Trying to Dance to Syncopated Rhythm: *The* Dynamics *of* Government Funding *for* Nonprofits

by Jodi R. Sandfort

Most nonprofit directors are all too familiar with the contracting dance. The dance is complicated—it involves scanning requests for proposals, writing grants, waiting as the proposed program is evaluated by faceless review panels, negotiating terms back and forth, and finally, when every move is executed, receiving the signed contract agreement from the city, county, state, or federal agency. Often, what makes this process so challenging is not the length of the grant proposal, the detailed criteria used to evaluate it, or the painstaking negotiations. It is the different expectations, processes, and terminology for every government agency. The dance is so convoluted because the songs keep changing and the actual DJ spinning the music changes, as well. Oftentimes, it feels like the county department plays R&B, and the city Hip Hop; some state agencies spin rock classics, and others light jazz. Sometimes, if contracting processes are occurring at the same time, nonprofits must dance to two different songs simultaneously.

Also troubling for the field of nonprofit management are the consequences of these dances, which are often hidden. The motivation to begin the dance seems clear—nonprofit agencies need public revenue to pay their staff, to cover the costs of program, to turn on the lights. The public revenue that an organization receives often helps legitimate it, a signal to other donors that it is a professional and competent operation. Yet, research over the last 15 years suggests there are important, albeit unintended, consequences of accepting government revenue—for nonprofit organizations, for the fields within which they work, and for the clients the organization exists to serve.

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Changing Reality of Nonprofit-Government Relationships

What is notable to scholars of both U.S. nonprofit management and public administration is the dramatic privatization over the last thirty years of services once carried out by the public sector. The increased reliance by all levels of government on both nonprofit and for-profit agencies is fueled by a confluence of forces. For one, the "reinvention of government" has increasingly put government in the place of *steering* (that is, deciding public policy priorities) rather than *rowing* (actually providing the services themselves). Secondly, there continues to be significant public mistrust in government and a wide-spread belief that contracting with private organizations allows for more efficient and effective services. Finally, in such an environment, public managers often have limited abilities to hire new public workers to respond to new legislative mandates; instead, partnering with private providers is seen to be a more reasonable solution. As a result of these forces, public tax dollars are now going to fund private organizations at unprecedented levels.

The particular shape that this trend toward privatization takes varies considerably from field to field, place to place, even service to service. In some fields, such as public health, there is sharp competition for public dollars between private for-profit and nonprofit organizations. In other fields, such as adult education, this com-

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petition might exist in the eastern United States but not in the upper Midwest. In some places, county government might contract with for-profit elder care programs for this service while state government only contracts with nonprofit providers. The larger trend, though, reveals that nonprofits are facing increasingly competitive environments. They are no longer the "preferred provider" of public services.

For governments at all levels, there are many benefits from using private organizations to implement public policy. When faced with legislative mandates, public managers can access expertise that would be almost impossible to provide in the public sector. Issuing specialized contracts also can allow the state to be more responsive to the particular needs of smaller groups of people—ethnic minorities, non-English speaking people, and those with disabilities. Such contracts also give the state more flexibility. As legislative priorities change or political winds shift, it is fairly easy to change the terms of the contracts—or cancel them completely—to reflect the new emphasis. Think, for example, of the new emphasis on government performance. With this trend in public management, governments at all levels have altered contracting practices to require nonprofit agencies to provide more evidence about the results of public investment.

The particular benefits that the government gets when relying upon nonprofits to carry out public programs depends significantly on the actual form the public revenue takes. Increasingly, there is a wide range of financing tools used by government. Certainly, contracts are often the most visible approach. Governments want to purchase specific services—employment training, supportive housing for multi-problem families, environmental education—and they do so by issuing contracts. Grants also are widely used to disburse public revenue and respond to an emerging public problem, to encourage new innovation, or to support interesting models. Increasingly, governments are providing subsidies to individuals to help them pay for many services, such as health care, child care, and housing. In this approach, the consumer determines where the public revenue goes, and thus increases the financial insecurity of the nonprofit organizations that must compete for the subsidy with other, more capitalized private organizations. Public tax policy, also, is an important tool used to direct revenue to private organizations. Tax credits and deductions—for business and individuals—create incentives that directly influence the revenue accessible to nonprofits. The most obvious example is the U.S. government's practice of allowing income tax deductions for charitable contributions. There are, however, many tax credits and deductions—for everything from children's care to financing affordable housing—that help bring additional revenue into arenas where nonprofits may benefit. Finally, the most basic tool government uses to finance nonprofit organizations is the "tax expenditure" (the amount of money foregone by the government) that exempts an organization from corporate and many other taxes.

