

**A COMPARATIVE EXAMINATION OF THE REVENUE STRUCTURE OF SOCIAL  
ENTERPRISES AND TRADITIONAL NONPROFITS IN MARYLAND**

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## **Abstract**

The debate over the viability of Social Enterprise echoes the broader inquiry into the merits of New Public Management (Light 2008). As with New Public Management, Social Enterprise presents an opportunity to increase the level of local control in the delivery of social services (Alvord, Brown et al. 2004; Nicholas 2005). It offers the opportunity to reduce the size of government (Light 2008), both as a direct actor and as a funder of contract services (Kucher 2011; Kucher 2012). Social Enterprise can also be subject to just as much ambiguity and loss of direction and control as the outsourcing and subcontracting aspects of New Public Management (Edwards 2008). If viable, an independent organization that is self-funding and not reliant on government funds to deliver social services may also represent a new manifestation of the concept of privatization, and change the nature of the relationships within public-private partnerships.

There has been significant academic inquiry and debate in the field of social entrepreneurship regarding terminology and taxonomy. There has also been some work done in defining and determining qualitative distinctions between nonprofits and social enterprises (Di Domenico, Haugh et al. 2010). However, there has been little research done on specific quantitative differences in financing strategies among firms with a social focus. This research develops a model for determining if such systematic differences exist and then tests the potential for generalizability of the model by examining certain financial ratios for a sample of organizations taken from a population of 5,781 nonprofits within the state of Maryland.

The model is examined through a series of financial ratio analyses that compare revenue sources for each entity and examine aspects of the financial condition of the organizations in the sample. These ratios because they are either generally accepted indicators of financial health in

nonprofits (Zietlow, Hankin et al. 2007) or they are often used in the debate on social entrepreneurship (Dart 2004; Edwards 2008).

Study findings indicate there are distinct differences in the financial conditions of a social enterprise as compared to either a high performing or average nonprofit. However, those distinctions do not support the idea that social enterprise is a unique practice. Further, the model has specific strengths but also a number of points where further research could refine this work.

This study adds to the literature by helping to resolve the debate over the emergence of social enterprise and social entrepreneurship, specifically of there is any actual difference between organizations that consider themselves social enterprises and those that do not. It also aids in the evaluation of the potential usefulness of social entrepreneurship as a tool for social change, and may help inform administrative and policy decisions in both the public and the private sector.

## **CHAPTER 1**

### **INTRODUCTION & OVERVIEW**

## Introduction

*"Different men seek after happiness in different ways and by different means, and so make for themselves different modes of life and forms of government."*

Aristotle –Politics – Book Seven Part VIII – 350 B.C.E.

*"It's very hard from a distance to figure out who has lost their minds. One party, the other party, all of us, the president."* -Democratic Missouri Sen. Claire McCaskill commenting on the U.S. Government shutdown of October 1, 2013<sup>1</sup>

*"Whether the true size of government has expanded or contracted depends almost entirely on how one sorts the dates and the data"* – Paul C. Light – The True Size of Government - 1999

The debate over the role of government in society is as old as the hills and as recent as today's headlines. From the earliest parts of society to the October 2013 shutdown of the US Federal Government, this debate often centers on money. The discussion of how society cares for the less fortunate is equally long standing, and just as contentious. It too comes down to how that care will be funded. Historically, charity has been the primary means of support for the underserved. It is only with the last 100 years that Governments have become a significant factor in the creation and delivery of social programs on a broad scale (Hall 2010; Zunz 2012). How much this role of government as a provider of social services has affected the size and scope of the U.S government is a matter of debate (Light 1999).

As the role of caring for the less fortunate began to shift toward the government, academic inquiry in the field of Public Administration began to consider how best to provide social services and manage the process of service delivery within a theoretical framework known

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<sup>1</sup> Time Magazine, 10/1/13 - <http://swampland.time.com/2013/10/01/12-quotes-about-the-government-shutdown/>



as New Public Management (Osborne and Gaebler 1992; Felts and Jos 2000). One of the main areas of debate and discussion is the role of government in the process (Freeman 2009). On one side of the issue are those who think that the government should be a direct provider of services (Brooks 2000). The opposing view is that government should set policy and provide funding, but leave the implementation to community issues (Maskin and Tirole 2008). The role of local implementation often falls to a nonprofit organization (Light 1999). Recent strategies to address this tension include the creation and administration of Federal Block Grants, Public-Private Partnerships, Government contracting and privatization, among others (Dilger and Boyd 2013).

A recent movement in the nonprofit sector may cause the debates in these issues to shift. The emergence of the Social Entrepreneurship movement, and its focus on innovative funding techniques for social programs could change the way that government interacts with the social sector; shifting the role of government in social services from a funder and enabler into a regulator. If that role is to shift, the uniqueness of the funding model for social entrepreneurship must be demonstrated. This study seeks to introduce and test a quantitative process for evaluating the effectiveness of this concept as it plays out in practice.

The economic recession that began in the United States in 2008 has caused a significant strain on the operating budgets of local and state governments. This strain has caused many government officials to search for new and previously untapped sources of revenue to help close budget deficits. Many of them have examined the reduction or elimination of the tax exemptions currently afforded to nonprofit entities (those organizations approved by the Internal Revenue Service as exempt from federal income tax) (Lustig 2010).

Throughout the U.S., state and municipal governments are examining a broad array of potential reductions or eliminations of various tax exemptions used to support nonprofits (Cohen

2010). In 2010, The City of Baltimore attempted to pass a “bed tax” that would generate revenue from area hospitals and universities who use city services without directly contributing to the tax base (Scharper 2010). This new financial pressure has revived a long-standing debate in the U.S. regarding the appropriate balance between market-based opportunities and the need to care for humankind (Okun 1975).

In a similar fashion, the 2008 recession has caused reductions in charitable contributions due to reductions in personal, corporate and institutional wealth (Wallace 2009). It has also accelerated a growing desire among philanthropic entities and individuals to see nonprofit organizations develop strategies that reduce or eliminate their dependence on charitable income for long term operating support (Bugg-Levine and Emerson 2011).

Nonprofit leaders, their supporters and their funders are increasingly turning to the idea that social entrepreneurship may be a means to address this tension, through the creation and development of a social enterprise (Taylor 2010). Social entrepreneurship is gaining attention as a valid field for academic inquiry and a useful financial model for funding a nonprofit organization’s social mission and driving social change (Bornstein 2007; Yunus and Weber 2007). Much has been made of the development of this concept of social entrepreneurship. Scholarly articles on the topic consistently begin with the acknowledgement that it is an emerging and ill-defined field, with much need for further research (Nicholls 2010). A movement (Yunus and Weber 2007), a debate (Light 2008), an idea (Di Domenico, Haugh et al. 2010), a debacle (Edwards 2008) – social entrepreneurship has been called all these and much more. Proponents say it is a better way to fund, organize or implement a social benefit program (Egger and Yoon 2004; Yunus and Weber 2007). Detractors say it is a fancy label for nothing new, and may even cause an otherwise well-run nonprofit to lose focus and drift away from its

mission (Edwards 2008). Notably, most of the writing comes from case studies and general assertions rather than empirically informed inferences.

This research examines this criticism and advances the debate regarding this new approach by making a more specific determination of the unique qualities that may exist in an organization that considers itself a social enterprise. If this new model creates an organization that is truly unique, it may present an innovative solution that would allow the delivery of social services to continue while improving the tax revenue to governments.

The primary issue this research addresses is the question of the viability and usefulness of an alternative model for funding a social mission. This question falls within the theoretical context of theories of government, and the concepts around New Public Management; wherein market oriented disciplines and practices are employed as tools for increased efficiencies, better decisions and improved results in the delivery of social services (Kelman 2002; Kettl 2005). Specifically, if social enterprise is viable, it has the potential to reshape the concepts of marketization and privatization that have been developed within the New Public Management framework (Walsh 1995). In the current context, privatization is viewed as beneficial due to the potential for increased efficiencies and reduced costs that may be derived by introducing competitive vendor bidding into the delivery of social and government services (Kelman 2002; Kettl 2005). A viable social enterprise might instead be a method by which governments could reduce public sector deficits without sacrificing needed social services (Kucher 2012).

In the same fashion, if viable as a distinct model for operating a venture that produces both economic and social benefit; social enterprise could provide a third option for resolving the tension between an efficient economic process and an equitable society (Okun 1975). This issue

is also relevant to the New Public Management discussion, specifically in regard to the debate on the role of government (Osborne and Gaebler 1992). As one of the current functions of government is to provide a safety net to society's less fortunate (Salamon 1995), a viable social enterprise could perform the same function without having to depend on government funding.

Finally, it must be noted that, in addition to the limited number of empirical studies in this field, there are few scholarly works within a specific Public Administration context that directly address social entrepreneurship and social enterprise. It is hoped that this work will take a few small steps toward opening a line of inquiry in that regard, in order to further inform the debate on the role of government and the issues of New Public Management.

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**CHAPTER 2**  
**LITERATURE REVIEW**

### **Literature Review Process**

As an emerging field of inquiry, the scholarly discussions and perspectives relevant to building the appropriate theoretical framework for this research are disparate and come from a number of disciplines (Kuhn 1970). Further, the concept of social entrepreneurship itself represents the blending of two somewhat divergent fields: the notion of generating earned income in support of a social mission and the use of entrepreneurial approaches to addressing social concerns (Dees 2008). Accordingly, a review of relevant literature will span a range of academic disciplines and perspectives. Specific search terms employed to develop this review include:

Public Finance	Taxation and Nonprofits	Social Change Theory
Social Enterprise	Social Entrepreneurship	Entrepreneurship
Economic Development	Public Administration	Public-Private Partnership
Public Policy	Nonprofit Organizations	Voluntary Action
Philanthropy	Civil Society	

Much of the relevant literature comes from research within the field of Entrepreneurship. Other relevant research comes from scholarship focused on nonprofit organizations. A few scholars working in the field of Public Administration have also produced work that contributes to the foundations for this research (Eikenberry and Kluver 2004; Korosec and Berman 2006; Lohmann 2007; Light 2008; Bielefeld 2009).

After setting a historical context for this work, the review of relevant literature begins with the basics of how social services in general and nonprofits in particular receive the funds needed to provide their services to their constituents. It then moves to the factors that have brought rise to the concepts of social entrepreneurship and social enterprise; followed by the key

issues that lead to the questions this research addresses. This chapter concludes with a section on the specific Public Administration literature that addresses this topic.

### **Historical Contexts**

Americans possess a strong belief in the ability of coordinated action to improve social conditions and quality of life. This belief takes a distinctive shape in that it seeks to balance the American principles of individuality and independence against the equally strong desire to care for and support each other as members of a community and a common society. This unique form is what has become known as the nonprofit sector (Salamon 2002). A relatively recent concept, the notion of a specific, structured “sector” did not take full shape in the United States until the 1970s. Around the world, most NGOs (Non-governmental entities, as they are known outside the U.S.) have only been formed in the last 40 years (Hall 2010). However, the underlying concepts go back much further.

#### **Historical roots of charitable behavior**

Humans have been joining in voluntary assembly and organization for thousands of years; be it for purposes of religious worship (churches, synagogues and mosques), education (universities) or the enhancement of trade (trade guilds and merchant associations) (Clark 2007; Hall 2010). In most developed countries, providing financial support for charitable activities is considered to be part of the normal behavior of a responsible citizen (Robbins 2006). The roots of this behavior reach back to early recorded history.

The early writings of the Judaic code are one of the first places where the moral and ethical compulsion to care for our fellow human is expressed. The obligation to perform charitable behaviors (giving money to the poor, providing hospitality to those less fortunate, or caring for the orphan, widow or refugee) is expressed consistently in sacred Hebrew texts

(Robbins 2006). Early Jewish historians also record examples of organized charitable behavior in the form of communal kitchens that travelers and the underprivileged were welcomed, and the development and operation of organized funds that would collect individual contributions and direct a coordinated funding effort toward a specific cause or concern (Robbins 2006).

The specific notion of philanthropy has its roots in ancient Greece, where the term was used to describe an act of extraordinary generosity (Robbins 2006). Wealth that was created by a specific individual was viewed as essentially a community asset. Consequently, Greek citizens who had obtained significant wealth were expected to provide financial support for civic projects such as the construction and maintenance of public buildings. Support for the arts, intellectual inquiry and philosophical analysis was also expected (Robbins 2006). Greek society also developed a series of rules and protocols that outlined how these duties were to be discharged (Robbins 2006). While these rules were not codified into law, a citizen who did not live up to his obligations could expect to face significant public derision and disgrace. As ordinary citizens served as jurors in public courts, negative opinions of a wealthy individual could have an indirect negative effect on the outcome of a legal proceeding (Robbins 2006). This failure to perform one's civic duty might also have a negative impact on business affairs as the individual would be viewed as less trustworthy (Robbins 2006).

As the Roman culture began to develop just to the north, it not only adopted many of these concepts but enhanced and expanded them (Cameron 1993; Gombrich 2005; Robbins 2006). Two noted Roman Philosophers (Cicero – *On Duties*, and Seneca – *On Benefits*) published texts that spelled out not only philanthropic duties and obligations, but also the means and methods for how to perform these duties (Robbins 2006). Roman society also provides the earliest known examples of philanthropic behavior being codified into law, with the creation of



a civic trust that would receive and hold individual donations and then disburse them for charitable purposes (Robbins 2006). As this body of law developed, it also expanded into regulations regarding posthumous bequests as well as the development of mutual benefit societies, commercial guilds and intellectual societies (Robbins 2006).

The development of Christianity represents the next stage in the growth of philanthropic behavior as a moral and ethical obligation of humankind (Robbins 2006). Drawing directly on the Jewish tradition of care for humankind, the Christian notions of charity, hospitality and generosity moved the Greek and Roman concepts from an obligation of those with wealth to a duty for all peoples regardless of social or economic standing (Robbins 2006). No brief overview can properly serve to fully describe the depth and breadth of Christian texts on the subject of charity. However, it is safe to say that the concept that fair to say that the notion of charity as an obligation for all and not just the privileged few was a significant step forward for society. As the Christian church grew and became established, it also came to play a central role in the collection and distribution of charitable funds; as well as becoming the conduit for the delivery of social services to those in need (Robbins 2006). Some historians point to the 3<sup>rd</sup> century CE as the time when the first notions of what we now know as a hospital began to take shape in society, enabled and supported by the Catholic church (Robbins 2006).

After the Western Roman Empire collapsed, the Byzantine Empire began to grow. Along with that growth came the development of philanthropic organizations with identities and legal status separate and distinct from the church (Cameron 1993; Gombrich 2005; Robbins 2006). This period also provides the first evidence of exemption from tax being granted to a charitable organization (Robbins 2006). As this practice continued to expand, charitable organizations began to develop staff and organizational structures with professional managers and structured

fundraising programs. It may be that the late Byzantine era – circa 1100 CE, was the first time that something resembling an organized and structured philanthropic sector existed in society (Robbins 2006). A significant advancement in structured philanthropy occurred as the city/state began to develop in the middle ages (a period in history that will also be shown to be pivotal when this study turns to the development of public finance) (Drucker 1993; Robbins 2006).

As the city began to gain strength as an economic and cultural force, philanthropic activity as a centralized and coordinated activity of the church fell further out of practice in favor of efforts that were organized locally and directed to local needs (Robbins 2006). This breaking away from the structures of the Catholic Church also was seen in the founding and growth of the Church of England and its separation from papal authority in the 14<sup>th</sup> century (Gombrich 2005). A landmark development in the history of philanthropy occurred two hundred years later when the British parliament, during the court of Queen Elizabeth, ratified the Statute of Charitable uses in 1601 (Robbins 2006). This act specified what sort of charitable cause could be supported by philanthropic trusts – including assistance to the poor, care for orphans, the promotion of higher learning and the advancement of religion (Robbins 2006). This period also saw a change in the philosophical approach to the application of philanthropic activity, toward the notion of making investments in projects that would raise the social standing of those receiving support through training and education and away from only meeting the direct needs of the recipient (Robbins 2006). This notion of active, organized philanthropy continued to spread over the next 100 years.

As the merchant economy began to produce a middle class that had some level of wealth and stability, it also fostered the role of a charitable organization as a conduit for individual donors to contribute to a cause that they might not be able to support without a collective process

for gathering and distributing funds (Robbins 2006). As Europeans began to colonize the North American continent, they brought these ideas with them.

### Historical development of nonprofits in America

The fundamental legal aspects of the modern U.S. nonprofit – the trust and the corporation – existed in colonial America (Hall 2006; Hall 2010). However, the distinctions between the public and private sector were murky and ill-defined (Robbins 2006). For example, all legal organized corporations were considered public entities, and most were established for the purposes we now ascribe to government (municipal corporations, townships and the like) (Hall 2010). While charitable giving was certainly active, the recipient was usually some sort of governmental entity, and the gift was given for purposes such as public libraries, courthouses, and other public uses (Hall 2006; Arnsberger, Ludlum et al. 2008). This was also a time when a number of founding donors established what would become major academic institutions (Harvard, William and Mary, Yale). However, these colleges were viewed at that time as public corporations and were subject to legislative supervision (Hall 2006). Religious congregations were also considered to be public corporations as well. Most of these institutions (municipalities, colleges and churches alike) received charitable support in the form of gifts or bequests and held them in some sort of trust agreement (Hall 2010). Citizens also contributed to the public good through physical labor, supporting projects like building and maintain roads, maintaining militia, constructing meeting houses and other activities. However, this work was not done in the same volunteer mode as we know it today. Rather, it was a common means of paying taxes in an economy where barter was a common form of currency (Hall 2010).

Even though these entities were quite different from what we know as nonprofits today, they did have several traits in common. First, they were self-governing, with formal leadership and directors organized as boards. Second, they did not have any legal ownership or stockholders. Third, they were exempt from taxation in most cases. Lastly, they were able to accept donations for charitable uses such as feeding the poor or educating the public (Hall 2010; Zunz 2012).

Economic, political and social structures became more complex and complicated as the colonies continued to grow. With this growth came new thinking about natural rights including the freedom of speech, assembly and worship as well as concerns and questions on the role of government (Hall 2010). As the unrest that led the American Revolution began to build, these new ideas often took shape in the form of voluntary associations such as the Freemasons. The “secular, translocal and transcolonial” nature of Freemasonry served as a structural model for many other groups that supported and connected many of the leaders of the revolution (Hall 2006; Arnsberger, Ludlum et al. 2008). Many religious organizations, supported by private contributions, also played an important role in organizing and supporting the war for independence (Hall 2006).

As the new republic began to take shape, Americans began to seek distinctions between society and government (Hall 2006). Many states aggressively discouraged private charity, repealing various sections of English common law regarding charities and limiting the ability of individuals to make donations to charitable organizations (Hall 2006). In 1792, the Commonwealth of Virginia abolished the laws that had been established in support of charitable trusts in the British model set 200 years earlier, going as far as to seize the assets of endowments held by the Anglican church (Hall 2010). This desire to separate public and private entities took

its first formal shape in the adoption of the first amendment to the U.S. Constitution, adopted in 1791 and establishing the concept of the separation of church and state as part of the American political fabric (Zunz 2012). Shortly thereafter, Virginia also became the first of many states to establish a state university, taking the place of the quasi-public form that had been established prior to the revolution (Hall 2010). While seeking to make these separations distinct, Americans also continued to desire the support for education, culture and science that was provided by independent charitably supported organizations (Hall 2006; Hall 2010). This tension eventually landed on the docket of the Supreme Court, which determined in *Trustees of Dartmouth v. Woodward* in 1819. This case established the private nonprofit as a distinct entity in federal law (Hall 2010).

As this framework became more generally recognized, voluntary associations played an ever increasing role in the promotion of social agendas and the delivery of support for the less fortunate (Hall 2010). This period also saw the beginnings of that we now know as organized fundraising, as well as the sales of goods and services to help fund the mission of the organization (Hall 2006). Along with the growth of large organizations with national reach such as the American Bible Society and the American Tract Society and the beginnings of national religious denominations, many smaller organizations sprang up to foster and support an ever widening range of causes and interests (Hall 2006; Hall 2010). Some sought the establishment of utopian societies that held property and the means of production in legally structured cooperatives and viewed the practice of local governance as a communal affair. Others were based on common religious principals, and some were based on concerns over the nature of commerce and capitalism (Hall 2006). The growth of these various forms of charitable organizations suggests that there were certain social needs and services that the government was

unable or unwilling to provide but were still desired by the general public (Arnsberger, Ludlum et al. 2008). While most of the work involved in caregiving, healing, education and worship had typically been the role of the family and the community (Egger and Yoon 2004; Hall 2006), the economic and social changes occurring in America fostered a transition to charitable organizations as a primary source for these services (Hall 2006).

The Civil War saw the development and growth of the many support and care organizations such as The United States Christian Commission that raised both funding and volunteer labor to care for those injured in battle (Hall 2010; Zunz 2012). Voluntary organizations also played a significant role in post-war reconstruction efforts (Hall 2010). The economic resurgence that came along after the war also saw the first wave of what would become the great industrialists, who became the funders of a nonprofit sector that grew at a rapid rate concomitant to the growth of the economy (Hall 2006; Zunz 2012). Large donations to major universities drove a significant expansion in academic inquiry and advanced education (Hall 2006). The expanding role of the federal government also brought about an increase in the use of private voluntary organizations as conduits for the delivery of social services funded by the government (Hall 2010). This growth also increased the level of debate over the potential negative effects of large industrial donors on the mission of the nonprofit (Hall 2006). One of these large industrial philanthropists, Andrew Carnegie, produced a series of essays on the role of philanthropy as a force in society, including a statement that charitable activity was a solution to social inequity and a force by which a competitive economy could be equitable sustained (Carnegie 1889).

The role of these industrialists become even more influential as the U.S. economy suffered a series of economic shocks including a stock market collapse in 1873, a national

railroad strike in 1877 and the Haymarket uprising in Chicago in 1886 (Arnsberger, Ludlum et al. 2008). In an attempt to establish guidelines for the behavior of these privately funded social benefit organizations, the Wilson-Gorman Tariff Act of 1894 was the first step towards the codification of nonprofit status (Arnsberger, Ludlum et al. 2008). In addition to establishing a flat 2 percent tax on corporate income, it also created an exemption for “corporations, companies or associations organized and conducted solely for charitable, religious or educational purposes”(Arnsberger, Ludlum et al. 2008). Although the Supreme Court struck down this law in 1895, the general concept of tax exemption for nonprofits was established and would serve as the foundation for tax law regarding nonprofits in the U.S (Arnsberger, Ludlum et al. 2008). The Revenue Act of 1909 brought this language forward from the 1895 statute and firmly embedded the idea of charitable tax exemptions in federal tax law (Arnsberger, Ludlum et al. 2008). In 1913, the ratification of the Sixteenth Amendment granted Congress with the power to impose and collect an income tax and the accompanying Revenue Act of 1913 used the same language as the earlier laws (Arnsberger, Ludlum et al. 2008). The Revenue Act of 1917 granted the right for individuals to deduct certain contributions made to tax-exempt organizations, and the Revenue Act of 1918 granted similar deductions for charitable bequests made as part of the execution of a will in divesting the assets of an estate (Arnsberger, Ludlum et al. 2008; Zunz 2012).

As the formal structure of the charitable sector began to take shape, a few wealthy individuals began to found and endow what would become the private charitable foundation we know today. Among these early formal organizations were the Russell Sage Foundation (1907), The Carnegie Corporation (1911) and the Rockefeller Foundation (1913) (Hall 2006; Hall 2010; Zunz 2012). As the number of appeals to donors began to grow, individual donors had little

ability to distinguish reputable organizations from those who were either less effective, less efficient or less honorable in their intent. This concern gave rise in 1910 to the first community foundation, the Cleveland Community Chest (Hall 2010). Led by a group of Cleveland businessmen, this organization would hold a single annual fund drive on behalf of all the charities in the area, then make decisions as to how to distribute the funds to those deemed most worthy (Hall 2010).

These private and civic charitable initiatives joined an already crowded field of charitable interests including the church, higher education, cultural institutions, and professional societies (Hall 2006; Hall 2010). Increased concern over inequitable social conditions (child labor, women's rights, immigration and others) also began to draw significant public attention, and an accompanying need to provide funding to support these organized advocacy movements (Hall 2010; Zunz 2012). At the same time, the first instances of professional fundraising began to appear (Hall 2010). This complexity and confusion increased the level of concern over ethical behavior in fundraising and operations of charitable entities (Hall 2010).

In 1915, the US Senate Commission on Industrial Relations held a series of hearings, including an investigation into the public influence of the private foundation on policy and government affairs (Hall 2006). One of the outcomes of these hearings was that private philanthropy began to focus more on direct social need and less on political and social change (Hall 2006). At the eve of World War 1, a spider's web of charitable interests began to coalesce into an "establishment" of socially concerned organizations and individuals, marking the beginnings of what we now know as the nonprofit sector (Hall 2006). This period also saw foundations begin to develop professional staff roles focused on the tools and techniques needed to address the social concerns the nonprofits were working on (Zunz 2012).



This same period saw the beginnings of mass production brought about by the scientific management (Hall 2006). Interestingly, many of these early efforts to make economic systems more efficient were motivated, not by interest in personal profit but by a desire to democratize social and political processes through access to goods that were previously unavailable to the general public (Hall 2010). Prominent amongst these efforts was the work of Henry Ford, who viewed the automobile as a means to liberate the public and his business as a way to provide stable jobs for the masses (Hall 2006). In fact, the Ford Motor Corporation, as originally constituted, may have been the first US example of a social enterprise (Hall 2006) – although no one would have thought of it as such at the time.

This period also saw the development of business groups aligned in service to the community through such organizations as Rotary, Lions and Kiwanis (Hall 2010). In 1922, Herbert Hoover published *American Individualism*, a book that called for trade associations to join with charitable entities to advance altruistic interests, and envisioned a society that advanced public welfare through voluntary efforts (Hall 2006; Hall 2010). Hoover also saw the potential for public-private partnerships to address issues of inequality through a coordinated effort that provided for both profit and public service (Hall 2006). Hoover's ideas never quite took hold in the US, in no small part due to the onset of the great depression. The collapse of the American economy brought with it a significant loss of faith in the ability of the private sector to provide the resources needed to care for those less fortunate (Salamon 1995). However, many of Hoover's core concepts reappeared in the Roosevelt's New Deal (Hall 2006). The fundamental structure of the National Recovery Administration relied on the cooperative relationship between philanthropy, business and government that had been outlined by Hoover (Hall 2006). After the NRA was declared unconstitutional in 1935, these same cooperative principles appeared in

organizations like the Works Projects Administration and the Civilian Conservation Corps (Hall 2010). These changes served to formalize a separation between social services delivered by the government, and those supported and delivered by private concerns (Zunz 2012).

As this nascent sector began to expand, efforts to regulate it also expanded. The Revenue Act of 1934 placed restrictions on the amount of direct lobbying a nonprofit could perform (Arnsberger, Ludlum et al. 2008). In 1936, Corporations were granted the ability to deduct charitable contributions from their tax liabilities under the Revenue Act of that year. The 1943 Revenue Act brought about the establishment of the income tax structure we know today, and required private citizens, as well as nonprofit organizations, to file a tax return and pay any income tax due as a result (Arnsberger, Ludlum et al. 2008). The implementation of this tax structure was a significant boon to the nonprofit sector. While tax rates on business income and the proceeds from estates were increased significantly, exemptions and deductions were established to encourage charitable giving to organizations designated as tax exempt under the Internal Revenue Service Guidelines (Arnsberger, Ludlum et al. 2008; Hall 2010). Obtaining nonprofit status also became a necessary requirement for an organization to receive grants and contracts from governmental agencies (Arnsberger, Ludlum et al. 2008; Zunz 2012). Subsequently, governmental support for nonprofit agencies began to increase dramatically (a trend that continues today) (Hall 2010). These changes brought about a dramatic increase in the number of nonprofit entities. – doubling in number between 1939 and 1950 and increasing by a factor of more than 20 by 1968 (Hall 2006). Taken collectively, this period marked the dawning of a nonprofit sector, as distinct from other economic or industrial activities (Hall 2006; Zunz 2012).

The Revenue Act of 1950 brought about the next significant change in the nonprofit sector. Prior to this act, tax-exempt organizations were able to earn tax-free income from activities, regardless of the presence or absence of any connection between the business activity and the mission of the organization. (Arnsberger, Ludlum et al. 2008). Faced with growing concerns that this created an unfair advantage over taxable organizations, the notion of unrelated business income was developed, and codified in the 1950 act (Arnsberger, Ludlum et al. 2008). Increasingly complex tax issues also drove a dramatic increase in the size and scope of formal charitable foundations during this time (Zunz 2012). The number of foundations with assets over \$1M grew from 203 in 1929 to almost 2,100 in 1959 (Hall 2010). Corporate foundations and structured corporate support for community projects and initiatives also grew during this period, driven in part by these same changes in tax law (Hall 2010; Zunz 2012).

By 1954, this system of tax exemptions on exceptions to exemptions had raised significant concern over the potential for abuse of the system. These concerns were addressed in the Revenue Act of 1954, which established the modern tax code and set out a classification system that granted certain tax privileges and levels of regulation to various types of entities (Hall 2006; Arnsberger, Ludlum et al. 2008). This formal structure transformed charitable contributions into a tax-driven pursuit where donations began to be constructed so as to provide maximum tax advantage to the donor (Hall 2006; Zunz 2012). The classification developed by this act included the now well-known section 501(C) which classified tax exempt organizations (Arnsberger, Ludlum et al. 2008).

These changes also drove the continued expansion of the nonprofit sector as a distinct economic force. By 1959, federal economists estimated that the combined economic impact of direct charity and voluntary labor amounted to 5 percent of the gross national product, with the

federal support of social programs adding an additional 4 percent of GNP (Zunz 2012). The tax classification system also brought about a change in how nonprofit entities were organized (Zunz 2012). While earlier organizations had been structured around fraternal concepts such as a specific place or a specific relationship amongst members, these new entities were more professionally managed, and more narrowly focused on a specific issue or cause such as civil rights, environmental causes and support for international concerns (Hall 2010; Zunz 2012). Direct government delivery and funding of social programs grew significantly during this time. The Economic Opportunity Act of 1964 created a network of nonprofit entities funded by the Federal government that sought to address anti-poverty issues, with over 900 programs receiving Federal funding for programs in more than 1,000 counties (Salamon 1995; Zunz 2012). The establishment of Medicare in 1965 established governmental reimbursement of health care costs as a cornerstone of the American health system (Salamon 1995). Amendments to the Social Security Act made in 1967 broadly expanded the scope of government contracting with nonprofit entities for the delivery of services to the aged (Salamon 1995).

Conservative backlash against this increasingly direct role in social action led to concerns about accountability amongst the growing number of private foundations, which took the form of law in the provisions of the Tax Reform Act of 1969 (Arnsberger, Ludlum et al. 2008; Zunz 2012). This legislation included the first formal definition, for tax purposes, of the charitable foundation (Arnsberger, Ludlum et al. 2008). It included a distinction between an operating foundation, where specific charitable programs were operated directly by the foundation; and non-operating foundations that were primarily grant-making entities (Arnsberger, Ludlum et al. 2008). This legislation also firmly cemented the separation between philanthropy and political life, requiring that foundations must remain non-partisan if they wish to maintain their tax-

exempt status (Zunz 2012). The act also reinforced and strengthened prohibitions on self-dealing and other abuses of fiduciary powers (Zunz 2012). This legislation also instituted a minimum annual disbursement requirement (initially set to increase over time, but subsequently fixed at 5% of assets), as well as requiring the payment of an excise tax to fund regulatory activities (Zunz 2012). If the requisite minimums were not met, the foundation would then be subject to taxation and other sanctions (Arnsberger, Ludlum et al. 2008). Further, the act increased the allowable deduction for individual contributions and expanded the tax implications of unrelated business income (Arnsberger, Ludlum et al. 2008).

The 1970s saw a dramatic increase in Federal funding for nonprofits being directed through state agencies. In 1971, the use of nonprofits to deliver social services under contract to a state amounted to less than 25 percent of the total state funding for social programs. By 1976, more than half of state level funding for social services went to nonprofits (Zunz 2012). This shift in funding sources sparked another growth spurt in the size of the nonprofit sector – by 1980, the nonprofit sector contained almost 1.2 million organizations – 336,000 religious groups, 320,000 charitable tax-exempt entities, and 526,000 non-charitable nonprofits (Hall 2010). This period also saw the development and implementation of the Federal block grant program under President Nixon's New Federalism program (Zunz 2012).

Two independent commissions formed during this time also had a strong impact on the development of nonprofits in America. The first of these was a study commissioned by the American Enterprise Institute for Public Policy Research (Salamon 1995). While the study did not result in any direct policy changes, it did represent a shift in thinking, in that it recommended that social services might best be delivered through non-governmental entities (Salamon 1995). Perhaps the most significant indication of this continued growth was the report of the Filer

Commission, delivered in 1975, which is the first known instance where the nonprofit community was formally identified as a unique economic sector (Hall 2006). The Filar report also generally accepted the expanded federal role in funding social services as an accomplished fact – particularly in direct human service programs (Zunz 2012). In part because of these two studies, nonprofits began to organize into association groups such as the Independent Sector, founded in 1979 with a mission to serve as a voice for the entire charitable community – funders and service providers (Salamon 1995). This period also saw an increase in the number of for-profit organizations that sought out and received government contracts to deliver social services (Salamon 1995).

