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Encouraging Innovation: a Task for Congress

By Aron P. Goldman

The Senate Finance Committee's examination of nonprofit groups is a historically unprecedented example of participatory policy making. As the committee looks for ways to stamp out abuses of the laws that govern charities and foundations, it has made extraordinary efforts to get the views of nonprofit leaders and experts. For instance, more than 100 of the nation's nonprofit executives have been urged to work together to draft suggestions for the senators, and this month they issued their first set of recommendations.

But in terms of content, something important has been missing from the debate. Closing loopholes in nonprofit laws and stepping up enforcement by regulators is important, but not all that needs to be done. The Senate Finance Committee, and other government officials, instead need to reshape federal policy to better reflect the sophisticated reality of today's -- and tomorrow's -- nonprofit world.

To get a better idea of what needs to be done, the Skoll Foundation, in Palo Alto, Calif., and Policy Development, a nonprofit group in Amherst, Mass., that seeks to make community-based organizations and social policy more effective, gathered several nonprofit scholars and executives to hold an online conversation about the issues raised by the Senate review. The highlights of the discussion offer a glimpse of what lawmakers should be considering -- and what society will lose if the debate is not expanded.

The participants in that discussion all agreed that public policy does little to encourage innovation in the nonprofit world. At the very least, public policy must not be an obstacle for innovators. And at most, thoughtful and well-informed public policy can be a catalyst to more innovative approaches to nonprofit work.

The barriers to getting nonprofit groups to work closely with business or government are just one example of the anachronistic nature of nonprofit policy, the discussion participants agreed. Getting important elements of society to work together to combine skills and resources is an approach that has proven itself.

But as a 2003 W.K. Kellogg Foundation report points out: "Any

substantial increase in earned income by nonprofits, or the interlocking of corporate and board structures of for-profits and nonprofits, will stimulate legislative scrutiny. Should the philanthropic community invest in the thinking needed to 'get ahead' of this issue? Future legislation driven by the first scandal resulting from a for-profit/nonprofit hybrid could chill or possibly destroy this emerging marketplace of innovation."

Prescient words. While the scandals that led to the current crisis of legitimacy in the nonprofit world were not connected to anything particularly innovative, the legislative responses being considered do have serious implications for innovators.

Could Congress pass a sort of Patriot Act III: the Nonprofit Sector, whereby the need for vigilance compromises the ability of nonprofit groups to pursue interesting new approaches to social change? Most nonprofit executives and scholars of charities and foundations would agree that federal laws and regulations do not match the modern, sophisticated reality of the nonprofit world. The mismatch could worsen if no specific attempt is made to consider what today's nonprofit groups need.

To be certain, the federal government must provide more vigilant and rigorous oversight of nonprofit groups. But at the same time, the nation needs a thoughtful reform of nonprofit law that is not prompted by scandals, but rather by the kind of innovative work that many charities are doing. High-quality nonprofit groups and the people they serve would benefit the most from reforms that accomplish both objectives: fewer loopholes and fewer burdens for innovators.

But, as Stanley Katz, professor of philanthropy at Princeton University, pointed out in our discussion, history shows that political will can be ephemeral. Beginning with the Walsh Committee hearings just before the First World War, nonprofit organizations seemed to become a topic of national policy and public interest -- or scrutiny -- every 10 to 15 years. Few of these outbursts of legislative consciousness resulted in any action at all, and only a very few resulted in significant legislation -- the Tax Reform Act of 1969 being the poster child for legislative intervention.

So what the Senate should really be considering today is the kind of reform that could accelerate the process of evolution of the nonprofit world. After a week of online discussion about this topic, here are some ideas that emerged, as well as excerpts from the online conversation:

- Responsible market-driven activities need more support.

The need to supplement traditional private and government grants with money generated by nonprofit-run businesses, as well as debt

and equity instruments designed to meet the needs of nonprofit groups, must be accepted by all. The survival of many nonprofit groups depends on public policies that support creative approaches to financial security and sustainability.

As Mike Burns, a nonprofit-management consultant in Branford, Conn., put it: "Rules must apply to all sectors equally. Nonprofits should not be excluded from public and private sources of lending just because they are nonprofit. Nonprofits should not be excluded from doing business that any other entrepreneur can conduct, just because they are nonprofit."

Jed Emerson, a senior fellow at Generation Investment Management, in London, added that to relegate nonprofit organizations to the traditional role of "charity" is to imply that they do not need "to be as entrepreneurial or market-oriented as for-profits in terms of how their overall assets and cash flows are managed."

Supporting market-driven nonprofit activities enables society to demand the same high standards in for-profit and nonprofit organizations.

- Performance criteria must be more meaningful and substantive.