Luckily for nonprofit managers, rarely does a particular organization receive public revenue

Government Tools for Financing Nonprofit Organizations

- Contracts
- Grants
- Subsidies to Individuals (directly or tax credits/deductions)
- Low-cost access to capital (tax-exempt bonds, tax-credit financing)
- Tax deduction for individual donations
- Exemption from corporate and other taxes

through all of these mechanisms. Certain funding tools tend to predominate in particular policy fields. For example, tax credit financing is common in low-income housing and economic development. Contracts are widespread in child welfare and employment services. Public grants are common for private colleges, universities, and arts organizations. However, over time, it seems there has been a trend moving from producer-side subsidies (contracts, grants) toward consumer-side subsidies (vouchers, tax deductions).[1] This change has significant management implications.

As many managers know from firsthand experience, there are trade-offs with each form of public revenue. While contracts are fairly predictable, they often require a number of new organizational procedures. While subsidies to individuals might be less predictable, they allow the agency to retain more control over the types and quality of services provided. The particular way managers weigh these trade-offs is often quite complicated. They make calculations in relation to the other sources of funding available (such as individual donations, foundation grants, earned income) and the need, at the end of the day, to cover program costs or respond to new community needs. Yet, often what gets overlooked are the unintended consequences for the agencies of receiving public revenue.

Organizational Consequences

It will not surprise many managers to learn that researchers find that one of the most significant changes organizations experience when they receive public revenue is increased management complexity. This takes many forms. For one, organizations must track program results, juggle various budgetary parameters and reimbursement practices, and document adherence to public rules. The costs of these activities are significant. In fact, large nonprofit agencies are more successful in absorbing these tasks, as they are more likely than small agencies to have a larger proportion of their revenue come from government sources.

Secondly, because of public rules, managers are often required to pull volunteers from assisting with government-supported programs and use them for more routine tasks. This, in turn, alters the types of volunteers who can be engaged by the agency, as there is often less intrinsic reward in these more routine tasks. Thirdly, there is some evidence that as management becomes more complex, and programmatic knowledge more technical because of public requirements, the relationship between board and staff changes. Because staff controls the managerial and technical resources the agency depends upon for revenue, they gain more power. As the amount of government revenue increases, boards often feel drawn to their fiduciary role and less focused on their responsibilities for governance and direction.

Another consequence for organizations receiving public dollars is the increasing demands on the executive directors' time. Top managers and leaders must focus on more diverse stakeholders, moving beyond the traditional customers, board, staff, and donors, and attending to the concerns of regulators, elected officials, and public administrators. Suddenly there are more parties—sometimes with contrary interests—that exert influence over the type of program or service provided by the organization. Agencies often grapple with the challenge of balancing these competing demands, advocating on behalf of their clients and yet not offending their government funders. This tension may well challenge the mission of many nonprofits and increase the likelihood of "mission creep."

Much of the existing research focuses on the effects of contracting, and some suggest that the size and history of an organization influence the effects of government contracts on agency operation. To respond to the increased management complexity, for example, small community-based organizations find themselves hiring more professional staff that have skills at program assessment, budget negotiation and financial management. Scholars worry that increasing the number of staff with these types of skills pulls the organizations from their intimate knowledge of community concerns. On the other hand, large, well-established nonprofits often must change their programming to respond to government parameters or service standards. This can create discontent, as long-term staff grapple with a mandate to deliver services that might not jibe with their experience or standards of quality.

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gramming, they also have less control over determining the client base. Public funds often come with specific eligibility criteria, which define who should receive programming. In some respects, this might be positive, allowing a nonprofit to expand to service groups of people that they might not otherwise reach. But it may also provide incentives to help those who require the least amount of service, thereby diluting their potential effectiveness among target groups.

In the face of these realities, innovative nonprofit managers develop strategies to cope. Some organizations refuse to accept government money. Others create structures that buffer the organization from external control, such as staff that focus exclusively on fulfilling government reporting requirements, or management information systems driven by the results desired by organizational leaders rather than multiple funders. Some organizations dedicate significant resources to monitoring public-sector activities by serving on advisory committees, participating in coalitions, or maintaining relationships with key legislators. Such experiences can provide the organization with valuable information about public-sector priorities and opportunities for exerting influence. Finally, many organizations try to build a strong fund reserve to cushion themselves from the financial challenges stemming from delayed reimbursement processes and political uncertainty.

Field Consequences

The actual form of government financing significantly influences the very structure of the field. For example, in the 1970s and early 1980s, when state and local governments began funding child care for low-income parents, many began by issuing contracts. Organizations providing child care could bid and receive contracts that guaranteed a certain number of slots would be paid by the government. When, in the late 1980s, federal legislation mandated that some of this subsidy be provided directly to parents—to allow them to choose any childcare provider—the whole field shifted to accommodate a less secure, more tenuous revenue stream. Nonprofit centers found themselves competing with for-profit centers, family childcare homes, and even friends or neighbors, since all could receive public money. Organizations began to do more extensive marketing and relied much more on intermediary organizations that provided parents with information about childcare openings.