One recommendation of the Filar commission is of particular relevance to this research. The commission recommended that the minimum payout rate for charitable foundations be reduced from 6 percent of assets to 5 percent. The intent of this recommendation was to guard against the depletion of foundation assets during an economic downturn. The recommendation was implemented in the Revenue Act of 1976 (Zunz 2012). This 5 percent cap is seen as one of the factors that are driving the expansion of social enterprise (Dees 1998) (as will be explored more fully in the ensuing pages).

This cap helped to fuel the growth of nonprofit dependence on government funding. It also generated concern about the use of government subcontracting as a tool for the delivery of social services, both in terms of government transparency and the effect that financial dependence would have on the health and independence of the nonprofit (Hall 2010; Zunz 2012) (a tension that exists to this day as will be discussed further in latter sections of this chapter). This issue was one of the social and economic concerns that drove a conservative backlash that resulted in the election of Ronald Reagan in 1980 (Hall 2006). By 1982, the federal government

had become the single largest source of funding for secular nonprofits (Hall 2010). However, the general budget cutting of the Reagan administration actually furthered the growth of the nonprofit sector as organizations began to develop sophisticated strategies for funding social missions, using budget cuts as a tool for soliciting increased private contributions (Zunz 2012). While direct government support for social programs decreased under the Reagan administration, there was a significant increase in the use of tax breaks as an incentive for the private purchase of social services such as day care and education (Zunz 2012). The ultimate effect of this policy on the level of charitable support provided by the private sector is a matter of some debate (Salamon 1995). However, it seems clear that this period in American history also was a turning point in the relative roles of government and the burgeoning social sector (Salamon 1995; Zunz 2012).

The continued push toward the privatization of the delivery of social services hit a new high with the election of George H.W. Bush, who in 1988 called for voluntary, community based organizations to be the primary venue for meeting the needs of those less fortunate (Hall 2006). However, the tax breaks and other incentives developed in the Reagan years continued and grew under Bush, further expanding the nonprofit sector and solidifying its place in the American economy (Hall 2010). The Clinton administration further expanded the role of the nonprofit as a key government partner while rolling out its “reinventing government” strategy led by Vice President Gore (Kettl 2005). By adopting Osborne and Gaebler’s notion that the role of government is to steer and not to row (Osborne and Gaebler 1992), Clinton/Gore cemented the private nonprofit as a vital and active partner in public service (Salamon 1995; Kettl 2005).

The growth of this sector, its current state and the issues of funding social programs will be addressed in subsequent pages. Prior to that review, a look at the history of the struggle for

social justice in the community to be analyzed is appropriate in order to provide additional context for this study.

### **Nonprofits and Social Justice in Maryland**

The population used in this study comes from the state of Maryland. Accordingly, an overview of the nonprofit environment in the state is appropriate in order to provide additional context for the study. While a detailed demographic description of the specific study population is provided in Chapter 4, a brief snapshot of other descriptors of the nonprofit landscape is provided here. The reader should note that the statistics reported here are not the same as those used in the formal statistical analysis performed in Chapter 4 due to differences in reporting and time frame of measurement.

The nonprofit sector in Maryland has been a significant part of the state's economy for most of its existence and is one of the state's engines of economic growth (Salamon, Berns et al. 1997). Maryland's nonprofit sector is growing, particularly in the area of government subcontracting. From 2000-2010 Maryland saw a 70% growth in public support provided to its nonprofit sector (Roeger, Blackwood et al. 2012). The overall sector grew by 42% during that same period (2000-2010) (Roeger, Blackwood et al. 2012). As of 2010, Nonprofits were a \$37B industry in Maryland (Roeger, Blackwood et al. 2012), representing 11.6% of the state's Gross Domestic Product (Nonprofits 2013).

The Internal Revenue Service reports that there are 21,374 registered nonprofit organizations in Maryland as of October, 2013 and that 7,720 filed an IRS form 990<sup>2</sup>. These organizations reported \$38.6B in revenue, which represents 13% of the Gross Domestic Product

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<sup>2</sup> See Chapter 4 for a formal review of the IRS form 990



of the state, more than twice that of the average of all states in the US (5.5%)<sup>3</sup>. 3 of the five largest employers in the state are nonprofits, with all 10 of the top 10 privately held employers also organized as nonprofits<sup>4</sup>. According to the Maryland Association of Nonprofits, these organizations are primarily small, with 77% having annual budgets of less than \$100,000<sup>5</sup>. The Maryland Nonprofits survey asks for a breakdown of areas of service for these organizations, but 47% replied as “unclassified”. The remaining 53% were distributed across a number of service areas including Human Services (16.5%), Education (10.3%), Health (8.3%), Arts, Culture and Humanities (7.3%), Crime (3.2%), Community improvement (2.9%), Environmental issues (2.7%) and Animal causes (1.9%).<sup>6</sup>

By comparison, the Nonprofit workers in the United States as a whole represent 7.7% of the workforce as of 2012 (Salamon, Sokolowski et al. 2012). To add an even broader perspective, that is slightly higher than the average of 5.2% of the workforce represented by nonprofits in an 13 country average recently reported by the United Nations (Salamon, Sokolowski et al. 2012).

### Historical perspectives

Generally speaking, the history of the social sector in Maryland follows an arc much like that of the rest of the United States. However, several unique conditions and a few outstanding moments give Maryland a distinctive place in the annals of social change. While a comprehensive history of this sector in Maryland is beyond the scope of this work, a few

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<sup>3</sup> Maryland Department of Business and Economic Development, <http://www.choosemaryland.org/factsstats/pages/faqs.aspx> accessed 11/2/13

<sup>4</sup> IBID

<sup>5</sup> Maryland Association of NonProfit Organizations <http://mdnonprofits.simplicitymetrics.com/> accessed 10/26/13

<sup>6</sup> Ibid

anecdotal illustrations are helpful in demonstrating the impact of the sector on the climate of the state.

Maryland has always been a bit different than most other states in the country in its social structure and environment, particularly when it comes to matters civil rights and social justice (Smith 2008). As with much of America, the central issues of the debate have been founded in matters of religion and race (Mills 2002). However, the ways in which these issues have manifested themselves in the social fabric of the state are somewhat unique (Smith 2008).

The founding father of the Maryland colony was the First Lord Baltimore, George Calvert. Calvert's interest in establishing this particular colony came in part from his decision in 1624 to leave the Church of England and become a Catholic (Marck 1998). Maryland quickly became known as a refuge of religious tolerance for Catholics in particular and many other faiths in general (Marck 1998). Maryland became known as "The Catholic Colony", at a time when the Catholic faith was not only a minority, but openly criticized (Marck 1998). The first American to be consecrated as a Bishop in the Catholic Church was The Rev. John Carroll of Maryland (Chapelle 2000). The first Catholic Cathedral in America was constructed (and still stands) in Baltimore, and the first Catholic Archdiocese in the country was founded in Baltimore (Chapelle 2000). One of the earliest American voices advocating for women's rights was a Marylander named Margaret Brent, who arrived in Maryland in 1638 (Chapelle 1986). In 1647, she was named the executor of the estate of Leonard Calvert (George's grandson) and used that role as a platform from which to champion a stronger role for women in society (Marck 1998), including an unsuccessful attempt to gain a seat in the Maryland General Assembly (Chapelle 1986). One of the most prominent workers on the Underground Railroad in the days leading up to the Civil War was a Maryland woman from Dorchester county named Harriet Tubman (Chapelle 1986).

The city of Baltimore, known for a time as “Mobtown” for its contentious citizenry, was the scene of a number of riots that impacted the course of social change in general and race relations in particular (Mills 2002). The most well-known of these are the civil unrest of 1861 that devolved into the firing of the first shot of what would become the U.S. Civil war (Chapelle 1986; Fuke 1999), and the disorder that occurred following the 1968 assassination of the Reverend Dr. Martin Luther King Jr. (Elfenbein, Hollowak et al. 2011). Lesser known but equally important riots occurred in 1835, when anger toward predatory practices in the banking industry served as the focal point for a growing series of race and class tensions that had been building in Baltimore for some time (Shalhope 2009) and again in 1858, when a black worker in a Fell’s Point brickyard was shot in a labor dispute – an event that served to inspire a young abolitionist by the name of Frederick Douglass (Mills 2002). Returning to modern times, the town of Cambridge, MD was a hotbed of racial unrest in the 1960’s, and the scene of a major riot in July of 1967 (Levy 2003).

On November 1, 1864, Governor Augustus Bradford signed an amendment to the Maryland constitution, setting free more than 87,000 slaves (Fuke 1999). This action was necessary because Lincoln’s 1863 Emancipation Proclamation only ended slavery in those states that had joined the confederation (Nathan 2011). This change in legal status that this act represented took a long time to filter through the social structure of the state. While the end of the war ended slavery in Maryland, it did not put an end to the attitudes and sympathies of those more friendly to the Confederate view (Pietila 2010). Even those in favor of equal status for African-Americans in Maryland debated exactly what form this equality should take (Fuke 1999). This struggle was further complicated by the fact that a significant portion of the black population in Maryland was already free. For example, At the time of the signing of the

amendment only two thousand of the twenty thousand blacks living in Baltimore were slaves (Fuke 1999). Across the state, half of Maryland's black population was already free at this time (Fuke 1999). A particularly large population of free blacks lived on the Eastern Shore of the Chesapeake (Davidson 1991). At the time of the 1835 riot, Baltimore was home to the largest population of free blacks in any city in America, and Maryland had a larger percentage of free blacks in its population than any other state in the union (Shalhope 2009).

This tension served to significantly weaken the reform efforts of both the black population in Maryland and those whites who were seeking equality on their behalf (Fuke 1999). Over the ten year period following emancipation, a parallel society had developed where the black population operated on its own, interacting with the white society when possible but working predominantly within its own realm (Fuke 1999). This bifurcated social structure was in part due to the fact that, unlike most southern states, Maryland had not formally seceded from the union (Marck 1998; Fuke 1999). For many years, Maryland in general, and Baltimore in particular, maintained a social structure that, at its best, was separate but equal; and at its worst, was still significantly unequal (Fuke 1999). Racial segregation was also codified in a series of "Jim Crow" laws, many of which remained on the books until well into the mid-1960s (Nathan 2011). It even spawned a separate newspaper, the Afro-American, founded in 1892 and still publishing to this day (Nathan 2011). Whatever progress black Marylanders were able to achieve during this time was achieved mostly through their own diligent effort (Fuke 1999).

In 1910, Maryland was the first state in the union to pass a law that prohibited blacks from moving into white neighborhoods, and vice versa (Pietila 2010). When that law was struck down by the US Supreme court in 1917, Baltimore's history of private agreements in the form of restrictive covenants took their place, and stood as a solid reinforcement of racial segregation

until they were declared unenforceable in 1948 (Pietila 2010). One interesting example of this was the development of Roland Park, initially a suburb just outside the city line, where (by virtue of restrictive covenant) Jews and Blacks were not allowed to purchase homes (Pietila 2010).

Baltimore's black population grew significantly in the 1920's and 1930's as the south suffered a series of economic crises that drove black workers to the industrial cities (Pietila 2010). The lead attorney for the plaintiff in the Supreme Court's landmark decision in *Brown V. Board of Education* was one Thurgood Marshall, a Baltimore native who was General Counsel for the National Association for the Advancement of Colored People at the time, and went on to become the first black Supreme Court justice (James 2010). Throughout his career, Marshall held an unceasing devotion to addressing what he saw as significant defects in the practical realities of American democratic process (Tushnet and Marshall 2001). Another well-known Baltimore civil rights leader of the modern era was Clarence Mitchell Jr. who served as the lead lobbyist for the NAACP for almost 30 years, and was a major force behind a long series of civil rights laws (Watson 1990). Mitchell's work carried on a great tradition of civil rights efforts lead by the Baltimore branch of the National Association for the Advancement of Colored People, which was the second oldest branch in the country, founded in 1912 (Peavler 2009). Another Maryland jurist who grew to prominence working in the civil rights struggle of the 1960s in Baltimore was Judge Robert Bell, who was to become the chief justice of the Maryland Court of Appeals. Bell was arrested in 1960 for trying to desegregate a restaurant (Nathan 2011).

The work of Marshall, Mitchell, Bell and others flows from a long line of African-American leaders who worked to make the social fabric of Maryland in general, and Baltimore in particular, more just and equitable. Leaders such as Elisha Tyson (1750-1824), William Watkins (c. 1803-c. 1858), George Hackett (1806-1870) and Isaac Myers (1835 – 1891) led

Baltimore to be viewed as the primary Black Metropolis of the 19<sup>th</sup> century (Graham 1982). It was not only the size of the black population that earned Baltimore this label, but the advocacy and intellectual pursuit of these civil leaders that were so influential at this time (Graham 1982).

The late 1960's were a pivotal time for the Social Change movement in Maryland (as it was for much of the country) as it was in May of that year that a group of Catholic anti-war activists stole and subsequently burned several hundred draft cards out of a Selective Service office in the suburban town of Catonsville, MD (Peters 2012). This act of civil disobedience, which came to be known as The Catonsville 9, was perhaps the single most impactful anti-war demonstration in the history of the U.S.(Peters 2012). Another notable moment in the Civil Rights movement of the 1960's occurred in the town of Gwynn Oak, MD on August 28, 1963 when a young African American girl rode the merry go round in Gwynn Oak Park, ending a 10 year struggle for the desegregation of the amusement park (Nathan 2011).

### Nonprofits in Maryland

Maryland also played a significant role in the growth of structured philanthropic endeavors, with the likes of Johns Hopkins, Enoch Pratt, George Peabody and others making significant donations to found the institutions that today form the core of much of the civic life of the region(Chapelle 1986). It is interesting to note that several of the more modern local philanthropic organizations in the Baltimore region were founded from fortunes made by real estate interests that profited from the blockbusting activities that occurred after World War II, fueled in large part by a mutual distrust between the Jewish and African-American communities in Baltimore (Pietila 2010).

Much of the history of the growth of this sector is held in the individual reports and filing of the various organizations. A few scholars have attempted to produce broader histories. A very interesting history of the early years is “A History of family and child welfare agencies in Baltimore, 1849-1943” (Gibson 1978). However, this study, as with other scholars who have studied the matter, focuses on a few organizations and does not provide a sector level perspective. However, a few intriguing anecdotes were uncovered and are mentioned here.

Prior to 1840, there was no real form or substance to charitable activity in Maryland other than general alms giving, poorhouses and other mostly church based activities (Gibson 1978). During the period from 1840 to 1870, some formal structuring of charitable activity began to take place in Maryland, particularly in Baltimore (Gibson 1978). The economic and social changes brought about immediately following the civil war led to a stronger demand for a more “scientific” approach to charity, in large part due to the influences of the British Charity Organization societies (Gibson 1978). Maryland’s unique position, both geographically and in terms of its political and social climate, created a climate where this concern for structured charity could grow (Gibson 1978).

Much of the growth in knowledge and expertise came from the academic community, notably The Johns Hopkins University and Goucher College (Gibson 1978). Early organized attempts to support social justice in Maryland include The Society for the Abolition of Slavery and the Relief of Poor Negroes unlawfully held in Bondage in 1798, The Society for Educating Poor and Orphan Hebrew Children in 1848 and the Hebrew Ladies Sewing Society in 1850 (Chapelle 2000).

The single largest private employer in the state of Maryland is the Johns Hopkins University system, founded in 1876 by virtue of a substantial philanthropic gift by its namesake

founder (Chapelle 2000). Other early pioneering organizations included The Association for The Improvement of the Conditions of the Poor founded in 1849, The Children’s Aid Society (1860) and the Charity Organizations Society formed in 1881 (Gibson 1978).

The roots of civic engagement and the development of the social sector in Maryland spring in large part from an early cooperative effort made by The Johns Hopkins University, The Johns Hopkins Hospital, The Baltimore YMCA and the Baltimore Charity Organization Society in the mid 1880’s (Elfenbein 2001).

While organized assistance to the poor in Maryland began to take shape after the Civil War (Elfenbein 2001) and had its first major effort in the Association for the Improvement of the Condition of the Poor in 1870 (Elfenbein 2001), it was the collaboration of these early leading institutions that pushed charitable activity forward in the region and moved it from the historical practice of direct aid and into the work of addressing a social condition (Tucker 1973; Elfenbein 2001).

Another charitable organization that had a significant impact on social change efforts in Baltimore was the YMCA (Elfenbein 1996). Interestingly enough, there was also a separate YMCA in Baltimore for young Black men (Elfenbein 1996). The Baltimore YMCA, like many of the other voluntary associations that grew in 20<sup>th</sup> century Maryland, gained strength alongside the cultural and social changes that were occurring in the state and across the US (Elfenbein 2001).

An interesting modern story of the social sector in Maryland is the founding of Tuerk House in 1970 (Alvarez 2012). This nationally renowned addiction recovery program was also founded in partnership with a major university, this time the University of Maryland Medical Center, where Dr. Isadore Tuerk had professional credentials as a psychiatrist (Alvarez 2012).



As an interesting side note, the economic pressures currently facing the nonprofit sector (discussed at greater length in further in this chapter) are not new, and certainly not new to Maryland. A report of the Baltimore Council of Social Agencies written in 1937 talks about the need for more stability in the funding of social agencies (Baltimore Council of Social 1936). A 1990 report on the Baltimore area nonprofit sector noted a “growth of fee and business income and continued lag in private support” (Salamon 1990).

### **Historical issues in funding social programs in the United States**

Having reviewed the general history of the nonprofit sector in the U.S. as well as selected highlights of specific events and programs in Maryland, a specific discussion of the means and methods for funding social programs is in order.

As discussed throughout this study, charitable care for the less fortunate was historically the role of the community and the church, with government playing a lesser role (Gombrich 2005; Robbins 2006; Clark 2007; Zunz 2012). While this was true for social programs, other government services such as roads, sanitation, public safety and justice, were often effectively delivered in partnership with various private entities (Freeman 2009). As far back as Medieval times, local government existed and functioned within a complicated alliance of landowners, trade unions, civic associations and religious societies (Freeman 2009).

The earliest examples of this system being brought to American soil are the charters that were issued by the British government to specific individuals or groups of persons to settle and cultivate territories in the colonies (Freeman 2009). The majority of the early corporate charters granted in the U.S. were awarded to organizations seeking to develop public infrastructure and

support entities (turnpike, bridge and canal companies; water supplies, fire protection, harbor services and the like) (Freeman 2009).

Even as structured philanthropy began to grow as a social factor, government funded social programs were the exception and not the rule (Zunz 2012). As the government began to become a bigger factor in supporting and delivering social programs, the effort was initially driven by local government (Blank 1997). Prior to 1930, direct public assistance was primarily delivered at the city or county level (Blank 1997). The series of federal domestic aid programs introduced from 1933-1938 (The “New Deal”) turned the tables and made the federal government a much stronger force in social programs (Salamon 1987).

Another major step forward in the expanding role of the federal government was the Great Society programs of the Johnson administration in the 1960s (Salamon 1987). As the federal government began to exert more influence (and provide more money), the mechanics of the funding process (as well as the politics) became more intricate (Wolch 1990). Issues such as accountability, local control, and equity within and among populations created tensions as the relationships between local, state and federal government as well as the nonprofit sector became more complicated (Wolch 1990; Blank 1997) Over the years, there have been numerous attempts to address these issues.

One method was the development of the Federal block grant program under President Nixon’s New Federalism program (Zunz 2012). Initially created in 1966, the first block grant was made in the area of health care services (Dilger and Boyd 2013). These programs typically consolidated numerous direct categorical grant programs into a single larger funding program where the funds were provided in a lump sum or “block”(Dilger and Boyd 2013). As the Federal government became a larger factor in funding local programs, it also began to impose greater

regulatory authority over how the money was spent (Blank 1997). Local agencies could apply for waivers, but granting such a waiver was not an automatic process (Blank 1997). President Nixon saw the Block Grant concept as a means to reduce the size and scope of the federal government, and implemented them across a broad range of initiatives, and consolidated 129 Federal grant programs into 6 general groupings (Dilger and Boyd 2013). The Block grant program grew in the Reagan administration and is still used (and actively debated) in federal policy discussions (Dilger and Boyd 2013).

One example of how the block grant process works is the Small Cities Community Development Block Grant program, which was initially administered by the U.S. Department of Housing and Urban Development and focused on the creation of affordable housing and expanded economic opportunities for low to moderate income individuals (Jennings 1986). In 1981, Congress expressly transferred the administrative responsibilities of this program to the state level (Jennings 1986). Prior to this time, the Federal Government had administered this program, along with its large city companion and other direct federal aid programs supporting work in urban renewal, sewer and water and other civic and infrastructure projects (Jennings 1986). States now had the ability to develop their own guidelines for how this money would be distributed, and reduced Federal control to the oversight of national goals for the program (Jennings 1986). This pattern was repeated in nine different Federal programs covering such areas as health, social services, education, energy and community services (Jennings 1986).

Other examples of expanded federal funding include a wide array of aid grants for everything from emergency relief to highway construction as well as loans, loan guarantees, tax subsidies, government insurance programs and many others (Salamon 1995) (it may also be noted that, as recently as 2010, the Patient Protection and Affordable Care Act included a

provision for low interest loans that were made available to establish operating reserves for nonprofit health insurance cooperatives (Cch Incorporated 2010)).

One of the goals of this initiative was to reduce the size of the federal government and reshape its role (Jennings 1986). However, the actual effect of this initiative on the size of the Federal government is a matter of debate (Wolch 1990; Light 1999). Another goal was to allow local governments a reasonable level of discretion in administering these funds so that local conditions can be acknowledged, and programs tailored to local needs (Blank 1997).

Both of these arguments are grounded in the debate over the role of government. Proponents of the block grant program believe that it is an effective tool for keeping the size of the Federal Government in check while detractors are concerned that block grants can be administered in ways that do not align with federal intent (Dilger and Boyd 2013).

More recently, the New Public Management movement has developed as a framework for both redirecting federal support to the local level and controlling its size and scope (Felts and Jos 2000). The rapid growth of this movement speaks to the American fascination with the independent actor (Felts and Jos 2000). It has also had a profound effect on the growth and expansion of the nonprofit sector (Salamon 1995).

### **Theoretical Perspectives**

The discussion of how public funding strategies brought the notions of New Public Management into the Public Administration debate forms a useful bridge between the historical and the theoretical. At the theoretical level, new public management seeks to develop a more collaborative process where the local community is able to direct the efforts of social programs in a manner that will best suit the local population in need (Agranoff 2003), thereby improving the quality of the service (Pollitt 2000). Generally considered a means to an end rather than an

end in itself, proponents of new public management also believe it to be more efficient and therefore less costly (Osborne and Gaebler 1992; Pollitt 2000). This transfer of local control is also thought to be able to provide for improved accountability (Osborne and Gaebler 1992; Pollitt 2000).

From an administrative perspective, the underlying spirit of reform at the heart of the movement has six core objectives (Kettl 2005):

- Increased Productivity
- Greater utilization of market forces as an incentive for performance
- A stronger service orientation
- Decentralization/Localization
- Increased accountability
- Increased clarity as to the role of government

The actual results of this effort are still a matter of debate (Pollitt 2000). Among the concerns of its detractors, this transfer can bring about a loss in control, an increase in costs, additional complexity, increased ambiguity and even a reduction in services due to a dearth of sufficiently qualified providers (Light 1999; Kelman 2002). Implicit within this contracting relationship are several government choices (Kelman 2002).

By contracting for a service, government is making a choice not to produce or provide a product or service itself. A second choice is made in how the relationship is managed. A contracting relationship behaves much more like a business than it does a governmental entity (Kelman 2002) and is likely to be more responsive to, and affected by, forces of competition and market dynamics (Osborne and Gaebler 1992). This market effect is one of the arguments presented to support the notion of increased efficiency and reduced cost (Walsh 1995). In social

service programs, the contract is specifically a purchase of services by the government, wherein a private organization (typically a nonprofit) is enlisted to provide the desired service at a local level (Kelman 2002).

The growth in this subcontracting of government services has produced what some refer to as a “shadow state” (Wolch 1990). It has created a complicated interdependent relationship between government and the nonprofit sector (Wolch 1990; Smith 1993). This interdependency has at times served to add complexity in a system that was intended to make the process less complex, and reduce accountability when it was intended to make government and its subcontractors more accountable (Donahue 2002). It has also been a significant factor in the growth of the nonprofit sector, making local nonprofits into government subcontractors on a wholesale basis (Salamon 1995; Light 1999). To cite one well-known example, Paul Light’s groundbreaking work, “The True Size Of Government” (1999) documents that despite a reduction of over 10% in the number of civilian employees of the federal government between 1984 and 1996; the total number of federally funded jobs increased by 20% during that same period when including workers employed by government contractors (Light 1999). Some scholars propose that this shift to federal support of nonprofits is in fact the next manifestation of the New Deal and Great Society models that came before it (Salamon 1995)

Contracting for services presents several administrative challenges for both the government and the contractor. Perhaps the biggest challenge (and hence one of the major concerns of the critics of New Public Management) is accountability (Bernstein 1991; Smith 1993). In the absence of direct supervision, the governmental agency must require (and the contractor must produce) regular reports of activity and progress toward goals (Bernstein 1991).

A reporting structure of this type imposes an administrative burden on both parties (Bernstein 1991). It also creates an opportunity for fraud (Bernstein 1991).

Another challenge that must be addressed is the management of expectations for both parties (Bernstein 1991). Even with carefully worded agreements and a close working relationship, the two parties to a contract can often have differing impressions of the goals and objectives of the contracted relationship (Bernstein 1991). Disparities in expectations can also exist due to differences in values and perspectives (Smith 1993). While governmental entities must take into account the overall good of the population, nonprofits are often focused on a specific socio-economic subset or a specific issue within the general population (Smith 1993). In extreme cases, it can create an interdependency that is almost co-dependent (Kramer 1981).

On a more practical level, serving as a government contractor can also cause challenges for the day to day operations of a nonprofit (Smith 1993). Operational cash flow can be affected by bureaucratic delays in processing invoices (Smith 1993). A nonprofit may also experience challenges in contract negotiations, either at inception or renewal as many nonprofit managers are not skilled in the tactics needed to successfully negotiate sophisticated contract relationships (Smith 1993).

A variation (or perhaps a subset) of the subcontracting of government services is the notion of privatization (Finley 1989). In this context, the contract relationship is a bit more direct and at least conceptually, objective (Finley 1989). The process of bidding for government contracts that is seen in privatization induces the forces of competition, which (theoretically) reduces cost (Finley 1989). While initially confined to service contracts, there are an increasing number of cases where physical assets such as turnpikes, bridges and airports have also been privatized (Finley 1989).

As with government subcontracting, privatization efforts seek to balance several objectives (Finley 1989). While cost is the concern most often expressed, other considerations include the impact that privatization may have on other services, the potential for disruption of service, the level of responsiveness that the service provider may produce and the overall quality and effectiveness of the service (Finley 1989). Practical matters such as the financial solvency and professional capacity of the service provider must also be taken into consideration (Finley 1989). Whether it is contracting or privatization, the underlying premise of New Public Management is that market forces can be used in a public administration context (Walsh 1995).

The fundamental tool for applying this market force is the competitive process of bidding for government contracts (Osborne and Gaebler 1992). Proponents of this model point to a historical process of a binary choice between raising taxes and cutting services in order to balance government budgets (Osborne and Gaebler 1992). The idea that competition can lower the cost of delivering a service without needing to reduce the scope of the service is developed as a third option, providing a middle ground between these two historical options (Osborne and Gaebler 1992)

The growth in popularity of social entrepreneurship (enumerated later in this chapter) comes in part from a lack of resolution in the debate on contracting and privatization (Light 2008). While entrepreneurial approaches to contracting a privatization have been held out as a “third way” (Osborne and Gaebler 1992; Light 2008), some scholars are starting to point to social entrepreneurship as another alternative that may be able to more equitably resolve the tensions that exist in New Public Management (Kucher 2012). It has been proposed that, in using market forces differently, social entrepreneurship may also be a way for government to resolve administrative challenges (Kucher 2011). Specifically:



“An interesting analogy exists in the field of economics, namely the notion of moral suasion (Romans 1966; Cochrane and Griepentrog 1977; Furfine 2006). Romans (1966) defines moral suasion as “the attempt to coerce private economic activity via governmental exhortations in directions not already defined or dictated by existing law.” This sense of persuasion as opposed to the imposition of force seems to fit well with the notion of social business. Accordingly, the use of the term “market suasion” for this practice is hereby suggested, and defined as the use of private economic activity to facilitate changes in social order or structure, or to address inequities within a society.” (Kucher 2011)

The result of this potential new use of the concepts of New Public Management would be a “well-ordered social market” where the “environmental, labor and other social aspects of products and processes of firms were fully transparent for everyone to see and judge” (Fung 2002). Such transparency would create a market where “consumers and investors could act confidently on their ethical preferences” (Fung 2002). In this model, the role of government would be to serve as a regulator, providing “structure and standards by which to adjudicate competing claims of these various associations”(Fung 2002). If such an end state is to be reached, the individual organizations participating in such a market must have unique characteristics. The nature of those characteristics, and a test to examine to what level they exist, is the subject of this study.

Having reviewed the historical contexts of this study, a review of the theoretical perspectives that form the basis of the research question is in order.

Public Finance

In a capitalist economy, private enterprise is the means by which wealth is created (Smith 1796; Baumol 2002). Although the definitions and concepts of wealth vary (Pirages 1996), for purposes of this research the term is used in the classical economic sense of the combined output of the land and labor of a society measured in monetary terms (Smith 1796; Baumol 2002). Having produced this wealth, the governmental process of a democratic society then constructs a social contract wherein the holders of the wealth transfer portions of the wealth to a governmental entity in the form of taxes and fees (Holcombe 1985). Historically, these taxes and fees have been used by local, state and federal government to fund matters that are deemed to be in the public interest. The justifications as to what makes something a matter to be publicly funded center around the rational choices that are made in determining the effect of market economic factors on the delivery of public services (Frederickson and Smith 2003). On one extreme are the conservative viewpoints that government should only fund the basics of defense, the administration of justice and selected public infrastructure. On the other end of the spectrum are the liberal perspectives that government should take a more active role in society by funding matters that can create new initiatives, change patterns in society or behavior, or balance a perceived inequality (Eckstein 1964). The public policy choices made based on a particular governmental administration's position along this spectrum then drive specific administrative choices regarding funding of programs and services, and direct and constrain the use of resources to deliver those programs (Smith 1796; Okun 1975).

These tradeoffs are also reflected in a basic tension within economic theory. On one side of this debate is the liberal economic perspective that holds that a just society exists when there is equality of opportunity (Cameron 1993; Clark 2007). This view also holds that the ultimate

output of an economic system is effectively unlimited and that the success of one actor in the system does not necessarily need to come at the expense of another (Cameron 1993; Clark 2007). On the other end of this debate is a socialist perspective that believes equality is achieved in output and distribution, that economic output is fundamentally limited, and that the advancement of one comes at the expense of another in a market system that effectively operates at a zero sum level (Holcombe 1985). The central notion in this debate is what goals or desires must be sacrificed in order to achieve the desired end.

Within the American context, this debate manifests itself in the potential tradeoffs that must be made when seeking to balance the competing objectives of an efficient economic process and an equitable society. The social fabric of the United States has tended to seek dual goals of equal opportunity and a just society. These goals would seem to be in direct conflict with each other when viewed through the traditional economic theories. In order to achieve equality, there are sacrifices that need to be made in the efficiency of a market economy, and vice-versa. This tradeoff is particularly evident when the subject is social or political rights that are distributed to the public as a whole. Seeking to achieve a balance between the two goals then forces a constant juggling act that examines each public policy in terms of both its ability to help make the economy function better and the impact that it might have across disparate social and economic classes (Okun 1975). One attempt to resolve this tension is the use of a charitable organization.

### Taxation and Nonprofits

The search for a root cause of the lack of social standing for a particular individual or group seems most often to come down to one of two sources, the individual or society. In the

former, there is an implication that for reasons of weakness or inability, certain individuals or classes of people simply “need a hand.” In the latter, the system is considered to be so flawed that it is literally impossible to change one’s lot in life without some sort of external intervention. Historically, efforts to close the gaps in social equity that are created by either of these causes has been the role of charity, either individually or collectively (Egger and Yoon 2004).

In early civilized societies, this desire to improve social equity was driven in large part by the religious community, financially supported by charitable contributions. These charitable activities have also historically been held out as separate from the commercial activities of everyday life. Further, they have been typically viewed as distinct in their economic status, specifically in that they are exempt from taxation in various forms. This tradition of tax exemption appears to be as old as the charitable activity itself, with direct references appearing in the civic codes of most ancient civilizations, as well as the vast majority of modern western societies (Colombo and Hall 1995).

