THE COMMERCIAL ACTIVITY OF NONPROFIT HUMAN SERVICE ORGANIZATIONS:

LATENT CLASS GROWTH ANALYSIS APPROACH

by

JUNGHEE BAE

(Under the Direction of Mary A. Caplan)

ABSTRACT

Over the past several decades, earned income from commercial sources such as service fees, investment earnings, and product sales, has surged in human service nonprofit organizations in the U.S. Although a few researchers have examined commercial activity among nonprofit human service organizations, these previous studies have been mostly descriptive and produced mixed results regarding the influencing factors and consequences of this commercial activity. Very little is known about how human service nonprofits utilized commercial revenues in the 2000s, including during the period of the Great Recession from 2007 to 2009. Therefore, this study aims to examine 1) how the commercial activities of human service nonprofits changed during the period from 2000 to 2012; 2) whether a decrease in government grants and private donations was associated with an increase in human service nonprofit organizations' commercial activities; and 3) how an increase in nonprofit human service organizations' commercial activities was associated with a change in organizations' financial health. This study used nonprofit financial data obtained from the Internal Revenue Services' (IRS) Statistics of Income (SOI) database compiled by the National Center for Charitable Statistics (NCCS). The sample used for this study included 501(c)(3) public charities in the human service sector that filed Form 990 in all the years between 2000 – 2012 (n = 1,471). For the analyses, latent growth curve analyses and latent class growth analyses were performed by using the statistics software Mplus. The results found that 1) the commercial revenue increased among nonprofit human service organizations during the period from 2000 to 2012 except for the period of the Great Recession; 2) a decrease in government grant ratio and donation ratio was associated with an increase in commercial activity ratio; and 3) an increase in commercial activity ratio was generally associated with a decrease in financial health. These results contribute to understanding the unique characteristics of commercial activities among nonprofit human service organizations and broadening the existing body of knowledge on the influencing factors and financial consequences of commercial activity. Recommended directions for future research include examining smaller and younger human service organizations by using diverse measures of financial health.

INDEX WORDS: Commercial activity, Nonprofit human service organization, Latent class growth model, The Great Recession, Financial health

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# CHAPTER 1

# INTRODUCTION

The commercial activity of nonprofit human service organizations has attracted a number of researchers in various disciplines including public policy, economics, business, and social work. Chapter one reviews the brief historical background of the commercial activities of nonprofit human service organizations in the United States. Focusing on changes in social welfare policy and social work practice throughout this history, this chapter articulates why examining the commercial activities of nonprofit human service organizations is important and desirable for social work fields. Based on this rationale and identified knowledge gaps, the purpose of this study is provided.

## Problem Statement

Since the 1980s, nonprofit human service organizations in the United States have increased their commercial income through program fees, investment income, and sales of products unrelated to their mission. Although commercial income has long traditionally supplemented the revenue of nonprofit human service organizations, the increase in commercial activities since the 1980s was not merely an additional supplement to the funding, but a major shift in the way that nonprofit human service organizations were funded. The commercial revenue became a major funding source for nonprofit human service organizations, and government grants and private donations supplemented this revenue. Shifting the revenue base led to not only changes in revenue composition, but also changes in the way nonprofit human service organizations treat their clients. As commercial revenue has increased, the perception of clients has shifted from citizens with civil rights to customers who are able to pay. This implies the more serious social exclusion of poor people who are unable to pay. However, for many researchers, the commercial activity of nonprofit human service organizations has been understood as an effective and innovative way of securing the financial health of an organization that can generate sustainable social services. This study begins with doubt about this belief. Many researchers have questioned whether increases in commercial activities by nonprofit human service organization indeed produce improved financial health. Considering the unique role of nonprofit human service organizations in the history of the United States, this study seeks to answer this question.

Throughout the history of the United States, nonprofit organizations have played a critical role as a "major vehicle of the welfare state" (Schmid, 2013, p.247) by providing a large portion of human services to disadvantaged people. Before the government established institutionalized social insurance and social welfare systems in the 1930s in response to the Great Depression, private charitable nonprofit organizations took the lead in helping those in need by providing education, training, counseling, and cash support (Salamon, 1993; Lipsky & Smith, 1989). Charitable Organization Societies and Settlement Houses offered a variety of social services to immigrant neighborhoods and the poor during the late 19th early 20th centuries (Schneiderhan, 2008). The important role of nonprofit organization in the U.S. was rooted in traditional American cultural values such as individualism, voluntarism, and hostility to centralized power (Salamon, & Anheier, 1997). Even after the role of government in social welfare substantially expanded after the passage of the Social Security Act (1935), nonprofit organizations contributed extensively to developing the welfare state by delivering a variety of human services with government support, such as direct grants, purchase-of-service contracts, and diverse reimbursement programs (Salamon, 1993). Private donations and government grants, the traditional revenue sources for nonprofit organizations, have been important financial foundations for nonprofit human service organizations, playing a unique role as advocates of civil society and intermediaries for social welfare services.

Due to its critical role as a channel of social welfare, the revenue base of nonprofit organizations has been closely related to the federal government social welfare spending. For example, during the period from 1965 to 1980, when government social welfare spending increased at an annual rate of 6.8% following the implementation of the social programs mandated by President Lyndon Johnson’s Great Society, government support accounted for more than half of nonprofit organizations’ revenue (Salamon, 2015). Particularly, small agencies more heavily relied on government subsidies (Lipsky & Smith, 1989). However, the government began to restrain the growth of spending on nonprofit organizations in the 1980s due to the increasing federal deficits. During the period from 1980 to 1990, despite the continuous growth of federal spending for hospital health services and key middle-class entitlement programs, such as Social Security and Medicare, federal spending related to social welfare programs for the poor, such as income assistance and social services, declined (Salamon, 1993). During this period, nonprofit organizations increased their commercial income by 93% and these funds became the largest single source of growth for the nonprofit subsector of social service and civil organizations (Salamon, 1993). Although government social welfare spending was resumed beginning in 1990, the influence of government on the growth of nonprofit organizations remained limited and the commercial revenue of nonprofits has continuously increased since the 1980s (Salamon, 2015).

More recently, many studies of the revenue sources of nonprofit organizations show that they have increased their commercial revenue even throughout the 2000s. Nonprofit income from commercial sources such as service fees, investment earnings, and product sales, surged 64% in real dollar terms from 1997 to 2007, accounting for nearly 60% of the nonprofit sector's revenue growth during this period (Salamon, 2015). This was mainly due to much slower growth of government spending compared to the period between 1965-1980, a trajectory influenced by increasing conservative political forces that called for a sharp reduction in government funding in the mid-1990s, and significant cutbacks by the Bush administration in 2002. The Great Recession in 2008 also resulted in cutbacks in government support on nonprofit organizations due to a decline in tax revenues of federal, state, and local governments (Morrealea, 2011).

These changes in U.S. social policies and increases in commercial activity among nonprofit organizations have since the 1970s been grounded in the expansion of neoliberalism. Neoliberals suggest that "human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade" (Harvey, 2005, p.2). Neoliberalism reconstructed the role of the welfare state by "shifting responsibility from state to market and from the collective to the individual" (Hasenfeld, 2012, p.301). The government introduced the logic of business management into public management by encouraging competition within and among public and private organizations, implementing corporate management strategies, and seeking cost-efficient models of service delivery (Hasenfeld, 2012).

This neoliberal paradigm in social policy has considerably affected nonprofit organizations. First, the way welfare was funded changed (Gilbert, 2002). In order to control increasing welfare spending, contracts between the government and nonprofit organizations were reformulated as block grants in the 1980s (Smith, 2010). Increasing contracts by state and local governments attracted many new organizations from the for-profit sector, which led to increasing competition between human service providers (Gilbert, 2002; Hasenfeld, 2012). Second, since the 1980s, government support of nonprofit organizations has shifted from producer-side grants and contracts to customer-side subsidies such as loan guarantees, tax expenditures, and vouchers (Salamon, 2015). Such neoliberal changes in social policy have altered the operational rules of nonprofit organizations. More nonprofit organizations began to adopt business management strategies and the distinction between the for-profit sector and the nonprofit sector has become blurred. Like the management of for-profit organizations, human service organizations have also started to seek "managerial efficiency, innovation, and cost containment" to survive in this neoliberal socio-political landscape (Salamon, 2015, p.25). In sum, neoliberal social welfare policies have compelled nonprofit human service organizations to rely more on market mechanisms, which has led to the embrace of more commercial activities.

In this vein, over the past several decades, commercial activity has been a distinctive feature of nonprofits in the United States. As of 2013, the major source of nonprofit organizations' revenue was fees and charges paid by their clients, which alone accounted for 47.5% of their revenue (McKeever, 2015). When adding fees for services from government contracts or reimbursements (24.5%), the revenue from fees constituted 70% of total revenue. Particularly, after the Great Recession, nonprofit organizations that experienced both financial uncertainty and increasing demand for services (Boris, de Leon, Roeger, & Nikolova, 2010) had to find alternative ways to maintain their financial resources by increasing commercial revenue.

Particularly, among various types of nonprofit organizations in the U.S., human service nonprofit organizations have seen considerably increased commercial revenue along with neoliberal socio-political changes. Human service nonprofit organizations represent 25% of all nonprofits (NCCS, 2016b), providing diverse social services such as legal aid, job training, housing and shelter for the poor, counseling services for people with mental illness, and educational programs for youths and women. Historically, human service nonprofit organizations tend to be funded by the government far more than other nonprofit organizations that address areas such as art, the environment, international affairs, public and social benefits, and religion. This was also true at the time of the financial crisis (Morreale, 2011). However, along with neoliberal changes in social policy, including increasing competition among and within for-profit and nonprofit organizations, and strict government grants for nonprofit organizations, human service organizations have also increased their commercial activities through program service revenues, membership dues, investment income, fundraising events, and inventory sales (Salamon, 2015). Particularly, program service revenue, which includes service fees and reimbursement paid by clients and government contracts, has accounted for most commercial revenue accrued by human service nonprofit organizations. Program service revenue varies based on the mission of the given human service organization and can include funds and resources derived from retail stores (e.g., Goodwill Industries), court awards (e.g., Legal Aid Society), food procurement (e.g., Feeding America), volunteer participation fees (e.g., Habitat for Humanity International), training programs (e.g., National Fire Protection), biomedical products and services (e.g., American National Red Cross), and long-term care service (e.g., Community Care Inc).

In understanding commercial activities among nonprofit human service organizations, many scholars have employed the theory of social enterprise (Young, 2017; Jenner, 2014; Austin, Stevenson & Wei-Skillern, 2006). According to social enterprise approach, nonprofit organizations involved in generating earned income are considered those that adopt an innovative finance strategy that helps them thrive in an increasingly competitive nonprofit marketplace (Weerawardena, McDonald & Mort, 2010; Connolly, 2004; Roy & Karna, 2015). In the social work field, there have been increasing arguments that social workers need to be grounded in social-entrepreneurial approaches to help their clients more effectively and that social work researchers should recognize market-driven strategies as important components of social work education and research (Ferguson, 2016; Germak & Signh, 2009; Gray, Healy & Crofts, 2003; Hoefer & Sliva, 2016). This argument is driven by changes in social policy that emphasize escaping poverty through client employment (Mallon & Stevens, 2011). Based on this perspective, the commercial activity of nonprofit human service organizations was perceived to be an innovative way to secure the financial health of an organization while providing sustainable social services to clients.

There have also been warnings about the commercialization of human service nonprofits. Scholars who criticize the commercial activity of nonprofits have argued that the commercialization of nonprofits is the inevitable and undesirable reaction of nonprofits to cutbacks in government funding and decreases in private donations since the 1980s (Salamon, 2015; Weisbrod, 2000). Furthermore, many scholars have warned that the commercial activities of nonprofits result in mission distraction (Cornforth, 2014; Tekula, 2009) and the weakness of civil society (Eikenberry & Kluver, 2004). Eikenberry and Kluver (2004) argued that nonprofit organizations could damage their roles in a civil society (as “value guardians, service providers and advocates, and builders of social capital”) through adopting private-market strategies (p.138). In this vein, Weisbrod (2004) argued that nonprofit organizations should utilize donative, rather than commercial revenue because of their unique goals and the various tax incentives related to donative income.

Some empirical studies have attempted to make sense of the changes in and implications of the commercial activity of nonprofit organizations. First, there have been studies that described the phenomena of increasing commercial activity and examined its causes within the framework of socio-economic factors and historical background. These studies have examined the diverse factors that influence commercialization, including cutbacks in government funding, decreases in private donations, competition within the nonprofit sector, and other organizational characteristics (Guo, 2006; Young, 1998; Kerlin & Pollak, 2011; Cortis, 2017; Weerawardena, McDonald & Mort, 2010). Second, there are also studies that have evaluated the consequences of commercial activity of nonprofit organizations. These studies examine how commercial activities among nonprofit organizations affect their financial stability, financial capacity, financial health (Carroll & Starter, 2008; Chikoto & Neely, 2014; Hodge & Piccolo, 2005; Kingma, 1993; Prentice, 2016a; Teasdale, Kerlin, Young, & Soh, 2013;) and mission distraction (Tekula, 2010).

However, despite these previous studies regarding the commercial activity of human service nonprofit organizations, there remain several knowledge gaps. First, previous studies have been mostly descriptive, normative, and cross-sectional. There is still a lack of knowledge on the increase in commercial activity among human service nonprofit organizations over time from a longitudinal perspective. Second, the associative relationship between commercial and donative revenue, including private donations and government grants, is still unclear as studies have produced mixed results. Third, empirical research has done little to illuminate the financial outcomes of commercial activities among human service nonprofits. Fourth, although many studies have examined the commercial activity of nonprofits, few studies have focused on the human service sector and its subareas. Fifth, few studies have examined the commercial activity of human service organizations since 2000. When considering the increasing demands for commercial approaches in the delivery of human service nowadays, a more precise examination of the commercialization of human service organizations is needed.

## Significance of the Study

For nonprofit human service organizations, the relationship between clients and workers is critical in delivering services. The client-worker relation is the "primary vehicle through which information about the client is obtained, assessment of need is made, services are delivered, client responses are evaluated, and client compliance is attained" (Hasenfeld, 1992, p.17). Changes in revenue sources fundamentally affect client-worker relations, because a different revenue base alters the characteristics of population they serve. The increase in commercial activity among human service nonprofits suggests a shift in services' target population from the poor to those who are able to pay (Salamon, 1993). This pivot occurred along with the neoliberal changes in social policy during the 1980s when "the center of gravity of the social welfare system [was] more toward the middle class and away from the poor" (Salamon, 1993, p.23). Under a more commercialized model, human service nonprofit organizations perceive their clients as customers rather than as citizens (Hasenfeld & Garrow, 2012). As a result, the recasting of the citizen as a customer shifts the responsibility for securing needed social services from the state to the individual, while concealing the mutual responsibility of citizen and state (Hasenfeld & Garrow, 2012). The interrelationship among citizens, the government, and nonprofit human service organizations has thus been completely reconstructed in this neoliberal model.

Particularly, the commercialization of nonprofit human service organizations fundamentally altered how social workers provide services. According to the code of ethics for social workers (National Association of Social Workers [NASW], 2017), social workers pursue social justice by helping people in need and by advocating for vulnerable and oppressed groups of people. If clients are charged service fees, “social workers should ensure that the fees are fair, reasonable, and commensurate with the services performed” (1.13) while taking into account “clients’ ability to pay” (1.13). However, an increased emphasis on commercial revenues has compelled social workers to focus more on those who are able to pay. In this environment, social workers strive to obtain paying customers and develop marketable products, rather than convince private donors and government agencies to aid marginalized people. In addition, clients who are not able to pay become increasingly excluded from the target population.

This commercialization of nonprofit human service organizations has been justified and expanded by the belief in the neoliberal paradigm that competition and market-driven strategies can solve any and all social problems. Certain researchers have increasingly argued for the necessity of market-driven revenue strategies in the field of social work (Ferguson, 2016; Germak & Signh, 2009; Gray, Healy & Crofts, 2003; Hoefer & Sliva, 2016). For example, increasing the employability of disadvantaged clients, selling products through employment, and distributing revenue to the employee-clients, have all been considered as innovative intervention models that can simultaneously solve the economic and psychosocial problems of clients. The commercial activities of nonprofit organizations, such as selling products that may or may not be mission-related and producing investment income, have been thought of as innovative means of generating revenue for an organization’s sustainability (Reilly, 2016; Defourny & Nyssens, 2006). However, there remains a lack of empirical studies examining whether the commercial activity of nonprofit organizations could indeed improve the financial health of such organizations. In response to these debates within the social work field, further critical, rigorous evaluation of the commercial activity among nonprofit human service organizations is needed.

The more serious problem is that a number of nonprofit human service agencies in the United States are still financially vulnerable. Recent research on nonprofit human service organizations in the United States has shown that about half of existing organizations “run persistent operating deficits” (Morris & Roberts, 2018, p. 7) and nearly one in three human service agencies have “minimal financial reserves, equivalent to less than one month of operating expenses” (Morris & Roberts, 2018, p.7). Many nonprofit human service organizations struggle with a lack of financial reserves that “ma[kes] them vulnerable to any fluctuation in their revenue and expense levels” (Morris & Roberts, 2018, p.7). Moreover, increasing financial uncertainty following the Great Recession (Dietz, McKeever, Brown, Koulish, & Pollak, 2014; Morrealea, 2011) requires nonprofit human service organizations to manage their revenue sources more effectively and secure financial health in order to provide mission-related work. Therefore, more empirical research on the association between the commercial activity of nonprofit human service organizations and financial health may contribute to providing evidence regarding effective revenue-generating strategies.

## Purpose of the Study

Therefore, this study has three purposes. First, this study describes how the commercial activities of nonprofit human service organizations have changed during the period from 2000 to 2012 by utilizing the latest financial data available. The percentage of commercial human service nonprofits, average commercial revenue in dollar terms, and average commercial activity ratios are examined both for the entire human service sector and eight human service subareas: crime, employment, food, housing, multi-purpose, public, recreation, and youth. Second, this study examines whether a decrease in government grants and private donation is associated with an increase in commercial activity ratios during the period from 2000 to 2012 by using latent class growth analyses. The longitudinal trajectories of the commercial revenue ratios of the groups that experienced decreased government grants ratios and private donation ratios are examined. Third, this study examines if and how an increase in commercial activity is associated with the financial health of the organization during the period from 2000 to 2012. The longitudinal trajectories of financial health (i.e., profit, margin, solvency, and liquidity) are examined based on the changes (i.e., constant, increase, or decrease) in commercial activity in human service organizations.

This study has implications in terms of social work research, practice, and policy. First, this study reveals the commercial activities of human service nonprofit organizations through the use of various indicators and examines the causes and the consequences of increasing commercial activity among human service organizations based on relevant theoretical framework. This contributes to a deeper understanding of the unique characteristics of commercial activities among human service organizations and broadens current knowledge regarding the influential factors and consequences of commercial activity among diverse human service organizations. Second, this study uses the latest longitudinal revenue data of human service organizations from 2000 to 2012, which includes the period of the Great Recession. The Great Recession of 2008 is the most critical macro-economic event in the 2000s, one that deeply damaged all of society: this catastrophic event produced high and persistent unemployment rate, caused a surge in poverty levels, and increased the financial uncertainty of nonprofit organizations. Through examining the trend of commercial revenue before and after the Great Recession, this study contributes to expanding existing knowledge of the effects of the financial crisis on human service nonprofit organizations. Third, this study contributes to evidence-based practice by providing rigorous evidence of the commercial revenue strategies of human service organizations. In contrast to previous studies, which were based on a small number of observations, this study examines a large number of human service organizations through longitudinal analysis and thus offers stronger evidence for making a decision regarding revenue strategies. Fourth, the commercial activity of nonprofit organizations is highly associated with federal, state, and local governments' support of nonprofit organizations. By examining the association between government grants, commercial activity, and private donation, and examining whether increasing commercial activity improves nonprofits' financial health, this study provides guidance on how government should support nonprofit human service organizations.

## Conclusion

This introductory chapter presented the brief rationale that research on the commercial activities of human service organizations is needed for social work research, practice, and policy. The three purposes of this study and their implications for social work were also presented. The remaining chapters are constructed as follows. The second chapter reviews existing literature on nonprofit human service organizations, the association between the Great Recession and human service nonprofits, the commercialization of human service nonprofits, and the financial health of human service nonprofits. The third chapter provides theoretical perspectives regarding the neoliberal socio-economic approach of the United States, the factors that affect commercial activity, and the consequences of commercial activity among nonprofit human service organizations. The fourth chapter describes research methods employed, including the research questions, this study's hypotheses, the research design, data and sampling methods, instruments, and procedures. The fifth chapter presents the results of this investigation. The sixth chapter summarizes the key findings and articulates the implications of this study. Based on limitations, future research is suggested.

