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## **Real Structure of the Non-profit Institutions' Funding Resources: Market or Government?\***

**JEL Classification:** L31; L38

**Keywords:** *non-profit institution; non-profit funding; economic crisis; system of national accounts; social services*

**Abstract:** *According to the theory, there are reasons to assume that non-profit institutions (NPI) behave specifically, in the way that is significantly different from the behaviour typical for both for-profit and public service providers. Paper investigates NPIs' reactions to the distinctive changes of the economic environment in the 2008–2013 when Czech NPIs were relatively strongly affected by the crisis, although this affection probably haven't been as heavy as in some other European countries.*

*Non-profit institutions (NPI) are characterized by their multi-source funding when payments from end-consumers are relatively low. The most reliable data sources are Annual National Accounts and the Satellite Account of NPIs, presenting macroeconomic data. In this article, we focus on structure of NPI funding resources changes in tough times of economic crisis.*

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*The paper derives from the preliminary results of our extensive research project focused on the impact of public financing on the structure of resources and production of non-profit institutions. This project utilizes a quantitative representative questionnaire survey of non-profit institutions. In this article we focus on a specific area of public social services only.*

*The proposed paper seeks to prove that existing data sources do not capture the real/complex structure of NPI funding resources and will identify the shortcomings of the macroeconomic data and their scope.*

## **Introduction**

As stated in the abstract, non-profit institutions (NPI) are generally characterized by their multi-source funding. There are numerous publications on this issue, including discussions on the public/private funding impact on the NPI production and behaviour. The examined question is to what extent the Czech official data capture the financial flows to NPI and their real structure. The first aim of this paper is to point to insufficient state of knowing in the context of the CR, especially concerning the structure of NPIs' revenues. After we explored these absent places in the realm of existing data on non-profit sector, we designed a project proposal for mapping the scope and structure of all resources of the Czech NPI. This proposal has been approved by the Czech Science Agency; we are in the second project year now.

Our paper briefly introduces the main objectives and research strategy of our survey-project which will allow us to test theories on the ratio of public and private revenue of NPIs. As the second goal of the paper, we bring some preliminary results of the survey concerning the Czech NPIs' behaviour in the times of economic crisis. Because of its specific nature, in particular because of the significant proportion of non-profit providers, the area of social services was selected.

## **Method of the Research**

We use a descriptive analysis of primary and secondary data to quantify the selected economic activity development and the financial flows to non-profit institution and to evaluate the development from 2008 till 2013.

We utilize secondary data from Satellite Account of Non-profit Institutions; we also use primary data in the form of preliminary findings from our representative survey of "The Impact of public financing on the structure of resources and production of NPIs" research.

The most substantial source of secondary data is represented by the Satellite Account of Non-profit Institutions (hereinafter referred to as SANI). SANI serves as a source of macroeconomic data, including production and resources (revenues) of NPIs, as well as other macroeconomic aggregates. The Czech Republic is one of the few countries that also draw up a Satellite Account of NPIs as a part of their national accounting.

We use relevant data to create a more complete picture of the current state and development of NPIs and their resources in the Czech Republic, specifically in the field of social care.

As described before (Fonadová & Hyánek, 2015, pp. 377-384) at the most general level, we will examine whether resp. how the changes in the public sources revenues affect the functioning (and sustainability) of the Czech non-profit institutions. Part of this analysis is to identify the shortcomings of the macroeconomic statistics that provide the information on NPIs in the Czech Republic in order to prove the impact of the resource portfolio on the structure and character of production generated by NPIs.

Our research project is based on the survey method; thus focusing research has not been implemented in the Czech context in this range (representative sample size of 600 units). At the most general level, we examine whether the changes of the public sources revenues affect the functioning and sustainability of the Czech non-profit institutions. Among others, we are focusing on the dominance of particular income components, significance of indirect and commercial sources or income over time changes. Organizational characteristics and total budgets are also being taken into account.