The work of public officials also alters depending upon the form of government financing. The work done to support government grant programs is quite different from that done to support tax credit financing. The work of negotiating contract terms is quite distinct from doing market surveys to ascertain a fair level of public subsidy for individuals. As such, the particular terms of a policy field—the things that get discussed in heated staff meetings and become the focus of community networks for advocacy—are often determined by the financing tool that government uses within that field. Additionally, the ease by which nonprofits can form alliances with their public-sector compatriots is often shaped by the financing tool used by the public sector. As a result, although not immediately apparent, the form of public financing may be as significant to a nonprofit's policy field as the amount of public financing it garners.

Social Consequences

As scholars reflect upon the changes in the American state—and the increased reliance upon private actors to carry out public policy—they evoke images of a "hollow state."[2] Although tax dollars pay for many services, from community theatre to summer youth activities, the "publicness" of these services is not visible. People remember the great production at their local theatre, the music camp and the youth sports events held during the summer by the nonprofit, and don't connect it to the work of the government. Some would argue that this is one of the most positive consequences of the use of public dollars to fund nonprofits. These agencies receive more support, and people in communities do not attribute it to the long-arm of government. On the flip side, some scholars are concerned that private organizations do not often provide citizens with due process that could be guaranteed by the public sector if program quality is low or the treatment they received unfair. While nonprofits might be more responsive to particular concerns, political scientists worry that often they are not very accountable to the public, that they rarely deliver public programs equitably, and that little is known about their effectiveness.

In the public sector, citizens are seen not just as "customers" but also as "owners" because they contribute tax dollars and elect decision makers who determine the use of that revenue. Public managers are schooled in the importance of public accountability, transparency, and equity which, while it might contribute to the frustrating inefficiencies of government bureaucracies, help to assure that public organizations function under different values from those of private, for-profit firms. Few nonprofit managers are schooled in these types of values or think of the general public as having ownership in their organization, even when a sizable proportion of their budget comes from public sources. An article published earlier in the *Nonprofit Quarterly*[3] suggests that nonprofit board members, too, rarely think of ownership or accountability, other than in fairly narrow terms of general fiscal oversight or accountability to funders for particular programmatic results. As private entities, nonprofits may also see themselves as more accountable to funders than to citizens, generally. While this is understandable, it raises flags among those concerned with keeping publicly funded services visible and accessible to that public.

Concluding Thoughts

Given all these consequences, why would nonprofit managers decide to pursue government revenue streams? For one, public money is typically a fairly stable revenue source; once contracts are awarded or tax credits secured, managers can count on the terms being honored. Secondly, the public sector leverages more resources to address public problems than most nonprofits ever could hope to leverage alone. As a result, public revenue helps to guarantee the expansion of programs so that they come closer to meeting the demand for them. Public revenue also helps organizations pay for more professional staff and engages nonprofits more directly in advocacy to influence the implementation of public policy. Finally, receiving public contracts often increases an organization's credibility and may precipitate more grants from private foundations or other funders.

Ultimately, each executive director and board must weigh these trade-offs. And, like much of nonprofit management, there are no easy answers. We do not yet know the full implications of the dance nonprofits must do—the struggle to retain balance and grace amidst the syncopated rhythm—when they allow the public sector to fund their charitable endeavors. What is now clear, though, is that while public dollars bring many benefits, there are more consequences of signing that contract or accepting third-party payment than the money it brings through the agency's door. The many other, more subtle, and perhaps more significant, shifts that occur for an organization, its field of work, and for society, will undoubtedly shape the role nonprofits play in the new century.

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Endnotes

1. Kirsten Gronbjerg and Lester Salamon. "Devolution, Marketization, and the Changing Shape of Government-Nonprofit Relations." *The Resilient Sector: The State of Nonprofit America*, ed. Lester Salamon. Brookings Institution Press: Washington, DC, pp. 447-470.
2. H. Brinton Milward and Keith Provan (1994). "Implications of Contracting Out: New Roles for the Hollow State." *New Paradigms for Government*. Patricia Ingraham, Barbara Romzek, and Associates. Jossey Bass: Washington DC, pp. 41-62.
3. Judith Miller (2002). "Who 'Owns' Your Nonprofit?" *Nonprofit Quarterly* (9:3).

Additional Resources

Elizabeth Boris and C. Eugene Steuerle, ed. (1999). *Nonprofits & Government: Collaboration and Conflict*. Urban Institute Press: Washington, DC.

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