# CHAPTER 2

# REVIEW OF LITERATURE

Chapter two presents the review of the literature. The extensive literature on overall nonprofit human service organizations, the relationship between the Great Recession and nonprofit human service organizations, the commercialization of nonprofit human service organizations, and the financial health of nonprofit human service organizations are reviewed. More specifically, the definition, history, and some statistics on nonprofit human service organizations in the United States are provided. Previous studies on how the Great Recession in 2008 influenced the operation of nonprofit human service organizations are reviewed. How existing studies have defined and measured the commercial activity of nonprofit organizations is presented and specific examples of commercial activities among nonprofit human service organizations are provided. Furthermore, previous studies that examine the association between commercial activity and financial health of nonprofit organizations are explored. Through this process, knowledge gaps regarding the commercial activity of nonprofit human service organizations are identified.

## Nonprofit Human Service Organizations

Nonprofit human service organizations are one kind of nonprofit organizations that operate in human service areas such as employment, legal support, food support, social services, and youth development. In order to understand nonprofit human service organizations, a general understanding of nonprofit organizations in the United States is needed. Therefore, this section begins with the definition of a nonprofit organization in the United States. A brief description of the subareas of nonprofit organizations is presented based on the National Taxonomy of Exempt Entities (NTEE) system. The financial status of all the relevant nonprofit organizations follows.

**Nonprofit organizations in the United States**

Across countries, a nonprofit organization is defined differently based on their respective socio-economic structures and legal systems. At the same time, various terms such as “charitable organizations”, “independent organizations”, “voluntary organizations”, “tax-exempt organizations”, “nongovernmental organizations (NGOs)” have been used while emphasizing a given aspect of these organizations (Salamon & Anheier, 1997, p.12). According to Salamon and Anheier (1997), who tried to construct a universal definition of nonprofit organizations, nonprofit organizations can be defined in four ways. According to an *economic/financial* definition, nonprofit organizations are “institutions that receive the bulk of their income not from the sale of goods and services in the market, but from the dues and contributions of their members and supporters” (Salamon & Anheir, 1997, p. 30). From a *functional* definition, nonprofit organizations are “private organizations serving a public purpose” (Salamon & Anheir, 1997, p. 32). The *structural-operational* definition identifies nonprofit organizations as “the collection of entities that are organized, private, non-profit-distributing, self-governing, and voluntary” (Salamon & Anheir, 1997, p. 32). Lastly, according to the *legal* definition of nonprofit organization, nonprofit organizations in the United States are defined as corporations that qualify for exemption from the federal income tax under any of twenty-six specific subsections of the Internal Revenue Code (Internal Revenue Code, 1986). Among all these definitions, the legal definition is commonly used to identify nonprofit organizations (e.g., Chambré & Fatt, 2002; Okten & Weisbrod, 2000; Kim, 2017).

Since the tax-exempt status of nonprofit organizations in the United States is determined under section 501(c)(3) of the Internal Revenue Code, satisfying the requirements of this section has been important for many organizations that pursue social purposes. In order to qualify for the legal status of a 501(c)(3) organization, "(1) the organization must be organized and operated exclusively for certain purposes; (2) there must not be private inurement to organization insiders; (3) there must be no more than an incidental private benefit to private persons who are not organization insiders; (4) no substantial part of the organization's activities may be lobbying; and (5) the organization may not participate or intervene in political activities" (Joint Committee on Taxation, 2005, p. 45).

When following the legal definition of a nonprofit organization, there are two broad types of nonprofit organizations (Salamon, 2015, p. 8): i) *member-serving organizations* such as "labor unions, business associations, social clubs, and fraternal societies"; and ii) *public-servicing organizations* such as "hospitals, universities, social service agencies, and cultural venues". The *public-serving organizations*, also known as charitable organizations, are exempted from federal income taxation under Section 501(c)(3) of the Internal Revenue Code, which is reserved for organizations that operate "exclusively for charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals" (Internal Revenue Service [IRS], 2017). Therefore, they are often called "501(c)(3) organizations". 501(c)(3) organizations are eligible to receive tax-deductible donations from individuals and business (Salamon, 2015), and do not have to pay taxes on their revenues (Holland & Ritvo, 2008). Even though some are private foundations, most Section 501(c)(3) organizations are public charities with a broader source of financial support than private foundations and greater interaction with the public (Fisherman, 2017). In this study, the term "nonprofit organizations" generally refers to these public charity organizations that meet Section 501(c)(3) of the U.S. Internal Revenue Code.

**Subareas of nonprofit organizations.** In the United States, nonprofit organizations have played important roles in diverse social areas of health, well-being, education, culture, artistic diversity, philanthropy, and community services based on the American tradition of volunteerism (Holland & Ritvo, 2008). Nonprofit organizations have provided social services such as health care, education, nursing homes, civil, women's, and LGBT rights advocacy, , and promoted artistic, social, and religious expression, as well as promoting community development through associations and charitable foundations (Holland & Ritvo, 2008). Such nonprofit organizations can be divided into 10 categories based on the National Taxonomy of Exempt Entities (NTEE), which groups nonprofit organizations according to their stated purpose. Each category includes one or more subareas, and each subarea has an assigned code from A to Z. Table 2-1 shows 26 subareas of nonprofit organizations under 10 categories: i) arts, culture, and humanities, ii) education, iii) environment and animals, iv) health, v) human services, vi) international, foreign affairs, vii) public, societal benefits, viii) religion related, ix) mutual/membership benefits, x) unknown, unclassified.

Table 2-1.

*National taxonomy of exempt entities core codes (NTEE-CC)*

| |
|---|
| I. Arts, Culture, and Humanities |
| A. Arts, Culture & Humanities |
| II. Education |
| B. Education |
| III. Environment and Animals |
| C. Environmental Quality, Protection, and Beautification |
| D. Animal-Related |

IV. Health
- E. Health
- F. Mental Health, Crisis Intervention
- G. Diseases, Disorders, Medical Disciplines
- H. Medical Research

V. Human Services
- I. Crime, Legal Related
- J. Employment, Job Related
- K. Food, Agriculture, and Nutrition
- L. Housing, Shelter
- M. Public Safety
- N. Recreation, Sports, Leisure, Athletics
- O. Youth Development
- P. Human Services - Multipurpose and Other

VI. International, Foreign Affairs
- Q. International, Foreign Affairs, and National Security

VII. Public, Societal Benefit
- R. Civil Rights, Social Action, Advocacy
- S. Community Improvement, Capacity Building
- T. Philanthropy, Voluntarism, and Grantmaking Foundations
- U. Science and Technology Research Institutes, Services
- V. Social Science Research Institutes, Services
- W. Public, Society Benefit - Multipurpose and Other

VIII. Religion Related
- X. Religion Related, Spiritual Development

IX. Mutual/Membership Benefit
- Y. Mutual/Membership Benefit Organizations, Other

X. Unknown, Unclassified
- Z. Unknown

*Note.* Retrieved from National Center for Charitable Statistics (NCCS; 2019)

**Statistics relating to nonprofit organizations in the U.S.** Although the exact number of nonprofit organizations in the United States is unknown, the number of nonprofit organizations registered with Internal Revenue Service (IRS) enables us to estimate the size of the nonprofit sector. As of 2015, the total number of registered nonprofit organizations was approximately 1.56 million, representing an increase of 10.4% since 2005 (McKeever, 2018). This number encompasses a diverse range of nonprofits, including public-serving organizations such as hospitals and social service organizations and member-serving organizations such as labor unions and business associations. When examining only 501(c)(3) public charities, the interest of this study, in 2015 about 1.09 million organizations were registered as 501(c)(3) public charities. Between 2005 and 2015, the number of registered 501(c)(3) public charities grew 28.4%, an increase that outpaced the growth of all other registered nonprofits (10.4%).

As of 2018, nonprofit organizations contributed about $1,138.7 billion to the economy in the United States, which accounting for 5.5% of the country's gross domestic product (GDP; Bureau of Economic Analysis, 2019). There were nearly 12.3 million jobs in nonprofit organizations in 2016, accounting for 10.2% of total U.S. private sector employment (Bureau of Labor Statistics, 2018). Table 2-2 displays the size and finances of public charities according to NTEE categories. According to McKeever (2018), at the National Center for Charitable Statistics, registered public charities (n = 314,744) reported $1.98 trillion in revenues and $1.84 trillion in expenses in 2015. Assets held by all the registered public charities amounted to $3.67 trillion in 2015. Nonprofit organizations in the health area (n = 38,861, 12.4%) earned $1,160.5 billion in revenue, accounting for 58.7% of total revenue in the nonprofit sector. Human service organizations, comprising 35.2% (n = 110,801) of all nonprofit organizations, reported $234.1

billion in revenue, 11.8% of total revenue. The total expense of human service organizations was $224 billion and total assets were $357.1 billion.

Table 2-2.

*Number and finances of public charities in 2015*

| Categories | Number (%) | Total Revenue (%) | Total Expense (%) | Total Asset (%) |
|---|---|---|---|---|
| I. Arts | 31,429(10.0) | 40.6(2.1) | 35.7(1.9) | 127.9(3.5) |
| II. Education | 54,214(17.2) | 354.3(17.9) | 315.5(17.2) | 1,128.8(30.8) |
| III. Environment and animals | 14,591(4.6) | 19.7(1.0) | 16.5(0.9) | 47.8(1.3) |
| IV. Health | 38,861(12.4) | 1,160.5(58.7) | 1,102.3(59.9) | 1,574.1(42.9) |
| V. Human services | 110,801(35.2) | 234.1(11.8) | 224.0(12.2) | 357.1(9.7) |
| VI. International | 6,927(2.2) | 38.5(1.9) | 34.5(1.9) | 43.2(1.2) |
| VII. Other public and social benefit | 37,478(11.9) | 111.3(5.6) | 93.3(5.1) | 347.1(9.5) |
| VIII. Religion related | 20,443(6.5) | 19.6(1.0) | 17.1(0.9) | 42.6(1.2) |
| Total | 314,744(100.0) | 1,978.6(100.0) | 1,838.9(100.0) | 3,668.6(100.1) |

*Note.* Retrieved from McKeever (2018). Total revenue, total expenses, and total assets are presented in $ billions.

**Description of nonprofit human service organizations**

This study particularly focuses on nonprofit organizations that operate in the human service area. According to U.S. Department of Health and Human Services (HHS; 2019), the human service area is a broad field that endeavors to enhance and protect the well-being of all individuals, families, and communities, especially those who are least able to help themselves. It covers diverse services in health, mental health, education, and social services areas (Patti, 2000). More specifically, human service programs provided and supported by the U.S. government include financial assistance for low-income individuals and families (e.g., Temporary Assistance for Needy Family), nutrition assistance programs for low-income individuals and families (e.g., the food stamp benefit of Supplemental Nutrition Assistance Program), self-sufficiency programs for low-income and hard-to-serve families and individuals, foster care support programs, school readiness programs for children from low-income families (e.g., Head Start), housing and complementary service programs for homeless individuals, and health programs for seniors (HHS, 2019). The distinctive features of human service organizations are that people are "raw material" to work with and the goal is to help and change them (Hasenfeld, 1992).

According to the National Center for Charitable Statistics (NCCS; 2016b), which provides a financial database for nonprofit organizations in the United States, as of August 2016, among the 1.58 million nonprofit organizations registered with the IRS, about 390,000 nonprofit organizations, including public charities and private foundations, operate in the human service area, which at the time accounted for 25% of entire nonprofits. The number of public charities in the human service area was 284,329 (NCCS; 2016b). Such human service organizations can be classified into eight activity-categories based on the National Taxonomy of Exempt Entities (NTEE): i) crime and legal-related; ii) employment; iii) food, agriculture & nutrition; iv) housing & shelter; v) public safety, disaster preparedness & relief; vi) recreation and sports; vii) youth development; and viii) multipurpose human services. Table 2-3 shows the primary purpose of each subarea and representative examples.

Table 2-3.

*Subareas of human service nonprofit organizations*

| NTEE(Code) & Primary Purpose | Examples |
|---|---|
| Crime & Legal-Related (I) | |
| Crime prevention, correctional facilities, rehabilitation services for offenders, administration of justice, law enforcement, protection against abuse, and legal services | - Legal Aid Society<br>- Institute for Justice |
| Employment (J) | |
| Employment preparation & procurement, vocational rehabilitation, labor unions | - Goodwill Industries<br>- Pride Industries |
| Food, Agriculture & Nutrition (K) | |
| Agricultural programs, food programs, nutrition, home economics | - Feeding America<br>- Food Bank |
| Housing & Shelter (L) | |
| Housing development, construction & management, housing search assistance, temporary housing, homeowners & tenants associations, housing support | - Habitat for Humanity International<br>- American Opportunity for Housing |
| Public Safety, Disaster Preparedness & Relief (M) | |
| Disaster preparedness & relief services, safety education, public safety benevolent associations | - National Fire Protection Association<br>- National Safety Council |
| Recreation & Sports (N) | |
| Camps, physical fitness & community recreational facilities, sports associations & training facilities, recreational clubs, amateur sports, professional athletic leagues | - National Collegiate Athletic Association<br>- Central Park Conservancy |
| Youth Development (O) | |

| | |
|---|---|
| Youth centers & clubs, adult & child matching programs, scouting organizations, youth development programs | - Boy Scouts of America<br>- Young Life |
| Multipurpose Human Services (P) | |
| Human services, children & youth services, family services, personal social services, emergency assistance, residential care & adult day programs, centers to support the independence of specific populations | - American National Red Cross<br>- Community Care Inc |

*Note.* NCCS (2018)

These human service nonprofits provide diverse goods and services by utilizing their income and assets (López-Arceiz, Bellostas & Rivera-Torres, 2017; Jean-François, 2015). Financial data, as reported on the tax return document, Form 990, along with data from the IRS, provides a comprehensive picture of the financial status of human service nonprofits. Table 2-4 shows the number of public charities, the number of public charities who filed Form 990, the total revenue of public charities that reported Form 990, and the total assets of public charities that reported Form 990 across eight human service subareas. The reported total revenue of public charities in the human service sector was over $221 billion, and total assets were over $344 billion. MacKeever (2018) found that the revenues, expenses, and assets of public charities in the human service sector increased 26.3%, 26.7%, and 30.2%, respectively during the period from 2005 to 2015.

Table 2-4.

*Financial data of public charities in the human service sector in 2016*

| NTEE (Code) | Number | Number filed Form 990 | Total revenue reported on Form 990 | Assets reported on Form 990 |
|---|---|---|---|---|
| Crime & Legal-Related (I) | 14,270 | 6,372 | 7,640,325,899 | 7,590,389,086 |
| Employment (J) | 7,226 | 4,137 | 16,622,437,262 | 15,569,907,316 |
| Food, Agriculture & Nutrition (K) | 10,135 | 4,638 | 13,354,502,549 | 6,836,766,343 |
| Housing & Shelter (L) | 25,813 | 17,701 | 24,329,547,600 | 84,408,365,878 |
| Public Safety, Disaster Preparedness & Relief (M) | 15,024 | 7,435 | 2,356,606,554 | 6,693,825,462 |
| Recreation & Sports (N) | 80,875 | 32,349 | 16,658,873,446 | 22,368,551,500 |
| Youth Development (O) | 39,464 | 9,246 | 8,379,947,544 | 16,662,877,254 |
| Multipurpose Human Services (P) | 92,035 | 44,421 | 132,251,750,209 | 184,779,814,581 |
| Total | 284,842 | 126,299 | 221,593,991,063 | 344,910,497,420 |

*Note.* NCCS (2016)

**History of nonprofit human service organizations in the United States**

Due to the important social role of nonprofit human service organizations in the United States, these organizations have been developed in tandem with the dynamics of social policy and citizens throughout the history of the United States. The following section that reviews the history of nonprofit human service organizations in the United States is organized by the time period.

**1860-1930: Early charitable organizations.** Throughout the history of the United States, nonprofit organizations have played a critical role in providing a large portion of human services (Gronbjerg, 1992; Norris-Tirrell, 2014). The traditional American values of individualism, volunteerism, and hostility to centralized power have contributed to expanding the nonprofit sector in the United States (Salamon, & Anheier, 1997), and they also have permitted the United States to develop its "distinctively decentralized delivery of services under an expanded national welfare state" (Hammak, 2002, p.1640). Prior to the New Deal of the 1930s, in which President Franklin D. Roosevelt established social insurance and social welfare systems through Social Security Act of 1935, defending and providing for those in need was largely done by private charitable nonprofit organizations (Salamon, 1993). Churches and many religious groups have contributed to serving the poor by establishing nonprofit organizations since the early history of the U.S. (Norris-Tirrell, 2014; Hammack, 2001). During this period, the Charity Organization Society (COS), which was operated by its religious and wealthy members (Martin, 2010), and Jane Addams's Hull-House Settlement house in Chicago, with its more proactive approach to poverty alleviation and social inequity, offered diverse social services to neighborhoods and the poor (Schneiderhan, 2008). In this vein, Americans have traditionally perceived nonprofit organizations as associated with images of "community, voluntarism, civic dependability, and neighbor-helping-neighbor" (Lipsky & Smith, 1989, p.625).

**1930-1980: Big government and the expansion of human service nonprofits.** These community-based nonprofit human service organizations began to expand gradually in the 1930s when the government started to provide institutionalized social services through the implementation of New Deal policies. The role of government in social welfare substantially expanded between the New Deal of the 1930s and the Reagan Revolution of the 1980s, with increasing welfare spending by the government (Burk, 2001; Hammack, 2001). Particularly, during the period between 1965 and 1980, government social welfare spending increased by

6.8% annually, driven by the social programs of President Lyndon Johnson's Great Society that expanded funding for a wide range of health and social services (Salamon, 2015). During this period, the government and private nonprofit organizations established a cooperative relationship, rather than one of conflict. The government delivered a wide range of human services through private nonprofit organizations, and supported them by direct grants, purchase-of-service contracts, and diverse reimbursement programs (Salamon 1993). Most nonprofit organizations relied heavily on the government, receiving government support for over half of their revenues, and many small agencies received their entire budget from the government (Lipsky & Smith, 1989). At the same time, the expansion of government grants, especially the purchase-of-service contracts, attracted many for-profit organizations into the social welfare field. As of 1977, for-profit organizations consisted of "57 % of the day-care centers, and 23% of the other social service agencies" (Salamon, 1993, p. 20). Additionally, the steadily increasing affluence of the American people along withthe Civil Rights movement also contributed to the expansion of nonprofit human service organizations during this period (Hammack, 2001).

**1980 – 2000: Retrenchment and commercialization of human service nonprofits.** However, nonprofit human service organizations have experienced a shift in the landscape since the 1980s. In the face of increasing federal deficits in the late 1970s, the Carter administration began to restrain the growth of government social welfare spending (Salamon, 1993). Increasing public perception that the public assistance system was too generous and unstable forced this retrenchment (Daguerre, 2011). Between 1977 and 1982, federal social service spending declined almost 30% and federal income assistance spending declined by 5% (Salamon, 1993). The Reagan administration that followed also made significant cutbacks to federal spending in many human service areas, education, and nonhospital health service (Hall, 2016). Although federal spending for hospital health services and key middle-class entitlement programs, such as Social Security and Medicare, continued to grow during this period, welfare programs targeted toward the poor, such as income assistance and social services, decreased (Salamon, 1993). This change in government spending effected the revenue sources of human service nonprofits. Between 1977 and 1989, nonprofit organizations increased their commercial income by 93%, and this commercial income became the largest single source of growth for human service organizations (Salamon, 1993).

During the following period, from 1990 to 2000, government social welfare spending was resumed through the expansion of entitlement program coverage (e.g., the federal Supplemental Security Income program expanded to cover people with disabilities, including children and youth), development of new federal initiatives (e.g., federal child care programs, special programs for homeless people, AIDS suffers, and drug and alcohol treatment), and the welfare reforms of 1996 (Salamon, 2015). However, nonprofit human service organizations were not able to rely on the government as in the previous period due to a much slower average growth rate compared to the 1965-80 period, and calls for sharp reductions in government funding due to conservative agitation in the mid-1990s (Salamon, 2015). Through the 1980s and into the 1990s, conservative social policies emphasized privatization (i.e., shifting responsibilities for social services from the federal government to private sector actors) and devolution (i.e., shifting responsibilities from the federal government to states and localities) of social services (Hall, 2016). The rationales for these policies was consistent with the logic guiding the expansion of neoliberalism, which holds that “more local and private service provision would not only be more flexible and responsive to the needs of beneficiaries, but also that competition for contracts among private providers would produce greater efficiency and effectiveness in service provision" (Hall, 2016, p.23). Hall (2016) describes the consequences of this conservative reformation of nonprofit human service organizations as follows.

> … [T]he most important impacts of these policies was to increase the need for professionally trained nonprofit managers and entrepreneurs – people who could master an increasingly complex and turbulent policy and funding environment. … Although Republican leaders like George H.W. Bush might enthuse about the "thousand points of light" comprising America's community-serving nonprofit organizations, the reality was that these organizations were being driven by circumstances into being less and less responsive to client and community needs, while becoming more businesslike in their attitudes and operation (Hall, pp. 23-24).

