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*Nonprofit Managers and the Economy*

by *Russell A. Cargo*

The economy has nonprofit managers concerned. A downturn in the economy such as we have recently experienced affects all sources of nonprofit revenue - donations, government funding, fees for service, and investment income. What should nonprofit managers be most concerned about in the current situation and what should they do about it?

First, it is important to appreciate that the current economic situation may not be as dire as many think. Some good news is coming from economic indicators that appear to signal that the recession, officially begun in March 2001, will not last long and recovery may already be underway. For example, the monthly unemployment rate that rose to 5.8% in December 2001 is just under the average annual unemployment rate of 5.94% for the past 40 years. In addition, the rate of new unemployment claims slowed dramatically in December 2001 and in the first week of January 2002. Some analysts believe this marks a turning point in the recession and the beginning of a rebound in employment.

The Wall Street Journal recently reported on three other factors that point to a recovering economy. Corporate earnings forecasts are showing signs of improvement. Even if they are not reporting record earnings, corporations are at least not issuing warnings of larger than expected losses. Another welcome indicator is that business is beginning to report lower inventories. That means manufacturing will pick up when inventories are depleted, probably resulting in some job creation. The third encouraging signal is a rebound in technology investments. The technology sector was badly hurt in the past two years. Purchases of technology will boost sales and cause production to increase. The use of technology will help companies operate more efficiently and be more competitive in the global marketplace. Such positive conditions are likely to encourage investments and increase stock prices.

These trends point to the beginnings of a recovery. Still, we continue to read about the nonprofit sector's worries about the economy's performance and how nonprofit leaders and managers should respond to it. Hence, let's consider the impacts of the economy on the four different sources of nonprofit revenue.

A substantial portion of nonprofit revenue comes from donations. The American Association of Fund Raising Counsel's Trust for Philanthropy reported that \$203.45 billion were donated to nonprofits in 2000. Thus, a significant decrease in charitable donations has the potential to seriously hurt nonprofit organizations across key segments of the sector. According to Lester Salamon's research, arts and entertainment nonprofits receive about

41% and human service organizations receive about 20% of their total revenues from donations. Almost half of the colleges and universities in the United States are private nonprofit organizations that count on donations for 13% of their total revenue.<sup>1</sup> Health care receives almost \$19 billion in donations each year.<sup>2</sup>

The current concern about donations has been sparked by documented declines in giving in the second half of 2001. The reductions in giving seem to be connected with the recession, a fall-off from direct mail solicitations due to the anthrax scare, and perhaps to a degree by the controversy surrounding the distribution of funds earmarked for 9/11 programs. The Center on Philanthropy at Indiana University reported that their Philanthropic Giving Index was down 8.2% in the post-September 11<sup>th</sup> period. However, this index only provides a snapshot of attitudes at the time of the survey and does not measure the resilience of America's philanthropy.

There is also some good news about donations. Certain nonprofits have actually reported increases in donations and many are reporting that their donated revenues are holding steady. It may be that the biggest impact of 9/11 was delayed giving, not a suspension or reduction of giving. Individuals, more than institutional donors, were staggered for a period of time, but have begun to recover their philanthropic strides. For the last months of 2001, individual giving, which constitutes about 85% of all charitable donations, will not register a significant decline. Perhaps most damage to nonprofits will have come from the re-direction of donations to respond directly to 9/11 and to recession-induced needs for increased human services. Although individual giving may be re-directed in the short-term, total giving will likely remain steady, and it is doubtful that money will be permanently re-directed in any significant way.

The response in foundations giving has centered on the uncertainty of the stock market and the effect market performance will have on the value of foundation investment portfolios. This raises the general issue of investment income, for all nonprofits with endowments and securities investments, as well as grant-giving foundations in particular. After a decade of a remarkable bull market that allowed investment portfolios to experience phenomenal growth, foundations and other nonprofits have reacted to the recession with understandable alarm. How do they preserve their assets and what obligations can they make, given an uncertain future? Suddenly expanded social needs and changing national priorities have sparked a wholesale review of giving interests and strategies. Future foundation giving policy is being decided against the backdrop of both the recession and the dramatic consequences of the terrorist attacks.