As societies became more sophisticated and complex, the role of social change agent began to shift to other players. One major turning point may have been thirteenth century Europe, when the city began to re-emerge as an economic and social nexus. The development of the trade guild, the resurgence of trade between nations and continents, the transition from the monastery to the university as the center of intellectual power and the growth of the bourgeoisie brought about a number of new thoughts on social order (Drucker 1993). The reason for this and its relevance to the context for this research is quite simple. Without the proximity of one person to another and the interaction and dialogue that occurs in such communities, social organization is impossible (Spencer 1896).

As the British settled into what would become the United States of America, the English legal tradition of charitable tax exemption crossed the Atlantic along with them. As the structure of the new American society and legal system began to develop, the notion of a distinct legal status for certain ventures that served public purposes began to expand, albeit fitfully and not without extensive debate and challenge. In the United States, by the mid-19<sup>th</sup> century, the distinct legal status of charitable organizations was firmly established at the federal level (Hall 2006). However, the full implications of this distinction on the revenues of the federal and local governments were yet to be established. It would take the passage of the first federal income tax laws in 1894 (Colombo and Hall 1995) to fully understand what this distinct status would mean.

With the rise of the industrial revolution came the creation of the great family wealth (e.g. The Rockefellers, Carnegies and Vanderbilts). Along with this great wealth came an idea that charity could be done better (Drucker 1993). Rather than focus on caring for the individual in a one-to-one relationship, it was thought that society as a whole could be affected for the common good, and the idea of philanthropy began to take shape (Egger and Yoon 2004). As these great philanthropic foundations were built, the notion of qualified tax exemptions was carried forward with them (Colombo and Hall 1995).

In current practice, the charitable organization in the United States is protected from various tax implications by virtue of section 501(c) 3 of the Federal Internal Revenue code, which provides an exemption from federal income tax for entities that are organized to support certain purposes (Colombo and Hall 1995). It is also important to note that this relief from the tax burden is not done for altruistic purposes. In fact, there is a direct exchange expected from the nonprofit enterprise, namely that they are prohibited from distributing the profits of the venture to the investors and owners (Hansmann 1981). Quoting from the tax code,

“The exempt purposes set forth in section 501(c)(3) are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term charitable is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency” (IRS 2009).

This federal exemption is carried through to the state level, with the majority of states maintaining parallel statutes that support and mimic the provisions of the IRS code and its accompanying restriction on distribution of profits (Colombo and Hall 1995).

#### Public Policy Justification for Nonprofit Tax Exemption

To gain further perspective, it is necessary to briefly review the major points of support for a tax exemption for charitable ventures. One of the main theoretical constructs for the existence of a charity and its accompanying tax-exempt status is as a response to failures in the commercial market. Simply put, this theory proposes that there are certain services that nonprofit firms can perform better than for profit firms. Historically, situations that have given rise to nonprofit ventures include scenarios such as:

- when productive output is difficult to measure directly,
- where the purchaser and recipient of the service are separate and unrelated or

- where the cost of the delivery of the service is higher than the individual purchaser is willing to bear.

The relief from tax burdens then becomes an economic incentive to undertake a venture that might otherwise be undesirable (Hansmann 1986). Also within this market failure view is the notion of a public or common good. This concept holds that the market cannot be a valid method for providing a service that is not easily held in individual ownership, or that provides a service where there is not a direct link between the one who purchases the service and the one who receives it (Rose-Ackerman 1986). This version of the market failure theory is also discussed under the notion of contract failure, and proposes that the standard method of making a business agreement (namely a contract) does not work when the purchaser and the recipient are not directly related to each other. In such a case, a nonprofit becomes a proxy for either or both parties and serves an intermediary function, becoming a bridge to connect the individual or organization funding the initiative and the person or group receiving the service (Salamon 1995).

Another theory for supporting such a policy is the government failure theory, which posits that there are a number of services which society desires that the federal, state and local governmental system cannot or chooses not to address. In response to this perceived or actual lack of service, private citizens develop and support organizations, funded by donations, to provide the desired service. This theory is particularly applicable to subsets of the population that are marginalized due to economic or geographic reasons (Weisbrod 1986), and can also be stated as the notion that nonprofits supplement governmental activities (Young 2006). A branch of this theoretical perspective takes the view that nonprofits are a complement to government service in what amount to a contractor/vendor relationship wherein the governmental entity is the funder while the nonprofit delivers the service (Salamon 1987). In essence, the governmental failure in

this theory is a lack of expertise in managing and delivering the service to the population that is in need (Young 2006). In either of these two cases, the rationale for the tax exemption is that the nonprofit is providing a service that is desirable from a public policy perspective that the government is either unwilling or unable to provide. By granting tax relief, an economic incentive is provided for a private enterprise to provide the service (Hansmann 1981).

A third element of the public policy perspective on nonprofit funding is the discussion about the role of government as a primary funder of social services that are effectively sub-contracted to various nonprofits (Rose-Ackerman 1986). A 2007 study indicated that over \$1 trillion in federal funding was allocated to the support of social concerns (as opposed to education, defense or other governmental activities). Within the nonprofit sector of the economy, the primary funding source for the majority of the larger enterprises is a governmental grant, subsidy or fee for services (Wolk 2007). However, some scholars question the impact that this governmental funding has on the level of private support a charity receives; specifically whether the support of the government increases or decreases the level of private funding – essentially crowding out money that might otherwise be available to the entity providing the service (Brooks 2000).

Each of the previously stated theories assumes that a governmental entity is the most effective way to deal with the delivery of social services. Salamon (1995) proposes that it is not the government's primary role to provide for the care of the less fortunate, but the role of private citizens and the community (referred to as the voluntary sector). This voluntary sector is then the primary source of both the funding for and delivery of services that support social needs. Salamon (1995) goes on to discuss how there are inherent flaws in this process, such as insufficient funding, special interests and pet projects, and a paternalistic attitude and



ineffective leadership within the philanthropic community. Salamon (1995) also proposes that the market failure theory is flawed in its notion that government is best suited to respond to social concerns, and states that nonprofits (the “voluntary sector”) are (or at least should be) the primary response mechanism for social concerns; leaving the government to respond only when the voluntary sector is unable to do so.

### Impact of Current Events on Nonprofits

In addition to the search for governmental revenue mentioned previously, the current economic crisis has only served to heighten the tensions within each of these theories and constructs. Current worries about the future of the capitalist system (Whitehouse 2009) echo the ruminations that have been underway for many years regarding the ethical and structural flaws of an economic system that is inherently competitive (Weber 1958; Drucker 1993; Marx, Engels et al. 2002). In a similar vein, there are long standing debates over the fate of democracy itself, particularly as it relates to the notions of equity and fairness (Forelle 2009; Walker 2009).

At the same time, there are new studies that indicate that a social conscience is good for a corporation’s stock price (Kanter 2009). There are also a number of debates as to how any one of several new models of capitalism could or should work (Bishop and Green 2008; Kinsley, Clarke et al. 2008), and why it may or may not be a good idea (Guo 2006; Hartigan 2006; Edwards 2008; Riley 2009). The impact of this turbulence has been particularly significant in the nonprofit sector due to its dependence on government grants and private philanthropy for funding (Salamon 1995; Riley 2009; Wallace 2009).

### Policy Options to Address Current Challenges

Three potential options are available to address this challenge. The first is to maintain the tax exemptions for nonprofits in place. While this will certainly help to safeguard the many noble social programs that nonprofits deliver, it will not allow for any progress to be made in reducing budget shortfalls. A second option is to eliminate the tax exemption or seek an alternative method for collecting revenue from tax-exempt entities. Many U.S. government entities are using a vehicle known as Payments in lieu of Taxes (PILTs) (Flaherty 2007). While this will certainly help to generate additional tax revenue for governmental needs, it will also serve to severely constrain the delivery of social services that nonprofits provide by placing additional financial burdens on the organization. A third option is to reduce or eliminate the tax exemption while taking additional action to support the continued delivery of social services through the concept of social entrepreneurship and the development of social enterprise. Accordingly, this review now turns to the relevant literature in this developing field.

### The Emergence of Social Enterprise

The philanthropic community and the wave of nonprofit firms that it has spawned have yet to develop anything like the market and regulatory forces of commerce to oversee, organize or streamline the operations of nonprofits (Hansmann 1981; Hansmann 1986; Light 2008). Many nonprofits become billion dollar operations, and nonprofits as an economic sector represent a significant portion of the U.S. economy - employing over 8% of the American private sector workforce and continuing to grow (Salamon and Sokolowski 2005; Roeger, Blackwood et al. 2012). However, most nonprofits are not able to sustain their operations in a manner that is the norm in the commercial world, and must rely on a steady stream of grants and gifts in order to maintain their efforts (Egger and Yoon 2004; Bishop and Green 2008). In

further contrast to a commercial venture where financial results and market share are generally accepted metrics, the means and methods for determining the success of a nonprofit's activities are not well defined (Light 2008). Despite (or perhaps because of) these challenges, the past 20 years have seen rapid growth in a new model known alternatively as social entrepreneurship, corporate social responsibility and social enterprise (Dees 2008; Light 2008; Brooks 2009).

As there are multiple terms for this new model that are sometimes used interchangeably, a few definitional matters need to be established to better frame the context of this research. Generally speaking, there are two similar terms that are often used interchangeably but are in fact quite distinct and can provide a level of differentiation that will help to structure the questions this research addresses. The first and generally broader term is “social entrepreneurship,” which has come to serve as a broad umbrella term for any number of activities that may or may not include the use of market based activities to generate funding. In fact, many ventures and individuals that consider themselves social entrepreneurs fund their operations from the individual donations and grants that are the mainstay of traditional philanthropy (Meyskens, Robb-Post et al. 2010). The second and more precise term used in this field is “social enterprise,” which refers specifically to those ventures that are generating at least a portion of their operating income from the market and not the donor (Austin, Stevenson et al. 2006; Yunus and Weber 2007; Light 2008; Lynch and Walls 2009; VanSandt and Baugous 2009).

Even within this more precise definition, there is some obscurity regarding the means by which the success of an undertaking can be determined. While the commercial aspects of a social business venture are readily measurable and easily evaluated, there remains a great deal of subjectivity around the ability to measure social outcomes. For example, there are some scholars who seek to define social value as part of a larger equation that includes more commercially

oriented operating metrics (Brooks 2009). There is also discussion within this field (as well as in the broader context of public administration) as to the difference between output and outcomes in the assessment of social impact (Julnes 2009; Lynch and Walls 2009; Lane and Casile 2010), making the evaluation of the social impact of the entity even more complex (Light 2008).

Bielefeld sums up the current discussion quite well when he states that “best practices are not standardized” (Bielefeld 2009). More importantly for this research, “theories of change are not aligned among grantors, investors and nonprofits” (Bielefeld 2009). Bielefeld (2009) states that some of the challenges in this field include “situations where values cannot always be measured, quality implementation of assessment is essential but difficult...and time horizons for output and outcome measurement are long.” Nonetheless, Bielefeld (2009) concludes that this field has much promise as a tool for effecting “major and positive” social change.

In recent years, significant thought has been given to the factors that can make a “social enterprise” successful. Bornstein (2007) identifies several critical factors including a willingness to self-correct, share credit, break free of established structures, cross disciplinary boundaries, work quietly and have a strong ethical impetus. Crutchfield and Grant (2008) produced a frequently cited empirical study that encourages the use of markets as a tool for funding mission, but focused their research on only twelve organizations that they defined as high impact based on criteria such as national scope, number of years in service, and level of impact on the social issue addressed by the entity. Lynch and Walls (2009), speaking from a social enterprise context, identify a number of “paradoxes” that must be balanced in order for a venture of this sort to succeed. Among these paradoxes are “Doing Good Versus Doing Well”, “Form Versus Function”, “Planning Versus Practice”, “Debits Versus Credits”, “Do-Gooders Versus

Good Doers”, “Perception Versus Reality”, “Value Versus Waste”, “Metrics Versus Instinct”, “Growth Versus Focus” and “Sweat Equity Versus Blood Equity”.

A useful model for this discussion of the factors that make a social enterprise successful comes from one of the most well-known innovators in this field, Dr. Muhammad Yunus. Made famous by his work as the founder of The Grameen Bank and one of the creators of a banking model known as Micro-Finance, Yunus has sought to expand the idea of what he calls “social business” beyond the field of banking into a broader initiative to reshape capitalist economies across the globe. Yunus’ social business model makes several claims that are relevant to shaping the questions addressed by this research. First and foremost, it is a business, not a charitable venture. Yunus is absolutely adamant that the venture must recoup all its expenses through operating activities (Yunus and Weber 2007). In the case of the Grameen Bank, the interest rate earned on the loan operates the same as it does in a commercial banking venture, namely as the means of generating a profit margin that is used to pay operating expenses such as payroll and associated costs, rent, utilities, advertising, and otherwise fund the operations of the venture (Bornstein 1996).

Second, these profits, once generated, stay within the business. After paying all operating expenses, net profit is reinvested in the enterprise and is passed along to the desired beneficiary group in the form of lower prices, better service or a broadening of the constituent base that is served. It is the use of this profit for a social benefit rather than the creation of personal wealth that separates it from the commercial enterprise (Yunus and Weber 2007). A close read of Yunus’ work will quickly lead one to understand that what he refers to as a social business is the same entity that is more commonly referred to as a social enterprise (Lynch and Walls 2009).

The ultimate ability of the social business model to impact social problems has yet to be determined (Edwards 2008; VanSandt and Baugous 2009). Further, it is not likely that this model will be the panacea for all the world's ills. There are most certainly human needs that will always require some sort of charitable or governmental support (Dees, Anderson et al. 2004; Wolk 2007; Light 2008). Further, most of the current practitioners of social enterprise have yet to build a venture or model of sufficient scale to have anything more than localized impact (Dees, Anderson et al. 2004). From a social change perspective, the development of that scale will certainly be needed if this model is to become a more significant factor (McAdam, Tarrow et al. 2001). In addition, the matter of ultimate impact on society must not be ignored.

However, the potential of this model for significant social change is certainly a matter of great interest at present (Di Domenico, Haugh et al. 2010; Meyskens, Robb-Post et al. 2010). In theory, when compared to a traditional nonprofit a social enterprise should have greater financial self-sufficiency, and a greater ability to effect social change due to a more entrepreneurial approach to the social issue at hand (Light 2008; Nicholls 2010). A more balanced mission that seeks to meet both business and social goals may also be a positive factor in the financial health of the organization (Kanter 2009).

A logic model comparing the traditional nonprofit with the social enterprise has been constructed as follows. An additional row in this model maps the relevant theoretical perspectives that are brought to bear in developing the research framework for this study, as supported by a review of relevant literature:

<b>Table 2.1</b>				
<b>Logic Model and Literature Map</b>				
	<b>Resources</b>	<b>Activities</b>	<b>Outputs</b>	<b>Outcomes</b>
<i>Traditional Nonprofit</i>	Donated Income, Social Workers, Social Need	Service of Social Need through programs and activities	Reduction in Social Need	Improved Society
<i>Social Enterprise</i>	Earned Income, Social Workers, Social Need	Service of Social Need through programs and activities that also generate earnings to the enterprise	Reduction in Social Need, Sustainable Revenue	Improved Society, Improved Capacity to meet Social Needs
<i>Relevant Literature</i>	Taxation of Nonprofits, Impact of Current Economic Events, Entrepreneurial Behavior	Public Finance, Entrepreneurial Behavior, Emergence of Social Enterprise	Public Policy Justification for Nonprofit Tax Exemption, Emergence of Social Enterprise	Public Policy Justification for Nonprofit Tax Exemption, Emergence of Social Enterprise

At the center of many of these discussions are questions as to the amount of revenue derived by commercial activities in a nonprofit as opposed to those derived through donations, grants and gifts (Grimm Jr 1999; Edwards 2008; Yan, Denison et al. 2009). While several studies have identified that fees for service represent a significant and growing portion of the revenue of a nonprofit, those studies do not distinguish between fees paid by a governmental entity in transfer of payments made and that income earned through the sales of goods and services on the open commercial market (Wing, Pollak et al. 2008). Some scholars hold forth that government is in fact the major source of funding for the nonprofit sector (Salamon 1990).

### Public Administration Perspectives

As mentioned in the preceding pages, the Public Administration context for this research is shaped by the general framework of theories of government, and the scholarly examination of

New Public Management in particular. Specifically, if social enterprise is viable, it has the potential to reshape the concepts of marketization and privatization that have been developed within the New Public Management framework. In the same fashion, if viable as a distinct model for operating a venture that produces both economic and social benefit, social enterprise could provide a new option for addressing the tension between an efficient economic process and an equitable society (Okun 1975). This issue is also relevant to the New Public Management discussion, specifically in regard to the debate on the role of government (Osborne and Gaebler 1992).

One of the central tenants of New Public Management theory is the notion that a market based process and perspective can create efficiencies in the delivery and administration of public services (Hood 1991; Walker, Brewer et al. 2011). Within this theory, privatization is viewed as beneficial due to its potential for increasing efficiencies and reducing costs by introducing competitive vendor bidding into the delivery of social and government services (Kettl 2005). Concerns have been raised regarding the effect that privatization in general and the search for commercial revenue in particular may have on the organization's focus and mission (Lohmann 2007). The concerns over the effect of commercial revenue on charitable support have also been raised within this context (Eikenberry and Kluver 2004). Waddock and Post (1991) suggest that a social entrepreneur can serve as a catalyst for social change and that this catalytic action is useful within a public administration context. Waddock and Post (1991) also make a specific distinction between social entrepreneurship and the public entrepreneur identified in the New Public Management literature. Governmental support for social entrepreneurship is held out as being beneficial to the administration of the public entity due to its ability to leverage scarce resources, foster innovation across sectors, improve efficiencies and effectiveness within public-



private partnerships and allow public administrators to focus more on planning and policy (Korosec and Berman 2006). It has also been proposed that governmental entities may wish to support social enterprise as a tool for reducing public sector deficits without sacrificing needed social services (Kucher 2012).

### **Summary of Relevant Literature**

One of the questions frequently raised throughout the literature is the concern about the effect that a market based entrepreneurial approach to social concerns may have on the organization's focus and mission (Lohmann 2007; Edwards 2008; Lerner 2009). Questions about the effect of earned income on the organization's ability to attract philanthropic support are also a common theme (Brooks 2000; Eikenberry and Kluver 2004). However, the most consistently raised question concerns the nature of the entity itself. Supporters argue that social entrepreneurship and social enterprise are new, unique, and potentially powerful concepts that will allow for sustainable entities that can produce lasting social change (Bornstein 2007; Yunus and Weber 2007; Brooks 2009). Critics claim that these ideas are at best a distinction without a difference, and at worst, potentially harmful to society (Eikenberry and Kluver 2004; Edwards 2008).

It therefore seems logical that empirical studies seeking to determine if actual differences exist between organizations claiming to be social enterprises and entities seeking to produce social change through more established means would add to the body of knowledge in this field. It would also seem that it would be useful to public administrators and policy makers to know if there is something unique about social enterprise, in order to better shape future policy and administrative decisions.

AN EXAMINATION OF THE REVENUE STRUCTURE OF SOCIAL ENTERPRISES  
AND TRADITIONAL NONPROFITS IN MARYLAND

**CHAPTER 3**  
**RESEARCH QUESTIONS**

### **Research Questions**

The idea of social entrepreneurship, and more specifically social enterprise, is that social service programs can be funded by market-based activities (e.g. commercial business entities) that also directly support a social agenda (Dees 1998). In effect, these entities blend market and mission into a “double-bottom line,” where success is measured not just on financial terms but also by the social impact the organization produces (Austin, Stevenson et al. 2006).

A frequent challenge to the concept of social enterprise is that it is just a convenient label, with no substantive difference in the makeup of the enterprise (Edwards 2008). This challenge would then lead one to question if there is any basis in fact for the currently favored use of different categories of organizations that seek to serve a social mission (Lohmann 2007; Shockley 2009). An additional criticism is that the focus on earned income (revenue generated by commercial activity as opposed to income from grants or gifts) is, in fact, a distraction and diverts needed resources from the social mission of the enterprise (Hartigan 2006; Lohmann 2007; Wallace 2009). Much anecdotal evidence and a number of case studies have been gathered that highlight specific success stories in social enterprise, and imply that the model may have broad applications (Dees, Anderson et al. 2004; Light 2008). However, these studies do not provide confirmatory evidence that there is a consistent difference in the structure of social enterprises when compared to other organizations seeking to produce social change.

Further, there is much current work being done on typologies, motives and frameworks (Austin, Stevenson et al. 2006; Shockley 2009). However, an empirical exploration of actual structural differences has yet to be performed (Shockley 2009). It may be that this lack of clarity as to the nature of any distinctive characteristics within social enterprises is a normal part of the evolution of a new field (Kuhn 1970). On the other hand, it may be the case that there is, in fact,

## Chapter 3 - Research Questions

no substantive distinction between the social enterprise and the well run nonprofit. It is this question that lies at the heart of this inquiry.

One recent study has attempted to quantify the effect of the use of a social enterprise model on the financial health of an organization (Pardee 2010). Examining the “effects of social enterprise among nonprofit behavioral healthcare providers on financial performance” in the state of Pennsylvania, the author of this study admits to several limitations and states that there are many questions in this debate that remain unanswered. Among the limitations are:

- Challenges in determining what qualifies an entity as a social enterprise
- Small sample sizes due to challenges in classification based on difficulty in qualification of entities
- Errors in reporting based on input error on the part of the reporting entity
- Regional influence and challenges in generalizing a regional sample to a national or international population
- Industry bias induced by studying only the behavioral health sector.

Some of the questions left unanswered by, or raised in the process of performing this study were:

- Do some industries lend themselves more easily to a social enterprise model?
- Are there specific operating costs that are increased when an organization seeks to produce a double bottom line (both financial success and social impact)?

## Chapter 3 - Research Questions

While not addressing all aspects of these questions, this research presents what may be a more robust model for examining some of the structural questions regarding social enterprise.

### **Methodology**

The primary hypothesis examined in this study is that the sources of revenue received by a social enterprise, when compared to a high performing nonprofit, do not make a material difference in the financial performance of the organization. The operational distinctions that are used to classify a nonprofit as high performing are enumerated in Chapter 4; as are detailed explanations of the financial ratios used to perform this analysis and the benchmarks against which the results of the calculations will be compared.

As a control, a distinction will be made between those nonprofits that are actively seeking to improve performance (high performing) and a general population of nonprofits. Of primary concern for this research is the determination that high performing nonprofits have been able to develop sustainable funding sources, which is one of the primary claims made by the proponents of social enterprise.

Accordingly, the primary hypothesis consists of several components as follows:

**H1:** The revenue sources of social enterprises (as measured by the percentage of total revenue received from grants and gifts, and the percentage of total revenue derived from program related activities) do not differ from those of high performing nonprofits.

## Chapter 3 - Research Questions

**H1A:** The revenue sources of social enterprises and of high performing nonprofits (measured as indicated in H1 above) both differ from those of the general population of nonprofits.

**H2:** The financial health of social enterprises (defined operationally by calculating the Return on Assets, Savings Ratio, Program Expense Ratio and Asset Ratio) do not differ from those of high performing nonprofits.

**H2A:** The financial health of social enterprises and of high performing nonprofits (calculated as indicated in H2 above) both differ from those of the general population of nonprofits.

**H3:** High performing nonprofits have less variability in revenue sources and financial health than social enterprises or the general population of nonprofits.

This study examines these questions by building a model that compares the financial performance of the social enterprise with that of both the general population of traditional nonprofits and those nonprofit entities that are performing at higher levels.

This examination is performed conducting a series of financial ratio analyses. The source of the raw data for this study is GuideStar USA, Inc. GuideStar USA, Inc. is a public charitable organization that gathers and aggregates financial data for the nonprofit sector. GuideStar collects Internal Revenue Service data for over 1.8 million nonprofit entities in the U.S., and maintains a database of IRS Form 990 filings for all nonprofits with revenues over \$25,000 (the minimum revenue level for which the filing of a Form 990 is required). This database includes a line item detail level of the Form 990 as reported by each organization. From this database,

### Chapter 3 - Research Questions

individual entities are aggregated by type to produce composite financial ratios by type of enterprise.

Each organization that files under the IRS classification of a 501 (c) 3 must file Form 990<sup>7</sup>. The revenue for the organization must be broken down into several classifications. Within the category of contributions, the entity must declare income from fundraising campaigns, membership dues, government grants and any other income (including non-cash contributions) it receives as a donation. A second category that must be reported is what the IRS calls Program Service Revenue. Within this category, any income earned through the delivery of a product or service must be declared. The entity is required to report each source of revenue individually and provide a classification code for the type of activity that earned the revenue. This classification coding uses the North American Industry Classification Code System, which provides over 1800 distinct codes to classify business activities. A sample IRS Form 990 is attached as Appendix I.

The use of Form 990 as the core data source allows for the calculation of some generally accepted measurements of the basic financial health of the organization. It is important to note that financial ratio analysis of nonprofits is not the same as it is in the commercial sector (Keating 2005; Zietlow, Hankin et al. 2007). For example, the notion of a profit margin, which is highly relevant in the commercial enterprise, does not exist in a nonprofit in the same sense nor can it be measured in the same way. In addition, revenue sources are much different, with a broader range of income streams. Further, the notion of equity is much different and not as easily quantified. However, some basic ratios used in the commercial world, such as Return on Assets (annual earnings divided by total assets), Savings Ratio (total revenue minus total expenses, divided by total expenses) and Asset Ratio (total assets divided by total liabilities) are relevant,

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<sup>7</sup> 501 C 3 Organizations with less than \$25,000 in gross revenue are not required to file a return.

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easily calculated, and able to be derived from the data provided by Form 990. In addition, an analysis of the distribution of revenue sources can be determined by calculating the Percentage of Grants and Gifts (Total revenue divided by Grant and Gift Income), Percentage of income from program related services (Total revenue divided by Program Service Revenue) and Program Expense ratio (Direct program expenses divided by Total Expenses).

The following table summarizes this analytical frame and the expected outcomes that would support the research hypothesis:

<b>Table 3.1</b>			
<b>Ratios &amp; Analyses</b>	<b>Typical Nonprofit</b>	<b>High Performing Nonprofit</b>	<b>Social Enterprise</b>
<i>Financial Ratios</i>			
Return on Assets	Low	Moderate to High	Moderate to High
Savings Ratio	Low	Moderate to High	Moderate to High
Program Expense Ratio	High	High	Moderate
Asset Ratio	Low	Moderate to High	Moderate to High
<i>Revenue Sources:</i>			
Grant & Gift Income	High	Moderate	Moderate
Program Service Revenues	Low	Moderate	Moderate

A logic model for this process has been constructed and is shown below. This model also serves as the data source table for this study:

<b>Table 3.2</b>				
<b>Logic Model</b>	<b>Resources</b>	<b>Activities</b>	<b>Outputs</b>	<b>Outcomes</b>
<i>Comparison of financial structure and revenue models</i>	IRS Form 990 data	1) Summarize, synthesize and disaggregate revenue sources 2) Develop Mean, Median and Mode of revenue by category	Comparative Table of revenue categories as a percentage of total revenue	Proof or refutation of the theory that there is a structural economic difference between social enterprises and nonprofits



AN EXAMINATION OF THE REVENUE STRUCTURE OF SOCIAL ENTERPRISES  
AND TRADITIONAL NONPROFITS IN MARYLAND

**CHAPTER 4**

**MATERIALS AND METHODS**

This chapter discusses the analytical strategy used to test the research hypothesis. It describes the data sources used in the study, and the methodology and analysis that address the research questions and hypothesis.

### **The Data**

As noted in the previous chapters, the source of data for this study is the database developed by GuideStar USA, Inc.<sup>8</sup> GuideStar USA, Inc. is a public charitable organization that gathers and aggregates financial data for the nonprofit sector. GuideStar collects Internal Revenue Service data for over 1.8 Million nonprofit entities, and maintains a database of IRS Form 990 filings for all nonprofits with revenues over \$25,000.

Form 990 is the U.S. Federal tax return that must be filed by any organization that has been granted an exemption from federal income tax under section 501 (c) of the Internal Revenue Service code. Organizations granted a 501 (c) exemption with annual income less than \$25,000 are not required to file a return. Organizations with less than \$200,000 in annual revenue or assets less than \$500,000 can file Form 990 E-Z (a simplified “short form” return).

The form consists of a main document that is 12 pages long and contains 12 sections along with 18 supplemental schedules of varying length. The specific schedules that an individual entity must file are determined by the answers it provides to questions asked in the main form. The information reported on Form 990 can be divided into 3 categories. The first category is mostly factual information on the organization filing the return (name, address, mission, names of board members and the like). The second category is financial information on the operations of the organization, including detailed income and expense data. The third category is information that relates to various legal compliance matters such as excess

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<sup>8</sup> GuideStar Premium - <http://www.guidestar.org/rxg/products/nonprofit-data-solutions/guidestar-premium.aspx>

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compensation and self-dealing transactions such as a board member who also has a business relationship with the entity or business relationships with former employees. A blank sample of the main section of IRS Form 990 is attached as Appendix I.

The following table identifies the specific data elements of IRS Form 990 used in this study, the place within the main Form 990 where the data elements are reported, and the use of each element in the study:

<b>Table 4.1 – Data Elements</b>		
<i>Data Element</i>	<i>Location</i>	<i>Use</i>
Name of Organization	Page 1	Identification for classification
Address	Page 1	Identification for classification
Employer Identification Number	Page 1	Identification for classification
Revenue - Contributions and Grants	Section I line 8	Ratio Calculations
Revenue - Program Service Revenue	Section I line 9	Ratio Calculations
Revenue - Total Revenue	Section I line 12	Ratio Calculations
Expense – Total Expense	Section I line 18	Ratio Calculations
Net Assets or Fund Balance – Total Assets	Section I line 20	Ratio Calculations
Net Assets or Fund Balance – Total Liabilities	Section I line 21	Ratio Calculations
Program Service Accomplishments – Total Program Service Expense	Section III line 4e	Ratio Calculations

The GuideStar database includes a line item detail level of the Form 990 information as reported by each organization. The database is regularly used as a source for analyzing the nonprofit sector, and is used by philanthropic foundations, academic researchers, journalists and others interested in nonprofits. It is one of the most commonly used sources of financial data for nonprofits. (Krishnan, Yetman et al. 2006; Powell and Steinberg 2007; Wing, Pollak et al. 2008).

GuideStar uploads data as it is received from the IRS, using a subcontractor that is employed to manually transcribe the information received from an IRS master file. An email inquiry into the process GuideStar uses for importing this information and the means employed

for ensuring the accuracy of the data generated the following response (copy attached as Appendix II):

“The IRS Business Master File is imported into the GuideStar database directly from the IRS's website when the IRS releases it for availability. However, financial data from Forms 990 are sent to a contractor to be keyed as digitized data. At the time it is digitized, every numerical value displayed on the GuideStar site is entered twice, and any disparity between entered values is reconciled. GuideStar Quality Assurance staff regularly monitors the accuracy of this "double-keyed" data. The numerical fields in the GuideStar database are captured accurately at the 99.9 percent level.”

In order to manage the problems that might arise from comparing different years, the 2010 tax year was selected as it was the most recent year in which records were complete at the time the data was obtained from GuideStar. While additional tax return years have been added since the data was accessed, no substantive changes to the format of the IRS Form 990 form or to the Guidestar reporting process have been made.

### **The Process**

#### 1) Sample

##### a) Geographic Boundaries

The geographic boundary for the sample was established to limit the sample to those nonprofits in the State of Maryland. This geographic boundary was chosen as the State of Maryland has three specific attributes that are of interest and useful for serving as the context for this study:

- i) an established community of Social Enterprises,
- ii) a high concentration of nonprofit entities (Wing, Pollak et al. 2008),

- iii) A rich history of social change along with a nonprofit community of significant size, scope and vibrancy (as detailed in the previous chapter).

It must be noted that these attributes improve the internal validity of the study as they allow for a larger sample size than might exist in other states that lack either or both of these characteristics. However, it may have a negative impact on the external validity of the study as the higher concentration of these entities might allow for sharing of information and resources that would not be available to organizations that are more geographically dispersed (Meyskens, Robb-Post et al. 2010).

### b) Taxonomy

A classification taxonomy was developed to sort individual nonprofit entities into mutually exclusive subgroups. This taxonomy was developed using a supertype-subtype (parent-child) scheme. The supertype population consists of all nonprofits in Maryland that have annual revenues of over \$100,000. The revenue threshold was chosen as prior research indicates that organizations with annual revenues below \$100,000 are subject to a wide variety of factors that can cause financial instability (Salamon and Sokolowski 2005; Carroll and Stater 2009). This financial variability would then potentially produce additional variability in the results that could mask the characteristics that are the subject of the study.