Particularly, the Welfare Reform of 1996 through the passage of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) made considerable changes to the welfare systems and nonprofit human service organizations in the United States (Pavetti & Wemmerus, 1999). The PRWORA replaced the Aid to Families with Dependent Children (AFDC) that had provided cash assistance to poor families with children since 1935 with the Temporary Assistance for Needy Families (TANF) program. The TANF is a "work-based antipoverty program" (Mallon & Stevens, 2011, p.115) that requires engaging in certain hours of work activity to receive TANF cash assistance (Mallon & Stevens, 2011; Daguerre, 2011). Based on this welfare-to-work paradigm, human service organizations transformed the mission of their income support programs from "client eligibility determination" to "client employability enhancement" (Austin, 2003, p.100). Nonprofit human service organizations began to provide programs to increase clients' employability and create jobs for clients, which is called work integration social enterprise (Cooney, 2011). Through this process, nonprofit human service organizations expanded their working areas to the business sector to provide job opportunities for the poor who face barriers to work. At the same time, the block grants of TANF increased contracts by the government and attracted many new organizations both from the for-profit and non-profit sectors, intensifying competition between service providers (Hasenfeld, 2012).

**After 2000: Economic uncertainty and the challenges of human service nonprofits**

After 2000, nonprofit human service organizations needed to survive in an even more challenging environment in which conservative calls for further sharp reductions in government social welfare spending had been increasing. Most recently, the Great Recession in 2008 caused by the banking crisis added new concerns for nonprofit organizations. Although the economic recovery program passed by Congress in early 2009 increased government social welfare spending at an annual rate of 2.3% between 2007 and 2013 and helped many human service nonprofits, it did not lead to an expanding role of government as a major source of nonprofit revenue growth due to  shifts in the country's political climate (Salamon, 2015). Rather, with powerful political forces insisting that reduction of the deficit is achieved entirely through spending cuts, another extended period of retrenchment began (Salamon, 2015). Federal, state, and local governments suffered from cutbacks in tax revenues, and this also resulted in cutbacks to their funding of nonprofits (Morrealea, 2011). Many nonprofit organizations experienced financial instability while under pressure to respond to the increased demand for services during and after the Great Recession (Boris, de Leon, Roeger, & Nikolova, 2010; Salmon et al., 2009).

## The Great Recession and Nonprofit Human Service Organizations

This study focuses on the commercial activity of nonprofit human service organizations between 2000 and 2012. During this period, the most important socio-economic incident in the

United States is the Great Recession, which began in 2007. The Great Recession impacted not only individuals and businesses, but also nonprofit human service organizations. The following section provides a more specific examination of how the Great Recession transformed the operational rules of nonprofit human service organizations.

**The Great Recession in the U.S.**

The Great Recession in the United States, which began in December 2007 and ended in June 2009, was the result of a severe financial crisis combined with a deep recession (Grusky, Western & Wimer, 2011). It was the longest recession since the Great Depression of the 1930s and damaged the economy and society in numerous ways (Grusky et al., 2011). Regarding employment, from May 2007 to October 2009, the unemployment rate surged from 4.4% to 10.1%, and the labor force lost over 8.5 million jobs (Hout, Levanon & Cumberworth, 2011). Long-term unemployment also increased, thus, over 40% of unemployed people could not find a job for more than six months by 2010 (Grusky et al., 2011). Throughout 2010 discouraged workers and involuntary part-timers accounted for between 16% and 18% of the unemployed workforce (Grusky et al., 2011).

Also, the Great Recession impacted overall earnings, poverty, and household incomes. From 2007 to 2009, poverty rates increased from 11.1% to 13.3% in the Midwest and from 12.0% to 14.8% in the West. All regions experienced higher poverty rates in 2008 than in earlier years (Smeeding, Thompson, Levanon & Burak, 2011). With disappearing retirement accounts and life savings, $11 trillion in household wealth vanished (Financial Crisis Inquiry Commission, 2011). Furthremore, the Great Recession increased uncertainty for U.S. nonprofit organizations (Salamon, Geller & Spence, 2009; Lee, Wong & Pfeiffer, 2017). Many nonprofit organizations experienced financial instability while under pressure to respond to the increased demand for services (Boris, de Leon, Roeger, & Nikolova, 2010; Salmon et al., 2009).

In response to this financial crisis, the U.S. government took a number of steps. Emergency legislation passed by Congress and extraordinary steps taken by the Federal Reserve in late 2008 and early 2009 sought to accomplish a number of goals: "i) prevent the failure of major U.S. financial institutions, ii) minimize the impact of financial institutions' weakness on ordinary business and consumer borrowing, iii) stimulate consumer spending by raising after-tax household income though temporary tax reductions and increase in government transfers, iv) stabilize state and local government budgets to reduce their need to boost taxes and reduce spending during the recession, v) protect the incomes and health insurance of newly laid-off workers and members of other economically vulnerable populations, vi) support infrastructure investments and research and development projects in health, science, and efficient energy production"(Burtless & Gordon, 2011, p.250). A number of federal government programs, including unemployment insurance, social assistance, and the income tax system provided automatic stimulus and protection against shrinking household income as a U.S. safety net policy (Burtless & Gordon, 2011). Also, the federal government's spending on government transfer programs, such as food stamps, Medicaid, federally financed welfare, and Social Security retirement and disability benefits increased during the recession (Burtless & Gordon, 2011).

**The Great Recession and nonprofit organizations**

Many researchers have examined how the Great Recession impacted nonprofit organizations. First and foremost, studies showed that many nonprofit organizations experienced difficulty surviving and deteriorations in their financial health as a result of the Great Recession (Salamon, 2015; Dietz et al., 2014; Morreale, 2011; Gassman et al., 2012). Salamon (2015) found that in contrast to the period from 1997 to 2007, which saw increasing total revenue among nonprofit organizations, the rate of revenue growth dropped to a 1.2% per year between 2007 and 2011 (Salamon, 2015). When comparing the closure rate among nonprofit organizations before the Great Recession from 2004 to 2008 and after the Great Recession from 2008 to 2012, organizational closure was more prevalent during the recession period throughout all subsectors (Dietz et al., 2014). Smaller organizations, that is, those with revenues between \$50,000 and \$99,999 were particularly vulnerable to closure (Dietz et al., 2014). Moreover, 30.1% of organizations with revenues from \$50,000 to \$99,999 saw their revenue fall below \$50,000 during the 2008-2012 period, while 22% of organizations had their revenue fall below \$50,000 between 2004 and 2008 (Dietz et al., 2014). The decrease in revenues led to reductions in the salaries and benefits of employees among many nonprofit organizations between 2009 and 2011 (Gassman et al., 2012). Morreale (2011) also found that foundations lost an average of 30% of their asset values during the Great Recession between 2007 and 2010 (Morreale, 2011). The American household's fear of economic insecurity, the high unemployment rate, and large debt burdens made it less realistic to expect them to donate as much as they could previously (Morreale, 2011). Furthermore, since federal, state, and local governments also suffered from sharp reductions in tax revenues and other revenue sources, this resulted in cutbacks to their funding of nonprofits (Morreale, 2011). However, the impact of these developments was felt differently across the various nonprofit sectors. Nonprofits regarding arts, culture and humanities, religion, and international, environmental, public and social benefits sustained far more damage than health care institutions, higher education and human service organizations during the Great Recession, because those organizations that provided direct human services were more readily funded due to increasing demand (Morreale, 2011; Salamon, 2015).

The increased financial uncertainty during the Great Recession altered the revenue structure of nonprofit organizations in the United States. That said, several empirical studies have produced inconsistent results. Salamon (2015) found that in contrast to the period from 1997 to 2007, which showed increasing commercial revenue over time, nonprofit organizations slightly decreased their commercial revenue ratio (i.e., 57.5% in 2007 to 55.8% in 2011) and slightly increased their government grants ratio (i.e., 32.5% in 2007 to 34.8% in 2011) during the Great Recession period from 2007 to 2011 (Salamon, 2015). He explained that this increase in government grants might reflect the impact of the safety net government entitlement programs such as Medicare and Medicaid, as well as that of the stimulus program enacted by the Obama administration (Salamon, 2015). Focusing on individual contributions during the Great Recession, Gassman et al. (2012) found that individual contributions increased during all three years from 2009 to 2011 while government grants, corporate donations, and investment income decreased (Gassman et al., 2012). However, Morreale (2011) found that contributions by the government and private donors declined during the Great Recession from 2007 to 2010, and nonprofits that relied on program service revenue (i.e., commercial revenue) were more stable than those that relied on donations or direct public support between 2007 and 2010 (Morreale, 2011).

Furthermore, some scholars have discussed appropriate fiscal strategies adopted by human service nonprofit organizations during the financial crisis. Lin and Wang (2016) found that during the Great Recession period from 2008 to 2011, general fundraising efforts such as having fundraising staff, including a fundraising consultant, and maintaining a fundraising budget were not significantly effective in enhancing revenue growth and expense growth among nonprofit organizations (Lin & Wang, 2016). Also, in contrast to Tuckman and Chang (1991), revenue diversification was associated with higher fiscal stress during the Great Recession, implying that revenue diversification might aggravate fiscal stress when all major funding sources diminish at the same time (Ling & Wang, 2016). Morreale (2011) found that due to a serious decline in government grants and private donations during the Great Recession from 2007 to 2010, nonprofits that relied on program service revenue displayed a more stable ability to raise revenue than those that relied on donations or direct public support between 2007 and 2010 (Morreale, 2011). In similar vein, Reilly (2016) pointed out that the Great Recession and its consequences forced nonprofits to search for new and different ways to address their challenges to achieve financial sustainability and scalability. He argued that additional funding sources beyond charity and government support should be considered to help nonprofits achieve their core mission, as charity and government support are insufficient to address the magnitude of the task that nonprofit organizations encounter (Reilly, 2016). The social enterprise model, in which an organization sells merchandise to support its charitable functions, was suggested as an answer for creating sustainable revenue after the Great Recession (Reilly, 2016).

In sum, the Great Recession of the United States that began in December 2007 posed new challenges for nonprofit human service organizations. Clearly, nonprofit human service organizations faced a situation in which they needed to respond to growing demands for social services with decreased revenues. The increasing financial uncertainty after the Great Recession has required nonprofit human service organizations to continue to seek appropriate financial strategies for their own survival. Reilly (2016) argues that an increase in commercial activity could be a solution. However, how the commercial revenues of nonprofit human service organizations have changed after the Great Recession, and the consequences of increased commercial revenues are still unclear. The next section reviews the commercial activity of nonprofit human service organizations.

## The Commercial Activity of Nonprofit Human Service Organizations

In a diverse socio-political landscape, shaped by expanded neoliberalism (Caplan & Ricciardelli, 2016; Gray, Dean, Agllias, Howard, & Schubert, 2015) and the privatization of human service (Mosley, 2011; Wells, Jolles, Chuang, McBeath, & Collins-Camargo, 2014), many researchers in recent decades have discussed the increasing commercial activities among nonprofit human service organizations (Anheier & Ben-Ner, 2003; Bryson, Gibbons, & Shaye, 2001; Dart, 2004; Fitzgerald & Shepherd, 2018; James & Rose-Ackerman 2013; Patten, 2017 ; Kerlin, 2006; Yang & Han, 2018). In this section, the major revenue sources of nonprofit human service organizations, the commercial activities of nonprofit human service organizations, and empirical studies of the impact of commercial activity on nonprofit human service organizations are described.

### Revenue sources of nonprofit human service organizations

Nonprofit human service organizations usually heavily rely on third-party financing (Patti, 2000). According to Young (2007), there are five major sources of income from which most nonprofit organizations obtain financial support: i) charitable giving, ii) government support, iii) fees and commercial income, iv) membership dues, and v) returns on investment.

**Charitable giving.** Charitable giving has been a major component of nonprofit finance (Seaman & Young, 2018). Charitable giving is usually provided by the local community, and donors provide money and financial gifts to local charities that could benefit people in the same community. Also, charitable giving is strongly related to personal income (Seaman & Young, 2018). According to Rooney (2007), donations from the top 10% of high-income donors account for 90% of the total gifts received (Rooney, 2007).

**Government support.** The government supports nonprofit organizations in various ways: i) direct support through grants and subsidies, ii) indirect support through tax exemption from corporate taxes and privilege of tax-exempt bonds, iii) allowing individuals and corporations to deduct gifts to qualified nonprofits from income tax liabilities, and iv) government contracts in delivery of particular goods and services (Seaman & Young, 2018).

**Fees and commercial incomes.** Fees and commercial income have often been the main revenue source among nonprofit organizations (Salamon, 2015). In 2013, 47.5% of public charities earned revenue from fees for services from private sources, and 24.5% earned revenue from fees for services from government sources (McKeever, 2015).

**Membership Dues.** Some nonprofit organizations such as the American Economic Association (AEA) or the American Medical Association (AMA) receive membership dues (Seaman & Young, 2018). Individual members also can purchase additional services such as seminars or vacation trips offered by the associations (Seaman & Young, 2018). Based on whether the monetary value of membership dues exceeds the value of the benefits they receive, this could be considered as either program service revenue or charitable giving (IRS, 2013).

**Returns on Investment**. Investment incomes include interest, dividends and capital gains (Seaman & Young, 2018). In 2013, investment income accounted for 4.8 % of total revenues (McKeever, 2015). One advantage of investment income is that it provides nonprofit organizations with the ability to survive in times of financial uncertainty, since this could be translated into unrestricted income (Seaman & Young, 2018).

**The commercial activity of nonprofit human service organizations**

The commercial activity of nonprofit human service organizations can be defined as "sustained activity, related, but not customary to the [nonprofit] organization, designed to earn money" (Skloot, 1987, p. 381). This definition differentiates business-like activity from nonprofit activity on the basis of the primary motivation for or goal of the activity (Dart, 2004). Although nonprofits in the United States have a long history of using commercial income to support their mission, such as churches holding bazaars and selling homemade goods to supplement voluntary donations (Kerlin & Pollak, 2011), many economic pressures on nonprofits have particularly pushed them to generate more commercial income since the 1980s (Kerlin, 2006). In this vein, commercialization, which is defined as a "process in which human service nonprofits are geared toward sales revenues rather than donations or government grants" (Guo, 2006, p. 124), has been one of the major and important topics of nonprofit research.

According to Salamon (2015), the major source of revenue of nonprofit organizations in the United States is fees and charges paid by their clients or customers, called earned income or commercial revenue. As of 2011, fees and charges from private sources accounted for 56% of the total revenue of $1.5 trillion (Salamon, 2015). Government grants (including grants for the public and reimbursement payments for qualified individuals) and private contributions accounted only for 35% and 9% of total revenue in 2011, respectively (Salamon, 2015). If the government's reimbursement payments for qualified individuals (e.g., Medicaid and Medicare) were considered fees and charges by the government, the total commercial revenues would be greater than 56%. These nonprofits' efforts to generate income through sales and fees have attracted the attention of many researchers, as have the expansion of interchangeable terms such as "business-like activity" (Maier, Meyer & Steinbereithner, 2016), "commercial activity"

(Kerlin & Pollak, 2011), and "entrepreneurial activity" (Zhang & Swanson, 2013; Austim, Stevenson & Wei-Skillern, 2006).

Figure 2-1 shows more recent data on revenue sources among the 237,632 reporting public charities in the United States in 2013. In the combined total revenue of $1.73 trillion, fees for services and goods from private sources constituted 47.5% of the total revenue and fees for services and goods from government sources accounted for 24.5% of total revenue (McKeever, 2015). This means that 72% of total revenue came from the fees and charges made by individuals or the government. Investment income made up 4.8% of total revenue (McKeever, 2015). Considering all the fees and investment income, commercial revenues accounted for 76.8% of public charities. Government grants for the public only accounted for 8% and private donations composed 13.3% of the total revenue (McKeever, 2015). Although this figure represents the average revenue structure of all public charities in nonprofit sector, this result implies that nonprofit human service organizations would also have a high proportion of commercial revenues.

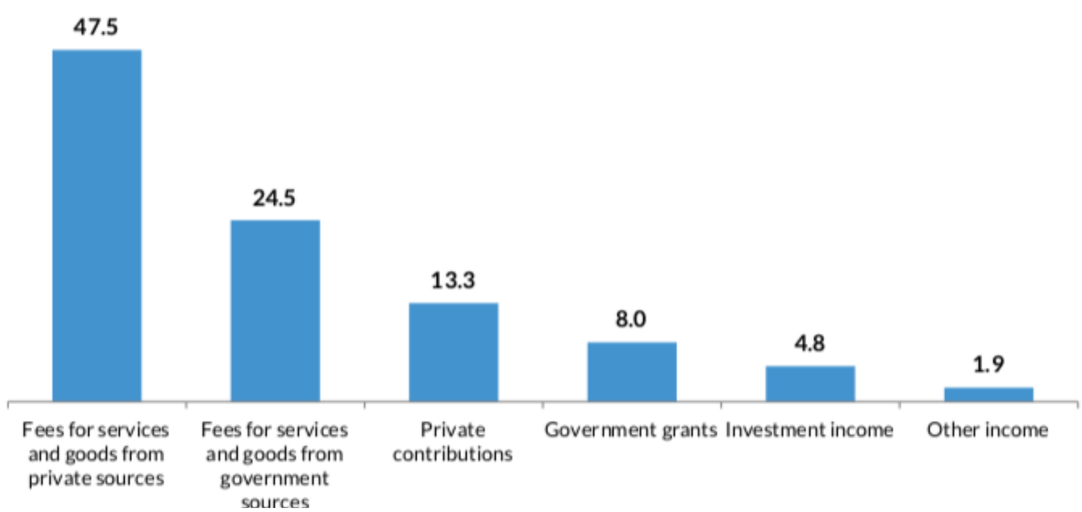



*Figure 2-1.* Revenue sources for reporting public charities in all sectors. Adapted from McKeever (2015)

**Measurement of commercial activity.** When measuring the commercial activity of nonprofit organizations, the sum of revenue from i) program service revenue, ii) membership dues and assessment, iii) investment income, iv) income from special events, and v) income from sales of inventory out of the total revenue have been commonly used metrics (Guo, 2006; Kerlin & Pollak, 2011; Cortis, 2017). The IRS Form 990 that nonprofit organizations with a certain amount of gross income should submit every year provides detailed definition about each source of commercial revenue.

Program service revenue refers to income earned through those activities that further the organization's exempt purposes. It includes earned income paid by a government agency and individuals' payments for goods and services received. For example, "Medicare and Medicaid payments, and other government payments made to pay or reimburse the organization for medical services provided to individuals who qualify under a government program for the services provided, payments for medical services by patients and their guarantors, tuition received by a school, revenue from admissions to a concert or other performing arts event or to a museum, royalties received as author of an educational publication" are considered program service revenue (IRS, 2013, p.38).

Membership dues and assessments include members' and affiliates' dues and assessments that are not contributions (IRS, 2013). When dues and assessments that are received compare reasonably with membership benefits received, they are considered a type of program service revenue. If the membership dues received by an organization are more than the monetary value of the membership benefits available to the due payer, the excess of dues is considered a contribution (IRS, 2013).

Investment income is usually operationalized as the sum of i) interest on savings and temporary cash investments, ii) dividends and interest form securities, iii) net rental income, other investment income, and iv) net gain from sales of assets other than inventory (Guo, 2006; Kerlin & Pollak, 2011; Cortis, 2017). An endowment, donated money to nonprofit organizations meant to be invested for special purposes, provides additional income for the future investing and expenditures of nonprofit organizations (Bowman, Keating, & Hager, 2007). Endowments that generate investment income are needed to protect the organization from economic uncertainty, such as prolonged economic downturns and loss of major donors (Bowman, Keating, & Hager, 2007).

Income from special events includes earned income from fundraising events and gaming events, not including contributions from fundraising events. Fundraising events include "dinners/dances, door-to-door sales of merchandise, concert, carnivals, spots events, and auctions" (IRS, 2013, p. 40). However, fundraising events sometimes generate both contributions and income, such as when an individual spends more than the retail value of the goods or services furnished. In this case, the amounts paid in excess of the retail value of goods or services are considered to be contributions. The gaming events include, but are not limited to, "bingo, pull tabs, instant bingo, and raffles" (IRS, 2013, p.40). Like fundraising events, this category does not include contributions from gaming activity (IRS, 2013)

Fifth, income from sales of inventory refers to the earned income from sales of inventory items. These inventory items include items "that were donated to the organizations, that the organizations made to sell to others, or that it bought for resale" (IRS, 2013, p. 41). However, sales of inventory do not include the sale of goods related to a fundraising event (IRS, 2013).