Most people take for granted that if an organization has earned the status of "nonprofit," it must be providing benefits to society. Many fewer people realize that, although organizations must document their social purpose in their application for tax exemption, as one IRS agent explained to me, "Applications are never refused on merit, only if forms are missing or incomplete." In other words, nonprofit groups are not asked to promise or deliver any level of substantive performance relative to their tax-exempt missions.

Nonprofit status is more an indication of fiscal controls than of social benefit. While fiscal controls are crucial, one cannot know if even the most fiscally sound nonprofit group has made any impact on society. And recent scandals suggest that sometimes fiscal health cannot be counted on either.

In Britain, lawmakers are now considering imposing substantive performance expectations. As Hillary Browne-Wilkinson, director of the Institute for Philanthropy, in London, explained, "The presumption of 'public benefit' has been removed. In the future, all charities will have to show that they provide a 'public benefit.'"

On the other hand, Mark Moore, a professor at Harvard University's Hauser Center for Nonprofit Organizations, said he worried that "it might be a big mistake for government to try to exercise control or oversight over the processes by which foundations and nonprofit organizations define public purposes."

As much as everyone wants a more meaningful and substantive

account of nonprofit organizations' performance, that kind of determination invites more subjectivity and the possibility of politicization.

Ms. Browne-Wilkinson conceded that, while obligating nonprofit groups to demonstrate actual "public benefit" is a major breakthrough, "there is no definition, however, of 'public benefit.'"

The process of codifying what many hold to be self-evident may prove elusive. More meaningful and substantive performance criteria nonetheless remain important and deserve further consideration.

- The division of labor between state and federal government overseers must be clarified.

Legally, federal oversight is almost entirely a matter of determining the tax status of charitable organizations, while states oversee both tax status and whether charitable trusts are carrying out their responsibilities. According to Princeton's Mr. Katz, "tax responsibilities are much narrower than those possessed by the attorneys general, which go to the underlying purpose and function of charitable corporations. The distinction is both philosophically and politically significant, though only a handful of states have taken their supervision of trusts sufficiently seriously."

More-vigorous enforcement of trust responsibilities, which articulate social purposes, could help set a precedent for how the government can ensure that nonprofit groups are benefiting society.

- Nonprofit groups must communicate better.

While government can do much to help citizens assess the worth of a nonprofit organization, it is no replacement for direct public accountability.

Stephen Heintz, president of the Rockefeller Brothers Fund, said that negative perceptions of foundations are largely "due to the traditional way we have exercised leadership, quietly supporting the work of our grantees."

Mr. Heintz's solution: "We need to do a much better job of telling our stories and the stories of our grantees. This means not waiting until a media story breaks to begin communicating our role."

Katrin Verclas, co-director of the nonprofit group Aspiration, in Amherst, Mass., said she believed "we have been on the defensive as a sector and are being boxed in by a regulatory and oversight paradigm."

Mr. Heintz said that "the key will be for foundations and nonprofits to move boldly themselves to create greater transparency, accountability, and governance and to adhere to the highest standards of ethical

conduct." He added: "By taking bold steps as a sector, we can demonstrate that undue governmental regulation is unnecessary."

Voluntary self-regulation builds trust, and may be the best defense against restrictive regulations.

- The dichotomy between nonprofit and for-profit could become obsolete.

While nonprofit organizations are adopting many ideas from the business world, the admiration seems to be mutual. Corporations are beginning to formally accept responsibility for their positive and negative impact on society. The discipline called "corporate social responsibility" is emerging from a recognition that multinational corporations are growing to the point that their influence over human development rivals that of many national governments.

Mr. Emerson said that to exclude for-profit organizations from the charity oversight and reform debate "is to largely remove the burden of social responsibility (much less accountability)" from them.

The debate over charities should really be about how nonprofit and for-profit entities can be incorporated into a single continuum of social benefit and financial return. In the place of a simplistic bifurcated world of socially beneficial nonprofit groups and profit-maximizing corporations, each entity should be expected to provide a degree of social and financial accountability.

That is certainly an experimental theory, and many people continue to be concerned about the limits of the marketplace to protect the common good. For example, Sara Melendez, former head of Independent Sector and now a professor of nonprofit management at George Washington University, asked: "Are there some needs in society so basic that they should be the responsibility of the government?"

But, as an alternative to the current and aging system, a regulatory and policy regime based on a continuum of social change and financial return could be well-suited to the complex and rapidly expanding set of circumstances facing the United States today.

A thorough rethinking of the nonprofit world is a long-term process, but an urgent one. The historic reality is that nonprofit groups change slowly, so the time is now to begin a serious debate about how policy makers can help ensure that business, charities, and government are working together to ensure that the public good is well-served.

Aron P. Goldman, executive director of Policy Development, a nonprofit group in Amherst, Mass., was moderator of the online discussion of issues raised by the Senate inquiry into nonprofit groups. The entire online discussion is available at <http://www.policydevelopment.org>.



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