In the state of Maryland, the Office of Charitable Organizations within the Office of the Secretary of the State is charged with registering all nonprofits in Maryland and reports that, in 2010,, there were 9,712 registered entities. Each of these entities has been granted an exemption from federal income tax under section 501 (c) (3) of the Internal Revenue Service tax code and has filed an IRS Form 990 (M.A.N.O. 2010). Within this population, hospitals and universities were excluded from the sample as they have been identified in previous studies as having

financial characteristics in the nature of their funding sources and the type of services offered that are unique and would therefore bias the study (Hansmann 1986). Specifically, these entities receive the majority of their income from the recipient of the service, who has numerous choices available as to what particular provider they may select. While the immediate funding may come from a secondary source (a health insurance company in the case of a hospital or a student loan in the case of a university), the selection of the service provider by the consumer creates a series of transactions that perform in a manner that is more commercially oriented than the grant and gift funding of a nonprofit, yet not affected by market forces in the same manner as the earned income that is seen in a social enterprise (Hansmann 1986).

From this population, two distinct subgroups were identified based on the research hypothesis. The distinctions were made by applying an additional qualifying characteristic to each entity in what is essentially a stratified purposeful sampling technique (Patton 2004). The first of these subgroups is that portion of the population that is currently recognized by an external evaluator as operating a high level of professionalism. The Maryland Nonprofits Standards for Excellence® Program was selected as the certification to serve this purpose as it has been recognized for its comprehensive and unbiased assessment of nonprofit organizational performance. A 2002 study by The Brookings Institute held out the Maryland Nonprofits Standards for Excellence® Program as a leading example of a professional standards program for nonprofits (Light 2002). Certification is awarded when an organization can demonstrate compliance with the Ethics and Accountability Code for the Nonprofit Sector®, which provides eight “Guiding Principles” as well as 55 specific performance benchmarks. Application for this certification is voluntary, and applications are peer reviewed to determine eligibility for certification. Operational areas assessed include clarity of Mission and Program, Governance,

Conflict of Interest, Human Resources, Finance and Legal, Transparency, Fundraising, and Public Affairs and Public Policy. Certification is awarded for a period of three years, after which an organization must apply for re-certification. Certified organizations are listed on the Maryland Nonprofits website. Approximately 230 Maryland entities held this certification in 2010.

The second subgroup is those organizations that have self-identified as social enterprises (as defined in the literature reviewed in Chapter 2). Two criteria were identified as indications that an entity considers itself a social enterprise. The first is that the organization had taken specific action to identify as a social enterprise by becoming a member of the Social Enterprise Alliance. The Social Enterprise Alliance is a membership organization composed of social enterprises, service providers, nonprofit organizations, corporations, and venture capitalists that are interested in furthering the vision that the social enterprise model has significant potential for creating sustainable organizations that can create effective social change. Internationally, the Social Enterprise Alliance has over 900 members.<sup>9</sup> In 2010, 30 entities in the state of Maryland were members of this organization<sup>10</sup>. By joining the organization, these organizations have taken a specific step to self-identify as a social enterprise. Unlike the Maryland Nonprofits Standards for Excellence® Program, there is no certification or other value to the organization in joining, other than to be affiliated with like-minded individuals. It is likely that not every organization which is a social enterprise is also a member of the Social Enterprise Alliance. In order to capture some of the entities that are social enterprises but are not members of the Social Enterprise Alliance, an additional qualifying characteristic was used.

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<sup>9</sup> <https://www.se-alliance.org/about#ourrole>.

<sup>10</sup> Social Enterprise Alliance records accessed directly by the author

## Chapter 4 – Materials & Methods

The second qualifying characteristic for this subgroup was that the organization had expressed a specific interest in and commitment to becoming a social enterprise by completing the social enterprise training course provided by the Baltimore Social Enterprise Collaborative (BSEC), housed at the University of Baltimore's Merrick School of Business. The Baltimore Social Enterprise Collaborative was established in 2005 and provided training in the development of earned income models for area nonprofits. Although the Collaborative itself ceased to exist in 2010, the training program established by the collaborative still exists. This semester long course requires the board chair and executive director of the nonprofit to commit to a graduate level course of study and make a \$3,500<sup>11</sup> investment in tuition, books and fees to complete the course. Admission is competitive, and the admission rate is roughly 50%. As of January 2010, 45 organizations had completed this training. As the University of Baltimore does not track the organization once it completes the training, there is no indication of its effectiveness. However, the act of choosing to participate and paying the tuition to complete the course is (as with membership in The Social Enterprise Alliance) an indication that the organization considers itself a social enterprise.

The 30 organizations that are members of the Social Enterprise Alliance and the 45 organizations that have completed the University of Baltimore program combined to total 75 entities in Maryland that have taken a specific step to self-identify as a social enterprise as of 2010.

These population subgroups were selected because they share several characteristics that aid in the validity of the study (Patton 2004). First, they are all focused on delivering a social benefit to a specific targeted population. Second, their geographic service areas are comparable.

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<sup>11</sup> In 2010 dollars



## Chapter 4 – Materials & Methods

Third, the funding sources for each are reported in the same manner. Each of these common characteristics was useful in providing construct validity to the study. The presence of such shared characteristics increases the utility of information obtained from small samples. On the other hand, it reduces the ability to make generalizations from the sample (Patton 2004).

### 2) Institutional Review Board

The proposal for this study was submitted to The University of Baltimore's Institutional Review Board (IRB) as an exempt application for approval. On March 4, 2011, the IRB replied that this research did not require IRB review as it did not involve human subjects and that no further review was required (See Appendix III for letter of determination)

### 3) Data Acquisition

On March 2, 2011, application was made to GuideStar for free (no charge) academic access to GuideStar Premium, which allows large data sets to be downloaded from the GuideStar master database. Approval was received on March 6, 2011, and the initial download contained detailed financial information for the 2010 tax year for 5,871 entities, comprising all nonprofits in the database domiciled in the State of Maryland.

The fields contained in the data include general identifiers such as the name, address and Federal Employer ID number of the organization, as well as summary financial data from the entity's IRS Form 990. GuideStar receives PDF copies of 990 forms directly from the IRS as soon as the IRS makes them available. These forms are sent to a contractor where they are

manually entered into a database. The data was initially downloaded and prepared for analysis using Microsoft Excel (2010 version). Additional analysis was performed using SPSS V 16<sup>12</sup>.

#### 4) Preparation of Data for Analysis

Several steps were taken to prepare the raw data for analysis. First, duplicate entries were eliminated. Then National Taxonomy of Exempt Entity (NTEE) codes were used to further refine the data. The NTEE system is used by the IRS to classify the primary activities of tax-exempt organizations and is a companion to the North American Industrial Classification System used to classify for-profit organizations.

All entities with NTEE Major Category B (Education) were deleted in order to eliminate all academic institutions as they have been identified in previous studies as having financial characteristics that are unique and would therefore bias the study (Hansmann 1986). The same process of classification by NTEE codes was used to identify and eliminate those entities in Major Category E (Health Care) and sub categories 20-99. These subcategories comprise all of the direct health care service entities such as hospitals, clinics and other community health providers. These entities were eliminated because they also have unique financial characteristics in the nature of the donor and the services provided that have been determined to bias studies of nonprofit activity in a manner similar to that of educational institutions (Hansmann 1986).

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<sup>12</sup> In evaluating the pairwise comparisons and the issue of multiple contrasts discussed in chapter 5, use of SPSS 21 was considered as this version is able to calculate pairwise comparisons in nonparametric tests under certain conditions. However, the distribution of the data in the study samples was not conducive to performing such tests. Accordingly, use of SPSS 21 was rejected and a manual calculation of the adjusted p value was performed to allow for the effect of multiple comparisons.

This process (summarized in the table below) eliminated 1,103 entities, leaving 4,768 entities left in the data set.

<b>Table 4.2</b>		
<b>Summary of Population Selection Process</b>		
<i>Source</i>	<i>Filter</i>	<i>Entities Added (Eliminated)</i>
GuideStar	Maryland 501 (c) (3)	5,871
NTEE	Classification Section B (Educational Institutions)	(775)
NTEE	Classification Section E, sub sections 20-60 and subsection 90 (Hospitals and Medical Clinics)	(328)
Net		4,768

The next step was to classify and code individual entities into the previously developed social enterprise taxonomy used in this research.

5) Classification and coding

i) Social Enterprises

The list of entities that are members of The Social Enterprise Alliance and domiciled in Maryland was obtained from the Social Enterprise Alliance Maryland Chapter. Verbal permission to use them in research was obtained from Mr. Kevin Lynch, CEO of the Social Enterprise Alliance, on June 15, 2011. The list of entities having completed the social enterprise training course provided by the Baltimore Social Enterprise Collaborative (BSEC) was obtained from The University of Baltimore. Verbal permission to use them in research was obtained from Mr. John C. Weiss III, Academic Director of the program, on June 15, 2011.

A name search was performed to find each of these entities within the GuideStar data set, and a manual cross check process was performed to ensure that each entity listed was appropriately coded. This process yielded 26 entities. This is smaller than the 75 entities

identified within these two categories prior to the elimination of entities using NTEE codes. These entities were then given the subgroup code of 3. For purposes of this discussion, this group (subgroup 3) will be referred to as “Social Enterprises.”

### ii) High Performing Nonprofits

The list of entities that have been certified as meeting the Maryland Nonprofits Standards for Excellence® Program is published on the Maryland Nonprofits website<sup>13</sup> and was retrieved on May 16, 2011. A name search was performed to find each of these entities within the GuideStar data set. An additional data field named “class code” was added to the GuideStar data table to indicate the sub-classifications assigned to each group. This subclass was assigned class code 2. A manual cross check was performed to ensure that each entity listed by the Maryland Nonprofits was appropriately coded. This process yielded 47 entities. This is smaller than the 230 entities that have achieved this classification due to the previously described elimination of entities using NTEE codes. For purposes of this discussion, this group will be referred to as “High Performing Nonprofits.”

The reduction in the number of entities in subgroups 2 and 3 is a concern for two reasons. The first is the statistical analysis issues raised by relatively small sample sizes, which will be addressed in more detail in the data analysis section. The second is the concern that this process excludes a large number of nonprofit entities. While the rationale for this exclusion is based on prior research (Babbie, Halley et al. 2000; Dancey and Reidy 2002), the broader concern of validity is addressed in Chapter 6 – Analysis and Implications.

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<sup>13</sup> <http://www.marylandnonprofits.org/dnn/Strengthen/StandardsforExcellence/CertifiedOrganizations.aspx>

### iii) General Population of Nonprofits

After classifying these two subgroups and separating them from the main data set by virtue of the sub-classification codes, 4,687 entities remained, and were classified as subgroup 1. For purposes of this discussion, subgroup 1 will be referred to as “General Population of Nonprofits.”

The General Population subgroup (subgroup 1) was then further refined using a random selection process to identify 100 entities within this subgroup to be used in performing the financial and statistical analysis. The random selection process was chosen as it improves the likelihood that that sample is a fair and unbiased representation of the population (Bogartz 1994). The choice of 100 samples was made as this number of samples serves to moderate the variance effects of smaller sample sizes (Babbie, Halley et al. 2000; Dancey and Reidy 2002).

This process of identifying members of the specific subgroups and constructing a final sample population produced a research dataset of 173 records: 26 Social Enterprises, 47 High Performing Nonprofits and 100 General Population Nonprofits.

In working with the data during this process, it was noted that under certain circumstances, GuideStar recorded an entry of N/A (not applicable) in certain fields (usually one of the income or expense categories). Investigation into this matter determined that this was a data entry protocol established by GuideStar when a field within a specific record was left blank in the 990 return. A visual review of a group of these returns indicated that in just over one-third (34%) of the cases, the actual reported value on the 990 return for that specific entity was 0 (zero). Therefore, each record was manually reviewed to confirm that this entry of N/A was in

fact a representation of a 0 (zero), and manual entries were made to replace each entry of N/A to a numerical value of 0 (zero).

This process also uncovered other data entry errors in the data set when compared to the actual 990 filed by the entity. In order to correct these errors, the 2010 990 return for each subject organization was reviewed and manually corrected to reflect the information filed with the Internal Revenue Service. More than half (63%) of the records required some sort of manual entry correction. This is a finding with broad implications for both this research and the field of nonprofit studies, and will be discussed in Chapter 6 – Analysis and Implications

### 6) Ratio Calculation

Six specific financial ratios were calculated using the research sample. This section identifies each ratio and describes the reason for its use in this study, and is summarized on Table 4.3 following.

#### a) Percentage of income from grants/gifts

This ratio measures the amount of revenue received from philanthropic sources. It is calculated by dividing the amount of revenue received by grants and gifts by the total gross income received by the organization. The higher the percentage, the more dependent the entity is on philanthropic income sources (Zietlow, Hankin et al. 2007).

#### b) Percentage of income from program related services

This ratio measures the amount of revenue received from program service revenue – defined by the Internal Revenue Service as any fees or income received for the

delivery of services, including when the services are delivered under contract to a governmental entity<sup>14</sup>. It is calculated by dividing the amount of revenue received by the delivery of direct services by the organization for which a fee is paid by the total gross income received by the organization. The higher the percentage, the less dependent the entity is on philanthropic sources (Zietlow, Hankin et al. 2007).

### c) Return on Assets (ROA)

ROA seeks to quantify the efficiencies of management in using organizational assets to generate earnings. In the case of a nonprofit, it is an indicator of operating efficiency. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as return on investment. ROA is often used as an indicator of the financial health of the entity, with a higher ratio implying that an organization is more financially healthy (Zietlow, Hankin et al. 2007).

### d) Savings Ratio

This ratio indicates how quickly the organization is using up its cash supply in funding operations. Calculated by subtracting the total expenses from the total revenue and then dividing the difference by the total expenses, a higher ratio would indicate that the entity is able to continue operating for a longer period of time as it is not expending all its revenue in funding operations (Zietlow, Hankin et al. 2007).

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<sup>14</sup> <http://www.irs.gov/instructions/i990ez/ch02.html#d0e1961>

e) Program Expense Ratio

This ratio measures the amount of expense used in the direct delivery of programs and services. It is calculated by dividing the direct program expenses by the total expenses. This ratio is often used by independent rating organizations as a key measurement of nonprofit effectiveness. By inference, it is also often used as a measurement of operating efficiency, with higher ratios indicating that funding is going to the delivery of programs and not to administrative overhead (Zietlow, Hankin et al. 2007).

f) Asset Ratio

This ratio measures the financial liquidity of the organization, by determining the amount of cash and cash equivalents. Calculated by dividing the total assets by the total liabilities, lower values for this ratio tend to indicate a higher level of fixed operating costs and higher amounts of operating debt being used to finance ongoing operations. Higher ratios indicate both lower levels of operating debt and an improved ability to meet financial obligations (Zietlow, Hankin et al. 2007).

The following table summarizes this information:



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Table 4.3				
Summary of Financial Ratios				
<i>Ratio</i>	<i>Formula</i>	<i>Indicates</i>	<i>Direction</i>	<i>Location on IRS Form 990</i>
% of Grant & Gift Income	Income from Grants & Gifts / Total Revenue	Dependence on traditional income sources	Higher % equals more dependence	Part I Line 8 – Grants & Gifts Part I Line 12 – Total Revenue
% Income from Program Related Services	Income from Program Related Services/ Total Revenue	Dependence on traditional income sources	Higher % equals less dependence	Part I Line 9 – Program Service Revenue Part I Line 12 – Total Revenue
Return on Assets	Total Revenue/Total Assets	Overall Financial Health	Higher % equals greater financial health	Part I Line 12 – Total Revenue Part I Line 20 – Total Assets
Savings Ratio	(Total Revenue minus Total Expenses) / Total Expenses	Rate of cash consumption to fund operations	Higher % equals larger cash reserves	Part I Line 12 – Total Revenue Line 18 – Total Expenses
Program Expense Ratio	Program Expense/Total Expense	Amount of revenue directed to delivery of programs	Higher % equals more revenue directed to programs	Part I Line 18 – Total Expenses Part IX – Line 25 Column B
Asset Ratio	Total Assets/Total Liabilities	Financial Liquidity	Higher % means less debt and greater ability to meet obligations	Part I Line 20 – Total Assets Part I Line 21 – Total Liabilities

7) Analytical Strategy

As the factors examined in this study are inherent in the entities that comprise the sample and cannot be controlled or manipulated by the researcher, a truly experimental process is not possible (Campbell and Stanley 1966). Using a quasi-experimental framework, a data reduction

process was used to summarize the ratios calculated for each record in the sample (Campbell and Stanley 1966; Wegener and Fabrigar 2000). Subsequently, an Exploratory Factor Analysis was conducted to examine the relationship between the ratios and the three classes constructed to categorize the individual records in the sample (Wegener and Fabrigar 2000).

Data reduction was performed by developing a group of descriptive statistics to examine the central tendencies of both the entire sample and the subgroups within the sample. These measures of central tendency (mean and median) were calculated for each ratio of each population so that each of the three subgroups had a mean and a median for each of the six ratios.

The Exploratory Factor Analysis was performed by comparing the median of each subgroup to the expected outcomes suggested by the hypotheses.

The statistical analysis was developed in order to assess probability that the observed differences between the subgroups occurred by chance.

The choice of the appropriate statistical test was made by plotting the distribution of the data in each subgroup and also plotting the distribution of the data for the entire sample. If the distribution of the data was approximately normally distributed, a parametric test was used. If not, a nonparametric test was employed.

In order to address outliers within the data and attempt to normalize the distribution of the data, a variance stabilizing transformation was performed on each ratio output (Neter 1996; Weisberg 2005). The specific technique employed was median centering. Other techniques such as logarithmic transformation, arc cosine and square root transformation were not effective due to the nature of the data (e.g. the square root technique did not work on some records because the value in the record was a negative number).

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Another attempt to normalize the data and address the issue of outliers was to use an inter-quartile range technique to construct “fences” or trimlines for the data set. After locating the median of the data and then determining the interquartile range (IQR), any points below ( $Q1 - 1.5 \times IQR$ ) or above ( $Q3 + 1.5 \times IQR$ ) were excluded from the plotting or the statistical test (Sim, Gan et al. 2005; Wilcox 2005).

Once identified as outliers, secondary data analysis was performed wherein the records identified as outliers were individually examined to determine whether some latent pattern or unique characteristics existed that would cause that specific data record to produce a result that was so far distanced from the other records in the sample.

Specific results of these plots and the ensuing choice of tools and statistical test are discussed in the following section.

### 8) Analytical Process

In order to examine the hypothesis, the individual records were categorized into the three subgroups. For each subgroup, distributions, measures of central tendency (mean and median) and variability were calculated. Due to the relatively small size of the samples in subgroups 1 and 2 and their skewed distribution, the median (rather than the mean) was selected as the basis for comparison of the populations (Bogartz 1994). The implications of selecting the median on the statistical analysis of the research are discussed in Chapter 6 – Analysis and Implications.

#### a) Plots of Descriptive Statistics

The medians for each classification subgroup were compared to each other. This comparison was made to determine any differences in the ratios for each subgroup. These initial comparisons also served as the first step in the analysis of the aggregated results of the ratios, and a comparison of the aggregated results between the previously established subgroups. The

specific tests selected and the steps taken to address the potential effects of multiple comparisons on the analytical process are discussed in the immediately following section.

### b) Tests for significance

#### i) Variables in The Study

The selected variables in the study are based on the conceptual framework established in chapters 1-3.

#### ii) Dependent Variables

The dependent variables in the study are the six ratios indicated in section E above.

#### iii) Independent Variables

The independent variable is the type of organization being studied. For analytical purposes, each of the classifications developed for the study were given a numerical identifier to aid in sorting and analysis. As previously indicated, the three classifications were labeled as groups 1-3 as follows:

- Subgroup 1 - General Population of Nonprofits
- Subgroup 2 - High Performing Nonprofits
- Subgroup 3 - Social Enterprises

### 9) Selection of Statistical Test

The statistical test employed to analyze the variance in the samples was made based on the distribution of the data within the samples. The specific steps taken in each analysis are described below, with the exhibits attached as Appendix IV:

#### a) Percentage of income from grants/gifts

- i) A box plot was constructed to determine the shape of the data. This analysis indicated that the data were not normally distributed.

- ii) A median-centering Variance Transformation was performed to try to normalize the data. The median outcome of this ratio analysis was calculated at 0.874. The formula for this calculation is therefore  $(X-0.874)$ . After performing this transformation, new box plots were constructed. This analysis indicated that the variance transformation process did not materially change the shape of the data.
- iii) A Boundary Line analysis was performed to look for outliers that might affect the shape of the data. The median outcome for this ratio was calculated at 0.874, and the Inter-Quartile Range was calculated at 0.8. Q1 was then calculated as 0.474  $(.874 - (.8/2))$  and Q3 was calculated as 1.274  $(.874 + (.8/2))$ . The lower limit boundary was then calculated as -0.726  $(0.474 - (1.5 * 0.8))$  and the upper limit boundary was calculated as 2.474  $(1.274 + (1.5 * 0.8))$ . No records were found to be outside these boundaries, so no data were recoded (Sim, Gan et al. 2005; Wilcox 2005).
- iv) As the data were not normally distributed, a non-parametric test was selected to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis as it is particularly useful when there are more than two subgroups being analyzed, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to control for multiple contrasts, the associated probability levels were interpreted at a significance level of 0.016. This significance level is equal to the p value of .005 divided by the number of subgroups in the test (3) (Dancey and Reidy 2002)<sup>15</sup>.

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<sup>15</sup> In evaluating the pairwise comparisons and the issue of multiple contrasts, use of SPSS 21 was considered as this version is able to calculate pairwise comparisons in nonparametric tests under certain conditions. However, the distribution of the data in the study samples was not conducive to performing such tests. Accordingly, use of SPSS 21 was rejected and a manual calculation of the adjusted p value was performed to allow for the effect of multiple comparisons.

v) In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002; Altman 2005).

b) Percentage of income from program related services

i) A box plot was constructed to determine the shape of the data. This analysis indicated that the data were not normally distributed.

ii) A median-centering Variance Transformation was performed to try to normalize the data. The median outcome of this ratio analysis was calculated at 0.126. The formula for this calculation is therefore  $(X-0.126)$ . After performing this transformation, new box plots were constructed. This analysis indicated that the variance transformation process did not materially change the shape of the data.

iii) A Boundary Line analysis was performed to look for outliers that might affect the shape of the data. The median outcome for this ratio was calculated at 0.126, and the Inter-Quartile Range was calculated at 0.8. Q1 was then calculated as  $-0.274 (0.126 - (0.8/2))$  and Q3 was calculated as  $0.526 (0.126 + (0.8/2))$ . The lower limit boundary was then calculated as  $-1.474 (-0.274 - (1.5 * 0.8))$  and the upper limit boundary was calculated as  $1.726 (0.526 + (1.5 * 0.8))$ . No records were found to be outside these boundaries, so no data were recoded (Sim, Gan et al. 2005; Wilcox 2005).

iv) As the data were not normally distributed, a non-parametric test was selected to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis

- as it is particularly useful when there are more than two subgroups being analyzed, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to control for multiple contrasts, the associated probability levels were interpreted at a significance level of 0.016. This significance level is equal to the p value of .005 divided by the number of subgroups in the test (3) (Dancey and Reidy 2002).
- v) In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002; Altman 2005).
- c) Return on Assets (ROA)
- i) A box plot was constructed to determine the shape of the data. This analysis indicated that the data were not normally distributed.
  - ii) A median-centering Variance Transformation was performed to try to normalize the data. The median outcome of this ratio analysis was calculated at 0.982. The formula for this calculation is therefore  $(X-0.982)$ . After performing this transformation, new box plots were constructed. This analysis indicated that the variance transformation process did not materially change the shape of the data.
  - iii) A Boundary Line analysis was performed to look for outliers that might affect the shape of the data. The median outcome for this ratio was calculated at 0.982, and the Inter-Quartile Range was calculated at 1.64. Q1 was then calculated as 0.1624 (0.982-

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- (1.64/2)) and Q3 was calculated as 1.802 (0.982+ (1.64/2)). The lower limit boundary was then calculated as -2.298 (0.162-(1.5\*0.982) and the upper limit boundary was calculated as 4.262 (1.802+ (1.5\*0.982). 20 records were found to be outside these boundaries. These records were then recoded to a value of 10, and that value was set to be excluded from further analysis (Sim, Gan et al. 2005; Wilcox 2005).
- iv) As the data were not normally distributed, a non-parametric test was selected to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis as it is particularly useful when there are more than two subgroups being analyzed, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to control for multiple contrasts, the associated probability levels were interpreted at a significance level of 0.016. This significance level is equal to the p value of .005 divided by the number of subgroups in the test (3) (Dancey and Reidy 2002).
  - v) In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002; Altman 2005).
- d) Savings Ratio
- i) A box plot was constructed to determine the shape of the data. This analysis indicated that the data were not normally distributed.



- ii) A median-centering Variance Transformation was performed to try to normalize the data. The median outcome of this ratio analysis was calculated at 0.008. The formula for this calculation is therefore  $(X-0.008)$ . After performing this transformation, new box plots were constructed. This analysis indicated that the variance transformation process did not materially change the shape of the data.
- iii) A Boundary Line analysis was performed to look for outliers that might affect the shape of the data. The median outcome for this ratio was calculated at 0.008, and the Inter-Quartile Range was calculated at 0.19. Q1 was then calculated as  $-0.086 (0.008 - (0.19/2))$  and Q3 was calculated as  $0.104 (0.008 + (0.19/2))$ . The lower limit boundary was then calculated as  $-0.371 (-0.086 - (1.5 * 0.19))$  and the upper limit boundary was calculated as  $0.388 (0.104 + (1.5 * 0.19))$ . 26 records were found to be outside these boundaries. These records were then recoded to a value of 10, and that value was set to be excluded from further analysis (Sim, et al., 2005; Wilcox, 2005).
- iv) As the data were not normally distributed, a non-parametric test was selected to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis as it is particularly useful when there are more than two subgroups being analyzed, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to control for multiple contrasts, the associated probability levels were interpreted at a significance level of 0.016. This significance level is equal to the p value of .005 divided by the number of subgroups in the test (3) (Dancey and Reidy 2002).
- v) In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the

subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002; Altman 2005).

e) Program Expense ratio

- i) A box plot was constructed to determine the shape of the data. This analysis indicated that the data were not normally distributed.
- ii) A median-centering Variance Transformation was performed to try to normalize the data. The median outcome of this ratio analysis was calculated at 0.798. The formula for this calculation is therefore  $(X-0.798)$ . After performing this transformation, new box plots were constructed. This analysis indicated that the variance transformation process did not materially change the shape of the data.
- iii) A Boundary Line analysis was performed to look for outliers that might affect the shape of the data. The median outcome for this ratio was calculated at 0.798, and the Inter-Quartile Range was calculated at 0.27. Q1 was then calculated as 0.663 ( $0.798 - (0.27/2)$ ) and Q3 was calculated as 0.933 ( $0.798 + (0.27/2)$ ). The lower limit boundary was then calculated as 0.258 ( $0.663 - (1.5 * 0.27)$ ) and the upper limit boundary was calculated as 1.338 ( $0.933 + (1.5 * 0.27)$ ). One record was found to be outside these boundaries. This record was then recoded to a value of 10, and that value was set to be excluded from further analysis (Sim, Gan et al. 2005; Wilcox 2005).
- iv) As the data was not normally distributed, a non-parametric test was selected to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis as it is particularly useful when there are more than two subgroups being analyzed,

- the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to control for multiple contrasts, the associated probability levels were interpreted at a significance level of 0.016. This significance level is equal to the p value of .005 divided by the number of subgroups in the test (3) (Dancey and Reidy 2002).
- v) In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002; Altman 2005).
- f) Asset ratio
- i) A box plot was constructed to determine the shape of the data. This analysis indicated that the data were not normally distributed.
  - ii) A median-centering Variance Transformation was performed to try to normalize the data. The median outcome of this ratio analysis was calculated at 0.142. The formula for this calculation is therefore  $(X-0.142)$ . After performing this transformation, new box plots were constructed. This analysis indicated that the variance transformation process did not materially change the shape of the data.
  - iii) A Boundary Line analysis was performed to look for outliers that might affect the shape of the data. The median outcome for this ratio was calculated at 0.142, and the Inter-Quartile Range was calculated at 0.45. Q1 was then calculated as  $-0.083 (0.142 - (0.45/2))$  and Q3 was calculated as  $0.367 (0.142 + (0.45/2))$ . The lower limit boundary

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- was then calculated as  $-0.758 (-0.083 - (1.5 * 0.45))$  and the upper limit boundary was calculated as  $1.042 0.367 + (1.5 * 0.45)$ . Eleven records were found to be outside these boundaries. These records were then recoded to a value of 10, and that value was set to be excluded from further analysis (Sim, Gan et al. 2005; Wilcox 2005).
- iv) As the data were not normally distributed, a non-parametric test was selected to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis as it is particularly useful when there are more than two subgroups being analyzed, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to control for multiple contrasts, the associated probability levels were interpreted at a significance level of 0.016. This significance level is equal to the p value of .005 divided by the number of subgroups in the test (3) (Dancey and Reidy 2002).
- v) In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002; Altman 2005).

Table 4.4						
Median of Financial Ratios for Each Subgroup						
	% income from grants/gifts	% income from program services	Return on Assets	Savings indicator	Program Expense ratio	Asset Ratio
General Population	66%	34%	91%	3%	76%	236%
High Performing	96%	4%	114%	-1%	85%	408%
Social Enterprise	91%	9%	112%	-3%	76%	515%

10) Establishment of Benchmarks for comparison

- a) In order to fully evaluate the hypotheses established in Chapter 3, the definition of Low, Moderate and High as descriptions of the financial ratios calculated were established in numerical terms. Roeger & Blackwood (2012) published a national summary report of the Nonprofit economy in the United States, using reporting year 2010. Using the data from this report, the same set financial ratios used in this study were calculated on a nationwide basis. In order to make any possible adjustments for regional differences, the same set of ratios was calculated for the population of Maryland nonprofits from which the study samples were extracted. For each of these sets of calculations, a set of boundary ranges was calculated using a multiplier of 1.25 for the upper boundary and .75 for the lower boundary. These boundary ranges were then averaged in order to develop a final set of benchmarks. The following table summarizes this step in the methodology:

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<b>Table 4.5</b>						
	<b>National Ratios</b>					
	<b>% income from grants/gifts</b>	<b>% income from program services</b>	<b>Return on Assets</b>	<b>Savings indicator</b>	<b>Program Expense ratio</b>	<b>Asset ratio</b>
<b>Results</b>	62%	33%	56%	4%	77%	244%
<b>Low &lt;(.75)</b>	47%	25%	42%	3%	58%	183%
<b>Moderate (=)</b>	62%	33%	56%	4%	77%	244%
<b>High &gt;(1.25)</b>	78%	41%	70%	5%	96%	305%
	<b>Maryland Ratios</b>					
<b>Results</b>	71%	29%	47%	2%	78%	391%
<b>Low &lt;(.75)</b>	53%	22%	35%	1%	59%	293%
<b>Moderate (=)</b>	71%	29%	47%	2%	78%	391%
<b>High &gt;(1.25)</b>	89%	36%	59%	2%	98%	488%
	<b>Benchmarks</b>					
<b>Low &lt;(.75)</b>	50%	23%	39%	2%	58%	238%
<b>Moderate (=)</b>	66%	31%	51%	3%	78%	317%
<b>High &gt;(1.25)</b>	83%	39%	64%	4%	97%	397%

AN EXAMINATION OF THE REVENUE STRUCTURE OF SOCIAL ENTERPRISES  
AND TRADITIONAL NONPROFITS IN MARYLAND

**CHAPTER 5**

**FINDINGS**

Having completed the steps outlined in the previous chapter, several observations can be made. These observations fall into three general categories:

1. The general nature of the data
2. The results of the specific ratio calculations
3. The results of the tests for statistical significance

The following pages will review specific observations within each of these categories. The implications of these observations will be discussed in Chapter 6.

### **General Observations**

Within the category of general observations, there were two specific sources of errors in the data. The first general category is GuideStar errors. The second is reporting errors made on IRS Form 990 by the specific entities.

As mentioned in the previous chapter, two specific issues arose in working with the GuideStar data during this process.

The first is that, under certain circumstances, GuideStar recorded an entry of N/A (not applicable) in certain fields (usually one of the income or expense categories). Investigation into this matter determined that this was a data entry protocol established by GuideStar when a field within a specific record was left blank in the Form 990. A visual inspection of a group of these returns indicated that, in some cases, the actual reported value on the Form 990 for that specific entity was 0 (zero). Therefore, manual entries were made to convert each entry of N/A to a numerical value of 0 (zero). While this issue did not have a material effect on the results of the analysis, it did have an effect on the computational process used to perform the analysis.



## Chapter 5 - Findings

The second general observation was that entry errors were made in the process of inputting data into the GuideStar database. As mentioned in the previous chapter, GuideStar receives digital copies of the 990 forms directly from the IRS and then employs a contractor to input the data. While making the corrections noted above regarding the use of N/A in place of 0 (zero), it was noted that specific entries in certain records did not match the information that was filed by the organization on its IRS 990 form. Specifically, income and expense figures did not match those reported by the organization. In order to correct these errors, the 2010 990 return for each subject organization was reviewed by hand and manually corrected to reflect the information filed with the Internal Revenue Service. This issue had a material effect on the analysis.

