact its future evolution and progress.
- To make recommendations to the nonprofit, private, and public sectors for future progress such that the interests of the end beneficiaries (i.e. the community) are not forgotten.

Our approach follows three points: Trends, Opportunities, and Progress. First, we have examined the implications of the changes in both funding and responsibility in both Canada and in Europe. With increasing responsibility, individuals and communities must act as entrepreneurs for the benefit of society on both local and global fronts. Yet what the Canadian nonprofit needs is not to create more nonprofits but to better manage existing ones. We have identified key opportunities for social entrepreneurs to improve the management, marketing, and transparency of nonprofits. Finally, we have reviewed key lessons from the past both in Canada and in other countries, and created benchmarks for guiding future performance. We have also proposed frameworks which can be used for improving nonprofit performance in with regards to Transparency, Marketing, and Finance.

We feel most countries will end up adopting a similar system to that currently in place in Canada whereby the social responsibility of nonprofits is placed on society and the governance of nonprofits as a “ministry” is placed on the government. This system ensures that communities are encouraged and incentivized to ensure their well being and while governments ensure that there is minimal overlap in terms of activities and services offered.
Introduction

To further understand the importance and implications of changes in the nonprofit sector, we should consider the size of the sector. The Canadian nonprofit sector represents almost $90 billion (CDN $), or approximately 8% of GDP. In 1995, Canada had 73,000 charitable outfits registered, increasing by 200/month. These organizations paid $40 billion in salaries and benefits to 1.32 million employees, approximately 9% of the Canadian labour force. In the U.S., revenues of nonprofits have grown from less than $200 billion in 1978 to $1.1 trillion in 1993.

Due to the lack of consistent information within the sector we have chosen to focus primarily on large, multinational, health-oriented organizations in Canada for which information is more readily available. These include: The Canadian Red Cross Society, Ontario Cancer Treatment & Research Foundation, International Development Research Centre, World Vision Canada, CARE Canada, Children’s Aid Society, United Way, Heart & Stroke Foundation, Canadian Diabetes Association, Kidney Foundation, and the Canadian Cancer Society.

Trends

We will first consider recent changes in both funding and responsibility in the Canadian nonprofit sector. These findings will then be considered in a more global context by discussing recent trends in Europe.

The Canadian nonprofit sector

Decreased Government involvement
Historically, two trends have promoted closer interaction between nonprofit organizations and the state. The first arose in the 1960s when citizen activism and disillusionment with government in the led many citizens to pour their hopes and energies into movements and organizations challenging traditional government practices and representing their rights. The second trend was driven by fiscal imperatives. In the face of rising public demands for services and declining revenues, government began to cast about for alternative means of providing services more efficiently. The redefinition and streamlining of government has caused policymakers to turn to third sector organizations to deliver services that governments no longer desire to provide or are unable to provide to citizens directly (3).

Financial diversification
Nonprofit organizations have traditionally relied on approximately two thirds of their total revenue to come from government sources. This revenue is in serious decline, particularly in the health sector. In face of this, nonprofits are confronting intense competition for donated funds and donor fatigue. As a result, an escalating number of charities are competing for the same shrinking pool of donor funds (3c). Furthermore, increased rivalry from for-profit companies entering the social sector is making nonprofits seriously question the stability of their revenue streams.
In fact, nonprofits are increasingly turning to the commercial arena to leverage or replace their traditional sources of funding. While one might question their practices, nonprofits are continually searching for the holy grail of financial stability. Earned income is more stable than donations and grants. At a minimum, organizations want to diversify their funding sources to provide a cushion in case one source declines or disappears. Organizations reported the following significant changes in government funding during the 1990s (2):

- Reduction in grant funding of existing programs
- The move from long term funding (program support) to short term funding (project support)
- A shift from grant funding to contribution funding
- Increased last-minute approvals of funding to contribution funding
- Increasing requirements tied to funding, such as accounting for volunteer contributions

In their plight to seek other sources of funding, nonprofits will face operational and cultural challenges as they attempt to learn many of the practices traditionally belonging to the expertise of for-profit organizations. One of the more fundamental concerns is that nonprofits are adopting modes of operation more akin to those found in the public and private sectors which may go against their social missions.

Foot (1996), a Canadian demographics writer, suggests that an increased crossover from the public and private sectors into the non-profit sector will impact the manner in which non-profits operate. Foot offers this perspective: These are complicated organizations to run, and they are likely to become even more complicated as governments back out of the delivery of services, leaving us all more dependent than ever on nonprofit organizations for many of these services. The result will be rapid growth in the nonprofit sector and tremendous pressure on these organizations to respond to society’s new demands.