**Examples of commercial activity.** Among diverse commercial revenue, program service revenue constitutes the majority of total commercial revenue. Human service organizations produce diverse program service revenues based on their respective missions. Form 990 for nonprofit organizations, provided by GuideStar, shows how human service nonprofit organizations produce their program service revenue. Table 2-5 shows the specific program revenue of representative human service organizations in the eight human service subareas in 2016 or 2017.

Crime and legally-related organizations with the mission of equal justice for marginalized people, such as the Legal Aid Society and the Institute for Justice earned program service revenue from court awards, attorney fees, and fees for professional services. Employment-related organizations that create job opportunities for people with barriers to employment, such as regional Goodwill Industries, earned program service revenue from retail stores, workforce development, material collection, handling, and processing, and cafeteria receipts. Pride Industries, focused on the employment of people with disabilities, earned program revenue from retail stores, facilities services, program fees, and manufacturing and logistics services. Nonprofit organizations for food, agriculture, and nutrition that fight to end hunger, such as Feeding America and the Atlanta Community Food Bank, earned program service revenue from food procurement revenue, share maintenance, product sales, member fees, and conference revenue. As for housing and shelter organizations, Habitat for Humanity International (HFHI), which repairs houses and provides affordable housing to families, produced program service revenue through a stewardship organizational sustainability initiative (i.e., cost-sharing program from HFHI that requires all affiliates to pay annual fees to support HFHI operations; HFHI of Minnesota, 2013), global work village fees (i.e., volunteers pay for their international volunteer program, which includes all the expenses for a one-week stay, approximately $1,000 – 1,500 per person; HFHI, 2019), AmeriCorps (i.e., a one year volunteer program), and registration fee income. The American Opportunity for Housing organization, which operates low-income housing apartments, earned program service revenue from low income housing.

A nonprofit organization in public safety and disaster preparedness and relief, the National Fire Protection Association, obtained program service revenue through training, meetings, conferences, and its member magazine. Another organization, the National Safety Council earned program service revenue through road safety services, including defensive driving safety training and state programs, and workplace initiatives such as workplace training, driver training, first aid training and so on. Other revenue sources include membership dues and home and community safety programs. Regarding the recreation and sports area, the National Collegiate Athletic Association, which helps students-athletes, acquired program service revenue from television rights fees, championships and national invitation tournaments, and academic amateur eligibility fees. The Central Park Conservancy, to restore, manage, and enhance Central Park, earned program service revenue from program fees, garden rental fees, control revenue, and project revenue. A youth development organization, the National Boy Scouts of America Council, had diverse sources of program service revenue, including fees for field trips, local council assessments, the Order of the Arrow and the National Eagle Scout Association, and regional and professional training. Young Life, dedicated to helping adolescents, received program service revenue from camping trips, field ministries, and employee camp rent. Lastly, regarding multipurpose human service organizations, the American National Red Cross, which prevents and seeks to alleviate human suffering, earned program service revenues mainly from biomedical products and services and other products and services. Community Care Inc., which provides managed long-term care services, received program service revenues from sources such as capitation revenue (i.e., a fixed amount of money per patient per unit of time paid in advance for the delivery of care services), revenue from patient services, and contract revenue.

Table 2-5.

*Program service revenue in 2016-2017*

| Organization (NTEE Code) | Mission | Program service revenue |
|---|---|---|
| Legal Aid Society (I) | To ensure that no New Yorker is denied their right to equal justice because of poverty. Through our Civil, Criminal Defense, and Juvenile Rights Practices, we provide an unmatched depth and breadth of legal expertise to marginalized New Yorkers. | Court awards |
| Institute for Justice (I) | Through strategic litigation, training, communication, and outreach, the Institute for Justice advances a rule of law under which individuals can control their destinies as free and responsible members of society. | Attorney fees; honoraria |
| Goodwill Industries (J) | Goodwill Industries International works to enhance the dignity and quality of life of individuals and families by strengthening communities, eliminating barriers to opportunity, and helping people in need reach their full potential through learning and the power of work. | Goodwill retail stores; contract department; workforce development; material collection & handling processing; cafeteria receipts |
| Pride Industries (J) | To create opportunities for people with disabilities or barriers to employment. | Facilities services; program fees; Manufacturing and logistics services; other |

| | | |
|---|---|---|
| Feeding America (K) | Our mission is to feed America's hungry through a nationwide network of member food banks and engage the country in the fight to end hunger. | Food procurement revenue; member fees; conference revenue |
| Atlanta community food bank (K) | The Atlanta Community Food Bank works to end hunger across metro Atlanta and north Georgia with the food, people, and big ideas needed to make sure all members of our community have access to enough nourishment to live a healthy and productive life. | Share maintenance; product sales |
| Habitat for Humanity International (L) | We build and repair houses all over the world using volunteer labor and donations. Our partner families purchase these houses through no-profit, no-interest mortgage loans or innovative financing methods. | Stewardship organizational sustainability; global work village fees; AmeriCorps; registration fee income |
| American Opportunity for Housing (L) | Operation of low-income housing apartments and delivery of social services | Low income housing |
| National Fire Protection Association (M) | Advocate for the elimination of death, injury, property and economic loss due to fire, electrical and related hazards | Training; meetings & conferences; member magazine |
| National Safety Council (M) | To save lives by preventing injuries and deaths at work, in homes and communities, and on the road through leadership, research, education and advocacy | Road safety; workplace initiatives; membership dues; home and community safety |
| National Collegiate Athletic Association (N) | Every year, the NCAA and its members equip more than 480,000 student-athletes with skills to succeed on the playing field, in the classroom and throughout life. They do | Television rights fees; championships and national invitation tournament; Academic, amateur eligibility fees |

| | | |
|---|---|---|
| | that by prioritizing academics, well-being and fairness. | |
| Central Park Conservancy (N) | The mission of the Central Park Conservancy is to restore, manage, and enhance Central Park in partnership with the public. | Program fees; garden rental fees; control revenue; project revenue |
| National Boy Scouts of America Council (O) | The Mission of the Boy Scouts of America is to prepare young people to make ethical choices over their lifetime by instilling in them the values of the Scout Oath and Law. | High adventure bases; Local council assessment; Order of the arrow and national eagle scout association; regional and professional training |
| Young Life (O) | Young Life's mission is to introduce adolescents to Jesus Christ and help them grow in their faith. | Camping; field ministry; employee camp rent; other revenue |
| American National Red Cross (P) | The American Red Cross prevents and alleviates human suffering in the face of emergencies by mobilizing the power of volunteers and the generosity of donors. | Biomedical products and services; other products and services |
| Community Care, Inc (P) | Managed long-term care services allow people to continue living in their own homes and community. | Capitation revenue; patient services; contract revenue; other |

Note: Based on the Form-990 of each organization (2016 or 2017), retrieved from GuideStar (https://www.guidestar.org)

**Empirical studies of the commercial activity of nonprofit human service organizations**

Many scholars have investigated the increased commercial activity among nonprofit organizations (Salamon, 2015; Kerlin & Pollak, 2011). According to Salamon (2015), nonprofit income from commercial sources such as service fees, investment earnings, and sales of products increased 64% in real dollar terms between 1997 and 2007. He argued that the dramatic revenue growth of the nonprofit sector during this period, or 4.3% average growth per year, was mainly due to substantial increases in commercial income (Salamon, 2015). Similarly, Kerlin and Pollak (2012) found that from 1982 to 2002, the commercial revenue of nonprofit organizations increased by 219%, while private revenue increased by 197% and government grants increased by 169%. As such, the proportion of commercial income to total revenue increased from 48.1% in 1982 to 57.6% in 2002 (Kerlin & Pollak, 2011). When focusing only on nonprofit human service organizations, government grants (337%) also increased tremendously, as did commercial revenue (270%) (Kerlin & Pollak, 2011). The proportion of commercial income to total revenue grew from 50% in 1982 to 59% in 2012 (Kerlin & Pollak, 2011). According to McKeever (2015), as of 2013, commercial revenues (i.e., the sum of program fees paid by individuals, and government and investment income) accounted for 76.8% of the total revenue of public charities in the United States. The government grants for the public constituted only 8%, and private donations made up 13.3% of total revenue (McKeever, 2015). This commercial revenue not only grew in overall scale but also spread to broader nonprofit subsectors. Particularly, nonprofit organizations in the field of education and health experienced significant growth in commercial income (Salamon, 2015).

However, Teasdale, Kerlin, Young & Soh's study (2013) of nonprofit revenue found that nonprofit organizations usually have stable revenue sources over time. For example, "nonprofits which were donative in 1998 derived on average 82% of their total revenue from grants and donations a decade later. Nonprofits which were commercial in 1998 derived on average 87% of their total revenue from commercial sources in 2007. Nonprofits which were mixed revenue in 1998 on average derived an almost identical proportion of total revenue from commercial and donative sources a decade later" (Teasdale et al., 2013, p. 79). The proportions of commercial revenue in 1998 and 2007 were highly correlated, and donative revenues also exhibited a high correlation between 1998 and 2007 (Teasdale et al., 2013).

A few scholars have made efforts to discern the factors influencing commercial activity (Cortis, 2017; Guo, 2006; Kerlin & Pollak, 2011). Cortis (2017), who examined 521 Australian nonprofits, found that organizational size (measured as annual revenue) was positively associated with commercial revenues. This may be because larger organizations have more access to commercial income, or because commercial revenue becomes a source of revenue growth over time (Cortis, 2017). Philanthropic income from individual donations was not clearly associated with organizational size. Main service type also affected commercial income. Organizations related to disability and housing services were more likely to earn income from client fees than other organizations (Cortis, 2017). However, organizations related to children, family, or youth were less likely to earn income from client fees (Cortis, 2017). The amount of donative revenues, including government grants and donative contributions, has been understood to influence the commercial activity of nonprofits according to the resource dependence theory. Guo (2006) explored factors associated with the commercialization of human service nonprofits using data collected from 67 human service nonprofits in the United States and found that commercial revenues were negatively associated with donative revenues, including government funding and private giving. However, Kerlin and Pollak (2010), who explored the longitudinal relationship between nonprofits' commercial revenue and government grants and private contributions by using IRS Form 990 data during the period from 1982 to 2002, found that there was little evidence that an increase in commercial activity was associated with declines in government grants and private contributions. When controlling for size (measured as annual expenses) and nonprofit status, increases in commercial revenue were not associated with a percentage change in government grants and private contributions (Kerlin & Pollak, 2011).

## The Financial Health of Nonprofit Human Service Organizations

This study examines the association between commercial activity and the financial health of nonprofit human service organizations for the third research question. Therefore, this section provides a broad understanding of the financial health of nonprofit organizations. A few empirical studies on the association between revenue sources and financial health are examined.

### The financial health of nonprofit organizations

Generally, the financial health of nonprofit organizations has been commonly defined as an organization's financial ability to survive and grow in a rapidly changing socio-economic environment (Greenlee & Tuckman, 2007; Prentice, 2016). Although financial health in the nonprofit sector has not been as extensively studied compared to for-profit sector and government sectors (Young, 2007), financial health is a major concern for all stakeholders of nonprofit organizations, because organizations that achieve financial health can continue to pursue their missions and provide services (Trussel, 2002). Researchers from economics, public administration, and management have significantly contributed to broadening current knowledge of the financial health of nonprofit organizations by applying the diverse financial measures used in the for-profit sector.

However, in understanding the concept of financial health among nonprofit organizations, many interrelated but distinct concepts have been commonly used (Myser, 2016). Some nonprofit studies referred to financial health as a general concept (Greenlee & Tuckman, 2007; Prentice, 2016; Kirchner, Markowski, & Ford, 2007), while some of the literature focused on only one dimension of financial health (Myser, 2016). The mostly commonly discussed dimensions are i) vulnerability (Tuckman & Chang, 1991; Hodge & Piccolo, 2005; Keating , Fischer, Gordon & Greenlee, 2005, Hager, 2001; Greenlee & Trussel, 2000; Chang & Tuckman, 2001; Trussel, 2002; Trussel, Greenlee, & Brady, 2002; Tevel, Katz & Brock, 2015; Maclndoe & Sullivan, 2014; Hodge, Hodge, Piccolo, 2011), ii) stability (Gronbjerg, 1990,1991a, 1991b; Carroll & Stater, 2008; Kingma, 1993; Jegers, 1997; Chikoto-Schultz, & Neely, 2016), iii) capacity (Chikoto & Neely, 2014; Bowman, 2011; Hackler & Saxton, 2007; Misener & Doherty, 2009), and iv) sustainability (Bowman, 2011; Besel, Williams, Klak, 2011; Sontag-Padilla, Staplefoote, Gonalez Morganti, 2012; Abraham, 2003; Bingham & Walters, 2013). In addition, the term “financial performance” was also interchangeably used to refer to the financial health of nonprofit organizations (Prentice, 2016; Ritchie, Kolodinsky & Eastwood, 2007; Ritchie & Kolodinsky, 2003; Kirk & Nojan, 2010; Ritchie & Eastwood, 2006; Levine & Zahradnik, 2012).

An organization is financially vulnerable if “it is likely to cut back its service offerings immediately when it experiences a financial shock” (Tuckman & Chang 1991, p. 445). Tuckman and Chang (1991) argued that organizations that lack flexibility are assumed to be more vulnerable those with flexibility. Financial flexibility is assumed to exist “if an organization has access to equity balances, many revenue sources, high administrative costs, and high operating margins” (Tuckman & Chang, 1991, p. 450). In this vein, i) inadequate equity balances, ii) revenue concentration, iii) low administrative costs, and iv) low or negative operating margins were assumed to be the indicators of financial vulnerability for nonprofit organizations. These four indicators, which together are called the financial vulnerability index (FVI), have since been tested often by many subsequent researchers.

An organization is financially stable when the organization has the ability “to adapt to unexpected declines in revenue” (Gronbjerg, 1991; Kingma, 1993, p. 108). Based on the revenue portfolio theory, the absence of revenue volatility is assumed to be an indicator of financial stability for nonprofit organizations (Carroll & Stater 2009; Chikoto & Neely 2014). Regarding financial stability, predictability of resources is important because it allows an organization to anticipate increases and decreases in revenues accurately (Kingma, 1993). Also, revenue diversification is also known to increase financial stability (Carroll & Stater, 2009).

Financial capacity is defined as “resources that give an organization the wherewithal to seize opportunities and react to unexpected threats” (Bowman 2011, p.38). Total revenue, total fund balance, and total unrestricted fund balance have been used to measure the financial capacity of nonprofit organizations (Chikoto & Neely, 2014).

Financial sustainability is defined as long-term financial capacity, which is measured by the rate of change in capacity in each period (Bowman, 2011). According to Bowman (2011), “an organization sustainable in the long-term and unstable in the short-term will be chronically short of cash. Conversely, an organization sustainable in the short-term but not in the long-term may have adequate cash but inflation will cause the value of its assets to erode over time (p. 94).”

Financial performance has been commonly understood to coincide with the efficiency and effectiveness of nonprofit organizations (Richie & Kolodinsky, 2003; Richie, Kolodinsky & Eastwood, 2007). However, there was for a long time no clear definition of financial performance of nonprofit organizations. According to Kirk and Nolan (2010), for nonprofit organizations “organizational performance is complicated by the absence of a single end product and the presence of multiple stakeholder groups” (p. 477). Diverse ratio analyses were conducted to examine the financial performance of nonprofit organizations across numerous studies (Prentice, 2016; Richie, Kolodinsky & Eastwood, 2007).

In the nonprofit finance literature, all these concepts listed above--vulnerability, stability, capacity, sustainability, and financial performance—have been examined by researchers focusing on the financial health of nonprofit organizations, who often give particular attention to one of those dimensions (Myser, 2016). In the current study, the term financial health is defined as a general term that represents an organization's financial ability to survive and grow in a rapidly changing socio-economic environment (Greenlee & Tuckman, 2007).

**Diverse measures of the financial health of nonprofit organizations**

Tuckman and Chang (1991), who developed measures for identifying the financial vulnerability of nonprofit organizations, began a line of inquiry about nonprofit financial health. Subsequent studies (Greenlee & Trussel, 2000; Trussel & Greenlee, 2001; Hager, 2001; Trussel, 2002) have expanded Tuckman and Chang's work, developed numerous models to predict financially vulnerable nonprofits, and provided diverse measures of financial performance.

Borrowing extensively from for-profit bankruptcy prediction models, ratio analyses have been commonly used to monitor the financial health of organizations (Greenlee & Tuckman, 2007; Prentice, 2016a). Ratio analyses compare associations between accounting numbers, and the set of ratios represents the economic characteristics and strategies of an organization. For example, Keating, Fischer, Gordon, and Greenlee (2005) identified 17 primary accounting measures that predict nonprofit financial vulnerability. This method is usually utilized to identify the past or current problems of nonprofit organizations.

According to Prentice (2016b), who reviewed various measures of nonprofit financial health, financial health is generally evaluated via four constructs: liquidity, solvency, margin, and profitability. These constructs illustrate "how much cash a nonprofit has on hand, how much debt the nonprofit has accrued, how efficient the nonprofit is in the use of its resources, and how stable the nonprofit is over time" (Prentice, 2016, p. 716). In his literature review, Prentice (2016b) found that these four constructs are measured through various criteria and there are nine common accounting measures commonly used by researchers. Table 2-6 shows the representative measures of the four constructs that Prentice (2016b) found.

Table 2-6.

*Financial health and measures*

| Constructs | Measures |
|---|---|
| Solvency | 1) total net asset / total revenue (Tuckman & Chang, 1991) |
| | 2) total net assets / total assets (Bowman, 2011) |
| | 3) total assets – total liabilities (Keating et al., 2005) |
| Liquidity | 1) working capital / total assets (Greenlee & Tuckman, 2007) |
| | 2) months of spending (Bowman, 2011) |
| | 3) (current assets – inventories) / current liabilities (Chabotar, 1989) |
| Profitability | 1) net income/ total assets (Bowman, 2002) |
| | 2) revenue – expenses (Bowman et al., 2012) |
| Margin | 1) net income / total revenue (Greenlee & Trussel, 2000) |
| | 2) markup (Bowman, 2011) |

*Note.* Prentice (2016b, p. 719)

**The commercial activity and financial health of nonprofit organizations**

Regarding the financial health of nonprofit organizations, many previous studies examined the association between revenue sources and financial health (Hodge & Piccolo, 2005; Carroll & Stater, 2008; Kingma, 1993; Jergers, 1997). One of these studies, the longitudinal empirical study by Teasdale et al. (2010) showed that hybrid nonprofits that earned between 40 and 60% of their revenue from commercial sources and between 40 and 60% from donative sources were less sustainable over time than predominately commercial or predominately donative nonprofits. Donative nonprofits and commercial nonprofits that earned more than 90% of their total revenue from donative sources or commercial nonprofits increased their total revenue more than 50% between 1998 and 2007, whereas the hybrid nonprofits increased their total revenue only by 33% during the same period (Teasdale et al., 2013). This study focused on the effects of mixed revenue strategies and found that predominantly commercial or predominantly donative strategies produced better financial performance than the mixed revenue strategies.

Regarding the expansion of the commercial activities of nonprofits, some scholars have argued that as opposed to revenue from donation or grants, earned income offers numerous financial benefits to nonprofits regarding consistent cash flow, the unrestricted use of funds, and diversification of the revenue base, which results in financial health (Lyons, Townsend, Sullivan, & Drago, 2010; Stecker, 2014). For them, generating earned income has been understood as an effective revenue strategy that nonprofits have adopted in response to diverse fiscal challenges over the last few decades (Oster, Massarsky & Beinhacker, 2004). Commercial activity has received particular attention as a revenue diversification strategy (Froelich, 1999) that can help overcome financial vulnerability (Chang & Tuckman, 1991). However, since having commercial revenues does not necessarily mean diversifying revenue sources (Chang & Tuckman, 1994; Teasdale, Kerlin, Young & Soh, 2013), a separate examination of the effect of commercial activity on financial performance is needed.

However, very few empirical studies have been conducted to evaluate the effects of commercialization on the financial health of nonprofits, and they have yielded inconsistent results regarding the effect of commercial activity on financial health. For example, Carroll and Stater (2008) investigated whether revenue diversification influenced greater stability in the revenue structures of nonprofits by using IRS Form 990 data and found that increasing commercial income may help organizations that rely mainly on contributions become more financially stable and serve their clients more effectively. Guo (2006) examined the effect of commercialization on the performance of nonprofits by surveying 67 nonprofits involved in earned-income business ventures and found that higher levels of commercial income could significantly contribute to an organization's self-sufficiency. However, Guo (2006) also found that commercial revenues did not make a significant contribution to an organization's ability to attract donors and volunteers. On the other hand, Prentice (2016a) examined nonprofit organizations' financial health by using IRS Form 990 information for the years from 1998 to 2003 and found that an increase in commercial revenue is not a reliable method of increasing financial health, especially for human services organizations. Prentice (2016a) argued that human service organizations should have revenue streams that are consistent with their mission-related activities and avoid transaction costs or possible mission distraction.