As we intend to map how the amount and structure of public funds develops, while using the retrospective method of study (cf. de Vaus, 2001), we shall compare the data from 2013, and then retrospectively for the year 2008. Then we will be able to determine whether and at what non-profit institutions report changes in the overall structure of income between the years. Finally, we shall answer the question whether there is a relationship between the changes in the revenue structure of the NPI and the amount of direct public revenue.

Special attention will be devoted to the division on public and private sources, and also on income from the capital and from economic activity incl. non-financial sources of income.

In this paper we use preliminary findings derived from the analysis of 82 NPIs in the field of social services from representative survey.

## State of Art

There are various theoretical definitions of private nonprofit sector organizations, such as the structural-operational definition (Salamon & Anheier, 1997), the definition based on the system of national accounts, definitions within SNA (United Nations, 2003), various functional definitions (Salamon & Anheier, 1997), specifications within the Pestoff welfare triangle (Pestoff, 1992), and the definition by means of a legal theory (Hurdik, 2003). Most of the definitions are negative ones, formed as authors attempt to perceive the private nonprofit sector alongside the public sector, the profit sector, and the household sector, or to assign definitional attributes to the private nonprofit sector.

Other terms are used in addition to private nonprofit sector, such as voluntary, civil, independent, nongovernmental, or third sector. The term selection depends on the discipline by which the phenomenon is analyzed and the characteristics that are the most important for the respective author, and such terms are sometimes used simply to achieve any definition of the sector other than a negative one. Other non-theoretical concepts of nongovernmental nonprofit organisations are used in the Czech legislation (where these organisations are perceived as making no profit) and in the political sphere (where these organisations are perceived as nongovernmental organisations). The information capacity of various data sources with respect to individual definitions is connected with these concepts.

We've decided to use the definition of nonprofit institutions according to the standards of the European accounting system where nonprofit institutions are defined as "a legal or social entity created for the purpose of production of goods or services whose status does not permit them to be a source of income, profit or other financial gains for the units that establish, control or finance them. In practice, their productive activities are bound to generate either surpluses or deficits but any surpluses they happen to make cannot be appropriated by other institutional units" (ESA, 1995, p. 62).

NPI funding, and especially the public-private resource mix, belongs to the key issues in the non-profit sector focused research. In a way, the prominent position is occupied by examining the role and impact of public funding.

Of course, this is a topic that is historically deeply rooted in economic research; both positive and negative connotations of public financing interest and provoke economists at least since the 70s of the 20th century. So, maybe not completely new, but still topical. Moreover, in the environment of post-communist countries, like the Czech Republic, this area remains

almost totally unexplored. It is surprising that in this environment we find no serious efforts to deepen the understanding of the structure of resources and their mutual substitution.

The most frequent issue in this context is the issue of the acceptance of commercial sources, especially in the situation of temporarily unstable public funding. Public finance can thus be seen as causing the phasing out the efforts of non-profit organizations to obtain additional private resources (crowding-out effect). And vice versa, we can expect positive impact of public finances (crowding-in) (Lecy & Van Slyke, 2012).

Space for alternative sources of income may generate public institutions themselves, simply by ceasing to subsidize certain types of services. According to Kerlin & Pollak, the nonprofit literature suggests that increases in public funding in earlier decades set the stage for the large impact of government cuts later on (Kerlin & Pollak, 2011).

In this context, strong connection of numerous non-profit subjects, and especially service providers, to any public budgets, represents the real problem. By the Salamon's estimate, social welfare cuts in the 1970s and 1980s resulted in the loss of US\$38 billion for nonprofits outside the health care field (Salamon, 1997). Other authors noted that the hopes that private contributions would fill the gap were not realized as private contributions dropped from 26% of nonprofit revenue in 1977 to 18% in 1992 (Hodgkinson & Weitzman, 2001). One of the reasons why the NPI reach for commercial sources is represented by constraints and cutbacks of public resources, typically in the tough times of economic crisis. Even here, however, there is no unanimous consensus among the authors (see Svidroňová & Vaceková, 2012).