However, while many critics and analyst fear that nonprofits are being profoundly transformed due to a changing funding environment, others feel this is greatly overstated. In their study, Juillet, Andrew, Aubry, and Mrenica have found that most nonprofits have been able to respond to pressure with certain organizational resilience (3).

In our opinion, a mistake of nonprofits has been to assume that they have only two possibilities to solve their financial woes: 1. Reduce the number of programs they offer, or 2. Increase the revenue from other sources. They have another option: make better use of what they have by increasing the efficiency and effectiveness of their programs.

**Perspectives from Europe (7)**

The European Union has been hesitant in its approach toward the nonprofit sector and civil society. This set of institutions was neglected by the Treaty of Rome, signed in a period of high economic growth, low unemployment, and the East-West Cold War. As soon as nonprofit organizations are able to compete with foreign for-profits and nonprofits, government support is seen as a distortion of fair competition and is prohibited unless it is justified by a contract precisely detailing and defending the public purpose of the nonprofit organizations. That is why with Europeanization there is a danger of nonprofit organizations becoming increasingly like the business firms with which they compete. The European Treaties should be amended to take account of the nonprofit sector. The 1996 Maastricht Treaty (Article 26) and the 1998
Amsterdam Treaty (Article 38) deal with private social establishments and services and suggest cooperation between this set of institutions and European headquarters. But at present time, these articles still remain rather empty shells.

The nonprofit sector is growing much faster than the total economy (growth similar to other countries even though EU economies have been growing relatively slowly recently). The existence of a vibrant nonprofit sector is increasingly being viewed not as a luxury or a hobby for the middle class, but more and more as a necessity in Europe, a check and balance to the invasion of a world-wide market in every part of human life, and every kind of relationship.

The evident growth in nonprofit employment has been made possible not chiefly by a surge in private philanthropy or public-sector support, but by a substantial increase in fee income. The philanthropy share of total nonprofit income actually declined. The following figure shows France as an example where in only 5 years (between 1990 and 1995) fees and charges grew by 1.6% and public sector support dropped by more than 2%.

The recent increases in the number of grant-making foundations suggest a positive trend toward greater philanthropic input – a trend that needs the active encouragement of policy-makers and nonprofit leaders. The expression of private philanthropy continues to be vital to ensuring a meaningful level of independence from both government and market. Corporate philanthropy is still low, though slowly rising, and corporate foundations remain very few. To increase the number of grant-making and corporate foundations, as in other countries, policy-makers must show less suspicion toward foundations and simplify the process necessary to create foundations. Moreover, long accustomed to significant levels of public support and fee revenues increase, the nonprofit agencies are in danger of losing touch with their citizen base.

Traditionally larger government social welfare tends to be associated with larger amounts of volunteering - Western Europe shows the highest voluntary involvement making it a region with the most highly developed voluntary and nonprofit sector (however, the volunteer time goes mainly to recreation and social services).
Moreover, changes in demographics and the labor force suggest that large reservoirs of potential volunteers remain “untapped” for the expansion of the philanthropic share of nonprofit operations. Among this “untapped” corps of potential volunteers are healthy early retirees who are frequently highly skilled and who can often pull from a wealth of professional experiences. There is also an unacknowledged reservoir of volunteers among students. High schools and universities do not treat volunteer activities in the curriculum the same as they do athletics or cultural activities.

While the governments in EU are reducing costs, those in Central and Eastern Europe are spending more and more on nonprofit organizations. The revenue structure of future Europe will probably converge to some intermediate level.

In Central and Eastern Europe the nonprofit sector is growing even faster than in Western Europe but from a very low base (ca.1% of GDP). A consolidation of the sector is expected, heavily influenced by the overall economic conditions, the further development of the legislative framework (which fails to create image of trust while facilitating the nonprofit organizations to operate freely), and the political climate.

Nonprofit organizations in Central and Eastern Europe have to fight with the hostility toward them (and toward volunteerism) during the Communist era and with the excessive centralism of nonprofit finance. Here the philanthropy still accounts almost for as much as government and fees are the main source of revenues.