Furthermore, when considering the recent research on the financial health of human service organizations, more research is needed to broaden our knowledge of the financial health of human service organizations. According to Morris and Roberts (2018), who examined the financial vulnerability of human services community-based organizations in the United States, a number of human service agencies are not financially strong or sustainable. Their results revealed that "about half of human service agencies run persistent operating deficits" (p. 7) and nearly one in three human service agencies have "minimal financial reserves, equivalent to less than one month of operating expenses" (p.7). This lack of financial reserves "made them vulnerable to any fluctuation in their revenue and expense levels" (p.7). Adding commercial revenue has been often understood as a revenue diversification strategy which can increase the financial flexibility of nonprofit organizations and prevent nonprofit organizations from being financially vulnerable (Tuckman & Chang, 1991). However, studies that focus on the increasing commercial activity of human service organizations have thus far been very limited. Along with the many challenges that human service organizations encounter, such as rising client demands, governmental cutbacks, and increasing competition for limited funds, examining the effect of commercialization on the financial health of human service organizations is needed.

## Conclusion

Many scholars in various disciplines have contributed to the discovery of the expansion of commercial activities among nonprofit organizations in the United States (e.g., Salamon, 2015; Young, 2003; Kerlin, 2006; Weisbrod, 2004; Jones, 2007). However, this study found that there are four major knowledge gaps.

Previous studies have been mostly conceptual, normative, descriptive, and cross-sectional. In order to understand the effect of commercialization on financial health and group differences in the pattern of commercialization, quantitative longitudinal study is required.

Regarding the influential factors of commercialization, the association between the donative revenue and the commercial revenue of nonprofits is still unclear since studies show mixed results. Although Salamon (2015) shows the longitudinal trajectories of government grants, private donations, and commercial income, he does not examine whether these changes are significantly interrelated to each other, and whether a decrease in government grants and private donations influences an increase in commercial revenue at a statistically significant level.

Moreover, inconsistent empirical results (Kerlin & Pollak, 2011; Guo, 2006) imply that further empirical studies employing rigorous research models are needed.

Empirical research has done little to illuminate the outcomes of commercial activities among human service nonprofits. Particularly, although the relationship between commercial activity and a nonprofit organizations' financial health (Weerawardena et al., 2010; Chang & Tuckman, 1994) has been the major subjects of debate, whether increased commercial activities are positively related to those variables is still unclear due to the inconsistency of the results from various studies. Particularly, due to the lack of longitudinal studies, the relationship between changes in commercial activity and changes in financial health has not been fully examined.

Although many studies have examined the commercial activity of nonprofits and examined the human service sector as one of the sectors of nonprofits, few studies have focused on the subareas of human service organizations. The pattern of commercialization of human service nonprofits might vary across specific subareas with particular missions. For example, Goodwill, in the employment area, could have more commercial activities than a food bank. Also, the effects of commercial activity on financial health might vary across specific subsectors because of their different missions, clients, and stakeholders. When considering increasing demands on entrepreneurial or commercial approaches in the delivery of human service, more precise examinations of the commercialization of human service organizations are needed.

Few studies have examined the commercial activity of human service organizations after the 2000s. The 2000s in the United States is an important period for nonprofit human service organizations because nonprofit organizations experienced a financial crisis while commercialization remained pervasive. In a neoliberal environment that encourages acquisition of commercial revenue, how nonprofit human service organizations reacted to the financial crisis and how their commercial activity was affected by it remains undiscovered.

Based on an identified knowledge gap, this study aims to explore the commercialization of human service nonprofits in the United States and examine how a change in donative revenue influences the commercialization of human service nonprofits and how commercialization influences their financial performance. To be specific, this study will answer three research questions:

1) How have the commercial activities of human service nonprofits changed over a 13-year period from 2000 to 2012?

2) Does a change in government grants and private donations between 2000 – 2012 influence a change in human service nonprofit organizations' commercial activities during the same period?

3) Does a change in nonprofit human service organizations' commercial activities between 2000 – 2012 predict a change in organizations' financial performance during the same period?

# CHAPTER 3

# THEORETICAL PERSPECTIVES

This chapter presents the theoretical perspectives that forms the ground of this study. The first research question of this study regarding how the commercial activities of human service nonprofits have changed over the 12-year period from 2000 to 2012 is descriptive, and therefore no specific theory was utilized. The second and the third research questions are explanatory of that aim: i) to examine whether the decrease in government grants and individual donations is associated with an increase in commercial activity among nonprofit human service organizations, and ii) to examine the association between increases in the commercial activity of human service organizations and changes in their financial health. In order to answer these questions, neoliberalism as the socio-economic context of commercial activity among nonprofit human service organization is reviewed. Then, theories about the factors contributing to commercial activity and the consequences of commercial activity are reviewed. Regarding the contributing factors of commercial activity specifically, resource dependence theory and Young's benefits theory are examined. Regarding the consequences of commercial activity, two competing theories, social enterprise approach and Weisbrod's behavior theory of nonprofit, are examined.

## Neoliberalism and the Commercial Activity of Nonprofits

Throughout history, nonprofit human service organizations have played a key role in developing the welfare state by advocating for social rights (Hasenfeld, 2012). Social rights are "the whole range from the right to [a] modicum of economic welfare and security to the right to share [in] the full  social heritage and to live the life of a civilized being according to the standards prevailing in the society" (Marshall, 1964, p.72; Recited from Hasenfeld, 2012, p. 296). The key principles of social rights are "that each citizen is entitled to an acceptable standard of living, that this standard is protected from market forces, and that it is guaranteed as a matter of right, not through some assessment of deservingness" (Hasenfeld, 2012, p. 296). During the Progressive Era (1890s to 1920s), nonprofit human service organizations pursued and encouraged social rights by offering a variety of social services to the poor and those in need, and this led to advocating for the passage of Social Security during the Great Depression of the 1930s and inspiring political action during the civil and women's rights movements of the 1960s (Hasenfeld, 2012).

However, since the 1970s, an expanded neoliberal ideology has changed the institutional, economic, and political environment for nonprofit organizations (Caplan & Ricciardelli, 2016). Neoliberalism proposes that "human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade" (Harvey, 2005, p. 2). This perspective was originally developed in the early 20th century by Friedrich Hayek and Milton Friedman, who opposed Keynesianism, which called for a regulated economy and a strong welfare state (Harvey, 2005). Neoliberalism is based on several principles such as "individualism, freedom of choice, rationality, self-interest, utilization of market mechanisms, and non-intervention of the state" (Caplan & Ricciardelli 2016, p. 21). Three major policies in the United States triggered the institutionalization of neoliberalism: i) the Economic Recovery Tax Act of 1981, the largest tax cut in American history, ii) the deregulation of business and financial institutions through the Airline Deregulation Act of 1978, the Electric Deregulation Law of 1997, the Financial Modernization Act of 1999, and so forth, and iii) the Omnibus Budget Reconciliation Act of

1981 that restrained eligibility for Aid to Families with Dependent Children (AFDC) program benefits with various welfare-to-work options (Prasad, 2006).

Neoliberalism reorganized the role of the welfare state by “shifting responsibility from state to market and from the collective to the individual” (Hasenfeld, 2012, p. 301). The government started to introduce the logic of business management into public management by encouraging competition within and among public and private organizations, implementing corporate management strategies, and seeking cost-efficient models of service delivery (Hasenfeld, 2012). Caplan and Ricciardelli (2016) state that the expanded neoliberal principles over the past 40 years were institutionalized in current social policies through privatization, contract service delivery, voucher systems, and consumer-directed spending. Such an institutionalization of neoliberalism considerably affected the operation of nonprofit human service organizations, who then must adapt to changing social policies in human service delivery.

Taking one aspect of the influence of neoliberalism, privatization is the process of contracting out of human services to private organizations (Marwell, 2004). This process has shifted the responsibility for human services from the federal government to private sector actors since the 1980s (Hall, 2016). Such privatization stimulated immense growth in nonprofit organizations in the delivery of publicly funded direct services (Salamon, 1995). The increasing contracts by state and local governments attracted many new organizations in not only the nonprofit sector but also in the for-profit sector to the field of human service delivery (Hasenfeld, 2012), which resulted in increasing competition between human service providers. During this process, the form of much government funding shifted to block grants that allow for discretion of local and state governments in determining spending. For example, the Temporary Assistance for

Needy Families (TANF) program, through the passage of the Personal Responsibility of Work Opportunity Reconciliation Act (PRWORA) in 1996, used block grants to control increasing spending in the AFDC program (Pavetti & Wemmerus, 1999). In employing block grants, the federal government provides a lump sum to the states, and the states use these funds to operate their own programs (Pavetti & Wemmerus, 1999). In addition to this, the government support of nonprofit organizations has been shifting from producer-side grants to customer-side subsidies such as loan guarantees, tax expenditures, and vouchers since 1980s (Caplan & Ricciardelli, 2016). While 53% of federal assistance to nonprofit organizations took the form of consumer-side subsidies in 1980, it had increased to 70% by 1986, and has continued to increase since (Salamon, 2015).

Overall, the cumulative effects of neoliberal social policies increased mixed-mode competition between for-profits and nonprofits. Accordingly, a new operational rule of nonprofit organizations has emerged: commercialism (Salamon, 2015). Historically, mixed-mode competition has taken place as some nonprofits have sought market places previously occupied by for-profits and some for-profits have extended into traditionally nonprofit areas such as day-care-centers, museums, job training programs, and hospitals (Tuckman, 1998). Over the last 40 years, this mixed-mode competition has thrived as the government has financed both nonprofit organizations and for-profit organizations through voucher schemes and block grants. Tuckman explains how the increased competition led to the commercialization of nonprofit organizations as follows (1998, p.185):

> Nonprofits competing in mixed-mode product markets must deliver services efficiently if they wish to enhance their revenues. The subsidies that 501(c)(3) organizations receive offer some cushion against competition but it makes little sense for nonprofits to

> subsidize for-profit activities if the goal of these activities is to generate revenues for nonprofit purposes. Over time, the forces of competition are likely to push nonprofits toward increased use of for-profit business techniques, at least in relation to the products and services they sell in mixed-mode settings. This additional dimension of commercialization—the adoption of for-profit production and delivery techniques—can have long- reaching effects on the operation of a nonprofit, particularly if approaches learned in a mixed-mode setting are applied to production in exclusively non-profit markets.

Through this process, the distinction between the for-profit sector and the nonprofit sector has been blurred (Dees & Anderson, 2003). Like the management of for-profit organizations, "managerial efficiency, innovation, and cost containment" have begun to be emphasized among human service nonprofit organizations (Salamon, 2015, p. 25). The strategy incorporated in the commercial impulse is to inject a different type of professionalism into the operation of nonprofit organizations. However, it is "not the subject-matter professionalism of doctors, social workers, and educators, but the business-oriented skills of the managerial professional…[which] includes the use of strategic planning, quantitative measurement of outcomes, identification of market niches, and heightened attention to operational efficiency" (Salamon, 2015, p. 26). Taken together, neoliberalism provides a theoretical underpinning of this study's examination of the commercial activity of human service nonprofits.

## Factors of Commercial Activity

When explaining the revenue strategies of nonprofit organizations, the most commonly employed theory is resource dependence theory. The resource dependence theory provides a framework that can explain why nonprofit organizations increase commercial activity rather than government grants and private contributions. On the other hand, Young's benefits theory (2017) provides a more elaborated perspective on nonprofits' income generation; specifically, how nonprofit organizations rely on commercial revenue or donative revenue, respectively. Young's benefits theory assumes that nonprofit organizations have a mixed revenue portfolio, which is determined by the services they offer and the beneficiary group of the services. The following sections provide a more detailed review of each theory.

**Resource dependence theory**

In order to explain the revenue generation strategy of nonprofit organizations, resource dependence theory has been commonly applied (e.g., Froelich, 1999; Hodge & Piccolo, 2005; Macedo & Carlos Pinho, 2006; Callen, Klein, & Tinkelman, 2010; De Los Mozos, Duarte, & Ruiz, 2016). Nonprofit organizations rely on various resource providers to provide mission-related services. According to resource dependence theory, "the key to organizational survival is the ability to acquire and maintain resources" (Pfeffer & Salancik, 1978, p. 2). An organization's survival depends on its resources and dependency relationships with external institutions (Hodge & Piccolo, 2005). Therefore, in order to obtain and maintain adequate resources, nonprofit organizations should interact with the individuals and groups that control resources (Froelich, 1999). According to this theory, organizations are restrained by the environment as a consequence of their need for resources (Froelich, 1999). The degree of dependence is determined by the importance and concentration of the resources provided (Froelich, 1999). Organizations that rely on few sources become highly dependent on those providers for survival. However, although much organizational action is determined by environmental conditions, managers' strategic decisions are also considered to be very important in obtaining resources (Heimovics, 1990; Hodge & Piccolo, 2005).

Froelich (1999) explains the cause of the commercial activity of nonprofit organizations through the resource dependence theory. According to him, continuous change in environments associated with major resource providers brings particular threats or opportunities for nonprofit funding (Froelich, 1999). Nonprofit organizations have traditionally obtained financial resources from charitable donation and governmental support (Hammack, 2001). However, Froelich (1999) found that nonprofit organizations started to locate alternative revenue sources due to growing uncertainty and scarcity associated with the traditional revenue sources. Declining private contributions and fluctuating government grants sensitive to changes in political leadership and public policy initiatives resulted in this uncertainty and scarcity of resources (Salamon, 2015; Hall, 2016). To protect themselves from the turbulence of traditional revenue sources, nonprofit organizations developed alternative revenue sources by engaging in commercial activity (Froelich, 1999). In this vein, the move towards commercial activity can be perceived as a way to reduce resource dependence on traditional revenue sources and also a means of preserving organizational autonomy.

**Young's benefits theory**

On the other hand, Young's benefits theory provides more elaborated mechanisms of nonprofit organizations' revenue generation. Benefits theory is based on the assumption that nonprofit organizations "have missions and service aimed at benefiting various groups of clients, consumers or constituents directly through their goods and services, for which they or their sponsors are willing to pay" (Young, 2017, p. 41). Based on this theory, nonprofit organizations are not all purely social mission-driven (Young, 2017). They produce both private benefits for owners and investors and mission-related benefits for their target clients (Young, 2017). Therefore, social enterprises that operate within the framework of nonprofit organizations do not rely exclusively on market revenues or traditional investors to finance their organizations (Young, 2015). According to this theory, revenue sources are matched with the benefits that can be supported through various income mechanisms (Young, 2017). Figure 3-1 shows this relationship between service benefits and income sources. This theory argues that different types of benefits, such as public, private, group, and exchange benefits, favor different revenue sources including government grants, fees, gifts, in-kind donations, and investment (Young, 2017). In addition, benefits theorists insist that the revenue portfolio of nonprofit organizations should reflect the distribution of service benefits (Young, 2017).

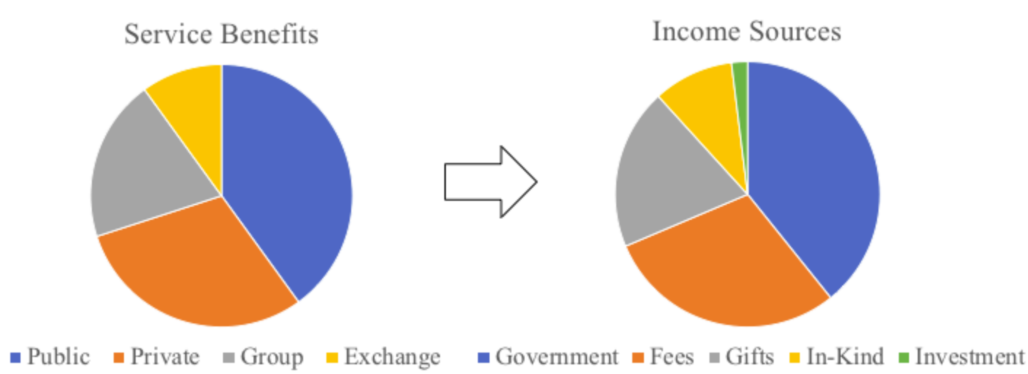



*Figure 3-2.* Young's benefits theory. Retrieved from Young (2017, p. 43)

Figure 3-2 presents the process through which nonprofit organizations determine their revenue portfolio from the demand-side. According to benefits theory, a nonprofit organization's revenue source portfolio is determined by the kinds of services it offers and the nature of the benefits it provides to its beneficiary groups. However, this path is shaped by various organizational and environmental factors such as local concerns, solvency, risk, and mission achievement.

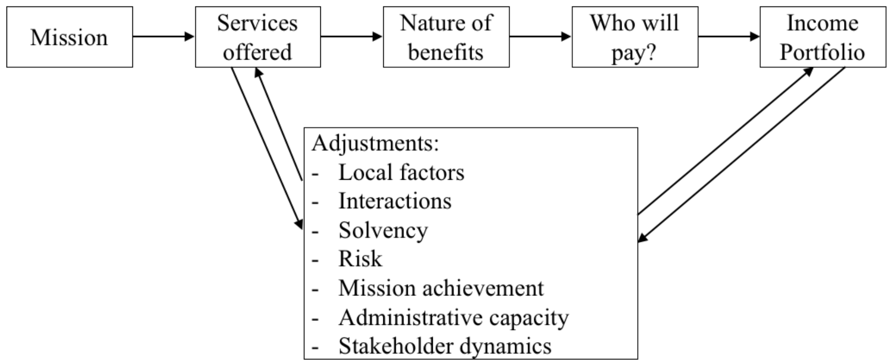



*Figure 3-3.* Demand-side view of benefits theory. Retrieved from Young (2017, p. 43)

This theory provides a useful framework to examine the different financial patterns of nonprofit subsectors. Young (2017) showed that the proportion of income from donative revenue (i.e., contribution, gifts, and grants), commercial revenue (i.e., program service revenue and contracts), and investment income is explained by the benefits theory. For example, nonprofits in the health care and educational fields are more heavily financed by fees such as tuition and insurance payments because "their services are consumed by individual clients who can be charged directly or indirectly for the benefits they receive" (Young, 2017, p. 45). However, revenue for nonprofits in the environment sector is almost entirely generated from contributions, gifts, and grants because the benefits of these services are consumed by the public (Young, 2017). A recent empirical study conducted by Kim, Pandey and Pandey (2018) also supports this theory. The study found that nonprofit arts organizations obtaining a larger share of revenues from market-based sources were less likely to promote increasing public accessibility whereas nonprofit art organizations supported by local governments were more likely to promote public accessibility by providing more free admissions (Kim, Pandey & Pandey, 2018)

## The Consequences of Commercial Activity

There are a few existing theories for understanding the consequences of the commercial activities of nonprofits. In recent years, there have been increasing arguments that nonprofit human service organizations should seek innovative solutions in order to survive in a challenging landscape characterized by reduced federal funding, the complex demands of stakeholders, and intensified competition (Jaskyte & Dressler, 2005; Jaskyte & Lee, 2006). In this vein, many researchers have argued that commercial activity could be an innovative and desirable management strategy to achieve higher efficiency and sustainability (Young, 2001; Jenner, 2014; Austin, Stevenson & Wei-Skillern, 2006; Reilly, 2016). Many scholars with this perspective have argued that as opposed to donative revenue from government and private contributions, earned income offers numerous benefits to nonprofits such as consistent cash flow, unrestricted use of funds, and diversification of the revenue base (Lyons et al., 2010). In this vein, nonprofit organizations involved in generating earned income are considered to have achieved a competitive edge that helps them thrive in an increasingly competitive nonprofit marketplace, which results in long-term sustainability (Weerawardena et al., 2010; Connolly, 2004; Roy & Karna, 2015). However, according to the behavioral theory of nonprofits by Weisbrod (2000), unlike for-profit enterprises, the commercial activities of nonprofits could have negative effects on nonprofits in terms of mission drift and legal and reputational risks, which threatens the sustainability of a nonprofit organization in a long term. As such, nonprofits should avoid commercial activities (Weisbrod, 2004). The following sections will provide two prominent approaches on commercial activities of human service nonprofit organizations: social enterprise approach and behavioral theory of the nonprofit as a multiproduct firm.

**Social enterprise approach**

Over the past few decades, the commercial activities of human service nonprofits in the United States have increased dramatically due to numerous factors (Maier, et al., 2016). On the most abstract level, discourses and ideologies, characterized by neoliberalism, managerialism, and professionalism (Crouch, 2011; Salamon, 2015) have pushed nonprofits toward engaging in more commercial activities. On a more concrete level, many scholars have understood that the economic decline of the late 1970s resulted in welfare retrenchment and a large reduction in federal funding for nonprofit organizations in the 1980s (Salamon, 1997), which led nonprofits to involve themselves in business activities as a way to fill the gap left by government cutbacks (Kerlin, 2006; Young, 2003). In the United States, the commercial activity of nonprofit organizations has been understood to be in close relation withthe development of social enterprise (Kerlin, 2006).