Scholars have tried to prove that non-profit organizations relying on government funding turned to commercial activities to fill the gap left by cutbacks (Crimmins & Keil, 1983.; Eikenberry & Kluver, 2004). Salamon states, that between 1977 and 1989, nearly 40 % of the growth of social service organization income and 51 % of the growth of civic organization income came from fees and other commercial sources (Salamon, 1993). However, Foster and Bradach argue that such statistics are taken out of context: "Fees and charges grew no faster in that 20-year period than other sources of revenue; they represented nearly half of the sector's total revenue in 1997, just as they had in 1977" (Foster & Bradach, 2005, p. 93).

Two research streams examining the phenomena of the public financing impact on the NPI behaviour can be identified. See Kerlin & Pollak: "Researchers who claim an increase in commercial revenue often use resource dependency theory to explain their findings. According to this theory, organizations depend on outside resources to operate and use "proactive

strategies that can be pursued to deal with environmental constraints” (Kerlin & Pollak, 2011, p. 218). Thus, resource dependency proposes that non-profit losses in government grants and other traditional funding (like private giving, both individual and corporate) may prompt an increase in commercial revenue as a replacement.

This line of thinking considers commercial activities as an alternative that comes into play after the previous major financial source fails. But there is an alternative approach, which argues that more gradual rising costs to nonprofits and increased competition for private and government dollars may be the reason behind a continuing rise in commercial activity (Dees, 1998; Weisbrod, 2004). Rather than resource dependency, this line of reasoning is more compatible with institutional theory which broadly examines the effect of an operating environment on an organization (Powell & DiMaggio, 2012).

This means that for sustainability of the organization, it is necessary to adapt to the institutional environment in which it operates. This is illustrated by the research of Flood, Fennel or Rao (Flood & Fennel, 1995; Rao, 1998). They, in their conclusions, even speak of "mimetic and isomorphic" tactics adopted by nonprofit organizations. Of course, this line of thinking would mean that the tendency to commercial behavior is higher in countries with higher commercial environment. The increase in the commercial activities of non-profit organizations can then be understood as a kind of passive acceptance of the situation and response “to a number of outside pressures rather than a deliberate effort to subsidize declining revenue from discreet sources.” (Kerlin & Pollak, 2011, p. 701).

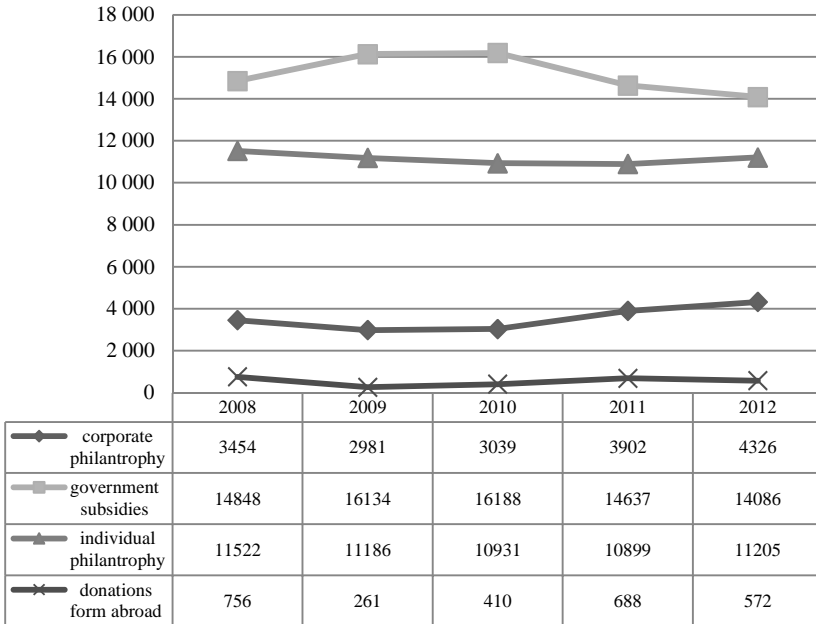
Here we’ve found a space for our research project whose academic (theoretical) ambition is to test relevant theories in the Czech environment. We shall examine whether in the Czech context the public finance cutbacks really lead to increasing effort of obtaining commercial income or other behavioural changes.