The nonprofit employment is devoted to different goals to a varying extent. In Western Europe, the dominance of welfare services in nonprofit employment is particularly marked. On average, three-fourths of all nonprofit employees in the Western European countries examined work in education, health, or social service organizations. A very distinguishing factor is the health sector – accounting for relatively small part - 22% in Western Europe (36% in Canada and other developed countries) - even smaller in Central and Eastern Europe (8%) where the recreation and culture takes a huge part of health and education. The growth in nonprofit employment in Western Europe is focused more on social services – 50% (vs. 15% on health).

![Figure 2: Distribution of types of nonprofits in the world (7).](image-url)
Opportunities

This section will use the trends previously examined to explore the entrepreneurial opportunities for improving the efficiency and effectiveness of the nonprofit sector in Canada.

Researchers looking at the 200,000 largest nonprofit organizations in the US (those with revenues over $25,000 per year) have discovered substantial opportunities for improvement (14). They estimate that by changing the way funds are raised nonprofits could save roughly $25 billion a year, by speeding the distribution of funds they could put an extra $30 billion to work, and more than $60 billion a year could be generated by streamlining and restructuring the way organizations provide services and by reducing administrative costs. And even more money - in fact, an amount that's impossible to estimate - could be freed up by better allocating funds among service providers (15).

According to Herzlinger in "Restoring Public Trust" (2), 4 problems stand out for nonprofits:
1. Ineffective organizations: ones that do not accomplish their social missions.
2. Inefficient organizations: ones that get too little mileage out of the money they spend. Of note are public schools, where inflation adjusted expenditures per student have risen 25% while performance measures for students have barely budged.
3. Private investment: individuals who control tax-exempt organizations attain excessive benefits for themselves.
4. Excessive risk: when organizations expose themselves to unnecessary risk to meet financial requirements.

We believe that opportunities in the sector will revolve around social entrepreneurs making the sector more efficient and effective. We have organized these opportunities in three sections: Management, Marketing, and Transparency.

Management

Nonprofit organizations require both social and commercial entrepreneurial skills in order to engage successfully in for-profit activities and not all are confident that this dual capacity can exist in charitable organizations. Moreover, obtaining these skills can prove to be costly and difficult for nonprofit agencies. The most commonly cited reasons for the paucity of program evaluation being undertaken by organizations were a lack of resources (i.e. time and/or funding that can be dedicated to a program evaluation) and a lack of in house expertise. Nonprofit organizations emulating for-profits risk facing operational and cultural problems. Commercialization requires skills, knowledge, and expertise commonly found in the for-profit sector. Thus, opportunities for experienced professionals to move to the nonprofit sector are and will continue to be abundant.
Marketing

In "Doing better at doing good" (2), the authors suggest that social marketing plans are not always adapted to their specific cases, and often fail for this very reason. Social marketers face the greatest challenge in cases where the cost is high and the personal benefit is intangible. Often managers in charge of social marketing rely too often on conventional, consumer goods oriented marketing methods to promote their missions. These are usually only effective when the benefits apparent to the customer clearly outweigh the costs. The opportunities in this case will be to create an innovative approach to nonprofit marketing to fight fatigue of donors who have grown all too accustomed to traditional non-profit sales pitches.

Transparency

Problems are amplified with nonprofit and government organizations because they lack the three basic accountability mechanisms of business: self-interest of ownership, competition which forces efficiency, and finally the profit measure.

Citizens want a way of checking out the merits of a specific organization as well as getting an overall sense of the sector's contribution to the working society. Nonprofits must respond to this need if they are to continue targeting the public for donations. To illustrate the wide ranging discrepancy of measures, consider how the often quoted total revenue figure of $86.6 billion for the Canadian sector compares to the $54.7 billion reported on tax returns (4). In 1994, more than 17,000 charities, about 1 in every 5 of these registered, didn't bother to file returns on time to Revenue Canada, and those that did frequently presented inaccurate or incomplete information. Out of these, only 3 had there charity numbers lifted for cause, another 237 withdrew from the field (5).

The nonprofit sector recognizes that it desperately needs more knowledge about: its size and composition, how it is financed, what other resources are at its disposal, where the money goes, what needs are addressed and what its "outcomes" are. This would indicate an important number of opportunities for statisticians and IT professionals. Furthermore to ensure the quality and guarantee accuracy of the data, third parties such as consultants and auditors, will be increasingly be demanded.
Progress

In this section we will review key lessons from the past both in Canada and in other countries, and create benchmarks for guiding future performance. We will also propose frameworks which can be used for improving nonprofit performance in with regards to Transparency, Marketing, and Finance. On a more long-term basis, general recommendations will be made for ensuring sustainable and beneficial growth in the nonprofit sector.