The term "social enterprise" has become widespread since the 1980s in the United States and is used to describe the expanded commercial activities of nonprofit organizations (Kerlin, 2009; Young, 2017). Social enterprise in the U.S. broadly includes organizations such as "profit-oriented businesses engaged in socially beneficial activities," "dual purpose businesses that mediate profit goals with social objectives", and "nonprofit organizations engaged in mission-supporting commercial activity" (Kerlin, 2006, p. 248). Although some have critiqued social enterprise is "an expression of a neoliberal welfare logic that challenges social rights by emphasizing market solutions to social needs and by devolving and privatizing social services to the local level and the private sector" (Garrow & Hasenfeld, 2014, p. 1475), the commercial activities of nonprofit organizations have attracted the extensive attention of a wide range of scholars (e.g., Dart, 2004; Guo, 2006; Kerlin & Pollak, 2011; Maier, Meyer & Steinbereithner, 2016; Zhang & Swanson, 2013). The increasing commercial activity of nonprofit organizations has been considered an innovative way of generating revenue to ensure the organization's sustainability (Reilly, 2016; Defourny & Nyssens, 2006). According to Alter (2007), nonprofit organizations may adopt particular social enterprise models to generate earned income, which include: 1) the "fee-for-service model" that commercializes its social services, and sells them directly to its clients, including individuals, firms, and communities; 2) the "low-income client as market model" that provides more access to products and services in the market to poor and low-income individuals in terms of price, distribution, and product features 3) the "service subsidization model" that sells the products or services of the organization to an external market and uses the income to fund its social programs; 4) the "organizational support model", in which a separate for-profit organization sells products and services to an external market and provides a funding stream to a nonprofit parent organization; and 5) the "employment model" that provides employment opportunities and job training to people who experience high barriers to employment, while generating sustainable revenue from their work.

Particularly, in the social work field, the commercial activity of nonprofit human service organizations has been discussed closely in relation to the employment of people with barriers to employment. After the welfare reform legislation of 1996 (i.e., the passage of the Personal Responsibility and Work Opportunities Reconciliation Act), antipoverty policy in the United States shifted to the welfare-to-work paradigm that eliminates poverty through supporting individuals to responsibly work. In this vein, many researchers in social work have discussed transitional job programs (e.g., Mallon & Stevenson, 2011; Redcross, Bloom, Azurdia, Zweig, & Pindus, 2009; Redcross, Millenky, Rudd, & Levshin, 2011) and work integration social enterprise intervention models (e.g., Caplan, 2010; Ferguson & Islam, 2008; Ferguson & Xie, 2008; Cooney, 2011; Ho & Chan, 2012; Seddon, Hazenberg, & Denny, 2014; Spencer, Brueckner, Wise, & Marika, 2016; Haugh & Talwar, 2017; O'Donnell, Tan, Kirkner, 2012; Denny et al., 2011; Maggurre, Ruelas, & Torre, 2016). Many nonprofit organizations have developed transitional job programs and tried to create sustainable jobs for individuals who experience difficulty obtaining a quality job in the labor market. Retail stores, cafe, restaurants, and bakeries have been launched by nonprofit organizations to employ people with mental illness and physical disabilities, ex-offenders, disadvantaged youths and older people (e.g., Goodwill Industries, Juma Ventures, Liberty's Kitchen, Greystone Bakery). In order to support the employment of clients, social workers should ideally  learn how to increase the employability of their clients and sell products that client-employees produced to the public at a fair price. Market-driven skills and knowledge among social workers, so called social entrepreneurship, has been emphasized by many researchers (Germak & Signh, 2009; Gray, Healy, & Crofts, 2003; Ferguson, 2007, 2012; Galera, 2010).

In sum, according to the social enterprise approach, nonprofit organizations have transformed to adopt market-driven strategies to effectively respond to the fiscal challenges that they have faced since the 1980s. Particularly, the new paradigm of antipoverty, welfare-to-work, has also stimulated nonprofit human service organizations to become involved in the for-profit market place. According to the social enterprise approach, the commercial activity of nonprofit organizations is seen as an innovative self-survival strategy that enables nonprofit organizations to fulfill their mission in daunting environments. However, a very few empirical studies have investigated whether the commercial activity of nonprofit organizations increases their financial health. Carroll and Stater (2008) found that increasing commercial income might help organizations that rely mainly on contributions to be more financially stable and serve their clients more effectively. Guo (2006) examined 67 nonprofits involved in earned-income business ventures in the United States and found that higher levels of commercial income could significantly contribute to an organization's self-sufficiency.

**Behavioral theory of the nonprofit as a multiproduct firm**

The behavioral theory of the nonprofit as a multiproduct firm as developed by Weisbrod (2000) explains the commercial activity of nonprofit organizations differently than social enterprise approach. This behavioral theory was built on the foundation developed by Estelle James (1983) and extended by Jerald Schiff and Weisbrod (1991) and assumes that nonprofit organizations and for-profit organizations have different goals and incentives (Weisbrod, 2000). Weisbrod (2000) supposes that there are two unique goals of nonprofits: 1) to provide socially valuable but privately unprofitable services, which include "collective" goods and private goods targeted at "socially deserving" groups; and 2) to avoid engaging in certain types of activity, including competing with private firms to sell conventional private goods or producing goods or services that do not directly contribute to its mission. Also, regarding the incentives, unlike for-profit enterprises, nonprofit organizations can receive tax-deductible donations and do not pay a corporate profits tax on their mission-related activities. These incentives affect their intention to engage in commercial activities (Weisbrod, 2000).

Based on the assumption of goals and incentives, nonprofits are assumed to prefer to provide goods "that are socially desirable but privately unprofitable, and hence, are underprovided in private for-profit markets" (Weisbrod, 2000, p. 52). On the other hand, nonprofits are assumed to dislike providing goods "that can be sold, may be provided by private firms, and are potential sources of revenue for nonprofits seeking funds to finance their mission-related activities" (Weisbrod, 2000, p. 52). In this vein, a nonprofit is a "multiproduct organization" (Weisbrod, 2000, p. 48) that chooses to provide different amounts of three types of goods (Weisbrod, 2000, p. 49):

1) a preferred collective good, which is difficult to sell in private markets

2) a preferred private good, which can be sold in private markets but which the nonprofit may wish to make available to some consumers independent of their ability to pay

3) a non-preferred private good, which is produced solely for the purpose of generating revenue for the preferred good

These three types of goods are provided through three different revenue sources respectively: i) donations of money and time from private individuals, corporations, foundations, and the government, ii) user fees charged to people who receive mission-related private services, and iii) the sale of ancillary goods and services that are not mission-related (Weisbrod, 2000). Based on the underlying consideration of goals and the three types of goods, this model provides several hypotheses regarding the behavior of nonprofits in their use of the different revenue sources (Weisbrod, 2000). First, nonprofits prefer (exogenous) donations[1] over commercial revenue since obtaining them does not require the nonprofit to divert activities from its mission. Second, nonprofits prefer to minimize the use of user fees, because their mission is to make services available either to everyone or to particular consumer groups. A user fee has the inevitable side effect of discouraging consumers whom nonprofits serve. Third, the ancillary (commercial) activities of nonprofits have direct negative effects on an organization's mission. It

[1] Weisbrod classifies two types of donations: exogenous donations, which are received by organizations essentially regardless of its activities, and endogenous donations, which are influenced by the nonprofits' activities such as fund-raising.

may distract management, which results in the weakening of its attention to an organization's central mission. It may also cause mission displacement, which sacrifices some elements of the organization's goal in order to satisfy prospective purchasers of the ancillary services.

Based on this theory, the expanding commercial activity of nonprofits is understood as the less desirable but inevitable reaction of nonprofits to a decrease in donative revenues. This means that commercial activity is just a defensive response rather than an innovative strategy that nonprofit organizations should actively engage in. Even though nonprofit organizations are involved in generating earned income and may seek to maximized profits, they do not reach profit-maximizing levels because of the disutility of commercialism that results from the direct negative effect of commercial activity on a mission (Weisbrod, 2000). Weisbrod (2004) argues that nonprofit organizations can obtain advantages by purely financing themselves through donative funding, due to the various tax benefits for nonprofits. In the long term, nonprofits should remove themselves from commercial ventures so as not to lose the sight of their social goals (Weisbrod, 2004). The behavioral theory of nonprofits provides a useful and comprehensive framework to understand the causes and consequences of commercialization. Also, unlike prevailing positive views of the business mechanisms adopted by an increasing number of nonprofits, this critical perspective of the commercial activity of nonprofits can shed light on the unique abilities and missions of nonprofits, which should address their social goals while remaining free of profit-making motives.

However, similarly to the social enterprise approach, very few empirical studies support the nonprofit theory of Wesibrod (2000). Guo (2006) found that commercial revenues did not make a significant contribution to an organization's ability to attract donors and volunteers. Prentice (2016a) found that an increase in commercial revenue was not a reliable method of increasing financial health, especially for human services organizations. However, some have found different results suggesting that the most commercialized organizations are also those receiving the largest share of public funds (Enjolras, 2002), and that the commercial income of nonprofit organizations increases an organization's self-sufficiency and financial stability (Carroll & Stater, 2008; Guo, 2006). Therefore, further empirical studies that examine the association between the commercial revenues of nonprofit organizations and their financial health is needed. This current study examines the association between the commercial revenues of nonprofit human service organizations in the United States and their financial health. Through this process, this study should establish which theory better explains the relationship between these variables.

## Conclusion

This section examined neoliberalism and four theories regarding the influencing factors and consequences of commercial activity. In this study, the resource dependence theory is tested by examining whether the decrease in government grants and donative revenue is associated with an increase in commercial activity. Young's benefits theory is applied in explaining different revenue strategies across human service organizations with different purposes. In terms of the relationship between commercial activity and financial health, this study examines which theory could explain the relationship better among two competing theories, social enterprise approach and Weisbrod's behavioral theory of the nonprofit.

# CHAPTER 4

# METHOD

Chapter four presents the method of this study. First, research questions and hypotheses based on the literature review and theory are provided. Second, the research design is explained with a research model. Third, detailed information about data and sampling is reviewed. Fourth, in the instruments section, how major variables (i.e., commercial activity, government grants, private donation, financial performance) and control variables (i.e., age, size, sector) were operationalized and measured is explained. Lastly, the specific procedures of this study, including data cleaning and data analyses, are explained in the following sections.

## Research Questions and Hypotheses

This study examines 1) how the commercial activities of nonprofit human service organizations changed in the period from 2000 to 2012; 2) whether changes in donative revenues were associated with changes in commercial activity ratios during the period of 2000 to 2012; and 3) whether changes in commercial activity ratios were associated with organizations' financial health during this same period.

The first research question has a descriptive purpose, to scrutinize the phenomenon of the commercialization of human service nonprofits in the United States between 2000 and 2012. Many scholars have argued that an increasing number of human service nonprofits in the United States have become involved in more diverse commercial activities since the 1980s (Weisbrod, 2004; Kerlin, 2006; Kerlin & Pollak, 2011). However, Salamon (2015) found that this overall pattern of commercialization has started to change, especially since the financial crisis in 2008, due to the impact of government entitlement programs--the so-called "safety net". In contrast to the previous period in which commercial activities constantly increased, the government share of overall nonprofit revenue increased from 32.5% in 2007 to 34.7% in 2011, while fee income declined from 57.5% in 2007 to 55.8% in 2011 (Salamon, 2015). However, whether nonprofit organizations in the human service area also experienced a similar transformation has not been tested yet. Furthermore, although revenue generation strategies could vary depending on organizational mission (Young, 2015), little is yet known about variations in the commercial activities between the eight subareas of nonprofit human service organizations. Therefore, this research examines how the commercial activities of human service nonprofits have changed during the period from 2000 to 2012 by investigating the longitudinal change of several indicators across these eight human service areas. This research is guided by four specific research questions, presented below. Since this is a descriptive research question, no hypothesis is generated.

**RQ 1.** How have the commercial activities of human service nonprofits changed over the 12-year period from 2000 to 2012?

RQ 1-1. How has the percentage of commercial human service nonprofits changed (i.e., human service nonprofits that earn more than 60% of total revenue from commercial activities)?

RQ 1-2. How has the commercial revenue of human service nonprofits been changed according to revenue type?

RQ 1-3. How have the commercial activity ratios of human service nonprofits been changed on average?

RQ 1-4. How have the commercial activity ratios of human service nonprofits been changed across the eight human service mission areas?

The second research question explores the association between donative revenues (i.e., government grants and private donation) and commercial revenues over the designated twelve-year period. According to the behavioral theory of nonprofits, donative revenues and commercial revenues have a negative relationship, and a decrease in government grants and private donations will increase the commercial activity of nonprofits (Weisbrod, 2000; Segal & Weisbrod, 2000). However, an empirical study conducted by Kerlin and Pollak (2010) examining the two decades between 1982 and 2002 found little evidence that decreases in government grants and private contributions were associated with an increase in commercial activity. Additional empirical studies are needed to illuminate the relationship between donative revenues and commercial activities. In addition, according to Young's benefits theory, nonprofits make different decisions about their commercial activities based on their mission, served clients, and the type of services (Weerawardena et al., 2010; Young, 2015). Therefore, this research examines the relationship between donative revenues and commercial revenues while including specific mission areas as a control variable. Furthermore, this research examines whether there is any sector difference in the association between donative revenues and commercial revenues. In sum, four hypotheses regarding the second research question are developed as follows.

**RQ 2.** Does a decrease in government grants and private donations between 2000 – 2012 increase human service nonprofit organizations' commercial activities during the same period?

H 2-1. Nonprofit human service organizations that decreased their government grant ratio between 2000 and 2012 will increase their commercial activity ratio during the same period.

H 2-2. Nonprofit human service organizations that decreased their private donation ratio between 2000 and 2012 will increase their commercial activity ratio during the same period.

H 2-3. The decrease in government grant ratio and private donation ratio will be associated with an increase in commercial activity ratio when controlling for mission areas, age, and size.

H 2-4. There will be a sector difference in the association between the decrease in the government grant and private donation ratios when controlling for age and size.

The third research question examines how the change in the commercial activity ratio of nonprofit human service organizations over these twelve years is associated with a change in their financial health. Recently, there has been an increasing argument that nonprofit organizations could secure financial sustainability through utilizing the advantages of commercial revenue such as consistent cash flow and unrestricted use of funds (Lyons et al. 2010; Reilly, 2016). However, according to the behavioral theory of nonprofits, the commercial activity of nonprofits may prove detrimental to their financial performance. This is because nonprofits involved in commercial activity might lose their tax incentives and potential donors may have an aversion to their commercial activity and may cease to provide contributions to these nonprofits (Weisbrod, 2004). This study tests Weisbrod's theory that a greater increase in the commercial activities of nonprofits could result in a greater decrease in their financial health. In addition, based on Young's benefits theory, this study examines whether the strength of the relationship between commercial activity and financial health varies across the subareas of human service. Therefore, three hypotheses for the third question are developed as follows.

**RQ 3.** Does a change in nonprofit human service organizations' commercial activities between 2000 – 2012 predict a change in organizations' financial health during the same period?

H 3-1. Human service nonprofit organizations that increased their commercial activity ratios between 2000 and 2012 will have an especially decreased trajectory in financial health compared to human service nonprofit organizations with constant or decreased commercial activity ratios.

H 3-2. The increase in the commercial activity ratios of human service nonprofit organizations will affect their financial health when controlling for mission areas, age, and size.

H 3-3. There will be a sector difference in the association between an increase in commercial activity ratio and financial health when controlling for age and size.

## Research Design

This study examines 1) how the commercial activities of nonprofit human service organizations changed during the period from 2000 to 2012 across the eight mission areas; 2) whether a decrease in donative revenues (i.e., government grants and private donation) influenced an increase in commercial activity during the same period; and 3) whether an increase in commercial activity influenced financial performance during the period from 2000 to 2012 across the eight mission areas of human service nonprofits. Figure 4-1 shows an integrated research model.

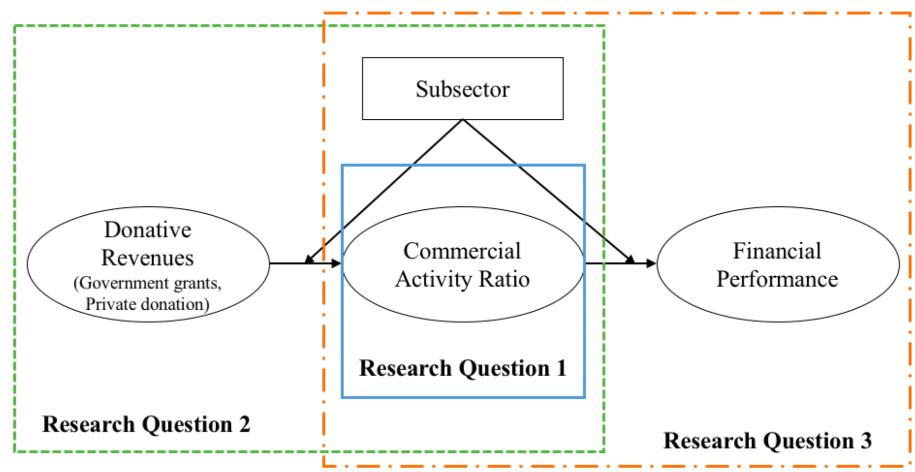



*Figure 4-4.* Integrated research model

The study design utilizes a longitudinal quantitative analysis of nonprofit financial data, since this study aims to examine the relationship between changes in multiple variables over time. Longitudinal studies use repeated and time-ordered measures to identify processes and causes of change in particular individuals (McArdle & Nesselroade, 2014). Compared to cross-sectional analysis, which analyzes multiple variables only at a given time and does not provide information regarding the influence of time on the variables, longitudinal study is more valid for examining the cause-and-effect relationships of multiple variables within individuals. Also, since all individuals do not change in the same way, longitudinal study examines the interindividual differences in intraindividual change (McArdle & Nesselroade, 2014).

## Data and Sample

This study utilizes the nonprofit financial data from the U.A. Internal Revenue Services' (IRS) Statistics of Income (SOI) database compiled by the National Center for Charitable Statistics (NCCS) at the Urban Institute, which is accessible to the public (Urban Institute, 2019). The SOI database consists of information from the Form 990 and Form 990-EZ that each nonprofit organization exempted from income tax is required to file annually with the IRS. An organization whose annual gross receipts are more than a certain threshold should file the Form 990. However, relatively smaller organizations whose gross receipts are less than a certain threshold can choose to report Form 990-EZ, which is the shortened version of Form 990. Table 4-1 shows each year's criteria for organizations that should file Form 990 or Form 990-EZ. For this study, only organizations that reported Form 990 were included, because Form 990-EZ does not have separate information on the revenue of government grants and private donations. To collect the data, the SOI database that includes financial information obtained from the annual Form 990 was downloaded from 2000 to 2012 from the NCCS data archive (http://nccs-data.urban.org).

Table 4-1

*Organizations that must file FORM 990 or FORM 990-EZ*

| Report Year | FORM 990 | FORM 990-EZ (shorten Form 990) |
|---|---|---|
| 2000 ~ 2008 | Gross receipts > $25,000 | Gross receipts < $100,000 &<br>total assets < $250,000 |
| 2009 | Gross receipts > $25,000 | Gross receipts < $500,000 &<br>total assets < $1,250,000 |
| 2010 ~ 2012 | Gross receipts > $50,000 | Gross receipts < $200,000 &<br>total assets < $500,000 |

NCCS data have been commonly used to investigate nonprofit organizations' financial performance (Kerlin & Pollak, 2011; Carroll & Stater, 2008; Prentice, 2016a; Trussel, 2002; Teasdale, Kerlin, Young & Soh, 2013). However, several weaknesses of the data should be taken into consideration. The sample of the data is skewed to large nonprofit organizations because this data excludes organizations grossing less than a certain amount (i.e., $25,000 in 2000-2009 or

$50,000 in 2010-2012). Therefore, the findings of this study may not be generalized to smaller nonprofit human service organizations. Also, as the format of Form 990 changed significantly in 2008, included items and lines of content on Forms 990 from 2008 to 2012 are different from the ones on Forms 990 from 2000 to 2007. Therefore, researchers should elaborately match the Forms 990 after 2008 and the Forms 990 before 2008 to construct a variable equally measured over twelve years. This study carefully matched all the variables from different forms and the specific procedures for doing so are described in the procedure section.