### **NPI Resources in the Time of Crises: Market or Government?**

Figure 1 shows the evolution of donations and grants provided for NPI. After 2008, we witness a very slight decline in corporate and individual donations (including voluntary work). A significant decrease occurs in the level of foreign donations (both corporate and individual); it is logical, since many of these donor countries have experienced more serious impacts of the economic crisis than it was in the CR.

In the case of public budgets subsidies, growth continues until 2010 (it took a while before the government responded by the cuts). The decline in these subsidies after 2010 returned to the level before the year 2008.

**Figure 1.** Public subsidies and various forms of donations in years 2008–2012 (in million CZK, 1 EUR = 27,7 CZK)



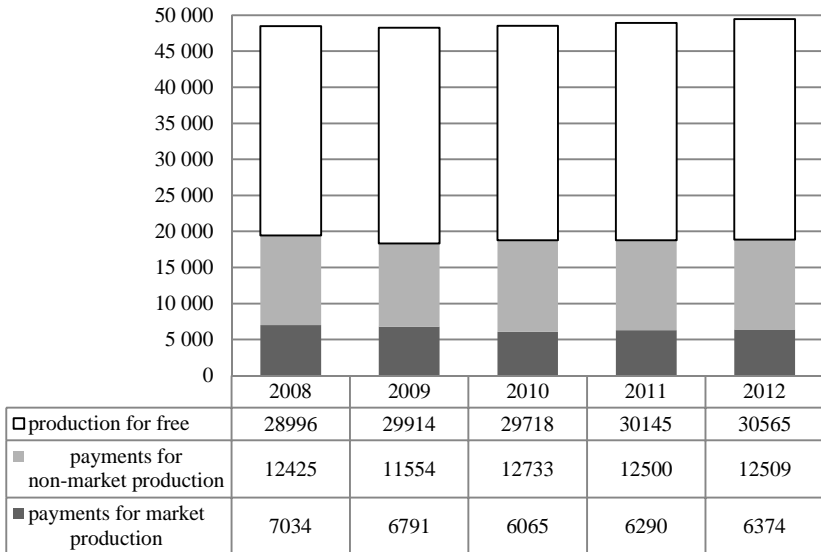
Source: own calculations based on Satellite Account of Non-profit Institutions (Czech Statistical Office, 2015).

Production NPI behavior on the markets of goods and services is illustrated by the figure 2 and 3.

In the evaluated period, free production for clients continues to increase. Until the 2010, we cannot talk about transferring the costs (in the form of increased prices) to consumers (see revenue from non-market production).

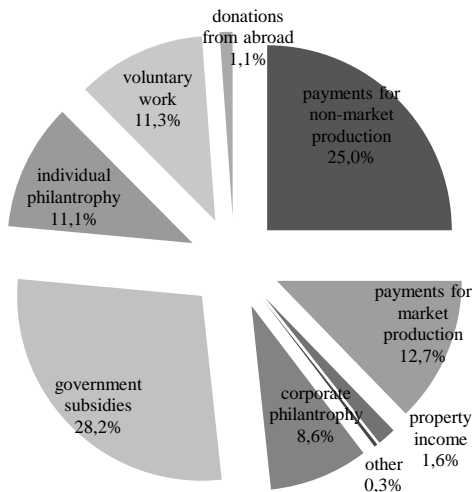
It is clear that the crisis did not move the nonprofit institutions in the direction of greater involvement in commercial activities. On the contrary, there is visible decline in the market production; the 2012 amount did not even reach the 2008 level.

**Figure 2.** Structure of the NPI production in years 2008–2012 (in million CZK, 1 EUR = 27,7 CZK)



Source: own calculations based on Satellite Account of Non-profit Institutions (Czech Statistical Office, 2015)

**Figure 3.** Structure of NPI resources according to the Satellite Account of NPIs (share of resources in %)



Source: own calculations based on Satellite account of Non-profit Institutions (Czech Statistical Office, 2015).