Moving from GuideStar errors to reporting errors, it was noted that many of the Business Activity Codes reported for Program Service Revenues were not reported correctly. As mentioned in Chapter 3, when reporting Program Service Revenue, the organization is required to also supply a Business Activity Code to categorize the type of activity for which the revenue is being earned. These codes are supplied by the IRS in Form 990-T – “Instructions for Form 990 Return of Organization Exempt From Income Tax,” and use the taxonomy developed by the North American Industry Classification System (NAICS). The NAICS is the standard used by business and government in the U.S., Canada and Mexico to classify income by type of economic activity when seeking to collect, analyze or publish statistical data related on these businesses. In reviewing both the GuideStar data and the individual 990 forms, it was discovered that many organizations that declared Program Service Revenue reported a Business Activity code of 900099 (other activity), 999999 (a code that does not exist in the IRS guideline) or no

code at all. This finding had material impact on the ability to perform secondary data analysis on the records in the data set.

The last general finding is that the output of the financial ratio analysis indicated that the financial status of these subgroups did not comport to the hypotheses. In particular, the analysis of the Social Enterprise subgroup produced results that seem to contradict the hypothesis.

### **Observations of Individual Ratio Analyses**

The first ratio calculated was the percentage of income the organization derived from philanthropic sources (grants and gifts). The higher the percentage, the more dependent the entity is on philanthropic income sources (Zietlow, Hankin et al. 2007). This ratio was highest in the High Performing subgroup where the mean was 72% and the median was 96%; and lowest in the General Population subgroup where the mean was 57% and the median was 66%.

The second ratio calculated was the percentage of income from program related services. The higher the percentage, the less dependent the entity is on philanthropic sources (Zietlow, Hankin et al. 2007). This ratio was highest in the General Population Subgroup where the mean was 43% and the median was 34%; and lowest in the High Performing subgroup where the mean was 28% and the median was 4%. The Social Enterprise subgroup showed a slightly lower mean (24%) but the median was higher (9%). As discussed in Chapter 4, the median is the focus of this study as it is a better indication of centrality in studies with small sample sizes.

The third ratio calculated was the return on assets. This ratio is often used as an indicator of the financial health of the entity, with a higher ratio implying that an organization is more financially healthy (Zietlow, Hankin et al. 2007). This ratio was highest in the High Performing subgroup where the mean was 142% and the median was 114%; and lowest in the General

Population subgroup where the mean was 571% and the median was 91%. The Social Enterprise subgroup produced a higher mean (637%) but a median that was between the other two subgroups (112%). The difference of over 400 percentage points between the mean and the median in both the General Population and Social Enterprise subgroups underscores the wide dispersion of the data that was uncovered in the statistical analysis.

The fourth ratio calculated was the savings ratio. This ratio indicates how quickly the organization is using up its cash supply in funding operations. A higher ratio would indicate that the entity is able to continue operating for a longer period of time as it is not expending all its revenue in funding operations (Zietlow, Hankin et al. 2007). This ratio was highest in the General Population subgroup where the mean was 16% and the median was 3%; and lowest in the Social Enterprise subgroup where the mean was -6% and the median was -3%. Both the Social Enterprise subgroup and the High Performing subgroup produced negative ratios in both the mean and the median. Only the General Population subgroup had positive ratios. All three of the subgroups produced low ratios.

The fifth ratio calculated was the program expense ratio. This ratio measures the amount of expense used in the direct delivery of programs and services and is often used by independent rating organizations as a key measurement of nonprofit effectiveness (Zietlow, Hankin et al. 2007). This ratio was highest in the High Performing subgroup where the mean was 93% and the median was 85%. The Social Enterprise subgroup developed a mean of 63% and a median of 76%. The General Population subgroup developed a slightly lower mean (59%) but the same median as the Social Enterprise subgroup (76%).

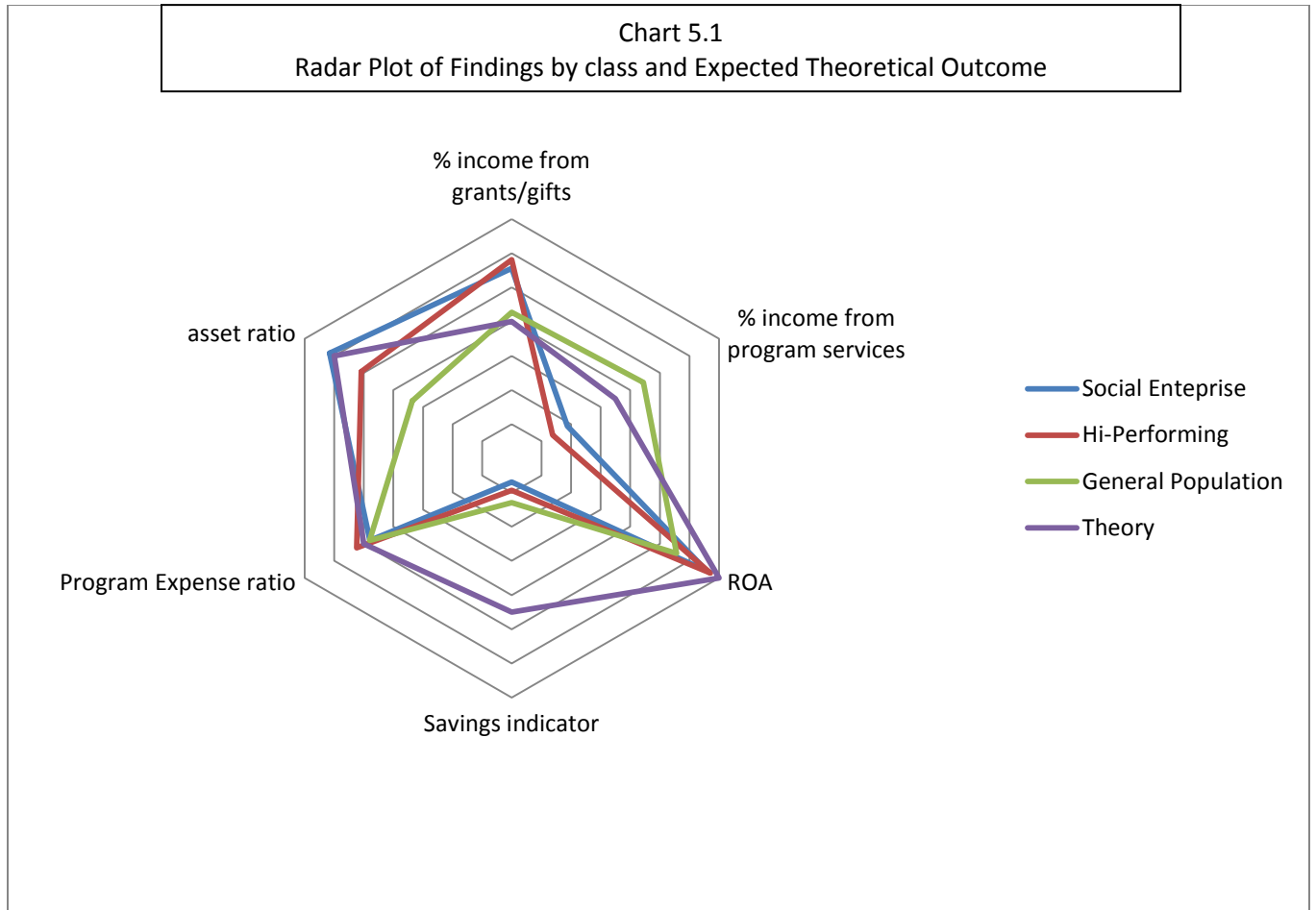
Chapter 5 - Findings

The sixth ratio calculated was the asset ratio. This ratio measures the financial liquidity of the organization. Higher ratios indicate both lower levels of operating debt and an improved ability to meet financial obligations (Zietlow, Hankin et al. 2007). This ratio was highest in Social Enterprise subgroup where the mean was 2120% and the median was 515%; and lowest in the General Population subgroup where the mean was 2359% and the median was 236%.

The following table summarizes the results of the ratio calculations:

Table 5.1						
Measures of Central Tendency						
	% income from grants/ gifts	% income from program services	Return on Assets	Savings indicator	Program Expense ratio	Asset ratio
Sub Group 1- General Population						
Mean	57%	43%	571%	16%	59%	2359%
median	66%	34%	91%	3%	76%	236%
Sub Group 2 -High Performing						
Mean	72%	28%	142%	-2%	93%	1608%
median	96%	4%	114%	-1%	85%	408%
Sub Group 3- Social Enterprise						
Mean	76%	24%	637%	-6%	63%	2120%
median	91%	9%	112%	-3%	76%	515%

A radar plot was constructed to further illustrate these outcomes. This graph also shows the results that might be expected from a Social Enterprise that conformed to the theories constructed for this study. Specific outcomes were normalized to a ten point scale in order to produce this illustration.



### Statistical Significance

As discussed in the previous chapter, the statistical significance of these results was examined using non-parametric tests to analyze the variance in the data. The Kruskal-Wallis test was selected for this analysis as it is particularly useful when there are more than two subgroups being analyzed, the data are not normally distributed and the sample sizes within the subgroups are not the same (Dancey and Reidy 2002). In order to further understand which particular subgroups may have affected the variances, a second non-parametric test was performed between each of the subgroups. The Mann-Whitney U pairwise comparison test was selected as it is useful when the subjects within the subgroups are not the same, the data are not normally

distributed and the sample sizes within the subgroups are not the same (Altman, 2005; Dancey & Reidy, 2002). Tables illustrating the numeric outputs of these tests are attached as Appendix V.

The Kruskal-Wallace tests indicated that these ratio results may not have been due to chance alone in three of the six ratios: Savings Indicator, Program Expense Ratio and Asset Ratio. While not conclusive, there is some possibility that the results of the ratio analysis for the other three ratios may not have been due to chance alone.

The results of the Mann Whitney tests provide pairwise comparisons that further examine the outcomes of the Kruskal-Wallace test. In the calculation of the percentage of income the organization derived from philanthropic sources (grants and gifts), the Mann-Whitney test results indicate a high probability that the results of the ratio analysis for the High Performing subgroup when compared to the results of the Social Enterprise subgroup are likely due to chance. The results of a comparison of the ratio analysis of the General Population subgroup and either the High Performing subgroup or the Social Enterprise Subgroup may be less likely to be due to chance alone, but chance cannot be rejected.

In the calculation of the percentage of income the organization derived from program service revenue, the Mann-Whitney test results indicate a high probability that the results of the ratio analysis for the High Performing subgroup when compared to the results of the Social Enterprise subgroup are likely due to chance. The results of a comparison of the ratio analysis of the General Population subgroup and either the High Performing subgroup or the Social Enterprise Subgroup may be less likely to be due to chance alone, but chance cannot be rejected.

In the calculation of the return on assets ratio, the Mann-Whitney test results indicate a high probability that the results of the ratio analysis for the High Performing subgroup when compared to the results of the Social Enterprise subgroup are likely due to chance. The results of

a comparison of the ratio analysis of the General Population subgroup and either the High Performing subgroup or the Social Enterprise Subgroup may be less likely to be due to chance alone, but chance cannot be rejected.

In the calculation of the savings indicator, the Mann-Whitney test results indicate a high probability that the results of the ratio analysis for the High Performing subgroup when compared to the results of the Social Enterprise subgroup are likely due to chance. The results of a comparison of the ratio analysis of the General Population subgroup and the High Performing subgroup may be less likely to be due to chance alone, but chance cannot be rejected. The comparison of the savings indicators developed for the General Population subgroup and the Social Enterprise subgroup are not likely to have resulted from chance alone.

In the calculation of the program expense ratio, the Mann-Whitney test results indicate a high probability that the results of the ratio analysis for the Social Enterprise subgroup when compared to the results of the General Population subgroup are likely due to chance. The results of a comparison of the ratio analysis of the General Population subgroup and the High Performing subgroup, as well as between the High Performing subgroup and the Social Enterprise subgroup are not likely to have resulted from chance alone.

In the calculation of the asset ratio, the Mann-Whitney test results indicate some probability that the results of the ratio analysis for the High Performing subgroup when compared to the results of the Social Enterprise subgroup are due to chance. The results of a comparison of the ratio analysis of the General Population subgroup and the High Performing subgroup may be less likely to be due to chance alone, but chance cannot be rejected. The comparison of the asset ratios developed for the General Population subgroup and the Social Enterprise subgroup are not likely to have resulted from chance alone.

**CHAPTER 6**  
**ANALYSIS**



## Chapter 6 - Analysis

Having reported the results of the financial examination in the previous chapter, this chapter will provide some insights into conditions that may have contributed to these results. After reviewing these conditions, the discussion will move to the implications of the results. It will then provide some suggestions for future research.

### **General Observations**

In the section on general observations reported in Chapter 5, there were several errors in the dataset observed – two of them in the GuideStar data and one in the raw information reported on the IRS 990 forms. The two GuideStar errors were the use of N/A for a field reported as Zero (0) on the IRS Form 990 and entry errors made in the process of inputting data into the GuideStar database. The most likely explanation for these two issues is clerical errors on the part of the contractor employed by GuideStar to input the data.

The error in the raw data was that many of the Business Activity Codes reported for Program Service Revenues were not reported correctly, with many organizations reporting a Business Activity code of 900099, 999999 or no code at all; even if Program Services Revenue was reported. It is worth noting in this matter that the IRS revised the Form 990 in 2008. As the returns reviewed were for the tax year 2010, it is possible that some returns were prepared by individuals who were not fully adjusted to the requirements of the new form. It does not appear that the IRS took a position that the 2008 changes would be phased in, or that any sort of grace period for full compliance with the revised reporting requirements would be provided. However, it is reasonable to consider that such changes do take time to be fully implemented, and it may be the case that these errors result from the incomplete assimilation of the change, and not from intentional attempts to mislead or obscure the activities of the entity.

The last general finding was that that the output of the financial ratio analysis indicated that the financial status of these subgroups, and the Social Enterprise subgroup in particular, did not comport to the hypotheses. While this certainly has broad implications for this study, its relevance to the larger field may not be as strong. It may well be that these results lend support to the argument that the notion of Social Enterprise as a unique tool is not really valid (Edwards 2008). However, it could also be a sign of an industry that is only just developing and has not had time to stabilize (Schumpeter 1934; Kuhn 1970; Nicholls 2010).

### **Observations of Individual Ratio Analyses**

The first ratio calculated was the percentage of income the organization derived from philanthropic sources (grants and gifts). The higher the percentage, the more dependent the entity is on philanthropic income sources (Zietlow, Hankin et al. 2007). This ratio was highest in the High Performing subgroup where the mean was 72% and the median was 96%; and lowest in the General Population subgroup where the mean was 57% and the median was 66%. While these results may support rejecting the research hypothesis, they also may arise from other factors. In the case of the High Performing Nonprofit, the high amount of philanthropic income may result from additional training received as part of the process of obtaining the Maryland Nonprofits Standards for Excellence® certification. It may also result from implied peer and evaluative pressure that may arise from obtaining and maintaining this standard (Goleman 2006). The results in the Social Enterprise subgroup may support the rejection of the research hypothesis as well. However, it could also be a sign of an industry that is only just developing and has not had time to stabilize (Schumpeter 1934; Kuhn 1970; Nicholls 2010).

The second ratio calculated was the percentage of income from program related services. The higher the percentage, the less dependent the entity is on philanthropic sources (Zietlow,

Hankin et al. 2007). This ratio was highest in General Population Subgroup where the mean was 43% and the median was 34%; and lowest in the High Performing subgroup where the mean was 28% and the median was 4%. The Social Enterprise subgroup showed a slightly lower mean (24%) but the median was higher (9%). The result showing that the General Population subgroup has the highest percentage of program services revenue may also support rejection of the research hypothesis. However, it could also be a result of the presence of government contracts where social services are subcontracted to the nonprofit (Salamon 1987). As with the previous ratio, the results in the Social Enterprise subgroup may support the rejection of the research hypothesis, or they may be indicative of an industry that is only just developing and has not had time to stabilize (Schumpeter 1934; Kuhn 1970; Nicholls 2010).

The third ratio calculated was the return on assets. This ratio is often used as an indicator of the financial health of the entity, with a higher ratio implying that an organization is more financially healthy (Zietlow, Hankin et al. 2007). This ratio was highest in High Performing subgroup where the mean was 142% and the median was 114%; and lowest in the General Population subgroup where the mean was 571% and the median was 91%. The Social Enterprise subgroup produced a higher mean (637%) but a median that was between the other two subgroups (112%). The difference of over 400 percentage points between the mean and the median in both the General Population and Social Enterprise subgroups underscores the wide dispersion of the data that was uncovered in the statistical analysis. In the case of the High Performing Nonprofit, the higher return on assets may result from additional training received as part of the process of obtaining the Maryland Nonprofits Standards for Excellence® certification. It may also result from implied peer and evaluative pressure that may arise from obtaining and maintaining this standard (Goleman 2006).

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The fourth ratio calculated was the savings ratio. This ratio indicates how quickly the organization is using up its cash supply in funding operations. A higher ratio would indicate that the entity is able to continue operating for a longer period of time as it is not expending all its revenue in funding operations (Zietlow, Hankin et al. 2007). This ratio was highest in the General Population subgroup where the mean was 16% and the median was 3%; and lowest in the Social Enterprise subgroup where the mean was -6% and the median was -3%. Both the Social Enterprise subgroup and the High Performing subgroup produced negative ratios in both the mean and the median. Only the General Population subgroup had positive ratios. All three of the subgroups produced low ratios. The results in the Social Enterprise subgroup may support the rejection of the research hypothesis as well. However, it could also be a sign of an industry that is only just developing and has not had time to stabilize (Schumpeter 1934; Kuhn 1970; Nicholls 2010). The low ratios in all three subgroups may also be due to the general industry pressure to devote the majority of funding to direct delivery of programs and services (Rose-Ackerman 1996; Zietlow, Hankin et al. 2007; Crutchfield and Grant 2008).

The fifth ratio calculated was the program expense ratio. This ratio measures the amount of expense used in the direct delivery of programs and services and is often used by independent rating organizations as a key measurement of nonprofit effectiveness (Zietlow, Hankin et al. 2007). This ratio was highest in High Performing subgroup where the mean was 93% and the median was 85%. The Social Enterprise subgroup developed a mean of 63% and a median of 76%. The General Population subgroup developed a slightly lower mean (59%) but the same median as the Social Enterprise subgroup (76%). Essentially, all three subgroups were very close to each other. This is most likely an indication of the effect of the general industry pressure

to devote the majority of funding to direct delivery of programs and services (Rose-Ackerman 1996; Zietlow, Hankin et al. 2007; Crutchfield and Grant 2008).

The sixth ratio calculated was the asset ratio. This ratio measures the financial liquidity of the organization. Higher ratios indicate both lower levels of operating debt and an improved ability to meet financial obligations (Zietlow, Hankin et al. 2007). This ratio was highest in Social Enterprise subgroup where the mean was 2120% and the median was 515%; and lowest in the General Population subgroup where the mean was 2359% and the median was 236%. This result does lend some support to the research hypothesis.

Ratio	General Population		High Performing		Social Enterprise	
	<i>Expected</i>	<i>Actual</i>	<i>Expected</i>	<i>Actual</i>	<i>Expected</i>	<i>Actual</i>
Grant/Gift Income	High (>83%)	Moderate (66%)	Moderate (~66%)	High (96%)	Moderate (~66%)	High (91%)
Program Service Revenue	Low (<23%)	Moderate (34%)	Moderate (~31%)	Low (4%)	Moderate (~31%)	Low (9%)
Return on Assets	Low (<39%)	High (91%)	Moderate/High (51-64%)	High (114%)	Moderate/High (51-64%)	High (114%)
Savings Ratio	Low (<2%)	Moderate (3%)	Moderate/High (3-4%)	Negative (-1%)	Moderate/High (3-4%)	Negative (-3%)
Program Expense Ratio	High (>97%)	Moderate (76%)	High (>97%)	Moderate/High (85%)	Moderate (~78%)	High (98%)
Asset Ratio	Low (<238%)	Low (236%)	Moderate/High (317-397%)	High (408%)	Moderate/High (317-397%)	High (488%)

The statistical tests for validity provide some indications that the characteristics of the samples observed in the descriptive statistics may not have occurred entirely by chance. In particular, the results of three of the ratio analyses (Program Expense ratio, Asset Ratio and Savings Indicator) may have some reasonable statistical support for being representative of the population from which these samples are taken. The analyses used to examine income sources

## Chapter 6 - Analysis

(Grant/Gift and Program Revenue) do not carry the same level of confidence that the results are due to chance alone, but do imply a possibility that chance may not be the only factor affecting the outcome of the analysis.

Table 6.2						
Test Statistics – (Kruskal Wallis test, Grouping Variable: Subgroup)						
	% Grant/Gift Income	% Program Service Income	Return on Assets	Savings Ratio	Program Expense Ratio	Asset Ratio
Chi-Square	4.535	4,535	0.569	7.613	8.592	10.008
Degrees of Freedom	2	2	2	2	2	2
Asymp. Sig	0.104	0.104	0.752	0.022	0.014	0.007

### Implications

In turning toward suggestions for further study, a few additional observations need to be made that have implications on future research on this topic. The first is that the general notion of earned income as a distinctive element of a social enterprise may be flawed. One of the problems with this notion is that what is reported as earned income may well be revenue earned via government contracts where social services are subcontracted to the nonprofit (Salamon 1987). The limitations of the IRS Form 990 do not allow for a distinction to be made between subcontracted revenue and income derived from other earned sources such as commercial sales of goods. While a review of audited financial statements might provide this information, gathering such statements from a large enough sample of organizations would present significant resource challenges to any study.

A second general observation is that the relatively recent changes to the IRS Form 990 may have had an effect on the reporting of the data, and that a similar study done using data from tax year 2012 or later data might produce different results.

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A third general observation is that the ideas that are emerging in Social Enterprise are new enough that the field has not matured to the point where a reasonable inference can be made. In other words, the firms examined here may be innovators or early adopters, who often behave quite differently than those in the majority, who are slower and more cautious in adopting new tools and methods (Kuhn 1970; Rogers 1983).

Finally, the limitation to only 501(c) 3 organizations may not be providing complete picture of all activity being undertaken in the name of Social Enterprise. One indication of the changing face of this movement is the preliminary results of a census being conducted in the U.S. by the Social Enterprise Alliance. Early reports from this census indicate a growing trend away from the nonprofit and toward a for-profit organizational structure<sup>16</sup>. While these results are very preliminary and have not yet undergone the scrutiny of academic rigor, they do provide an initial bellwether indication that looking beyond the traditional nonprofit structure will be needed in order to develop broader insights into this trend.

A larger implication for future study is the need for a new set of data from which to draw samples for additional analysis. The issues with the quality of the data in GuideStar noted in this study are certainly one reason that this new data set is needed. In addition, the classification techniques used to develop this model could certainly be better refined. If the efforts of the census currently underway prove valid, they would also support the need for a different data set to be constructed. A significant step towards this improved data set occurred in April of 2013

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<sup>16</sup> The Great Social Enterprise Census - <http://www.se-alliance.org/upload/SEA%20News/The%20Great%20Social%20Enterprise%20Census%20-%20Preliminary%20Findings.pdf>

when the Internal Revenue Service granted the general public access to Form 990 information on a wholesale basis.<sup>17</sup>

While certainly far from perfect, this study does provide some support for an enlightened skepticism about social enterprise and its ability to serve as a more sustainable vehicle for the delivery of social services. Within the community that it examines (the state of Maryland); the results of this study indicate that the nonprofit community should continue to devote significant effort to traditional fundraising in order to maintain its vibrancy and effectiveness. The study results also suggest that efforts to produce earned income to support nonprofits need to be thought of as part of a larger overall funding strategy rather than as a potential solution for current stresses in funding – a conclusion that has local as well as national implications. At the local level, this implication means that individual nonprofits and local government agencies will need to continue to explore and refine partnership strategies to meet the needs on citizens. At the national level, it means that federal priorities and budgets will need to include support for specific social causes and concerns.

Study results also imply that the relationship between government and specific social issues and concerns will continue to be complex, and will continue to generate significant political debate as to the merits, usefulness and efficacy of the various programs supported by government funding.

As it does not conclusively indicate a specific distinction in the economic structure of a social enterprise, this study's contribution to the literature helps to resolve the debate over the emergence of social enterprise and social entrepreneurship in favor of those who are skeptical

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<sup>17</sup> "IRS Takes Step to Make Charity Data More Accessible" – Chronicle of Philanthropy Tax Watch, April 5, 2013 - <http://philanthropy.com/article/IRS-Takes-Step-to-Make-Charity/138395/>



about the potential usefulness of social entrepreneurship as a tool for social change. In addition, this study may help inform administrative and policy decisions in both the public and the private sector.

In the private sector, it points toward a greater need for philanthropy to play a stronger role in providing long term financial support for nonprofits in order to offset the variations that exist in federal programs. By implication, this may also bring about a reduction in the number of nonprofits active in a community by forcing nonprofits to collaborate, consolidate and cooperate more in order to gain efficiencies and increase effectiveness.

At the government level, the results of this study point toward a need for public funds to continue to be a significant source of financial support for nonprofits if American society is to reach its goals of social equity and social justice. Within the New Public Management framework, the study results suggests that block grants, public private partnerships and privatization efforts may need to be reviewed further, and that a greater level of government oversight may be needed to ensure program effectiveness. The current interest in performance measurement and the evaluation of outcomes within both government and philanthropy have a strong potential for providing the level of information and detail necessary to make this oversight possible.(Behn 2003; Zimmermann and Stevens 2006; O'Connell and Straub 2007; Julnes 2009; Morino, Thompson et al. 2011)

As the study results suggest that it may not be possible for an independent social services organization to be self-funding and not reliant on government funds, it reinforces the structure of existing relationships in public-private partnerships and the current systems for government contracting and privatization. Further, this study indicates that Social Enterprise may not provide

an opportunity to increase the level of local control in the delivery of social services or reduce the size of government as either a direct actor or as a funder of contract services.

One implication of the study results affects both parties in the government contracting relationship. Since social enterprise is seen in part as a way for nonprofits to become independent, the results of this study suggest that managing the interdependencies that exist between the government and the social sector will continue to be a challenge for both parties.

It seems clear that financial pressure from reduced government funding, changes in philanthropy and reduced individual giving will continue to push nonprofits to seek alternative means of funding for their work. The debate over the merits of social enterprise asks if the nonprofit able to meet the challenges that come with an earned income strategy, and is capable of behaving in the business like fashion that is necessary to be successful in deploying such a strategy. This study provides some preliminary indication that nonprofits may not be up to the task.

Finally, the results of this study may inform the ongoing discussions on the role of government by bringing the challenges of funding social programs into greater clarity and focus. It is sincerely hoped that it will also serve as inspiration to others to perform additional studies to gain further insight on these questions.

AN EXAMINATION OF THE REVENUE STRUCTURE OF SOCIAL ENTERPRISES  
AND TRADITIONAL NONPROFITS IN MARYLAND

**APPENDICIES**

**APPENDIX I - IRS FORM 990**

**Return of Organization Exempt From Income Tax**

Department of the Treasury  
Internal Revenue Service

Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)

▶ The organization may have to use a copy of this return to satisfy state reporting requirements.

**A For the 2012 calendar year, or tax year beginning** , 2012, and ending , 20

**B** Check if applicable:  
 Address change  
 Name change  
 Initial return  
 Terminated  
 Amended return  
 Application pending

**C** Name of organization  
 Doing Business As  
 Number and street (or P.O. box if mail is not delivered to street address) Room/suite  
 City, town or post office, state, and ZIP code

**D** Employer identification number

**E** Telephone number

**F** Name and address of principal officer:

**G** Gross receipts \$

**H(a)** Is this a group return for affiliates?  Yes  No  
**H(b)** Are all affiliates included?  Yes  No  
 If "No," attach a list. (see instructions)

**I** Tax-exempt status:  501(c)(3)  501(c) ( ) ◀ (insert no.)  4947(a)(1) or  527

**J** Website: ▶

**K** Form of organization:  Corporation  Trust  Association  Other ▶

**L** Year of formation:

**M** State of legal domicile:

**Part I Summary**

**1** Briefly describe the organization's mission or most significant activities: \_\_\_\_\_

**2** Check this box  if the organization discontinued its operations or disposed of more than 25% of its net assets.

**3** Number of voting members of the governing body (Part VI, line 1a) . . . . . **3**

**4** Number of independent voting members of the governing body (Part VI, line 1b) . . . . . **4**

**5** Total number of individuals employed in calendar year 2012 (Part V, line 2a) . . . . . **5**

**6** Total number of volunteers (estimate if necessary) . . . . . **6**

**7a** Total unrelated business revenue from Part VIII, column (C), line 12 . . . . . **7a**

**7b** Net unrelated business taxable income from Form 990-T, line 34 . . . . . **7b**

		Prior Year	Current Year
<b>Revenue</b>	<b>8</b> Contributions and grants (Part VIII, line 1h) . . . . .		
	<b>9</b> Program service revenue (Part VIII, line 2g) . . . . .		
	<b>10</b> Investment income (Part VIII, column (A), lines 3, 4, and 7d) . . . . .		
	<b>11</b> Other revenue (Part VIII, column (A), lines 5, 6d, 8c, 9c, 10c, and 11e) . . . . .		
<b>12</b> Total revenue—add lines 8 through 11 (must equal Part VIII, column (A), line 12)			
<b>Expenses</b>	<b>13</b> Grants and similar amounts paid (Part IX, column (A), lines 1–3) . . . . .		
	<b>14</b> Benefits paid to or for members (Part IX, column (A), line 4) . . . . .		
	<b>15</b> Salaries, other compensation, employee benefits (Part IX, column (A), lines 5–10)		
	<b>16a</b> Professional fundraising fees (Part IX, column (A), line 11e) . . . . .		
	<b>b</b> Total fundraising expenses (Part IX, column (D), line 25) ▶		
	<b>17</b> Other expenses (Part IX, column (A), lines 11a–11d, 11f–24e) . . . . .		
<b>18</b> Total expenses. Add lines 13–17 (must equal Part IX, column (A), line 25)			
<b>19</b> Revenue less expenses. Subtract line 18 from line 12 . . . . .			
<b>Net Assets or Fund Balances</b>	<b>20</b> Total assets (Part X, line 16) . . . . .	Beginning of Current Year	End of Year
	<b>21</b> Total liabilities (Part X, line 26) . . . . .		
	<b>22</b> Net assets or fund balances. Subtract line 21 from line 20 . . . . .		

**Part II Signature Block**

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

**Sign Here**

Signature of officer \_\_\_\_\_ Date \_\_\_\_\_

Type or print name and title \_\_\_\_\_

**Paid Preparer Use Only**

Print/Type preparer's name \_\_\_\_\_ Preparer's signature \_\_\_\_\_ Date \_\_\_\_\_ Check  if self-employed PTIN \_\_\_\_\_

Firm's name ▶ \_\_\_\_\_ Firm's EIN ▶ \_\_\_\_\_

Firm's address ▶ \_\_\_\_\_ Phone no. \_\_\_\_\_

May the IRS discuss this return with the preparer shown above? (see instructions) . . . . .  Yes  No

For Paperwork Reduction Act Notice, see the separate instructions.

**Part III Statement of Program Service Accomplishments**

Check if Schedule O contains a response to any question in this Part III . . . . .

**1** Briefly describe the organization's mission:  
.....  
.....  
.....

**2** Did the organization undertake any significant program services during the year which were not listed on the prior Form 990 or 990-EZ? . . . . .  **Yes**  **No**  
If "Yes," describe these new services on Schedule O.

**3** Did the organization cease conducting, or make significant changes in how it conducts, any program services? . . . . .  **Yes**  **No**  
If "Yes," describe these changes on Schedule O.

**4** Describe the organization's program service accomplishments for each of its three largest program services, as measured by expenses. Section 501(c)(3) and 501(c)(4) organizations are required to report the amount of grants and allocations to others, the total expenses, and revenue, if any, for each program service reported.