The sample of this study includes 501(c)(3) public charities in the human service sector that filed a Form 990 in all the years between 2000 – 2012 to create balanced panel data. There are two reasons for creating a balanced panel data that lacks missing observations for any year. First, since this research aims to examine changes in the commercial activities of organizations, having a balanced panel data without missing observations for a given year is integral to accurately capturing the longitudinal trajectory of each organization. The missing data of certain samples in certain years could result in biased statistics, such as a reduced or inflated mean value that could affect the results (Heckman, 1979). Second, since the criteria for the organizations who must file Form 990 changed in 2010 (See Table 4-1), the target nonprofit organizations after 2010 are different from those before 2010. According to these criteria, nonprofits grossing between $25,000 and $50,000 that filed Form 990 from 2000 to 2010 may not file Form 990 from 2010 to 2012, which could result in non-random gaps. Therefore, among 7,551 unique human service organizations in the SOI datasets, only N = 1,471 (19.48%) organizations were included as a sample of this study (See Table 4-2).

Regarding the balanced panel data, several limitations should be taken into consideration. Since the sample of this study only includes the organizations that reported their financial status consecutively from 2000 to 2012 based on the criteria of FORM 990 (e.g., gross income more than $25,000), it implies that the dataset includes only the organizations that have survived and experienced great financial performance over the twelve years. The organizations that ceased their business due to their low financial performance during the period from 2000 to 2012 and the organizations that had fluctuating gross income (e.g., greater than $25,000 in several years but fewer than $25,000 in other years) during the same period are not included in the dataset. Therefore, the dataset in this study is only able to predict variances between surviving organizations that had good financial performance over this twelve-year period. This skewed sample remains the limitation of this research.

Table 4-2.

*Number of organizations and sample data*

| Data Year | Number of Observations | Number of Years Observed | Number of Organizations (%) |
|---|---|---|---|
| 2000 | 4371 | 1 | 942 (12.48) |
| 2001 | 4634 | 2 | 666 (8.82) |
| 2002 | 4847 | 3 | 1,005 (13.31) |
| 2003 | 3774 | 4 | 482 (6.38) |
| 2004 | 3951 | 5 | 379 (5.02) |
| 2005 | 4110 | 6 | 346 (4.58) |
| 2006 | 4400 | 7 | 433 (5.73) |
| 2007 | 4095 | 8 | 300 (3.97) |
| 2008 | 3695 | 9 | 286 (3.79) |
| 2009 | 4105 | 10 | 568 (7.52) |
| 2010 | 3191 | 11 | 263 (3.48) |
| 2011 | 3255 | 12 | 410 (5.43) |
| 2012 | 3381 | **13** | **1,471 (19.48)** |
| Total | 51809 | Total | 7,551 (100.00) |

## Measurement

The three research questions include four main variables and three control variables. The main variables are commercial activity, government grants, private donations, and financial health, and the control variables are mission area, size, and age, and these are defined and measured as follows.

### Commercial activity

Commercial activity is defined as the total commercial income, which refers to income from i) program service revenue, ii) membership dues and assessments, iii) investment income (i.e., interest on savings and temporary cash investments, dividends and interest from securities, net rental income, and other investment income), iv) income from special events, and v) income from sales of inventory (Guo, 2006; Kerlin & Pollak, 2011; Cortis, 2017). The important thing to notice is that the program service revenue includes not only payments by individuals and private organizations but also government payments of reimbursement for qualified individuals (e.g., Medicare and Medicaid payments) and contracts from government agencies for a service, facility, or product that primarily benefits the government agencies (IRS, 2012). For example, "a payment by a governmental agency to a medical clinic to provide vaccinations to employees of the agency" is considered as a program service revenue, while "a payment by a governmental agency to a medical clinic to provide vaccinations to the general public" is reported as a government grant below (IRS, 2012, p. 38). Therefore, the commercial revenue in this study includes all the commercial revenues obtained from individual, private organizations, and government agencies.

Also, the commercial activity in this study includes both mission-related incomes and mission-unrelated incomes. The mission-related incomes involve the sales of products or services consistent with the expressed purpose of the organization (e.g., an orchestra sells a ticket for a performance, a health institution charges clients health-related service fees). On the other hand, mission-unrelated incomes involve sales not directly related to the nonprofit's purpose (e.g., a nonprofit sells cookies at market rates to the general public during a bake sale). Some researchers differentiate mission-unrelated commercial incomes from mission-related commercial incomes (Tuckman & Chang, 2003; Tuckman, Chatterjee, & Muha) because this unrelated revenue is subject to income tax, known as the Unrelated Business Income Tax (UBIT). However, according to Weisbrod (2002), both mission-related business income and mission-unrelated business income are considered the same in the sense that nonprofit organizations must expend additional attention and energy to obtain it. Therefore, in this study, the income from the five commercial sources listed above was included regardless of whether it is mission-related or not.

**Government grants**

Government grants are defined as the total financial contributions given by government agencies. Government grants are measured as "the amount of contributions in the form of grants or similar payments from local, state, or federal government sources, as well as foreign governments" (IRS, 2012, p. 37). A grant or other payment from a governmental unit is considered to be government grants "if its primary purpose is to enable the organization to provide a service to, or maintain a facility for, the direct benefit of the public rather than to serve the direct and immediate needs of the governmental unit" (IRS, 2012, p. 38). In other words, if the general public receives the primary and direct benefit from the governmental payment, it is considered to be a government grant. For example, "payment by a governmental unit for the construction or maintenance of library or museum facilities open to the public," "payments by a governmental unit to nursing homes to provide care to their residents (but not Medicare / Medicaid or similar payments made on behalf of the residents)," and "payments by a governmental unit to child placement or child guidance organizations under government programs to better serve children in the community" are all government grants. As stated above, payments of a governmental agency for reimbursement (i.e., Medicaid, Medicare), governmental employees, or a government facility are considered to be program revenues under the definition of commercial activity.

**Private donation**

Private donation is defined as total contributions received by individuals or private organizations. It includes contributions received from i) federated campaigns, ii) membership dues, iii) fundraising events, iv) related organizations, and v) all other contributions. Noncash contributions are included as cash value. Federated campaigns represent the "contributions received indirectly from the public through solicitation campaigns conducted by federated fundraising agencies and similar fundraising organizations (such as from a United Way organization)" (IRS, 2012, p. 37). Membership dues here are different than those classified as commercial revenue because they represent contributions from the public rather than payments for benefits received from organizations. Among membership dues, the proportion that exceeds the market value of affiliation is reported as private donations. The contribution from related organizations "that stand in a parent/subsidiary relationship, brother/sister relationship, sponsoring relationship, or supporting/supported organization relationship" (IRS, 2012) is also included in the domain of private donation.

**Financial health**

For nonprofit organizations, financial health is commonly defined via four indicators: solvency, liquidity, profitability, and margin (Prentice, 2016b; Tuckman & Chang, 1991; Bowman, 2011; Chabotar, 1989; Bowman et al., 2012; Greenlee & Trussel, 2000). Although each indicator is measured variously across researchers, this research utilizes the most commonly used measures for each indicator as follows: i) solvency = total net asset / total revenue (Tuckman & Chang, 1991); ii) liquidity = quick ratio = current assets -inventories / current liabilities (Chabotar, 1989); iii) profitability = net income / total assets (Bowman, 2002); iv) margin = net income / total revenue (Greenlee & Trussel, 2000). Since the original value of liquidity showed too dispersed a distribution, this study uses a log-transformed liquidity variable.

**Mission area**

Based on NTEE classification, eight mission areas are included as control variables: i) crime, legal related; ii) employment, job related; iii) food, agriculture, and nutrition; iv) housing, shelter; v) public safety; vi) recreation, sports, leisure, athletics; vii) youth development; and viii) multipurpose human services. For research questions 2 and 3, mission area is included as a binary variable (multipurpose human services = 1, other areas = 0).

**Size**

Studies found that the size of nonprofits influences their commercial activity, level of mission achievement, and financial sustainability (Maier, Meyer, & Steinbereithner, 2016; Carroll & Stater, 2008). Therefore, size is included as a control variable. Size was measured as the amount of total assets. Based on the sample code classification developed by NCCS, the amount of assets was measured as a categorical variable: Assets i) under $500,000; ii) $500,000 under $1,000,000; iii) $1,000,000 under $2,500,000; iv) $2,500,000 under $5,000,000; v)

$5,000,000 under $20,000,000; vi) $20,000,000 under $50,000,000; and vii) $50,000,000 or more.

**Age**

**A n**onprofit organization's age influences its behavior (Jaskyte, 2013; Weerawardena & Mort, 2012) and financial outcomes (Jacobs & Marudas, 2009; Ashley & Faulk, 2010). Therefore, organizational age as of the year 2000 is included as a control variable.

## Procedures

**Data cleaning**

In order to create a unified balanced panel data that includes 1,471 samples from 2000 to 2012, this study had following data cleaning procedures.

1) The researcher downloaded 13 years of Statistics of Income (SOI) data from 2000 to 2012 as compiled by the National Center for Charitable Statistics (NCCS) at the Urban Institute from the NCCS website (http://nccs-data.urban.org).
2) The researcher selected only human service organizations from all 13 years of SOI data by using SPSS statistics software.
3) The researcher selected required variables from all 13 years of SOI data by using SPSS statistics software.
4) Since Form 990 was changed in 2008, the variable names of SOI data and the classification of variables were also changed after 2008. For example, the SOI data from 2000 to 2007 coded program service revenue as "R050" and membership dues and assessment as "R060". However, the SOI data from 2008 to 2012 coded program service revenue including membership dues and assessment as "psr_tot". Therefore, the researcher relabeled or computed variables from the data of each year to represent the

same meaning. For example, the sum of "R050" and "R060" in 2000 ~ 2007 SOI data and "psr_tot" in 2008 ~ 2012 SOI were relabeled as "program service revenue". Major variables, commercial activity (i.e., sum of program service revenue, investment income, income from special events, and income from sales of inventory), government grants, private donations, total revenue, solvency, liquidity, profitability, and margin were relabeled from all the data from 2000 to 2012. Table 4-3 presents the specific procedures.

5) The researcher merged 13 years of data and selected organizations that existed in all the data from 2000 to 2012 (n = 1,471). This merging process was conducted using statistics software STATA.

Table 4-3.

*Relabeled variables from original variables*

| Relabeled variables | 2000~2007 original variables | 2008 ~ 2012 original variables |
|---|---|---|
| Commercial activity | | |
| - Program service revenue | R050+R060 | psr_tot |
| - Investment income | R070+R080+R110+ R120+R190 | inv_incm_tot_rev+bonds_tot_rev +roylrev_tot_rev+net_rent_tot_re v+sale_asts_tot_rev |
| - Income from special events | R220 | fndrsng_tot_rev+gaming_tot_rev |
| - Income from sales of inventory | R250 | invntry_tot_rev |
| Government grants | R030 | govt_grnts |
| Private donation | R010+R020 (for 2000~2005) or R010+R020+R005 (for 2006, 2007) | federated_campaigns+memshp_d ues+fndrsng_events+rltd_orgs+al l_oth_contri |

| | | |
|---|---|---|
| Total revenue | R270 | tot_rev |
| Solvency | B020/R270 | tot_net_asts_fnd_bal_eoy/tot_rev |
| Liquidity | ((A040+A050+A060+A070+A080+A110+A120)-A110)/(L020+L030) | ((csh_nnint_bearng_eoy+savngs_temp_csh_invst_eoy+accts_rcvbl_eoy+pledge_grnts_rcvbl_eoy+invntry_for_sl_or_use_eoy+prepaid_exp_defrd_chrgs_eoy)-invntry_for_sl_or_use_eoy)/(accts_pybl_accr_exp_eoy+grnts_pybl_eoy) |
| Profitability | N010/A180 | rev_less_expns_cy/tot_asts_eoy |
| Margin | N010/R270 | rev_less_expns_cy/tot_rev |

*Note.* Data source is Urban Institute (2019) IRB Statistics of Income Division Exempt Organizations Sample Files. Retrieved from http://nccs-data.urban.org

**Data analysis**

Although diverse data analyses were performed across different research questions and hypotheses, the main analyses this study employed were latent growth curve analysis and latent class growth analysis.

**Latent Growth Curve Analysis.** Latent Growth Curve Analysis (LGCA) examines interindividual (between-person) differences in intraindividual change based on structural equation modeling (Ram & Grimm, 2009). LGCA, which is commonly used in development and education research, has gained popularity in the social sciences, particularly organization studies (Bansal, Gao, & Qureshi, 2014; Eggert, Hogreve, Ulaga, & Muenkhoff, 2011), due to its unique benefits in analyzing temporal variations. The unique characteristic of this approach is that LGCA captures growth patterns with two latent variables (intercept and slope) that best represent the average trajectories (Maia, Bastos & Solinger, 2016). The intercept represents the initial level of the growth trajectory, while the slope represents the rate of change (Curran & Willoughby, 2003). If there is non-linear relationship, a quadratic term is added to the model. This technique is useful in capturing the dynamics of change in variables (Maia, Bastos & Solinger, 2016; Vandenberg & Stanley, 2009). Also, the LGCA approach provides access to both individual and group changes and enables the study of the effects of independent variables on change (Vandenberg & Stanley, 2009). The software program Mplus version 8.0 (Muthen & Muthen, 2018) was utilized to conduct all LGCA analyses.

**Latent Class Growth Analysis.** Latent Class Growth Analysis (LCGA) is a person-centered approach that classifies individuals into groups based on the individual longitudinal patterns of a variable (Muthen & Muthen, 2000) and is a specific and more simplified case of growth mixture modeling (GMM; Muthén, 2004; Muthén & Shedden, 1999). LCGA has been used in social work research to classify service utilization trajectories (Mowbray, McBeath, Bank, & Newell, 2016), and the behavior changes of individuals (Cranford, Krentzman, Mowbray & Robinson, 2018). Although there remains a lack of studies that utilize latent class growth analysis for organizations, LCGA is increasingly needed for advanced organizational research (Wang & Hanges, 2011). While conventional latent growth curve analysis provides a single average growth estimate and a single estimation of variance of the growth parameters by assuming that all individuals are drawn from a single population with common parameters, LCGA allows for differences in growth parameters across unobserved subpopulations (Jung & Wickrama, 2008). LCGA captures a subset of individuals whose growth trajectories are significantly different from the overall estimate and identifies latent trajectory classes which allow for different groups of individual growth trajectories to vary around different means (Jung

& Wickrama, 2008). Through this process, LCGA provides separate growth models for each latent class with its unique estimates of variances and covariate influences (Jung & Wickrama, 2008). In LCGA, the variance and covariance estimate for the growth factors within each class are assumed to be fixed to zero influence (Jung & Wickrama, 2008). Because of this assumption, all individual growth trajectories within a class are homogeneous. The advantage of LCGA is that class membership can be used as an outcome variable on covariates or as a predictor for other outcomes (Jung & Wickrama, 2008). The optimal number of latent growth classes were determined based on statistical fit indices that include Lo–Mendell–Rubin likelihood ratio test (LMR-LRT; Lo, Mendell & Rubin, 2001), Akaike information criterion (AIC; Akaike, 1974), Bayesian information criterion (BIC; Schwarz, 1978), and sample-size adjusted BIC (SSABIC; Sclove, 1987). The number of organizations within a class was also considered for the practical relevance of determined classes. The software program Mplus version 8.0 (Muthen & Muthen, 2018) was utilized to conduct all LCGA analyses.

**Research Question One.** To be more specific, the following analyses were performed for the first research question. First, descriptive analyses on the change in percentage of commercial human service nonprofits and the change in commercial revenues from 2000 to 2012 were performed using SPSS version 23 (IBM, 2015). Second, the trajectory of the commercial activity ratio of nonprofit human service organizations from 2000 to 2012 has been examined through a latent growth curve analysis by using Mplus 8.0 (Muthen & Muthen, 2018). In this study, the average trajectory of the commercial activity ratio that represented the line of best fit over all time periods for this ratio was explored using a linear latent growth model and a quadratic latent growth model. Third, latent class growth analysis examined different trajectories in commercial activity ratio and identified distinct classes based on homogenous individual growth trajectories. After identifying three different classes (constant, increasing, or decreasing trajectory of commercial activity ratio), the researcher identified how many organizations belonged to each class across the eight mission areas.

**Research Question Two.** To examine the first hypothesis, whether a change in donative revenues (i.e., government grants and private donations) of nonprofit human service organizations from 2000 to 2012 is associated with a change in the commercial activity of the organizations during the same period, a latent class growth analysis was performed. First, as an initial step, a single-class and unconditional latent class model for government grants ratio was specified. Second, this study identified three classes of government grants ratios based on fit indices. Three, different trajectories of commercial activity ratio across the class membership of government grants ratio were examined. Regarding the second hypothesis on donation ratio, same procedure above was performed. Regarding the third hypothesis, whether the organizations that decreased government grants and private donations over 12 years increased commercial activity during the same period when controlling for mission areas, age, and size, a latent growth curve analysis was performed. Furthermore, to examine whether such association between donative revenues (government grants and private donations) and commercial activity differs across mission areas, latent growth curve analysis was also conducted. All the latent growth curve analyses and latent class growth analyses were performed by using Mplus 8.0 (Muthen & Muthen, 2018).

**Research Question Three.** To examine whether a change in nonprofit human service organizations' commercial activity between 2000 and 2012 is associated with a change in financial health during the same period, a latent class growth analysis was performed. First, this study identified each organization's class membership regarding a change in commercial activity ratio through latent class growth analysis. Second, this study utilized this class membership as a predictor for a change in financial health. Therefore, different trajectories in financial health across class membership of commercial activities were examined. Third, this study examined whether the group that increased commercial activities over 12 years was associated with the trajectory of financial health when controlling for age, size, and mission areas by using a latent growth curve model. Furthermore, to examine whether the association between commercial activity and financial health is different across mission areas, a latent growth curve analysis was performed. All the latent growth curve analyses and latent class growth analyses were conducted by using Mplus 8.0 (Muthen & Muthen, 2018).

## Conclusion

This chapter addressed the method of this study. In summary, this study examines 1) how the commercial activities of nonprofit human service organizations changed during the period from 2000 to 2012 across the eight mission areas of human service nonprofits; 2) whether a change in donative revenues during the period from 2000 to 2012 is associated with a change in commercial activity during the same period; and 3) whether an increase in commercial activities during the period from 2000 to 2012 is associated with a change in financial health during the same period. To these ends, this study conducts latent class growth analysis and latent growth curve analysis by utilizing the nonprofit financial data from the Internal Revenue Services' (IRS) Statistics of Income (SOI) data. Sample characteristics were explained. The measurement for the main variables (i.e., commercial activity, government grants, private donation, financial health) and control variables (i.e., age, size, sector) were reviewed. In the next chapter, the findings of this study are presented.

# CHAPTER 5

# RESULTS

This chapter presents the findings of the investigation of the three research questions. The commercial activity of nonprofit human service organizations in the United States during the period from 2000 to 2012, the relationship between donative revenues (i.e., government grants and private donations) and commercial activity, and the relationship between commercial activity and financial health are examined. The three specific research questions are as follows.

1. How have the commercial activities of human service nonprofits changed over a 12-year period from 2000 to 2012?
2. Does a decrease in government grants and private donations between 2000 – 2012 increase human service nonprofit organizations' commercial activities during the same period?
3. Does a change in nonprofit human service organizations' commercial activities between 2000 – 2012 predict a change in organizations' financial performance during the same period?

## Research Question One

This section reports the findings of research question one. In order to describe how the commercial activities of human service nonprofits have changed, the following four areas are examined. First, this study examines the percentage of commercial human service nonprofits from 2000 to 2012. Second, the trajectory of commercial revenue is examined in dollar terms while considering the specific characteristics of commercial activities. Third, the trajectory of the commercial activity ratio, which means the percentage of commercial activity income in total revenue, is examined. Also, this study identifies how many organizations have increased, decreased, or maintained their commercial activity ratio from 2000 to 2012. Fourth, the differences in commercial activity ratio across the eight mission areas are examined.

**Sample characteristics**

Table 5-1 shows sample characteristics. Among 1,471 organizations, 62.3% (n=917) were multipurpose human services organizations, 17.6% (n = 259) were housing and shelter related organizations, 5.3% (n = 78) were youth development organizations, 4.9% (n = 72) were recreation and sports related organizations, 4.5% (n = 66) were employment organizations, 2.4% (n = 36) were crime and legal related organizations, 1.8% (n = 27) were food, agriculture and nutrition organizations, and 1.1 % (n = 16) were public safety, disaster preparedness, and relief organizations. The average organizational age in 2000 was 40.6 years (SD = 37.4), with a range from one to 201 years. On average, total revenue was 15,978,204 dollars in 2000 (SD = 75,725,952), with a range from 21,163 to 2,720,042,706. Average commercial revenue in 2000 was 11,010,753 (SD =54,411,775), average government grants revenue in 2000 was 2,000,376 (SD = 11,994,896), and average private donations revenue in 2000 was 2,685,624 (SD = 21,560,038). Also, 31.4% (n = 462) had an asset size of more than \$50,000,000 in 2000. Twenty-one percent (n = 309) had an asset size between \$ 20,000,000 ~ \$50,000,000. Only 5.6% (n = 82) had an asset size under \$500,000.