Public initiatives in Canada (3)

In February 1999, the Panel on Accountability and Governance for the Voluntary Sector (PAGVS) issued its report, *Building on Strength: Improving Governance and Accountability in the Voluntary Sector*. Five guiding principles animated the report: the need to encourage the sector's contribution in building social trust and social capital; the need to enhance its role in promoting democracy; the need to strengthen the capacity of the sector; the need to recognize the diversity of the sector; the need to respect its desire for autonomy and self-governance.

Among the many recommendations, the PAGVS identified four priorities; adoption of a good practices guide in the sector; establishment of a Voluntary Sector Commission to oversee the sector and act as a liaison with government; statutory enactment of a definition of "charity"; and negotiation of a compact between the voluntary sector and federal and provincial governments.

In June 2000, the federal government, jointly with members of the voluntary sector, announced the Voluntary Sector Initiative (VSI), which is designed to act on the recommendations of the two commissions (PAGVS, Joint Tables). An unincorporated group of national voluntary organizations, the Voluntary Sector Roundtable tasked a panel of six eminent Canadians, chaired by Ed Broadbent, former leader of the federal New Democratic Party, with the responsibility of consulting widely with the voluntary sector and advising the community on methods of improving accountability and governance in a changing environment.

For the first time in Canadian history, the Canadian government is reaching beyond the department level to engage the voluntary sector community at a more strategic level. The initiative seems to place the voluntary sector in a position to influence policy development and government design in a substantive way. Nevertheless VSI faces important challenges as it is heavily dependent on continued political enthusiasm of the government of the day and therefore vulnerable to changing political fashion.
Frameworks for improvement

Transparency and information management
Aside from employing a structured information management system, nonprofits need a framework to guide their everyday attitude to promoting transparency. We feel an adequate framework is DADS, proposed by Herzlinger (2):

**Disclosure**: Regularly publish useful measures of effectiveness such as client satisfaction.
**Analysis**: Analyze your result and understand their implications.
**Dissemination**: Make information freely available.
**Sanctions**: Penalize failure to provide useful and periodical information.

Marketing
In "Doing better at doing good" (2), the authors developed a framework to determine which causes can be promoted through conventional marketing methods, which need an alternative approach, and what options are available in the latter case. This has led to 3 key recommendations:

- Define the primary beneficiaries as specifically as possible (avoiding overly general mission statements).
- Make the benefits of the proposed behavior change to the target community as clear as possible.
- Remain "mission driven, market led", understanding the change from the viewpoint of the market, the target community, while considering the wishes of the organization's supporters (financial and other...).

Finance
Philanthropic fundraising can be time consuming and uncertain, and some analysts suggest that diversified funding can improve their efficiency and effectiveness by decreasing the need for donated funds, forcing nonprofit organizations to be more client-focused, and refocusing the organization energy on its mission (3). Specifically, cost cutting and other financial efficiency measures should be targeted at the following areas:

- Cut costs for raising and distributing funds from 18% to between 5% and 10%.
- Distribute excess funds over the next 25 years or up payout rates to 7%.
- Reduce program service costs by roughly 15% for the bottom half of performers.
- Trim administrative costs (SG&A) by 15% for the bottom half of performers.
- Increase sector effectiveness by allocating funds to organizations that produce the greatest social return.

Furthermore, developmental action must keep the social objective of nonprofits in the forefront in order to ensure the long term integrity of the sector.
Conclusions and future research areas

Clearly the nonprofit sector suffers from a lack of management expertise which can be fundamentally traced to its financial inability to attract the best professionals money can buy. However, as the sector continues to grow, a growing number of entrepreneurial opportunities exist where highly capable professionals can leverage their expertise by offering their consulting services to nonprofits. We believe this is a win-win situation where entrepreneurs can take advantage of the current inefficiencies of the sector and nonprofits can employ benchmarks and best practices to improve their performance.

With regards to government, we believe more and more countries will follow Canada’s approach where the responsibility and accountability of social programs are placed in society’s hands and government plays a “governing” role to consolidate nonprofit activity as a whole. We feel that this model ensures that society maintains responsibility while limiting overlap among activities of similar nonprofit organizations.

In the future, we would like to enlarge and intensify our benchmarking study of similar nonprofits (large health oriented multinationals) in Europe, Asia, and Australia. As we have seen, because nonprofits are highly subject to public policy, we would think it would be useful to study public policy with regards to nonprofits in other countries and analyze the measures used by nonprofits to deal with those policies.
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