**4a** (Code: \_\_\_\_\_) (Expenses \$ \_\_\_\_\_ including grants of \$ \_\_\_\_\_) (Revenue \$ \_\_\_\_\_)  
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**4b** (Code: \_\_\_\_\_) (Expenses \$ \_\_\_\_\_ including grants of \$ \_\_\_\_\_) (Revenue \$ \_\_\_\_\_)  
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**4c** (Code: \_\_\_\_\_) (Expenses \$ \_\_\_\_\_ including grants of \$ \_\_\_\_\_) (Revenue \$ \_\_\_\_\_)  
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**4d** Other program services (Describe in Schedule O.)  
(Expenses \$ \_\_\_\_\_ including grants of \$ \_\_\_\_\_) (Revenue \$ \_\_\_\_\_)

**4e** Total program service expenses ►



**Part IV Checklist of Required Schedules**

	Yes	No
<b>1</b> Is the organization described in section 501(c)(3) or 4947(a)(1) (other than a private foundation)? If "Yes," complete Schedule A . . . . .	<b>1</b>	
<b>2</b> Is the organization required to complete Schedule B, Schedule of Contributors (see instructions)? . . . . .	<b>2</b>	
<b>3</b> Did the organization engage in direct or indirect political campaign activities on behalf of or in opposition to candidates for public office? If "Yes," complete Schedule C, Part I . . . . .	<b>3</b>	
<b>4</b> <b>Section 501(c)(3) organizations.</b> Did the organization engage in lobbying activities, or have a section 501(h) election in effect during the tax year? If "Yes," complete Schedule C, Part II . . . . .	<b>4</b>	
<b>5</b> Is the organization a section 501(c)(4), 501(c)(5), or 501(c)(6) organization that receives membership dues, assessments, or similar amounts as defined in Revenue Procedure 98-19? If "Yes," complete Schedule C, Part III . . . . .	<b>5</b>	
<b>6</b> Did the organization maintain any donor advised funds or any similar funds or accounts for which donors have the right to provide advice on the distribution or investment of amounts in such funds or accounts? If "Yes," complete Schedule D, Part I . . . . .	<b>6</b>	
<b>7</b> Did the organization receive or hold a conservation easement, including easements to preserve open space, the environment, historic land areas, or historic structures? If "Yes," complete Schedule D, Part II . . . . .	<b>7</b>	
<b>8</b> Did the organization maintain collections of works of art, historical treasures, or other similar assets? If "Yes," complete Schedule D, Part III . . . . .	<b>8</b>	
<b>9</b> Did the organization report an amount in Part X, line 21, for escrow or custodial account liability; serve as a custodian for amounts not listed in Part X; or provide credit counseling, debt management, credit repair, or debt negotiation services? If "Yes," complete Schedule D, Part IV . . . . .	<b>9</b>	
<b>10</b> Did the organization, directly or through a related organization, hold assets in temporarily restricted endowments, permanent endowments, or quasi-endowments? If "Yes," complete Schedule D, Part V . . . . .	<b>10</b>	
<b>11</b> If the organization's answer to any of the following questions is "Yes," then complete Schedule D, Parts VI, VII, VIII, IX, or X as applicable.		
<b>a</b> Did the organization report an amount for land, buildings, and equipment in Part X, line 10? If "Yes," complete Schedule D, Part VI . . . . .	<b>11a</b>	
<b>b</b> Did the organization report an amount for investments—other securities in Part X, line 12 that is 5% or more of its total assets reported in Part X, line 16? If "Yes," complete Schedule D, Part VII . . . . .	<b>11b</b>	
<b>c</b> Did the organization report an amount for investments—program related in Part X, line 13 that is 5% or more of its total assets reported in Part X, line 16? If "Yes," complete Schedule D, Part VIII . . . . .	<b>11c</b>	
<b>d</b> Did the organization report an amount for other assets in Part X, line 15 that is 5% or more of its total assets reported in Part X, line 16? If "Yes," complete Schedule D, Part IX . . . . .	<b>11d</b>	
<b>e</b> Did the organization report an amount for other liabilities in Part X, line 25? If "Yes," complete Schedule D, Part X . . . . .	<b>11e</b>	
<b>f</b> Did the organization's separate or consolidated financial statements for the tax year include a footnote that addresses the organization's liability for uncertain tax positions under FIN 48 (ASC 740)? If "Yes," complete Schedule D, Part X . . . . .	<b>11f</b>	
<b>12 a</b> Did the organization obtain separate, independent audited financial statements for the tax year? If "Yes," complete Schedule D, Parts XI and XII . . . . .	<b>12a</b>	
<b>b</b> Was the organization included in consolidated, independent audited financial statements for the tax year? If "Yes," and if the organization answered "No" to line 12a, then completing Schedule D, Parts XI and XII is optional . . . . .	<b>12b</b>	
<b>13</b> Is the organization a school described in section 170(b)(1)(A)(ii)? If "Yes," complete Schedule E . . . . .	<b>13</b>	
<b>14 a</b> Did the organization maintain an office, employees, or agents outside of the United States? . . . . .	<b>14a</b>	
<b>b</b> Did the organization have aggregate revenues or expenses of more than \$10,000 from grantmaking, fundraising, business, investment, and program service activities outside the United States, or aggregate foreign investments valued at \$100,000 or more? If "Yes," complete Schedule F, Parts I and IV . . . . .	<b>14b</b>	
<b>15</b> Did the organization report on Part IX, column (A), line 3, more than \$5,000 of grants or assistance to any organization or entity located outside the United States? If "Yes," complete Schedule F, Parts II and IV . . . . .	<b>15</b>	
<b>16</b> Did the organization report on Part IX, column (A), line 3, more than \$5,000 of aggregate grants or assistance to individuals located outside the United States? If "Yes," complete Schedule F, Parts III and IV . . . . .	<b>16</b>	
<b>17</b> Did the organization report a total of more than \$15,000 of expenses for professional fundraising services on Part IX, column (A), lines 6 and 11e? If "Yes," complete Schedule G, Part I (see instructions) . . . . .	<b>17</b>	
<b>18</b> Did the organization report more than \$15,000 total of fundraising event gross income and contributions on Part VIII, lines 1c and 8a? If "Yes," complete Schedule G, Part II . . . . .	<b>18</b>	
<b>19</b> Did the organization report more than \$15,000 of gross income from gaming activities on Part VIII, line 9a? If "Yes," complete Schedule G, Part III . . . . .	<b>19</b>	
<b>20 a</b> Did the organization operate one or more hospital facilities? If "Yes," complete Schedule H . . . . .	<b>20a</b>	
<b>b</b> If "Yes" to line 20a, did the organization attach a copy of its audited financial statements to this return? . . . . .	<b>20b</b>	

**Part IV Checklist of Required Schedules (continued)**

	Yes	No
<b>21</b> Did the organization report more than \$5,000 of grants and other assistance to any government or organization in the United States on Part IX, column (A), line 1? <i>If "Yes," complete Schedule I, Parts I and II . . . . .</i>		
<b>22</b> Did the organization report more than \$5,000 of grants and other assistance to individuals in the United States on Part IX, column (A), line 2? <i>If "Yes," complete Schedule I, Parts I and III . . . . .</i>		
<b>23</b> Did the organization answer "Yes" to Part VII, Section A, line 3, 4, or 5 about compensation of the organization's current and former officers, directors, trustees, key employees, and highest compensated employees? <i>If "Yes," complete Schedule J . . . . .</i>		
<b>24a</b> Did the organization have a tax-exempt bond issue with an outstanding principal amount of more than \$100,000 as of the last day of the year, that was issued after December 31, 2002? <i>If "Yes," answer lines 24b through 24d and complete Schedule K. If "No," go to line 25 . . . . .</i>		
<b>b</b> Did the organization invest any proceeds of tax-exempt bonds beyond a temporary period exception? . . . . .		
<b>c</b> Did the organization maintain an escrow account other than a refunding escrow at any time during the year to defease any tax-exempt bonds? . . . . .		
<b>d</b> Did the organization act as an "on behalf of" issuer for bonds outstanding at any time during the year? . . . . .		
<b>25a Section 501(c)(3) and 501(c)(4) organizations.</b> Did the organization engage in an excess benefit transaction with a disqualified person during the year? <i>If "Yes," complete Schedule L, Part I . . . . .</i>		
<b>b</b> Is the organization aware that it engaged in an excess benefit transaction with a disqualified person in a prior year, and that the transaction has not been reported on any of the organization's prior Forms 990 or 990-EZ? <i>If "Yes," complete Schedule L, Part I . . . . .</i>		
<b>26</b> Was a loan to or by a current or former officer, director, trustee, key employee, highest compensated employee, or disqualified person outstanding as of the end of the organization's tax year? <i>If "Yes," complete Schedule L, Part II . . . . .</i>		
<b>27</b> Did the organization provide a grant or other assistance to an officer, director, trustee, key employee, substantial contributor or employee thereof, a grant selection committee member, or to a 35% controlled entity or family member of any of these persons? <i>If "Yes," complete Schedule L, Part III . . . . .</i>		
<b>28</b> Was the organization a party to a business transaction with one of the following parties (see Schedule L, Part IV instructions for applicable filing thresholds, conditions, and exceptions):		
<b>a</b> A current or former officer, director, trustee, or key employee? <i>If "Yes," complete Schedule L, Part IV . . . . .</i>		
<b>b</b> A family member of a current or former officer, director, trustee, or key employee? <i>If "Yes," complete Schedule L, Part IV . . . . .</i>		
<b>c</b> An entity of which a current or former officer, director, trustee, or key employee (or a family member thereof) was an officer, director, trustee, or direct or indirect owner? <i>If "Yes," complete Schedule L, Part IV . . . . .</i>		
<b>29</b> Did the organization receive more than \$25,000 in non-cash contributions? <i>If "Yes," complete Schedule M . . . . .</i>		
<b>30</b> Did the organization receive contributions of art, historical treasures, or other similar assets, or qualified conservation contributions? <i>If "Yes," complete Schedule M . . . . .</i>		
<b>31</b> Did the organization liquidate, terminate, or dissolve and cease operations? <i>If "Yes," complete Schedule N, Part I . . . . .</i>		
<b>32</b> Did the organization sell, exchange, dispose of, or transfer more than 25% of its net assets? <i>If "Yes," complete Schedule N, Part II . . . . .</i>		
<b>33</b> Did the organization own 100% of an entity disregarded as separate from the organization under Regulations sections 301.7701-2 and 301.7701-3? <i>If "Yes," complete Schedule R, Part I . . . . .</i>		
<b>34</b> Was the organization related to any tax-exempt or taxable entity? <i>If "Yes," complete Schedule R, Part II, III, or IV, and Part V, line 1 . . . . .</i>		
<b>35a</b> Did the organization have a controlled entity within the meaning of section 512(b)(13)? . . . . .		
<b>b</b> If "Yes" to line 35a, did the organization receive any payment from or engage in any transaction with a controlled entity within the meaning of section 512(b)(13)? <i>If "Yes," complete Schedule R, Part V, line 2 . . . . .</i>		
<b>36 Section 501(c)(3) organizations.</b> Did the organization make any transfers to an exempt non-charitable related organization? <i>If "Yes," complete Schedule R, Part V, line 2 . . . . .</i>		
<b>37</b> Did the organization conduct more than 5% of its activities through an entity that is not a related organization and that is treated as a partnership for federal income tax purposes? <i>If "Yes," complete Schedule R, Part VI . . . . .</i>		
<b>38</b> Did the organization complete Schedule O and provide explanations in Schedule O for Part VI, lines 11b and 19? <b>Note.</b> All Form 990 filers are required to complete Schedule O . . . . .		



Part V Statements Regarding Other IRS Filings and Tax Compliance

Check if Schedule O contains a response to any question in this Part V

Table with columns for question number, question text, and Yes/No response boxes. Includes questions 1a through 14b regarding IRS filings and tax compliance.

**Part VI Governance, Management, and Disclosure** For each "Yes" response to lines 2 through 7b below, and for a "No" response to line 8a, 8b, or 10b below, describe the circumstances, processes, or changes in Schedule O. See instructions. Check if Schedule O contains a response to any question in this Part VI

**Section A. Governing Body and Management**

		Yes	No
<b>1a</b>	Enter the number of voting members of the governing body at the end of the tax year . . . . . If there are material differences in voting rights among members of the governing body, or if the governing body delegated broad authority to an executive committee or similar committee, explain in Schedule O.		
<b>1b</b>	Enter the number of voting members included in line 1a, above, who are independent . . . . .		
<b>2</b>	Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee? . . . . .		
<b>3</b>	Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors, or trustees, or key employees to a management company or other person? . . . . .		
<b>4</b>	Did the organization make any significant changes to its governing documents since the prior Form 990 was filed? . . . . .		
<b>5</b>	Did the organization become aware during the year of a significant diversion of the organization's assets? . . . . .		
<b>6</b>	Did the organization have members or stockholders? . . . . .		
<b>7a</b>	Did the organization have members, stockholders, or other persons who had the power to elect or appoint one or more members of the governing body? . . . . .		
<b>7b</b>	Are any governance decisions of the organization reserved to (or subject to approval by) members, stockholders, or persons other than the governing body? . . . . .		
<b>8</b>	Did the organization contemporaneously document the meetings held or written actions undertaken during the year by the following:		
<b>a</b>	The governing body? . . . . .		
<b>b</b>	Each committee with authority to act on behalf of the governing body? . . . . .		
<b>9</b>	Is there any officer, director, trustee, or key employee listed in Part VII, Section A, who cannot be reached at the organization's mailing address? If "Yes," provide the names and addresses in Schedule O . . . . .		

**Section B. Policies** (This Section B requests information about policies not required by the Internal Revenue Code.)

		Yes	No
<b>10a</b>	Did the organization have local chapters, branches, or affiliates? . . . . .		
<b>10b</b>	If "Yes," did the organization have written policies and procedures governing the activities of such chapters, affiliates, and branches to ensure their operations are consistent with the organization's exempt purposes? . . . . .		
<b>11a</b>	Has the organization provided a complete copy of this Form 990 to all members of its governing body before filing the form? . . . . .		
<b>11b</b>	Describe in Schedule O the process, if any, used by the organization to review this Form 990.		
<b>12a</b>	Did the organization have a written conflict of interest policy? If "No," go to line 13 . . . . .		
<b>12b</b>	Were officers, directors, or trustees, and key employees required to disclose annually interests that could give rise to conflicts? . . . . .		
<b>12c</b>	Did the organization regularly and consistently monitor and enforce compliance with the policy? If "Yes," describe in Schedule O how this was done . . . . .		
<b>13</b>	Did the organization have a written whistleblower policy? . . . . .		
<b>14</b>	Did the organization have a written document retention and destruction policy? . . . . .		
<b>15</b>	Did the process for determining compensation of the following persons include a review and approval by independent persons, comparability data, and contemporaneous substantiation of the deliberation and decision?		
<b>15a</b>	The organization's CEO, Executive Director, or top management official . . . . .		
<b>15b</b>	Other officers or key employees of the organization . . . . .		
	If "Yes" to line 15a or 15b, describe the process in Schedule O (see instructions).		
<b>16a</b>	Did the organization invest in, contribute assets to, or participate in a joint venture or similar arrangement with a taxable entity during the year? . . . . .		
<b>16b</b>	If "Yes," did the organization follow a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements under applicable federal tax law, and take steps to safeguard the organization's exempt status with respect to such arrangements? . . . . .		

**Section C. Disclosure**

- 17** List the states with which a copy of this Form 990 is required to be filed ►
- 18** Section 6104 requires an organization to make its Forms 1023 (or 1024 if applicable), 990, and 990-T (Section 501(c)(3)s only) available for public inspection. Indicate how you made these available. Check all that apply.  
 Own website     Another's website     Upon request     Other (explain in Schedule O)
- 19** Describe in Schedule O whether (and if so, how), the organization made its governing documents, conflict of interest policy, and financial statements available to the public during the tax year.
- 20** State the name, physical address, and telephone number of the person who possesses the books and records of the organization: ►



**Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors**

Check if Schedule O contains a response to any question in this Part VII . . . . .

**Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees**

**1a** Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization's tax year.

- List all of the organization's **current** officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.
  - List all of the organization's **current** key employees, if any. See instructions for definition of "key employee."
  - List the organization's **five current** highest compensated employees (other than an officer, director, trustee, or key employee) who received reportable compensation (Box 5 of Form W-2 and/or Box 7 of Form 1099-MISC) of more than \$100,000 from the organization and any related organizations.
  - List all of the organization's **former** officers, key employees, and highest compensated employees who received more than \$100,000 of reportable compensation from the organization and any related organizations.
  - List all of the organization's **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than \$10,000 of reportable compensation from the organization and any related organizations.
- List persons in the following order: individual trustees or directors; institutional trustees; officers; key employees; highest compensated employees; and former such persons.

Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee.

(A) Name and Title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)					(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee			
(1) .....									
(2) .....									
(3) .....									
(4) .....									
(5) .....									
(6) .....									
(7) .....									
(8) .....									
(9) .....									
(10) .....									
(11) .....									
(12) .....									
(13) .....									
(14) .....									

**Part VII Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees** (continued)

(A) Name and title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former			
(15)										
(16)										
(17)										
(18)										
(19)										
(20)										
(21)										
(22)										
(23)										
(24)										
(25)										

<b>1b</b> Sub-total . . . . .	▶			
<b>c</b> Total from continuation sheets to Part VII, Section A . . . . .	▶			
<b>d</b> Total (add lines 1b and 1c) . . . . .	▶			

**2** Total number of individuals (including but not limited to those listed above) who received more than \$100,000 of reportable compensation from the organization ▶

	Yes	No
<b>3</b> Did the organization list any <b>former</b> officer, director, or trustee, key employee, or highest compensated employee on line 1a? <i>If "Yes," complete Schedule J for such individual</i> . . . . .		
<b>4</b> For any individual listed on line 1a, is the sum of reportable compensation and other compensation from the organization and related organizations greater than \$150,000? <i>If "Yes," complete Schedule J for such individual</i> . . . . .		
<b>5</b> Did any person listed on line 1a receive or accrue compensation from any unrelated organization or individual for services rendered to the organization? <i>If "Yes," complete Schedule J for such person</i> . . . . .		

**Section B. Independent Contractors**

**1** Complete this table for your five highest compensated independent contractors that received more than \$100,000 of compensation from the organization. Report compensation for the calendar year ending with or within the organization's tax year.

(A) Name and business address	(B) Description of services	(C) Compensation

**2** Total number of independent contractors (including but not limited to those listed above) who received more than \$100,000 of compensation from the organization ▶

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**Part VIII Statement of Revenue**

Check if Schedule O contains a response to any question in this Part VIII.

			(A) Total revenue	(B) Related or exempt function revenue	(C) Unrelated business revenue	(D) Revenue excluded from tax under sections 512, 513, or 514
<b>Contributions, Gifts, Grants and Other Similar Amounts</b>	<b>1a</b> Federated campaigns . . . . .	<b>1a</b>				
	<b>b</b> Membership dues . . . . .	<b>1b</b>				
	<b>c</b> Fundraising events . . . . .	<b>1c</b>				
	<b>d</b> Related organizations . . . . .	<b>1d</b>				
	<b>e</b> Government grants (contributions)	<b>1e</b>				
	<b>f</b> All other contributions, gifts, grants, and similar amounts not included above	<b>1f</b>				
	<b>g</b> Noncash contributions included in lines 1a-1f: \$					
	<b>h Total.</b> Add lines 1a-1f . . . . .					
<b>Program Service Revenue</b>	<b>2a</b> _____	Business Code				
	<b>b</b> _____					
	<b>c</b> _____					
	<b>d</b> _____					
	<b>e</b> _____					
	<b>f</b> All other program service revenue . . . . .					
	<b>g Total.</b> Add lines 2a-2f . . . . .					
<b>Other Revenue</b>	<b>3</b> Investment income (including dividends, interest, and other similar amounts) . . . . .					
	<b>4</b> Income from investment of tax-exempt bond proceeds					
	<b>5</b> Royalties . . . . .					
		(i) Real (ii) Personal				
	<b>6a</b> Gross rents . . . . .					
	<b>b</b> Less: rental expenses					
	<b>c</b> Rental income or (loss)					
	<b>d</b> Net rental income or (loss) . . . . .					
	<b>7a</b> Gross amount from sales of assets other than inventory	(i) Securities (ii) Other				
	<b>b</b> Less: cost or other basis and sales expenses . . . . .					
	<b>c</b> Gain or (loss) . . . . .					
	<b>d</b> Net gain or (loss) . . . . .					
	<b>8a</b> Gross income from fundraising events (not including \$ of contributions reported on line 1c). See Part IV, line 18 . . . . .	<b>a</b>				
	<b>b</b> Less: direct expenses . . . . .	<b>b</b>				
	<b>c</b> Net income or (loss) from fundraising events . . . . .					
<b>9a</b> Gross income from gaming activities. See Part IV, line 19 . . . . .	<b>a</b>					
<b>b</b> Less: direct expenses . . . . .	<b>b</b>					
<b>c</b> Net income or (loss) from gaming activities . . . . .						
<b>10a</b> Gross sales of inventory, less returns and allowances . . . . .	<b>a</b>					
<b>b</b> Less: cost of goods sold . . . . .	<b>b</b>					
<b>c</b> Net income or (loss) from sales of inventory . . . . .						
Miscellaneous Revenue		Business Code				
<b>11a</b> _____						
<b>b</b> _____						
<b>c</b> _____						
<b>d</b> All other revenue . . . . .						
<b>e Total.</b> Add lines 11a-11d . . . . .						
<b>12 Total revenue.</b> See instructions. . . . .						



**Part IX Statement of Functional Expenses**

Section 501(c)(3) and 501(c)(4) organizations must complete all columns. All other organizations must complete column (A).

Check if Schedule O contains a response to any question in this Part IX

**Do not include amounts reported on lines 6b, 7b, 8b, 9b, and 10b of Part VIII.**

	(A) Total expenses	(B) Program service expenses	(C) Management and general expenses	(D) Fundraising expenses
<b>1</b> Grants and other assistance to governments and organizations in the United States. See Part IV, line 21				
<b>2</b> Grants and other assistance to individuals in the United States. See Part IV, line 22				
<b>3</b> Grants and other assistance to governments, organizations, and individuals outside the United States. See Part IV, lines 15 and 16				
<b>4</b> Benefits paid to or for members				
<b>5</b> Compensation of current officers, directors, trustees, and key employees				
<b>6</b> Compensation not included above, to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)				
<b>7</b> Other salaries and wages				
<b>8</b> Pension plan accruals and contributions (include section 401(k) and 403(b) employer contributions)				
<b>9</b> Other employee benefits				
<b>10</b> Payroll taxes				
<b>11</b> Fees for services (non-employees):				
<b>a</b> Management				
<b>b</b> Legal				
<b>c</b> Accounting				
<b>d</b> Lobbying				
<b>e</b> Professional fundraising services. See Part IV, line 17				
<b>f</b> Investment management fees				
<b>g</b> Other. (If line 11g amount exceeds 10% of line 25, column (A) amount, list line 11g expenses on Schedule O.)				
<b>12</b> Advertising and promotion				
<b>13</b> Office expenses				
<b>14</b> Information technology				
<b>15</b> Royalties				
<b>16</b> Occupancy				
<b>17</b> Travel				
<b>18</b> Payments of travel or entertainment expenses for any federal, state, or local public officials				
<b>19</b> Conferences, conventions, and meetings				
<b>20</b> Interest				
<b>21</b> Payments to affiliates				
<b>22</b> Depreciation, depletion, and amortization				
<b>23</b> Insurance				
<b>24</b> Other expenses. Itemize expenses not covered above (List miscellaneous expenses in line 24e. If line 24e amount exceeds 10% of line 25, column (A) amount, list line 24e expenses on Schedule O.)				
<b>a</b> .....				
<b>b</b> .....				
<b>c</b> .....				
<b>d</b> .....				
<b>e</b> All other expenses				
<b>25</b> <b>Total functional expenses.</b> Add lines 1 through 24e				
<b>26</b> <b>Joint costs.</b> Complete this line only if the organization reported in column (B) joint costs from a combined educational campaign and fundraising solicitation. Check here <input type="checkbox"/> if following SOP 98-2 (ASC 958-720)				

**Part X Balance Sheet**

Check if Schedule O contains a response to any question in this Part X

		(A)	(B)
		Beginning of year	End of year
<b>Assets</b>	<b>1</b> Cash—non-interest-bearing . . . . .		<b>1</b>
	<b>2</b> Savings and temporary cash investments . . . . .		<b>2</b>
	<b>3</b> Pledges and grants receivable, net . . . . .		<b>3</b>
	<b>4</b> Accounts receivable, net . . . . .		<b>4</b>
	<b>5</b> Loans and other receivables from current and former officers, directors, trustees, key employees, and highest compensated employees. Complete Part II of Schedule L . . . . .		<b>5</b>
	<b>6</b> Loans and other receivables from other disqualified persons (as defined under section 4958(f)(1)), persons described in section 4958(c)(3)(B), and contributing employers and sponsoring organizations of section 501(c)(9) voluntary employees' beneficiary organizations (see instructions). Complete Part II of Schedule L . . . . .		<b>6</b>
	<b>7</b> Notes and loans receivable, net . . . . .		<b>7</b>
	<b>8</b> Inventories for sale or use . . . . .		<b>8</b>
	<b>9</b> Prepaid expenses and deferred charges . . . . .		<b>9</b>
	<b>10a</b> Land, buildings, and equipment: cost or other basis. Complete Part VI of Schedule D	<b>10a</b>	
	<b>b</b> Less: accumulated depreciation . . . . .	<b>10b</b>	<b>10c</b>
	<b>11</b> Investments—publicly traded securities . . . . .		<b>11</b>
	<b>12</b> Investments—other securities. See Part IV, line 11 . . . . .		<b>12</b>
	<b>13</b> Investments—program-related. See Part IV, line 11 . . . . .		<b>13</b>
	<b>14</b> Intangible assets . . . . .		<b>14</b>
	<b>15</b> Other assets. See Part IV, line 11 . . . . .		<b>15</b>
<b>16</b> <b>Total assets.</b> Add lines 1 through 15 (must equal line 34) . . . . .		<b>16</b>	
<b>Liabilities</b>	<b>17</b> Accounts payable and accrued expenses . . . . .		<b>17</b>
	<b>18</b> Grants payable . . . . .		<b>18</b>
	<b>19</b> Deferred revenue . . . . .		<b>19</b>
	<b>20</b> Tax-exempt bond liabilities . . . . .		<b>20</b>
	<b>21</b> Escrow or custodial account liability. Complete Part IV of Schedule D . . . . .		<b>21</b>
	<b>22</b> Loans and other payables to current and former officers, directors, trustees, key employees, highest compensated employees, and disqualified persons. Complete Part II of Schedule L . . . . .		<b>22</b>
	<b>23</b> Secured mortgages and notes payable to unrelated third parties . . . . .		<b>23</b>
	<b>24</b> Unsecured notes and loans payable to unrelated third parties . . . . .		<b>24</b>
	<b>25</b> Other liabilities (including federal income tax, payables to related third parties, and other liabilities not included on lines 17-24). Complete Part X of Schedule D . . . . .		<b>25</b>
	<b>26</b> <b>Total liabilities.</b> Add lines 17 through 25 . . . . .		<b>26</b>
<b>Net Assets or Fund Balances</b>	<b>Organizations that follow SFAS 117 (ASC 958), check here</b> <input type="checkbox"/> <b>and complete lines 27 through 29, and lines 33 and 34.</b>		
	<b>27</b> Unrestricted net assets . . . . .		<b>27</b>
	<b>28</b> Temporarily restricted net assets . . . . .		<b>28</b>
	<b>29</b> Permanently restricted net assets . . . . .		<b>29</b>
	<b>Organizations that do not follow SFAS 117 (ASC 958), check here</b> <input type="checkbox"/> <b>and complete lines 30 through 34.</b>		
	<b>30</b> Capital stock or trust principal, or current funds . . . . .		<b>30</b>
	<b>31</b> Paid-in or capital surplus, or land, building, or equipment fund . . . . .		<b>31</b>
	<b>32</b> Retained earnings, endowment, accumulated income, or other funds . . . . .		<b>32</b>
<b>33</b> Total net assets or fund balances . . . . .		<b>33</b>	
<b>34</b> Total liabilities and net assets/fund balances . . . . .		<b>34</b>	

**Part XI Reconciliation of Net Assets**

Check if Schedule O contains a response to any question in this Part XI

<b>1</b>	Total revenue (must equal Part VIII, column (A), line 12) . . . . .	<b>1</b>	
<b>2</b>	Total expenses (must equal Part IX, column (A), line 25) . . . . .	<b>2</b>	
<b>3</b>	Revenue less expenses. Subtract line 2 from line 1 . . . . .	<b>3</b>	
<b>4</b>	Net assets or fund balances at beginning of year (must equal Part X, line 33, column (A)) . . . . .	<b>4</b>	
<b>5</b>	Net unrealized gains (losses) on investments . . . . .	<b>5</b>	
<b>6</b>	Donated services and use of facilities . . . . .	<b>6</b>	
<b>7</b>	Investment expenses . . . . .	<b>7</b>	
<b>8</b>	Prior period adjustments . . . . .	<b>8</b>	
<b>9</b>	Other changes in net assets or fund balances (explain in Schedule O) . . . . .	<b>9</b>	
<b>10</b>	Net assets or fund balances at end of year. Combine lines 3 through 9 (must equal Part X, line 33, column (B)) . . . . .	<b>10</b>	

**Part XII Financial Statements and Reporting**

Check if Schedule O contains a response to any question in this Part XII

		Yes	No
<b>1</b>	Accounting method used to prepare the Form 990: <input type="checkbox"/> Cash <input type="checkbox"/> Accrual <input type="checkbox"/> Other _____ If the organization changed its method of accounting from a prior year or checked "Other," explain in Schedule O.		
<b>2a</b>	Were the organization's financial statements compiled or reviewed by an independent accountant? . . . . . If "Yes," check a box below to indicate whether the financial statements for the year were compiled or reviewed on a separate basis, consolidated basis, or both: <input type="checkbox"/> Separate basis <input type="checkbox"/> Consolidated basis <input type="checkbox"/> Both consolidated and separate basis		
<b>b</b>	Were the organization's financial statements audited by an independent accountant? . . . . . If "Yes," check a box below to indicate whether the financial statements for the year were audited on a separate basis, consolidated basis, or both: <input type="checkbox"/> Separate basis <input type="checkbox"/> Consolidated basis <input type="checkbox"/> Both consolidated and separate basis		
<b>c</b>	If "Yes" to line 2a or 2b, does the organization have a committee that assumes responsibility for oversight of the audit, review, or compilation of its financial statements and selection of an independent accountant? If the organization changed either its oversight process or selection process during the tax year, explain in Schedule O.		
<b>3a</b>	As a result of a federal award, was the organization required to undergo an audit or audits as set forth in the Single Audit Act and OMB Circular A-133? . . . . .		
<b>b</b>	If "Yes," did the organization undergo the required audit or audits? If the organization did not undergo the required audit or audits, explain why in Schedule O and describe any steps taken to undergo such audits		



## **APPENDIX II – GUIDESTAR CORRESPONDENCE**

**RE: Customer Service Request #5387 GUIDESTAR:00598798**

GuideStar\_EDU [GuideStar\_EDU@guidestar.org]

Sent: Monday, February 11, 2013 3:56 PM

To: Jim Kucher

Thank you for contacting GuideStar.

The IRS Business Master File is imported into the GuideStar database directly from the IRS's website when the IRS releases it for availability. However, financial data from Forms 990 are sent to a contractor to be keyed as digitized data. At the time it is digitized, every numerical valued displayed on the GuideStar site is entered twice, and any disparity between entered values is reconciled. GuideStar Quality Assurance staff regularly monitors the accuracy of this "double-keyed" data. The numerical fields in the GuideStar database are captured accurately at the 99.9 percent level.

For more information on digitized data, please visit our FAQs on the subject at:

<http://www.guidestar.org/rxq/help/faqs/financial-data/index.aspx#faq1925>

If you have additional questions, please contact us by clicking "Reply" on this message.

Regards,

GuideStar Information Support

-----Original Message-----

From: info@guidestar.org [<mailto:info@guidestar.org>]

Sent: Monday, February 11, 2013 10:00 AM

To: Guidestar Information

Subject: Customer Service Request #5387

Name: J Howard Kucher

Preferred Email: jkucher@ubalt.edu

Topic: Other

Question: I am a doctoral candidate doing research on nonprofits and was granted permission for academic access to your data. I have been asked some questions about your process, and would like your assistance.

It is my understanding that you use a subcontractor to input the IRS master file data. Can you please tell me what sort of auditing practices you employ to check the work of this subcontractor?

Thank you.

J.H, Kucher

University of Baltimore

Phone number: 4104195893

Registered E-Mail: jkucher@ubalt.edu

Request ID: 5387

System Information: Browser: Chrome, Browser Version: 24, Operating

System: Windows, Screen Size: 1366 x 768, Browser Window Size: 1366 x

643

## **APPENDIX III –IRB EXEMPTION**

**RE: Kucher IRB Application**

Marc Lennon

**Sent:** Monday, March 14, 2011 10:35 AM

**To:** Jim Kucher

**Cc:** Alan Lyles

Jim,

There is a distinction between research with human subjects that is exempt from IRB review and research that does not involve human subjects at all. Research that in no way involves human subjects does not need to be submitted to the IRB.

This particular research protocol is outside the purview of the Institutional Review Board. No further review is required.

Please let me know if you have any questions or need any additional information.

Thanks,

Marc Lennon

---

**From:** Jim Kucher

**Sent:** Saturday, March 12, 2011 2:50 PM

**To:** Marc Lennon

**Subject:** RE: Kucher IRB Application

Marc,

No worries, thanks for the follow up - especially on a Saturday.

The subject of the study is organizations, not individual human subjects. I am not interviewing, surveying, observing or otherwise interacting with individuals.