It is useful to place these worries in perspective as well. Over the long term, the market has done well. Its remarkable growth in the past several years has accounted for huge gains to nonprofit asset bases. Although not clearly reported in the news, the sizable jumps in foundation assets from 1994 to 2000, overshadow recent portfolio losses. With the stock

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<sup>1</sup> Salamon, Lester. American's Nonprofit Sector: A Primer. 2ed. New York: The Foundation Center, 1999.

<sup>2</sup> AAFRC, Giving USA – 2000, New York: AAFRC, 2001.

market off to a relatively strong start during the first weeks of trading in 2002, there is reason for optimism. Foundations and other nonprofits with conservative investment policies and diversified portfolios can be cautiously optimistic about returns on their investment income. Most foundations that have been seriously hurt are those that have their investments tied to a single stock. Unfortunately, despite the well-known benefits of diversification, several notable foundations must maintain that arrangement, due to legally backed donor constraints.

What about earned income from fees and charges? This is a major and fastest growing source of nonprofit revenues, especially significant in certain sub-sectors such as arts and education. Overall, U.S. nonprofits receive more than a third of their income from this source. There are recent indications that loss of fee income has been a serious problem for some nonprofits. Arts organizations in lower Manhattan have obviously have suffered the most because of 9/11. Overall, however, the impact on nonprofit revenues of economic recession is necessarily mixed. Those organizations that produce services whose demand is income elastic - where consumers can cut back usage or choose cheaper alternatives when they feel an economic pinch, suffer more than organizations that produce essential services for which there is little choice. (Indeed the economic demand for services of some nonprofits increases in a recession.) Performing arts and private education are more likely to suffer losses of earned income than health care, for example. As the economic picture improves, so should the earned income prospects of those nonprofits that have experienced the most serious losses in the recent economic downturn.

Finally, one area where the economic prospects for nonprofits remain of great concern is revenue from government sources, which accounts for a third of total nonprofit revenues. For nonprofits, possibly the most serious fall-out from the recession and 9/11 is the sudden and serious impact those events have had on government budgets. Increased security costs, unemployment benefits, and other human service expenses were coincident with a sudden decrease in tax revenues due to the recession and tax cuts. In most areas, the recession has badly hurt tax revenues. The likely result of these rising costs and decreased revenues will be a negative impact on nonprofit funding. The stress will be concentrated in the areas where nonprofits are the delivery vehicles for human services. However, most government-funded nonprofits should be prepared for reduced funding. Tax receipts lag economic changes and government is slow to react to sudden changes in revenue. Thus, while everyone's focus has been on the recession, the full impact on the public sector is only now being felt.

If there is any way in which nonprofit managers need to refocus themselves as a result of changes in the economy, it is that they need to pay closer attention to the decisions being made in government budget committee meetings. As nonprofits assess their projected revenues in the coming years, they must ask how much they are counting on from government sources. In human services, almost 37%, of revenue comes from government. That is one area where the problems are likely to be encountered in the coming year. Fiscal pressures on government are real and substantial, and likely will endure for some time to

come. Nonprofit managers must monitor government budget processes and make sure they understand the latitude they have in engaging legislators and executive branch officials to advocate for the mission of their nonprofit organizations. Many nonprofits are scared off by the “no lobbying” myth, but this is certainly a time to learn the rules and exercise responsibility as stewards of organizations operated in the public interest. Advocacy work is not just permissible, but at this time it is critical for those organizations that count on government funding to support services for their clientele.

Nonprofit managers must understand how changes in the economy can impact their financial stability if they are to respond with wise economic decisions and strategies for their organizations.

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