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Paper Title: Understanding the Revenue Mix of Nonprofit Organizations

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Summary of Research

This paper sketches a theory of nonprofit revenue portfolio composition and tests hypotheses using IRS 990 data for three narrowly defined nonprofit industries. First,we posit that the more closely an organization's output resembles a public good the more it will depend on non-earned income. Second, diversification of a nonprofit's income is related to its need to manage risk. Third, diversification of income may be understood in terms of organizational life cycles - young nonprofits are likely to depend on fewer sources of income while mature ones are likely to seek stability through diversification over time.

Description

Nonprofit organizations finance their operations through a wide variety of sources, including charitable contributions, government grants and contracts, earned revenues from fees and commercial ventures, and returns on investment. Earlier research has demonstrated that the content and variation of nonprofit revenue portfolios varies by broad fields of service. There is some evidence also that revenue diversification may be positively related to the size of a nonprofit organization, as measured by its asset base, to indicators of financial health, such as operating surpluses, and to a relative reliance on donations compared to earned income (Chang and Tuckman, 1994). However, an explicit theory of nonprofit revenue portfolio composition remains to be developed, and hypotheses concerning both the degree of revenue diversification and the specific content of nonprofit revenue portfolios, generated from such theory, are yet to be tested empirically.

The present paper proposes to sketch a theory of nonprofit revenue portfolio composition and to test propositions from that theory using sample data from IRS 990 forms for three different narrowly defined nonprofit industries. Three strands of theory will be explored. First, the dependence of a nonprofit organization on a particular type of revenue will be considered in the context of public goods theory. Here it is expected that the more closely an organization's output corresponds to the character of a public good (in terms of nonrivalry and nonexcludability) the more it will depend on non-earned income sources such as gifts and grants. Second, the diversification of a nonprofit's income portfolio may be related to its need to manage risk. Hence, the portfolio management concepts of finance theory come into play. According to this viewpoint, organizations with a weak asset base, or in a volatile field of service, or located in a region that is less supportive of nonprofit organizations, are more likely to diversify their sources of funds. Moreover, larger organizations, which can be expected to contain more organizational slack, may be less at risk than smaller ones, hence less inclined to diversify. Third, diversification of nonprofit's income portfolio may be understood in terms of organizational life cycle theory. Here, one may expect that a young nonprofit is likely to depend on fewer sources of income than an older one. However, as an organization matures it is likely to seek stability through income diversification over time, as a way of overcoming the "liability of newness".

These three strands of theory suggest that significant differences should exist in the income portfolios of nonprofit organizations, along the following lines:

- Dependence on particular revenue sources should vary by nonprofit industry according to the public/private character of the services provided, and perhaps by the philanthropic generosity of the region in which they are located

- Diversification of revenue sources should vary by nonprofit industry, asset base, organizational size, organizational age and location

This paper will develop the above theory into formal hypotheses for testing, using samples from three fairly narrowly defined nonprofit industries as selected from the National Taxonomy of Exempt Entities (NTEE) – specifically, Performing Arts Centers (NTEE code A61), Community Health Systems (NTEE code E21) and Environmental Beautification and Open Spaces (NTEE code C50). (Roughly speaking, these categories represent a progression from more private type to more public type goods.) Samples of approximately 100 each have been randomly selected within these categories from the 990 forms for the years 2000 to 2002.

Multiple regression models with the following dependent variables - a Herfindahl index to describe revenue diversification, and percentage of revenues from earned income sources and non-earned income sources to describe specific revenue dependencies – will be estimated, with independent variables including industry dummies, size as measured by budgets, assets or employment; organizational age since incorporation; region and urban/rural location. Results of the regression analyses will be interpreted in light of the theories described, and recommendations will be made for further data collection, analyses and theory refinement, to advance general understanding of revenue portfolio development by nonprofit organizations in alternative circumstances.

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