My submission is being made in accordance with the DPA handbook. I do believe I am exempt, but need to have that determined formally by IRB for my files.

Thanks again for your help.

Jim

---

**From:** Marc Lennon

**Sent:** Sat 3/12/2011 12:26 PM

**To:** Jim Kucher

**Subject:** RE: Kucher IRB Application

Jim,

Forgive me if I'm being thick-headed here, but does your research deal with data for individuals or for organizations (or both)?

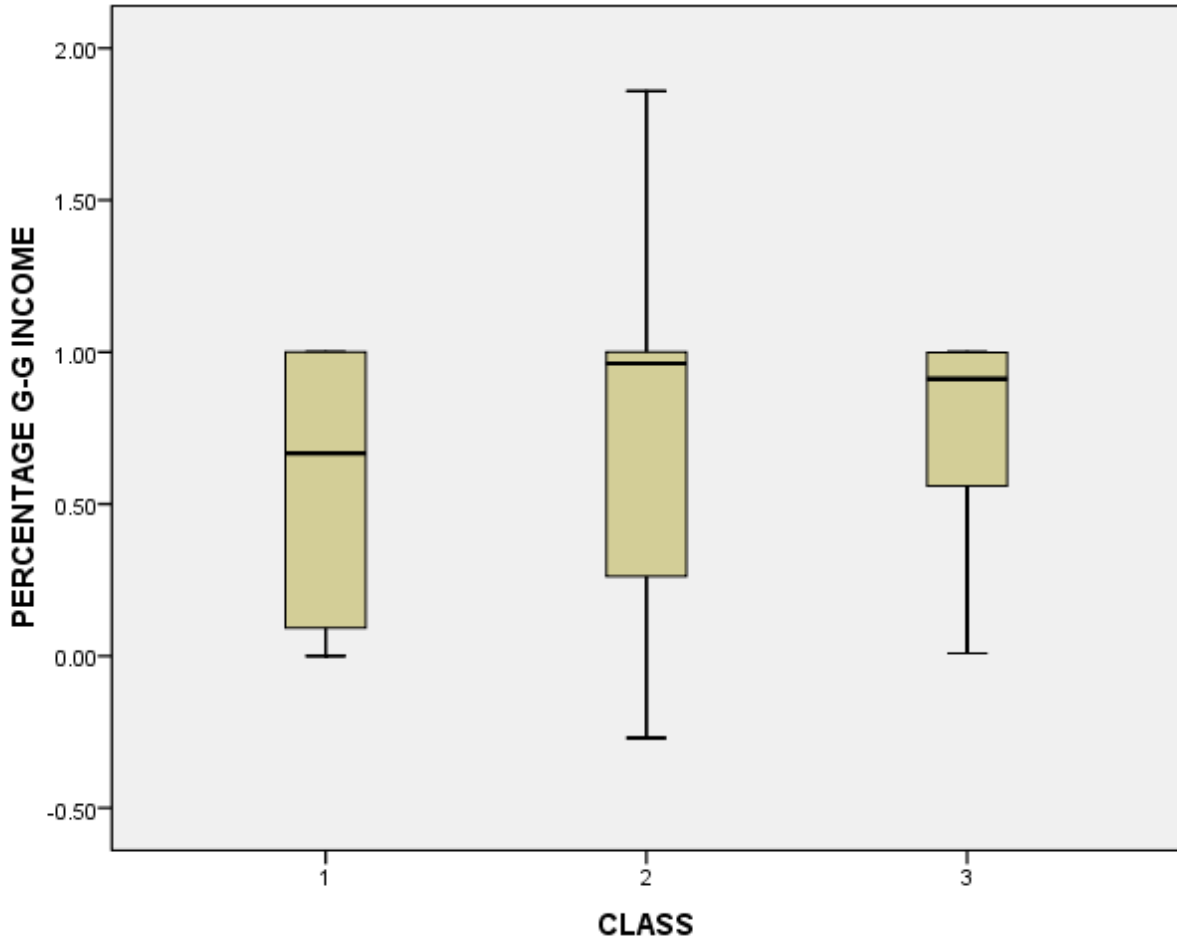
<https://webmail.ubalt.edu/owa/?ae=Item&t=IPM.Note&id=RgAAAAA5eDNR4o2AS5a8F...> 4/28/2013

## **APPENDIX IV – DISTRIBUTION OF DATA**

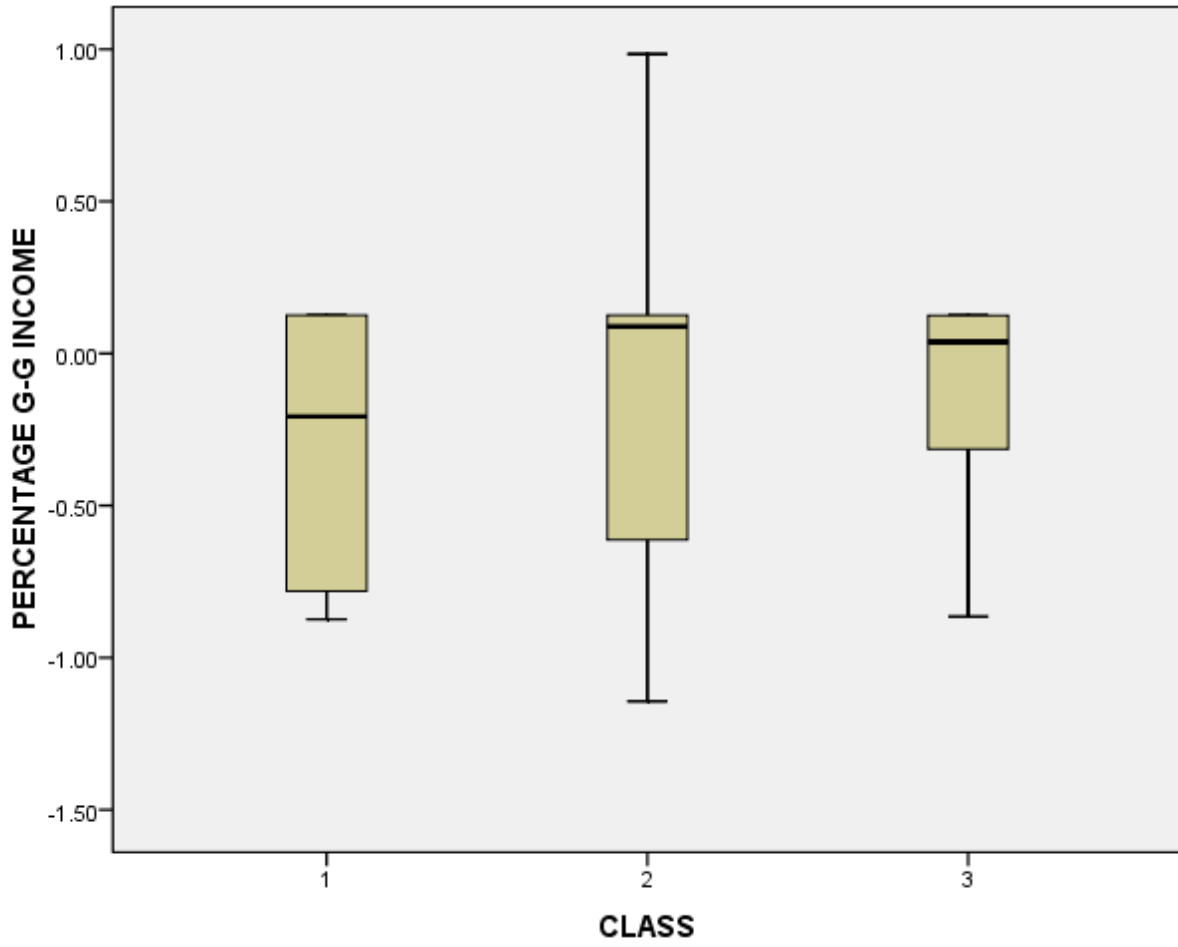
## Box and Whisker Plots

Percentage of income from grants/gifts

Initial Data Set

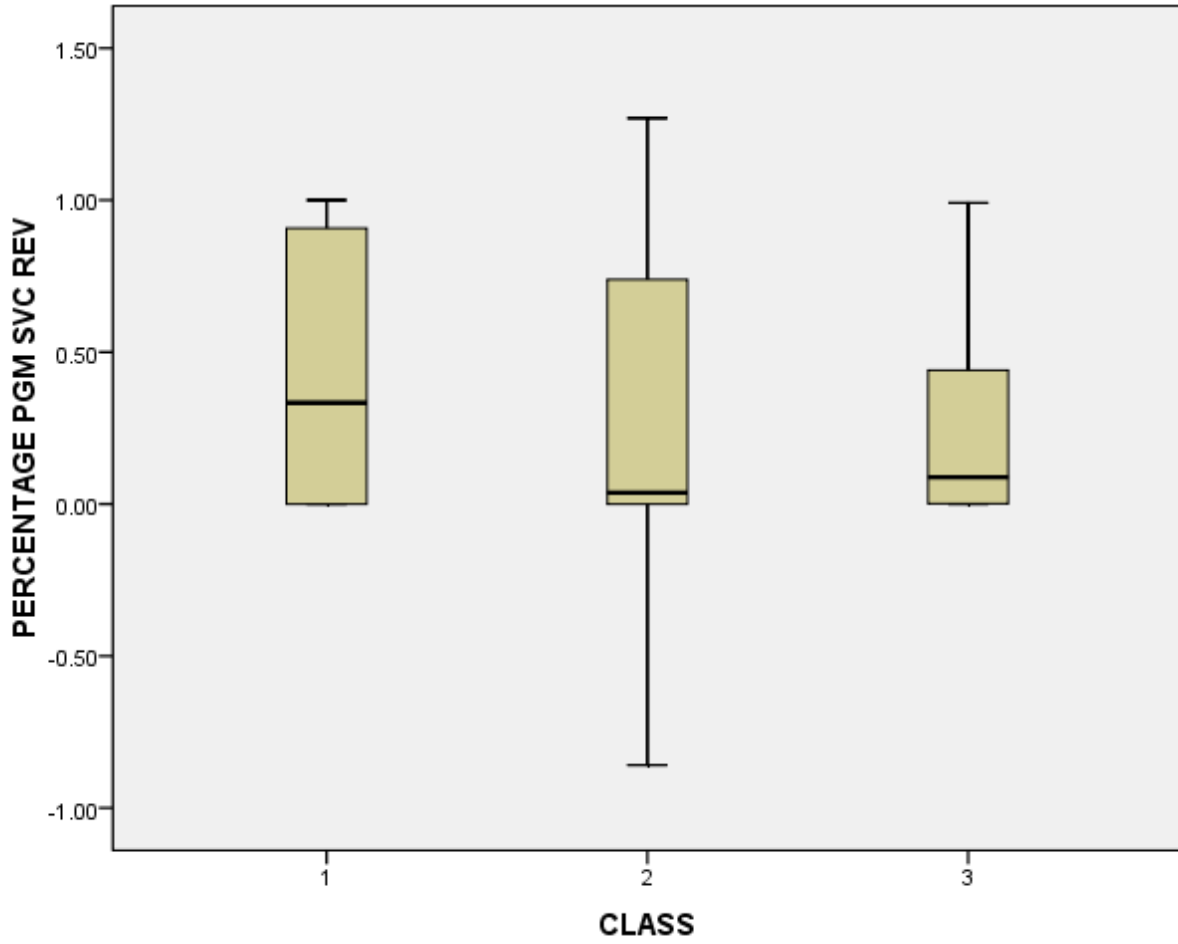


Data set after Variance Transformation



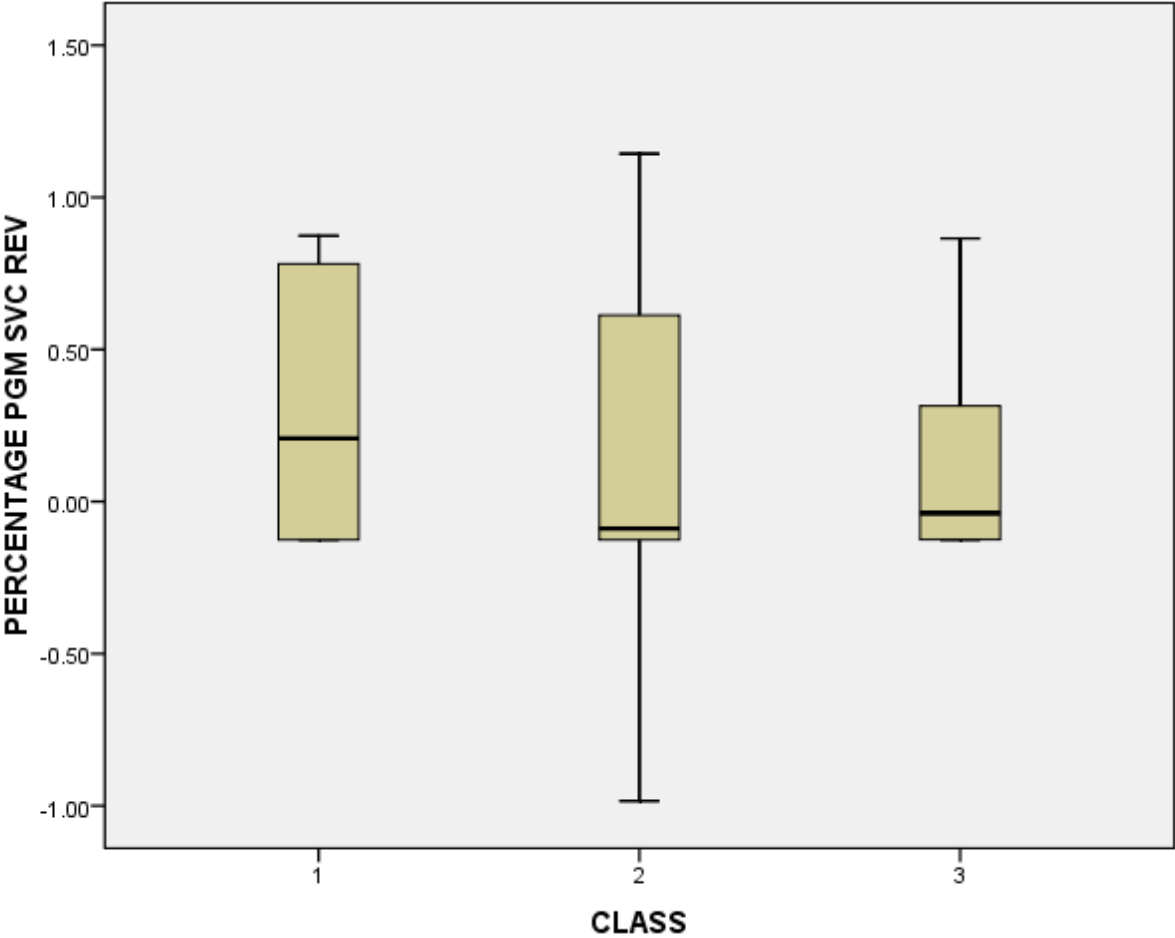
9) Percentage of income from program related services