## **Satellite Account of Non-profit Institutions Shortcomings: Case of Social Services**

Czech macroeconomic data can show the structure of revenues and structure of production. But are we able to provide an explicit explanation of the impact of various funding resources on the overall production structure of Czech NPIS based on macroeconomics data? Do the existing data sources capture the real and complex structure of NPI resources and their mutual relationships?

We want to show the shortcomings of National Account in the field of NPI resources at the representative sample of 82 social services NPI.

Over 18% of NPI in the field of social services have no financial income. Their production is created by members and volunteers in rented buildings and bestowed or donated means of production.

One-third of the remaining 81% NPI, (which have also financial income) indicates high importance of indirect sources. In addition to the above mentioned indirect sources we can identify an extra tax relief, free accounting, legal and cleaning services, and advertising.

Macroeconomic statistics do not include indirect sources (except of voluntary work) and do not reflect their relevance to the NPI. The question remains, which could be the role of these resource in times of economic crisis.

Donations, in addition to the above mentioned corporate and individual donations, voluntary work and from foreign donors are also being obtained from the inside of the nonprofit sector. Nonprofit institutions obtain approximately 10% of total donations from other nonprofit institution. These are donations and grants from foundations, charities and religious organizations as well as funds provided by central or umbrella organizations.

In social services, payments for non-market production represent 34% of total financial income. According to our estimates, more than half of this 34% consists of contributions, which the government provides to clients in order to be able to purchase the social services. It is therefore an overrating of NPI income from the provision of goods and services and vice versa underestimation of revenues from public budgets.

## **Conclusions**

In the article, we focused on two areas of concern. The first examined question was to what extent the Czech official data capture the financial flows to NPI and their real structure. After explaining the officially report-

ed scope and structure of resources, we took the area of social services to show the “real” structure of resources. We identified indirect sources that official statistics do not capture as important, but officially neglected, kind of resources. These include tax allowances, tax exemptions from local and administrative fees, discount sales, loans or leasing of property, material equipping, services provided for symbolic or non-market prices or even for free, and the use of communication channels.

Similarly, we noted statistically unrecorded financial flows within the nonprofit sector, i.e. between different nonprofit institutions. The structure of NPI resources according SANI is distorted by contributions for client from public finance to social services. Public finance spent on social services (in the form of contributions for client) appears in the budget of NPI as a sale of services. Because of its specific nature, in particular because of the significant proportion of non-profit providers, the area of social services was selected.

As the second goal of the paper, we have produced some preliminary results of the survey examining the Czech NPIs’ behavior in the times of economic crisis. Our analysis led to the following conclusions: statistical data and our research have showed that Czech NPI were not significantly affected by the economic crisis. The only exceptions can be found in a development of the volume of donations from abroad. A significant decrease occurs at the level of foreign donations, both corporate and individual. As we argue, it is only logical, since many of these donor countries have experienced more serious impacts of the economic crisis. It is also evident that non-profit institutions in the analyzed period did not incline to greater use of commercial sources.

Basically, the Czech non-profit institutions prefer a non-market solution of their potential financial insufficiency. Although a certain decline of public subsidies actually occurred, it has been delayed. That’s probably also why the NPI managed to prepare for the potential lack of resources. Those potentially lost resources have been substituted by the private philanthropy, or other types of resources, but not by the commercialization of its activities.

This observation can be considered as a contribution to the international debate on the role of commercial revenues of nonprofit organizations. Likewise, it can be seen as confirmation of the thesis that increasing in the commercial activities of non-profit organizations can then be understood as a kind of passive acceptance of the situation and response “to a number of outside pressures rather than a deliberate effort to subsidize declining revenue from discreet sources.” (Kerlin & Pollak, 2011, p. 701).

In conclusion, this article brings new information not only about the structure of the real sources of the non-profit sector, but also about the behavior of non-profit entities. Of course, our conclusions are still only preliminary, and they will be subjected to other tests in the future. We believe that our work could serve as a basis for the work of other researchers, too.

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