Initial Data Set



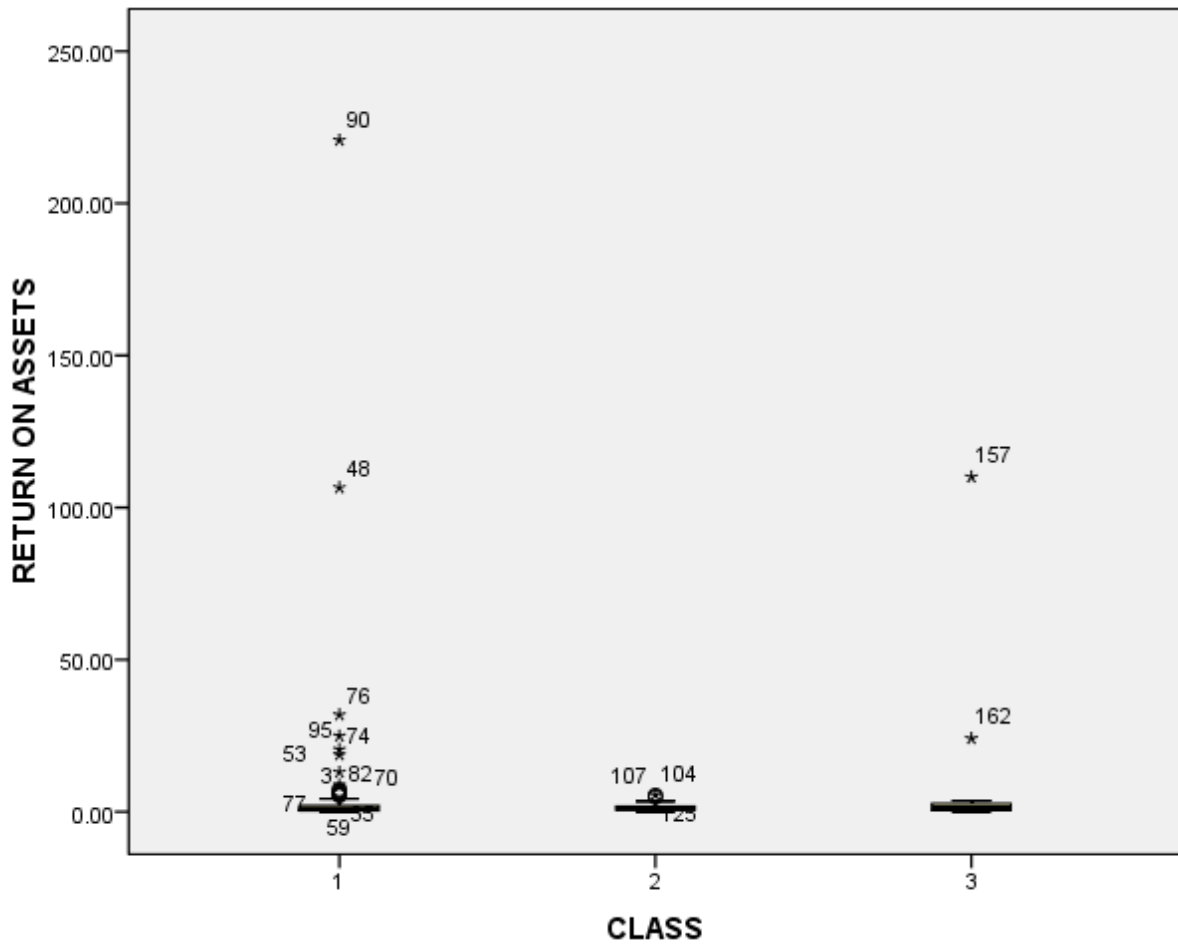


Data set after Variance Transformation

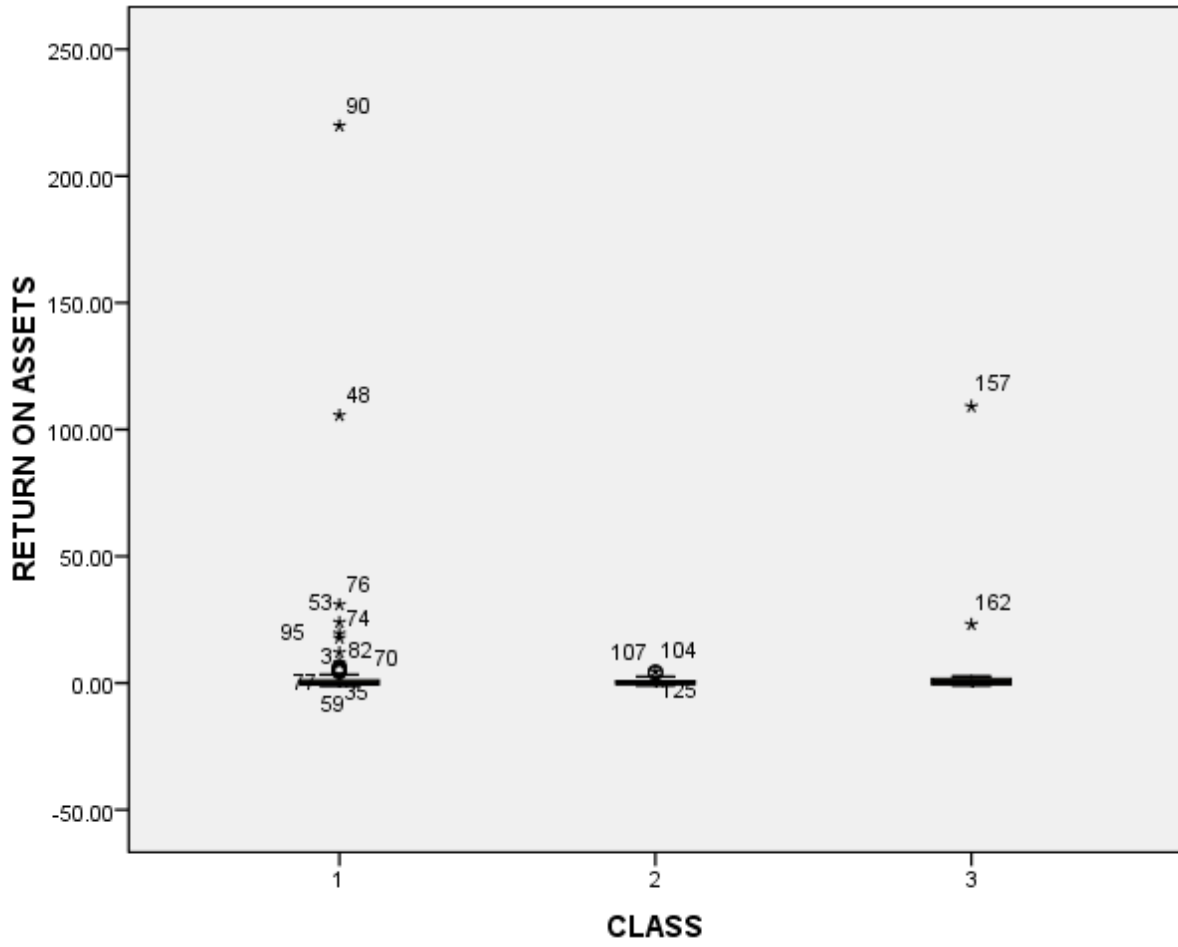


### 3) Return on Assets

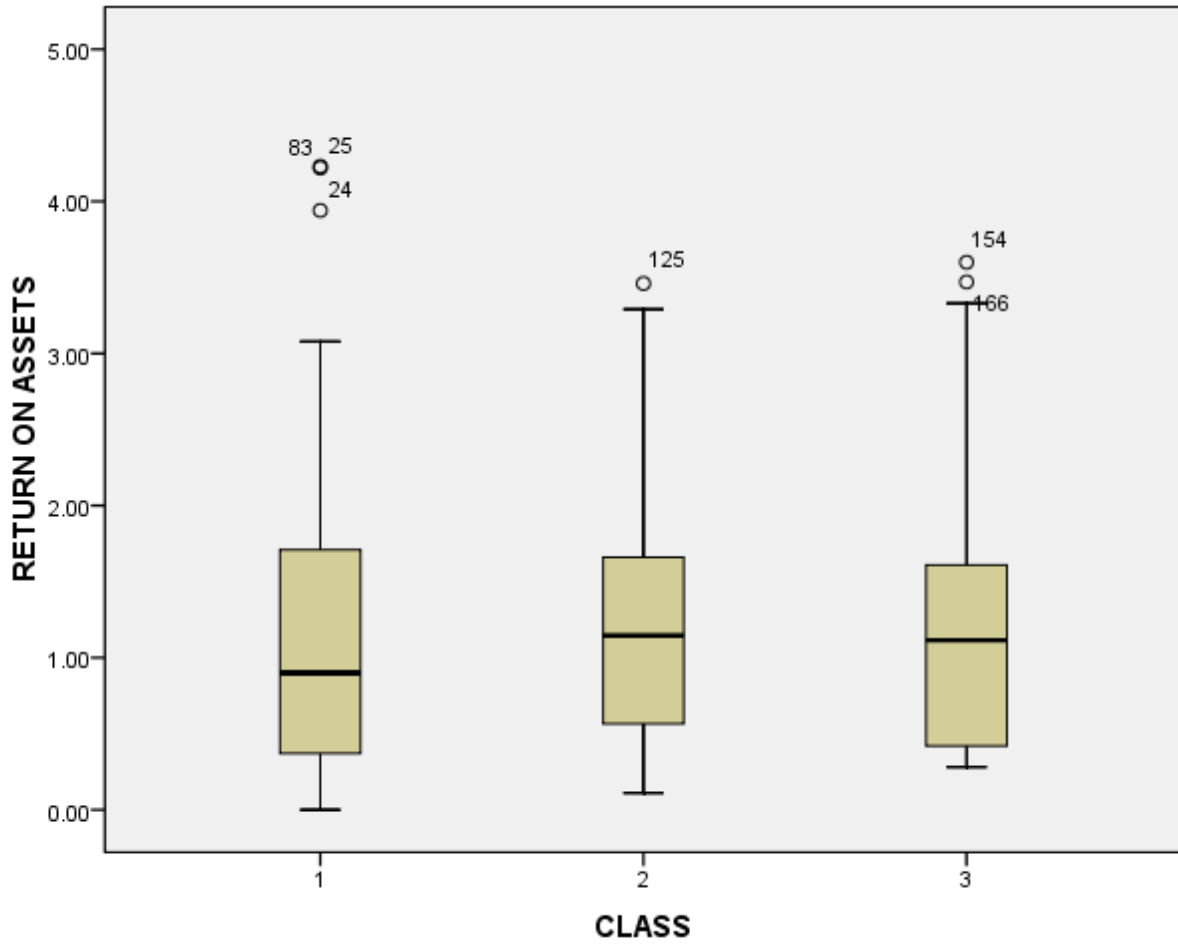
Initial Data Set



Data Set after Variance Transformation

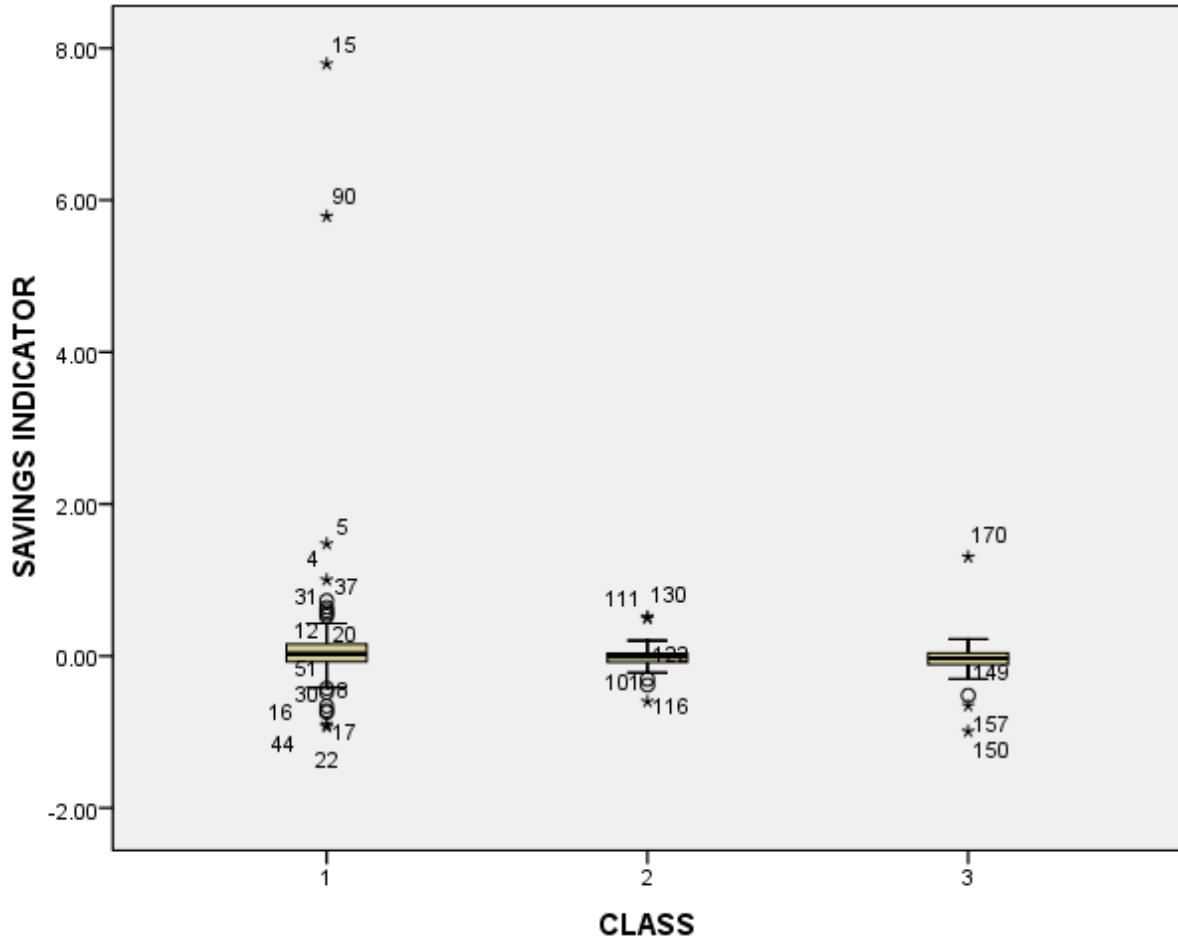


# Data Set after Boundary Line Analysis

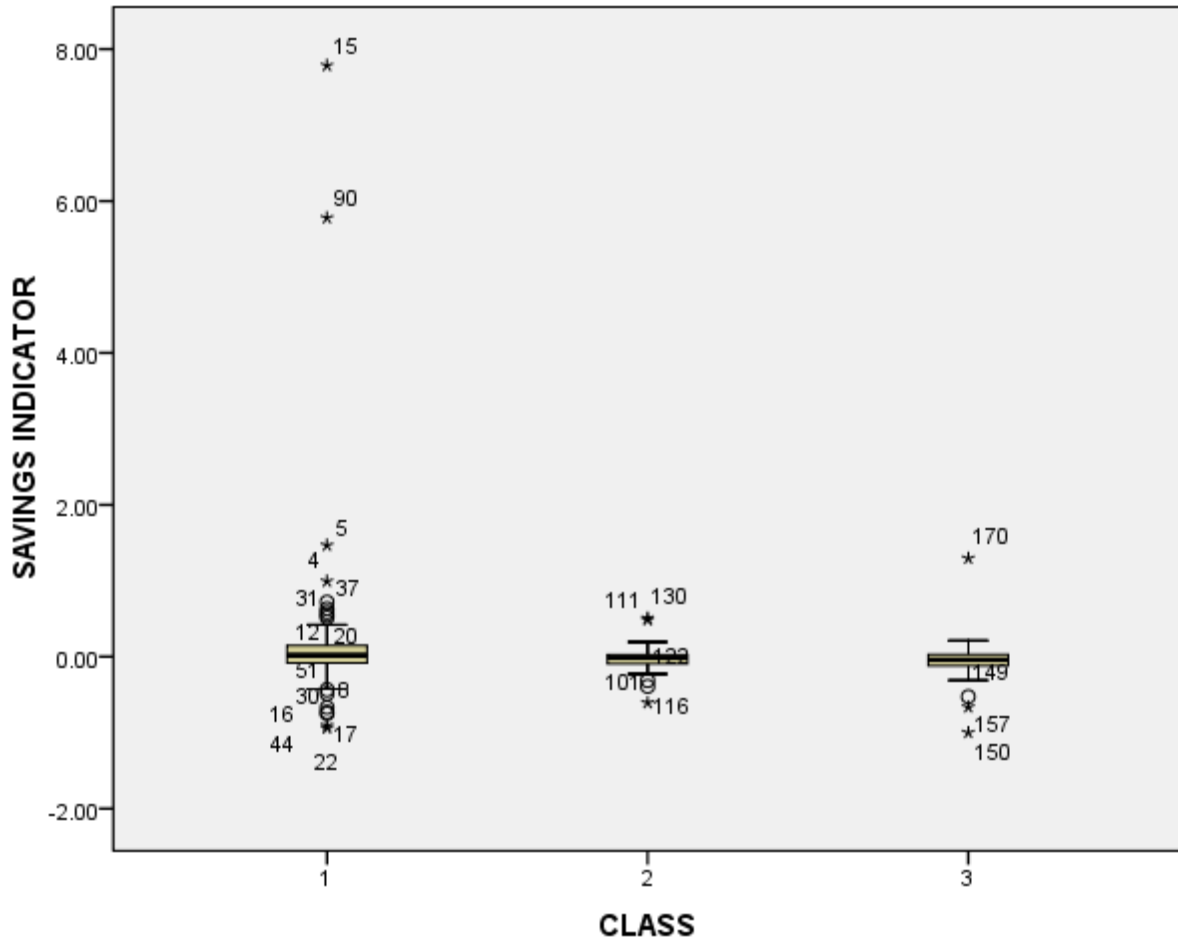


4) Savings Ratio

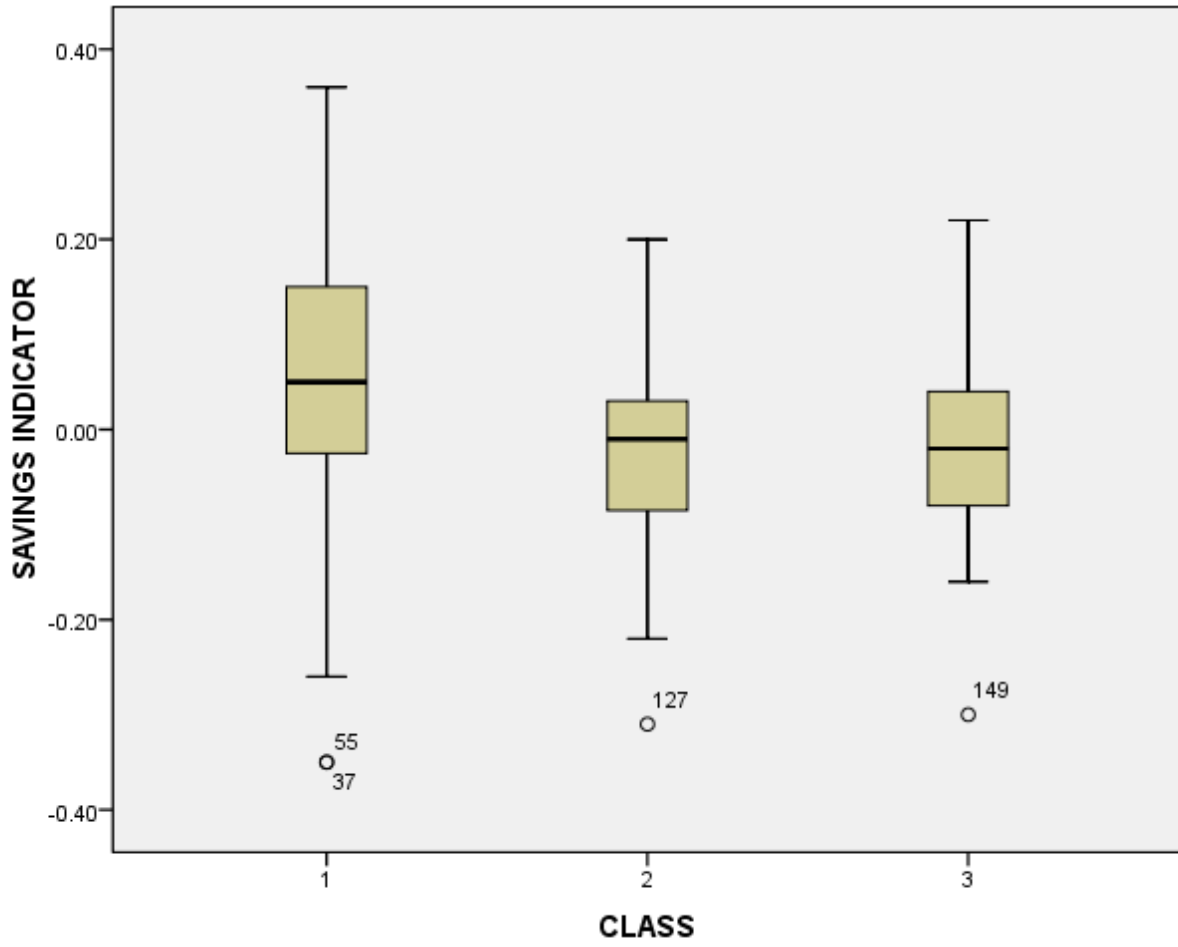
Initial Data Set



Data Set after Variance Transformation

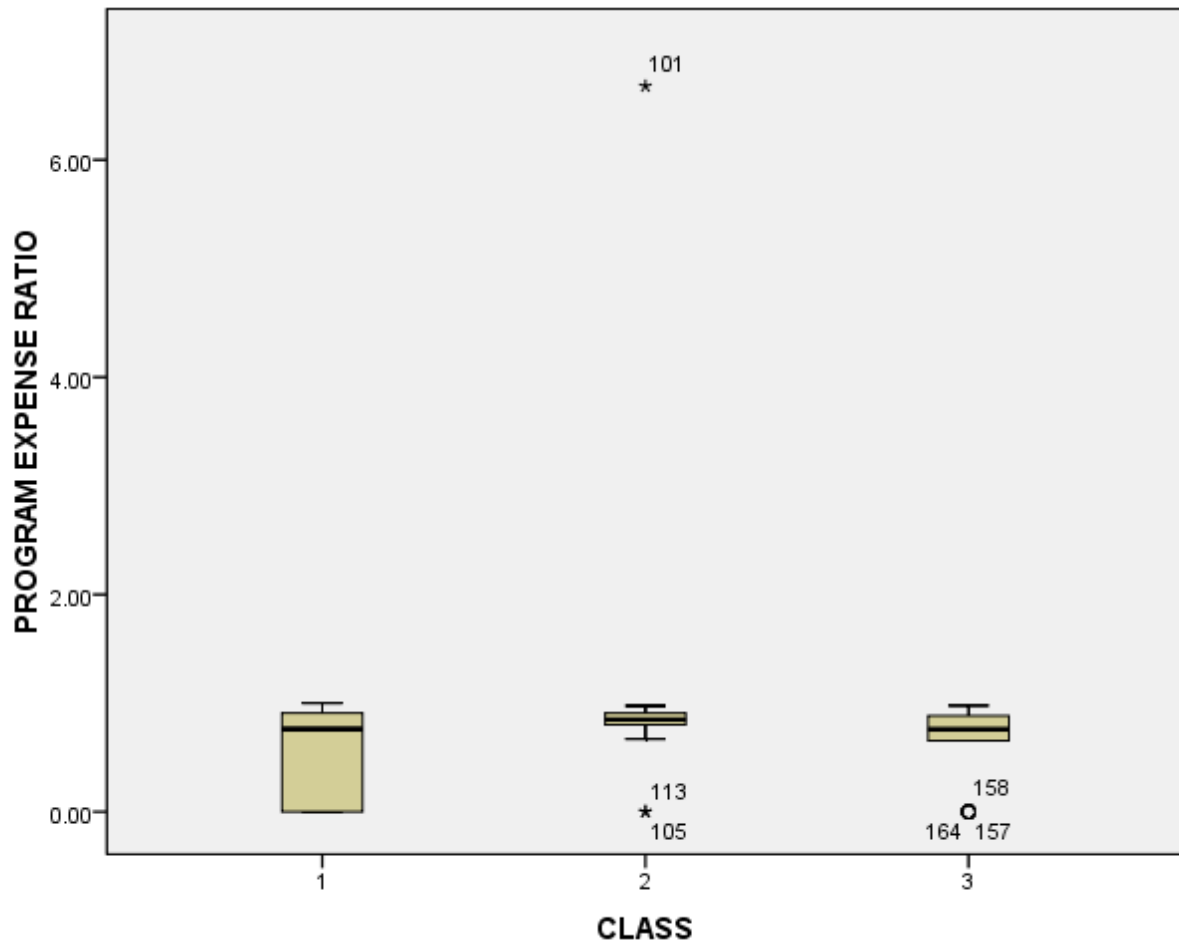


# Data Set after Boundary Line Analysis



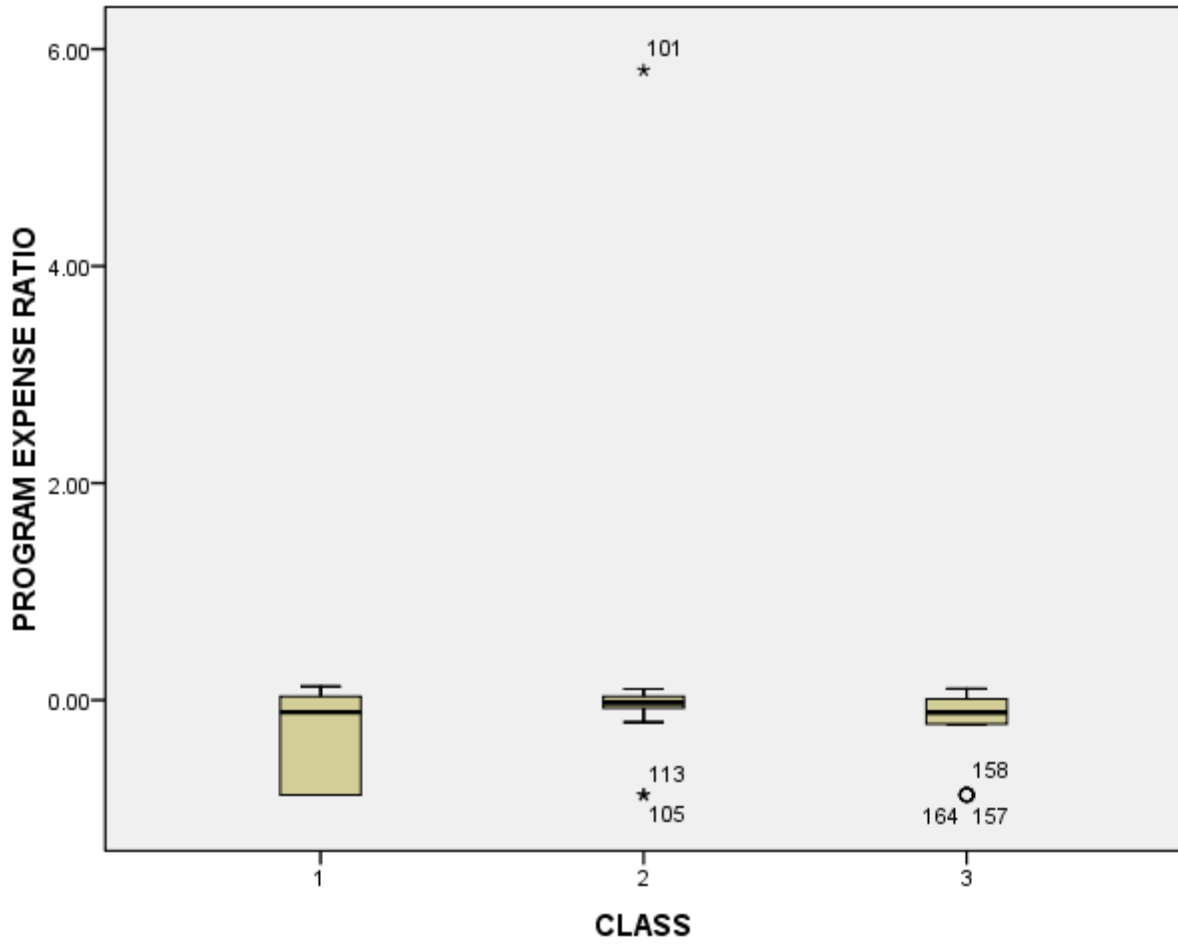
## 5) Program Expense Ratio

Initial Data Set

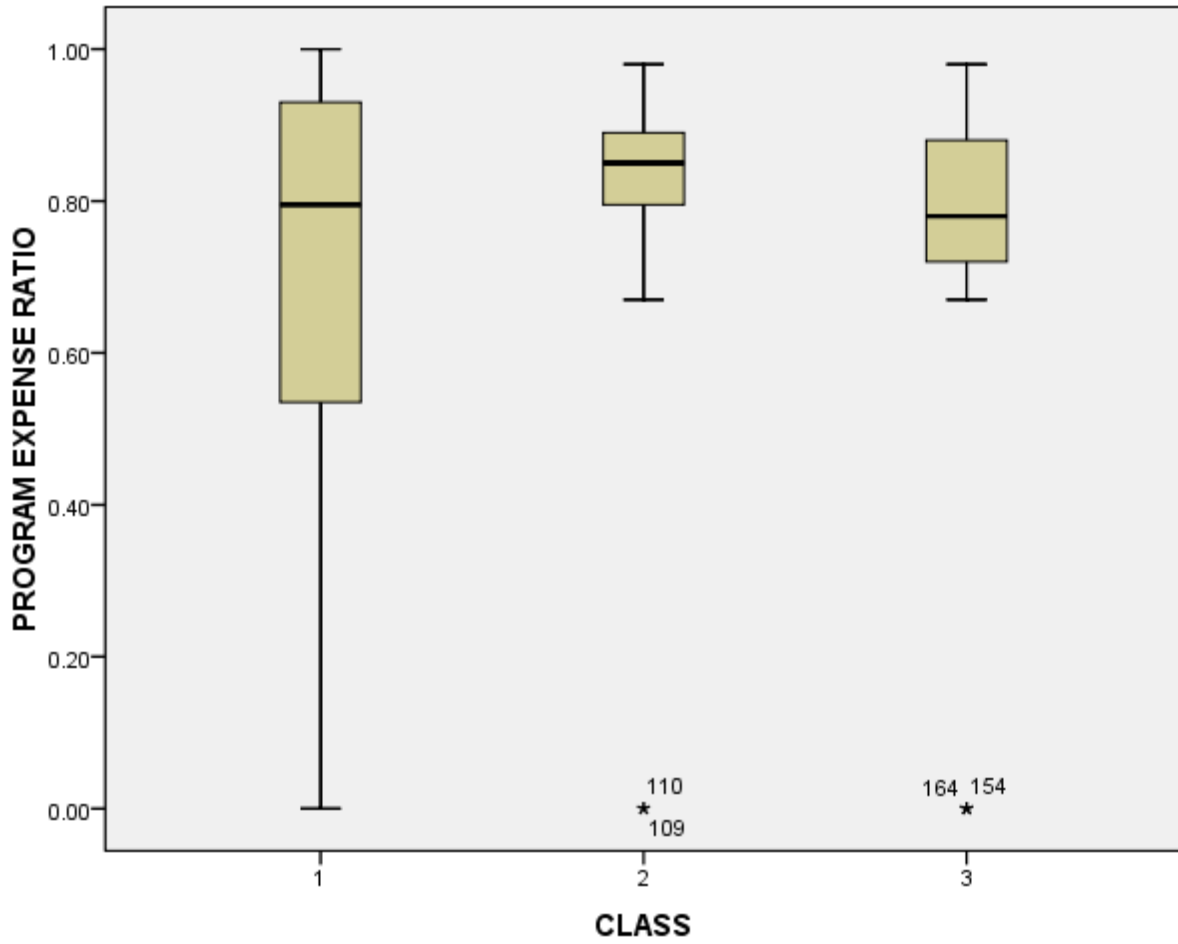




Data Set after Variance Transformation

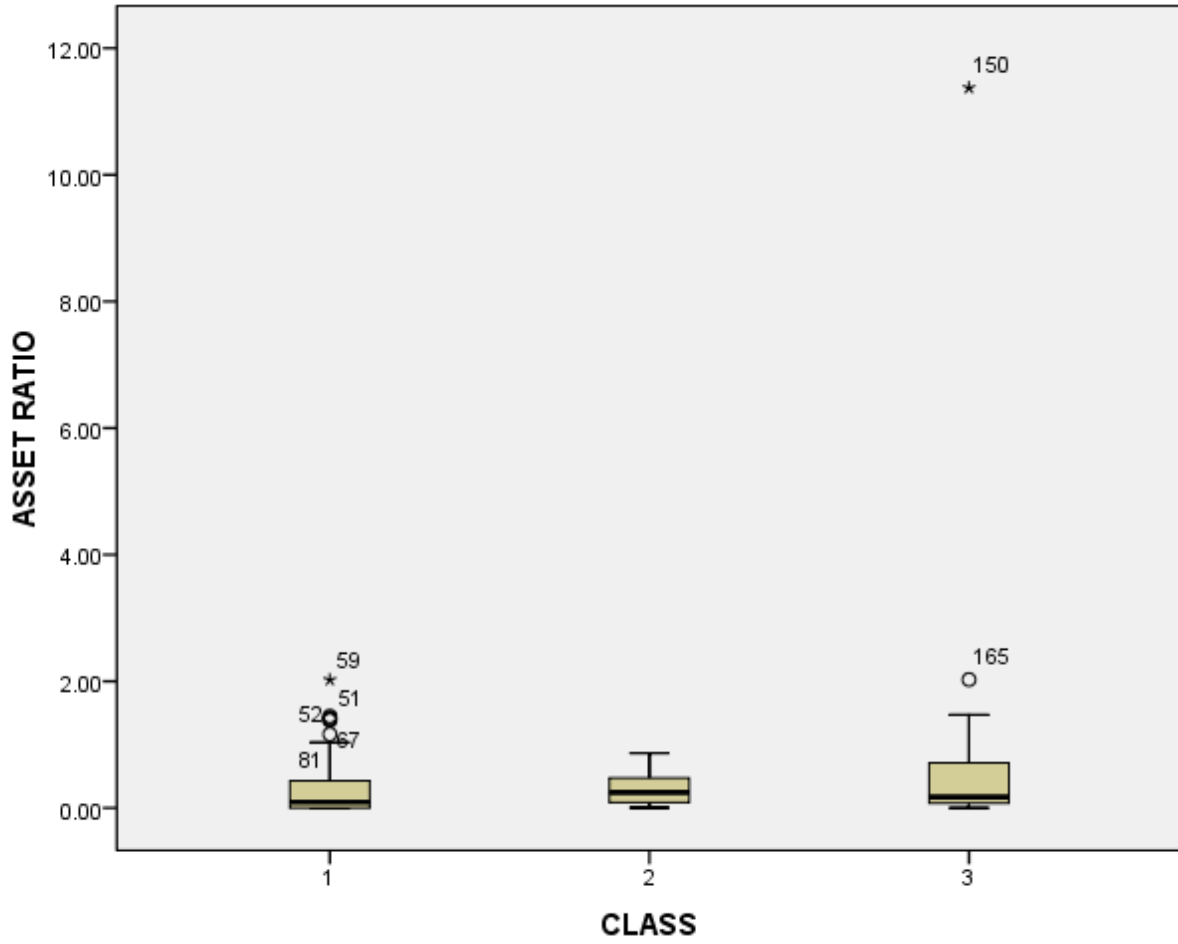


Data Set after Boundary Line Analysis

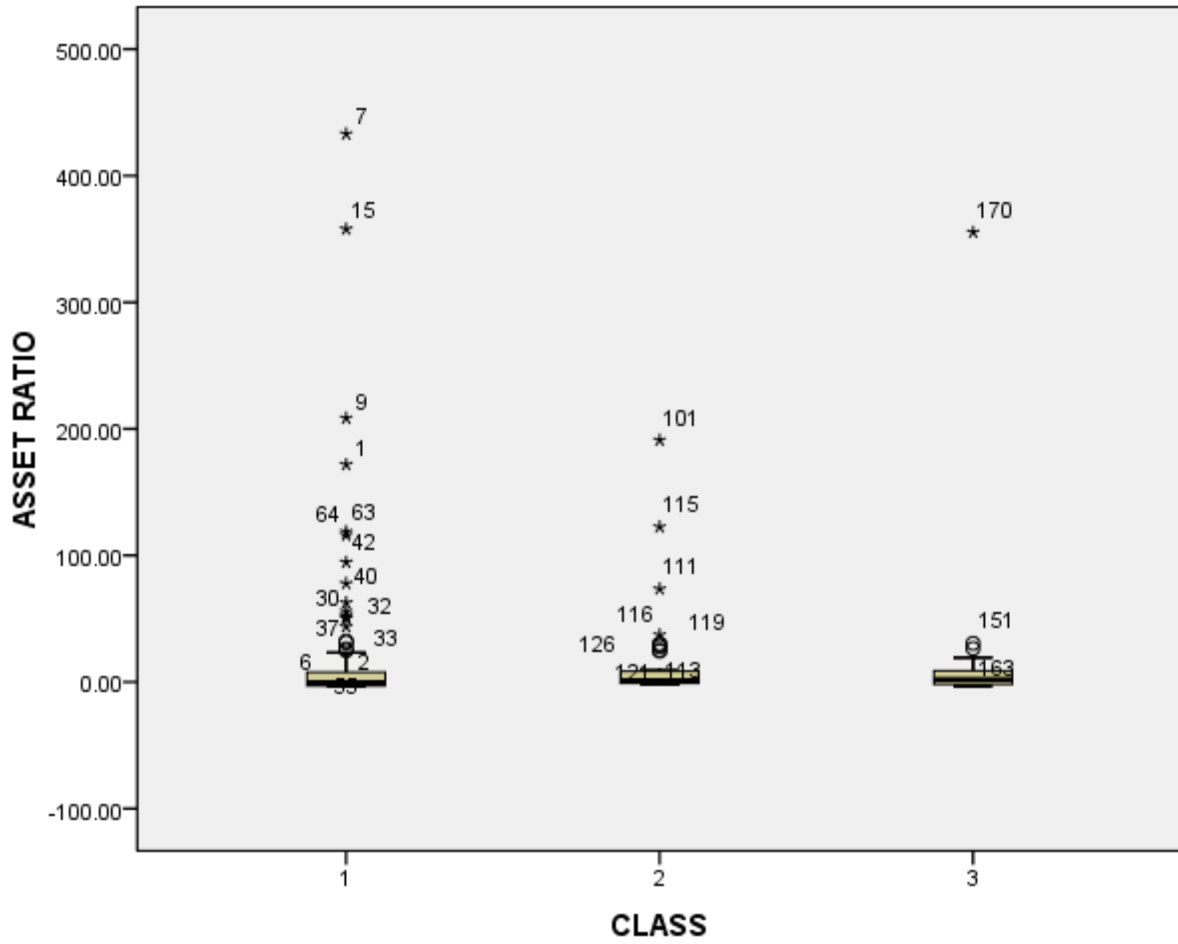


6) Asset ratio

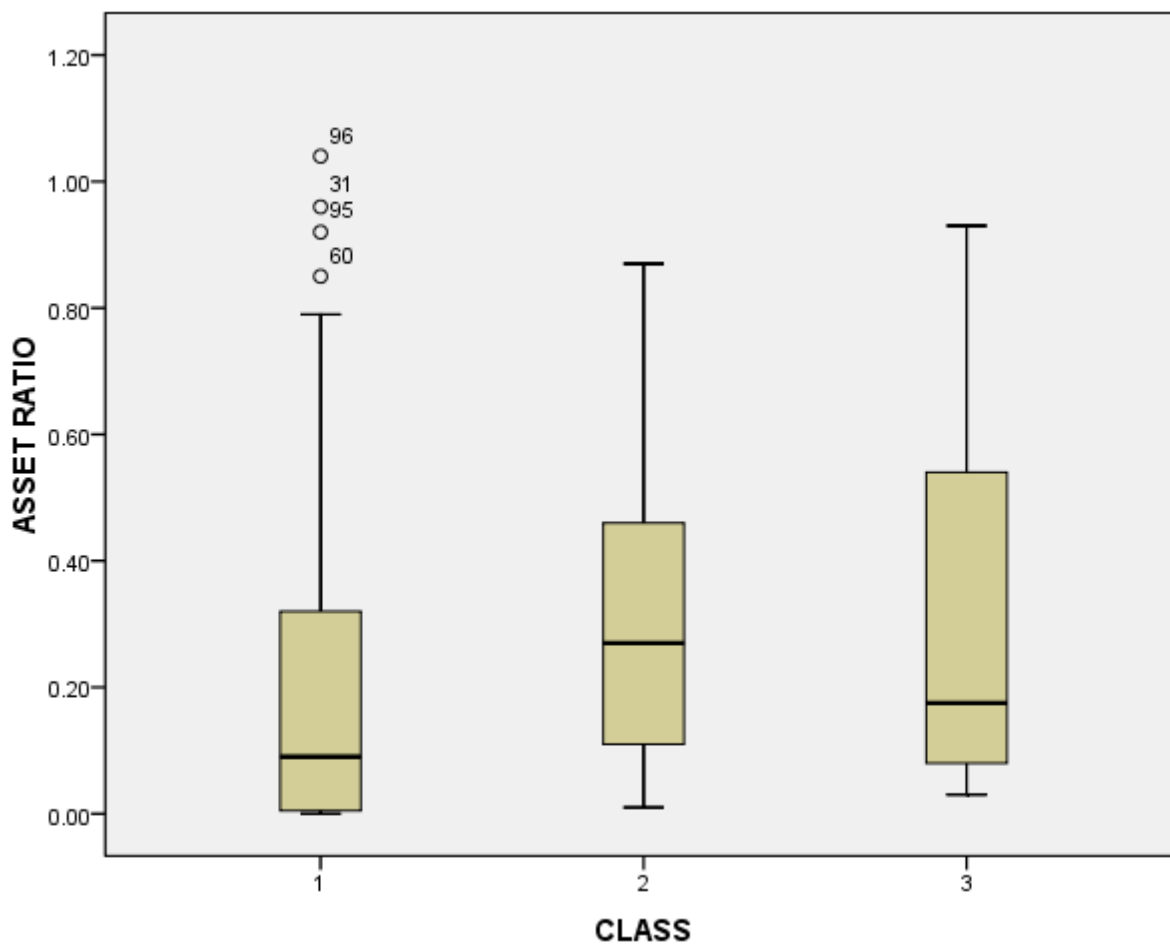
Initial Data Set



### Data Set after Variance Transformation



Data Set after Boundary Line Analysis



## **APPENDIX V – STATISTICAL ANALYSIS**

Measures of Central Tendency						
	% income from grants/ gifts	% income from program services	Return on Assets	Savings indicator	Program Expense ratio	Asset ratio
Sub Group 1- General Population						
mean	57%	43%	571%	16%	59%	2359%
median	66%	34%	91%	3%	76%	236%
Sub Group 2 -High Performing						
mean	72%	28%	142%	-2%	93%	1608%
median	96%	4%	114%	-1%	85%	408%
Sub Group 3- Social Enterprise						
mean	76%	24%	637%	-6%	63%	2120%
median	91%	9%	112%	-3%	76%	515%

Kruskal Wallis Test						
	PERCENTAGE G-G INCOME	PERCENTAGE PGM SVC REV	RETURN ON ASSETS	SAVINGS INDICATOR	PROGRAM EXPENSE RATIO	ASSET RATIO
Chi-Square	4.975	4.975	3.748	8.098	7.497	13.954
df	2	2	2	2	2	2
Asymp. Sig.	.083	.083	.153	.017	.024	.001

a. Kruskal Wallis Test

Mann-Whitney Test Subgroups 1 & 2 Test Statistics<sup>a</sup>

	PERCENTAGE G-G INCOME	PERCENTAGE PGM SVC REV	RETURN ON ASSETS	SAVINGS INDICATOR	PROGRAM EXPENSE RATIO	ASSET RATIO
Mann-Whitney U	1919.500	1919.500	1541.000	1292.500	1710.500	1374.500
Wilcoxon W	6969.500	3047.500	5196.000	2238.500	6760.500	5745.500
Z	-1.808	-1.808	-1.635	-2.447	-2.495	-3.593
Asymp. Sig. (2-tailed)	.071	.071	.102	.014	.013	.000

Mann-Whitney Test Subgroups 1 & 3 Test Statistics<sup>a</sup>

	PERCENTAGE G-G INCOME	PERCENTAGE PGM SVC REV	RETURN ON ASSETS	SAVINGS INDICATOR	PROGRAM EXPENSE RATIO	ASSET RATIO
Mann-Whitney U	1013.500	1013.500	824.000	645.000	1295.000	767.500
Wilcoxon W	6063.500	1364.500	4479.000	898.000	1646.000	5138.500
Z	-1.744	-1.744	-1.433	-2.047	-.030	-1.832
Asymp. Sig. (2-tailed)	.081	.081	.152	.041	.976	.067



Mann-Whitney Test Subgroups 1 & 3 Test Statistics<sup>a</sup>

	PERCENTAGE G-G INCOME	PERCENTAGE PGM SVC REV	RETURN ON ASSETS	SAVINGS INDICATOR	PROGRAM EXPENSE RATIO	ASSET RATIO
Mann-Whitney U	1013.500	1013.500	824.000	645.000	1295.000	767.500
Wilcoxon W	6063.500	1364.500	4479.000	898.000	1646.000	5138.500
Z	-1.744	-1.744	-1.433	-2.047	-.030	-1.832
Asymp. Sig. (2-tailed)	.081	.081	.152	.041	.976	.067

a. Grouping Variable:  
CLASS

Mann-Whitney Test sub groups 2 & 3 Test Statistics<sup>a</sup>

	PERCENTAGE G-G INCOME	PERCENTAGE PGM SVC REV	RETURN ON ASSETS	SAVINGS INDICATOR	PROGRAM EXPENSE RATIO	ASSET RATIO
Mann-Whitney U	599.500	599.500	507.500	452.500	401.500	437.500
Wilcoxon W	950.500	1727.500	1497.500	705.500	752.500	690.500
Z	-.134	-.134	-.263	-.285	-2.310	-1.024
Asymp. Sig. (2-tailed)	.893	.893	.792	.776	.021	.306

a. Grouping Variable:  
CLASS

## **GLOSSARY**

Asset Ratio	This ratio measures the financial liquidity of the organization, by determining the amount of cash and cash equivalents. Calculated by dividing the total assets by the total liabilities, lower values for this ratio tend to indicate a higher level of fixed operating costs and higher amounts of operating debt being used to finance ongoing operations. Higher ratios indicate both lower levels of operating debt and an improved ability to meet financial obligations.
Capitalist	One who invests assets in an enterprise (usually a business) with a hope of receiving a financial return greater than the value of the asset invested.
Charity	An entity or organized effort to provide care of or service to a targeted population, usually one viewed as underserved; and typically exempt from State and Federal income taxes.
Double bottom line	A management measurement that seeks to quantify the result of a business or charitable endeavor in terms of both financial value and social impact.
Earned income	That portion of a charity's revenue that comes from direct commercial activity such as sales of goods or services (as opposed to income from philanthropic sources such as grants or donations).
Entrepreneur	A person who creates or builds an entity by assembling various assets, not all of which may be readily apparent at the time. Usually applied in the context of creating something that did not exist prior to the undertaking.
Entrepreneurial	The mindset, tools and techniques used to develop or create an innovation or innovative solution, usually where one did not exist and typically without regard to existing perceived or actual constraints.
Gift	In the charitable context, a donation made without expectation of financial return to the donor.

Grant	In the charitable context, a structured donation typically awarded by a charitable foundation or governmental entity. As with a Gift, it is made without expectation of financial return to the donor.
IRS 990 or 990	The form used by the U.S. Internal Revenue Service to receive the income and expense reports of entities who have been granted tax exempt status by the U.S. Government.
Nonprofit	A charitable entity that has been awarded tax exempt status by the U.S. Government.
Philanthropy	The undertaking (and usually funding) of a private initiative to provide for the care of or service to a specific population, usually one viewed as underserved. Funding for such activities that comes from private sources rather than from government.
Private Enterprise	Individually, an undertaking that seeks to deploy invested assets in order to increase their value and return that value to the investor(s). Collectively, that portion of society composed of such entities.
Program Expense Ratio	This ratio measures the amount of expense used in the direct delivery of programs and services. It is calculated by dividing the direct program expenses by the total expenses. This ratio is often used by independent rating organizations as a key measurement of nonprofit effectiveness. By inference, it is also often used as a measurement of operating efficiency, with higher ratios indicating that funding is going to the delivery of programs and not to administrative overhead.
Program Related Services	Activities undertaken by a charity that create Earned Income.

Program Service Revenue	The income derived from Program Related Services (See also Earned Income).
Return on Assets (ROA)	ROA seeks to quantify the efficiencies of management in using organizational assets to generate earnings. In the case of a nonprofit, it is an indicator of operating efficiency. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as return on investment. ROA is often used as an indicator of the financial health of the entity, with a higher ratio implying that an organization is more financially healthy.
Savings Ratio	This ratio indicates how quickly the organization is using up its cash supply in funding operations. Calculated by subtracting the total expenses from the total revenue and then dividing the difference by the total expenses, a higher ratio would indicate that the entity is able to continue operating for a longer period of time as it is not expending all its revenue in funding operations.
Social business	An entity that seeks to produce a positive financial return and a positive impact on a specified population, usually one viewed as underserved. Typically it is legally organized as a for-profit entity.
Social change	A change in the social condition or standing of a specific group or class of individuals within a society.
Social Enterprise	An entity that seeks to produce a positive financial return and a positive impact on a specified population, usually one viewed as underserved. It may or may not be organized as a charity.
Social Enterprise Alliance	A U.S. based membership organization that seeks to support the growth of Social Enterprise as a technique for funding and achieving a social mission.

Social Entrepreneur	A person who creates or builds an entity by assembling various assets, not all of which may be readily apparent at the time; with the specific intent of affecting social change. Usually applied in the context of creating something that did not exist prior to the undertaking.
Social Entrepreneurship	The application of entrepreneurial tools and techniques to the creation of positive social change.
Social Equity	The notion of fairness within a societal structure. In a charitable context, the idea that a social imbalance exists and can be corrected.
Social impact	The end result of action taken to correct a social inequity.
Social Mission	An organizational or individual objective that seeks to improve social equity.
Social Services	The activity undertaken to provide for the care of or service to a specific population, usually one viewed as underserved. This particular derivation often connotes an activity that is funded by government rather than private philanthropy.
Tax Exemption	The legal granting of relief from the payment of local, state or federal income tax; it is granted in the U.S. by filing for tax exempt status with The Internal Revenue Service.

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