Table 5-1

*Sample characteristics*

| Continuous variables | Mean | S.D. |
|---|---|---|
| Age (2000) | 40.6 | 37.4 |
| Total revenue (2000) | 15,978,204 | 75,725,952 |
| Total revenue (2012) | 27,547,789 | 111,064,565 |
| Commercial revenue (2000) | 11,010,753 | 54,411,775 |
| Commercial revenue (2012) | 18,700,306 | 69,279,136 |
| Government grants (2000) | 2,006,376 | 11,994,896 |
| Government grants (2012) | 3,491,299 | 19,081,988 |
| Private donations (2000) | 2,685,624 | 21,560,038 |
| Private donations (2012) | 5,068,106 | 57,147,726 |
| **Categorical variables** | **Count** | **Percentage** |
| Asset size (2000) | | |
| under $500,000 | 82 | 5.6 |
| $500,000 ~ $1,000,000 | 52 | 3.5 |
| $1,000,000 ~ $2,500,000 | 192 | 13.1 |
| $2,500,000 ~ $5,000,000 | 198 | 13.5 |
| $5,000,000 ~ $20,000,000 | 176 | 12 |
| $20,000,000 ~ $50,000,000 | 309 | 21 |
| $50,000,000 or more | 462 | 31.4 |
| Mission Area | | |
| Human Services- multipurpose (P) | 917 | 62.3 |
| Housing & Shelter (L) | 259 | 17.6 |
| Youth Development (O) | 78 | 5.3 |
| Recreation & Sports (N) | 72 | 4.9 |
| Employment (J) | 66 | 4.5 |
| Crime & Legal-Related (I) | 36 | 2.4 |
| Food, Agriculture & Nutrition (K) | 27 | 1.8 |
| Public Safety, Disaster Preparedness & Relief (M) | 16 | 1.1 |

*Table 0-7*

**The percentage of commercial human service nonprofits**

Figure 5-1 shows the percentage of commercial human service nonprofits based on different thresholds. Specifically, the percentage of human service nonprofits that earned more than 60% of their total revenue from commercial activities was 65.5% (n = 963) in 2000 and 66.3% (n = 975) in 2012. The percentage of human service nonprofits that earned more than 70% of their total revenue from commercial activity was 59.8% (n = 879) in 2000 and 60.7% (n = 893) in 2012. The percentage of human service nonprofits that earned more than 80% of their total revenue from commercial activity was 53.2% (n = 782) in 2000 and 55.2% (n = 812) in 2012. The percentage of human service nonprofits that earned more than 90% of their total revenue from commercial activity was 43.3% (n = 637) in 2000 and 46.2% (n = 679) in 2012. Although there were about 1~3%p decreases in percentage of commercial human service nonprofits between 2007 and 2008 regardless of thresholds, the percentage of commercial human service nonprofits slightly increased over the twelve years. This result shows that more than 50% of human service nonprofits earned more than 80% of their total revenue through commercial activities from 2000 to 2012.

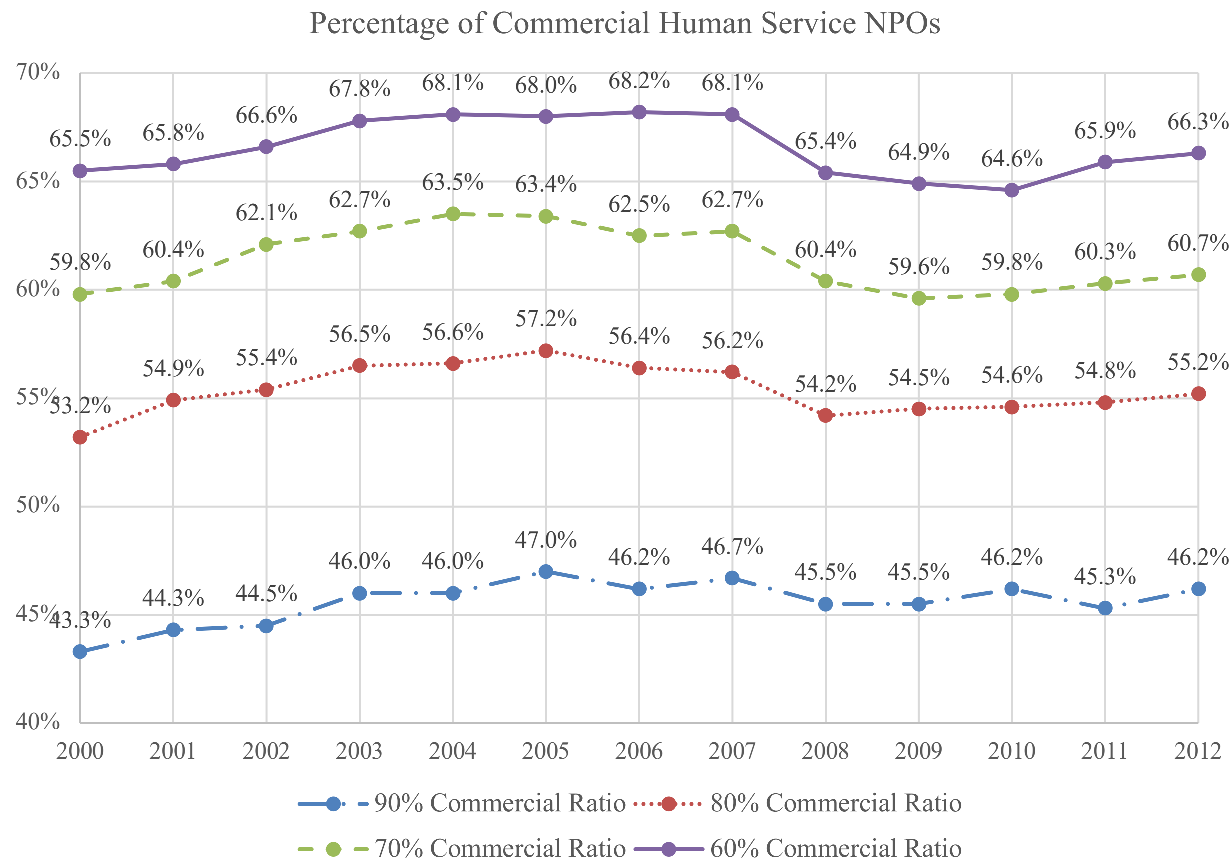



*Figure 5-5.* Percentage of commercial human service NPOs

**Average commercial income by revenue type**

Table 5-2 shows the average commercial revenue that human service nonprofit organizations earned from 2000 to 2012 and presents how much each commercial activity accounts for the total commercial income. In order to eliminate the effect of inflation over time, all commercial revenue was converted to 2012 dollars using the Consumer Price Index (Bureau of Labor Statistics, 2019). When examining average commercial income as adjusted to 2012 dollars, the average commercial revenue increased from $14,534,194 in 2000 to $18,700,306 in 2012, which means human service nonprofit organizations increased their commercial revenue by approximately 30% over twelve years. However, when breaking down the period, the results show that while commercial income increased from $14,534,194 in 2000 to $18,571,679 in

2006, it started to decline after 2006. During the period from 2006 to 2009 leading up to the Great Recession, commercial income decreased by approximately 4.6% from $18,707,050 in 2006 to $17,841,190 in 2009. However, after the Great Recession, commercial income increased again by 5% in 2010. In the following years, it showed a decrease of 1.5% in 2011 and increase of 1.4% in 2012.

Table 5-2

*Average commercial income*

| Year | Average commercial income | Change in commercial income | Program service revenue | Investment income | Income from special events | Income from sales of inventory |
|---|---|---|---|---|---|---|
| 2000 | 14,534,194 | | 87.8% | 10.1% | 0.5% | 1.6% |
| 2001 | 15,180,281 | 4.4% | 92.1% | 5.8% | 0.5% | 1.6% |
| 2002 | 15,795,615 | 4.1% | 93.4% | 4.6% | 0.4% | 1.6% |
| 2003 | 16,675,920 | 5.6% | 91.7% | 6.4% | 0.4% | 1.5% |
| 2004 | 17,523,139 | 5.1% | 91.0% | 7.2% | 0.4% | 1.4% |
| 2005 | 18,571,679 | 6.0% | 89.5% | 8.8% | 0.4% | 1.2% |
| 2006 | 18,707,050 | 0.7% | 88.7% | 9.7% | 0.4% | 1.2% |
| 2007 | 18,657,351 | -0.3% | 89.7% | 8.5% | 0.3% | 1.4% |
| 2008 | 18,438,984 | -1.2% | 93.7% | 4.9% | 0.2% | 1.3% |
| 2009 | 17,841,190 | -3.2% | 93.8% | 4.7% | 0.2% | 1.4% |
| 2010 | 18,730,005 | 5.0% | 92.5% | 5.9% | 0.1% | 1.5% |
| 2011 | 18,442,841 | -1.5% | 92.7% | 5.6% | 0.1% | 1.5% |
| 2012 | 18,700,306 | 1.4% | 92.1% | 6.3% | 0.1% | 1.5% |

*Note.* The rate of inflation was adjusted to 2012 dollars using the Consumer Price Index (Bureau of Labor Statistics, 2019) for all commercial revenue.

When examining the types of commercial revenue, throughout the entire period in question, program service revenue accounted for about 91.4% of total commercial revenue.

Investment income including i) interest on savings and temporary cash investments, ii) dividends and interest form securities, iii) net rental income, other investment income, and iv) net gain from sales of assets other than inventory accounted for about 6.8% of commercial revenue. Income from sales of inventory items that were donated to the organizations, that the organizations made to sell to others, or bought for resale accounted for about 1.4% of total commercial revenue. Lastly, income from special events such as fundraising and gaming events accounted for about 0.3% of total commercial revenue. Figure 5-2 shows how each commercial revenue type contributed to the total commercial revenue of human service nonprofit organizations over the twelve years from 2000 to 2012.

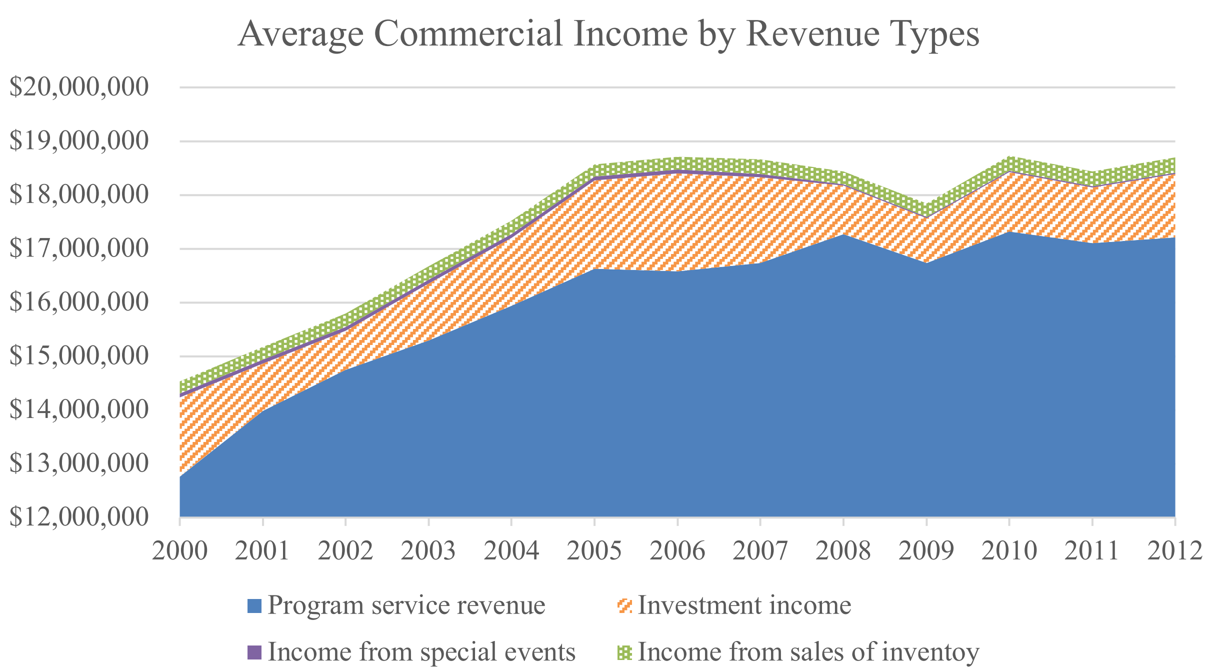



*Figure 5-6.* Average commercial income by revenue types. The rate of inflation was adjusted to 2012 dollars using the Consumer Price Index (Bureau of Labor Statistics, 2019) for all commercial revenue.

**Trajectory of the commercial activity ratio of human service nonprofits**

Table 5-3 shows the results of the latent growth model that examined the trajectory of the commercial activity ratio of human service nonprofit organizations during the period from 2000 to 2012. The linear model showed that there was no significant linear growth in the commercial activity ratio from 2000 to 2012 (B = -0.047, p > .05). However, the quadratic model showed that the change in commercial activity ratio followed a non-linear trajectory. Also, the quadratic model had a better model fit. In the quadratic model, a positive slope (B = 0.632, p < .001) and a negative quadratic term (B = -0.053, p < .001) suggest that the commercial activity ratio gradually increased over time during the pre-recession, but it gradually decreased over time during the post-recession.

Table 5-3

*Latent growth model of the commercial activity ratio*

| | | Linear Model | Quadratic Model |
|---|---|---|---|
| Intercept | | 68.647 *** | 67.343 *** |
| Slope | | -0.047 | 0.632 *** |
| Quadratic | | | -0.053 *** |
| Model Fit | $x^2$(df) | 4089.370(86) | 3077.963(82) |
| | CFI | 0.895 | 0.921 |
| | TLI | 0.905 | 0.925 |
| | RMSEA | 0.178 | 0.158 |
| | SRMR | 0.044 | 0.041 |

*** p < 0.001 ** p < .01 * p < .05

Figure 5-3 shows the sample mean of the commercial activity ratio and estimated trajectory of the commercial activity ratio through latent growth modeling. When examining sample means, which is presented as a blue dotted line, the result shows that the commercial activity ratio increased generally over seven years from 2000 (67.2%) to 2007 (69.8%). However, there was a dramatic decrease in commercial activity ratio between 2007 (69.8%) and 2008 (67.3%). The following year 2009 (67.0%) also had a slightly decreased commercial activity ratio. However, it started to increase again from 2009 and this increasing pattern continued during the period from 2009 to 2012. On the other hand, the quadratic latent growth model represents an average trajectory of the commercial activity ratio for 12 years with a simple curved line, which is presented as a red solid line. When examining the estimated trajectory of the commercial activity ratio via a quadratic latent growth model, the result shows that the commercial activity ratio gradually increased during the initial period from 2000 to 2006 and it gradually decreased during the later period from 2006 to 2012.

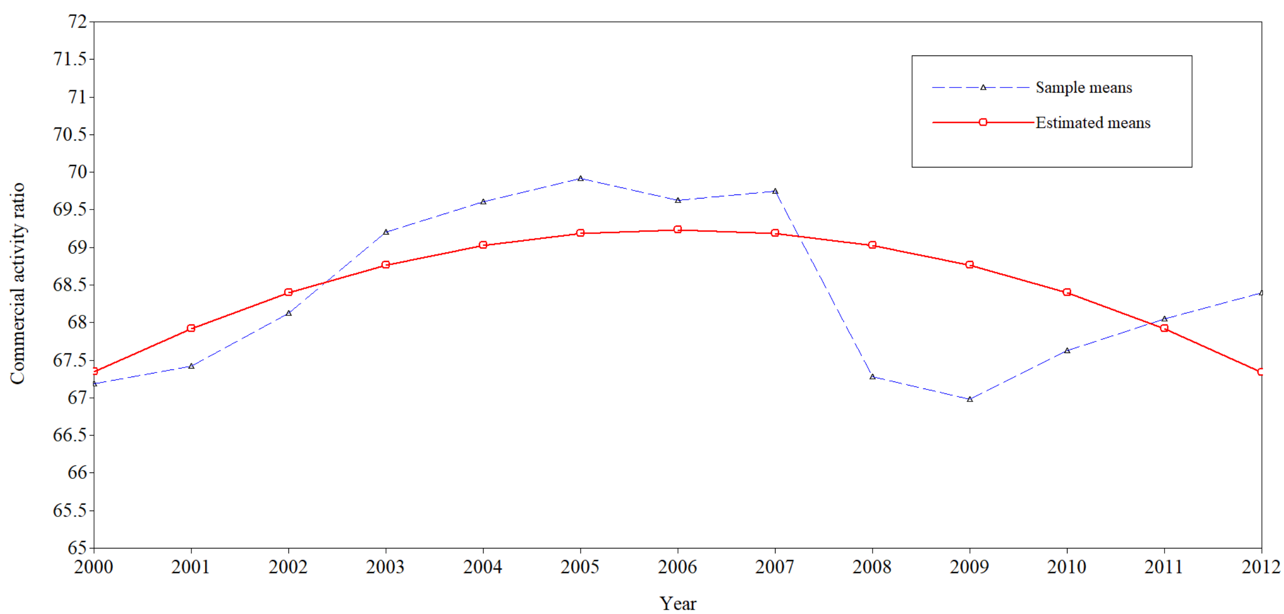



*Figure 5-7.* Estimated trajectory of the commercial activity ratio

In addition, this study identified different classes in the trajectories of the commercial activity ratio by using the latent class growth analysis. The latent class growth model identified three groups in the trajectory of the commercial activity ratio based on fit indices including BIC, SSABIC, AIC, and LMR-LRT. Compared to a two-group solution and a four-group solution, a three-group solution showed the best model fit and the relevant number of cases within identified classes. Figure 5-4 illustrates the trajectory of each group: i) the group of organizations with a constant commercial activity ratio from 2000 to 2012 (n = 1296, 88%), ii) the group of organizations with an increasing commercial activity ratio from 2000 to 2012 (n = 88, 6%), and iii) the group of organizations with a decreasing commercial activity ratio from 2000 to 2012 (n = 87, 6%).

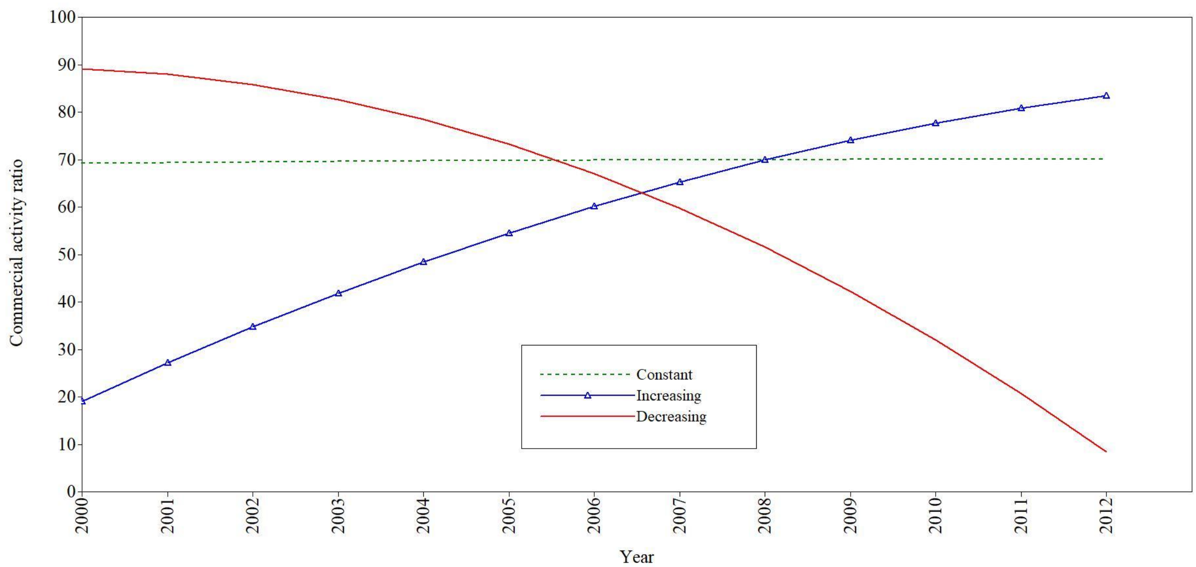



*Figure 5-4.* Three groups in trajectories of the commercial activity ratio

Table 5-4 shows the commercial activity ratio of each group. First, the group of constant organizations had a ratio of about 69% 2000 and it remained almost the same for 12 years (slope = 0.14, $p > .05$; quadratic = -0.006, $p > .05$). Of 1,471 human service organizations, 88% (n = 1296) were classified in this group. Second, the group of increasing organizations had a ratio of about 19% in 2000 and it dramatically increased to about 80% by 2012 (slope = 8.333, $p < .001$; quadratic = -0.247, $p < .05$). 6% (n = 88) of human service organizations were classified in this group. Third, the group of decreasing organizations had a ratio of about 89% in 2000 and it decreased to about 10% by 2012 (slope = -0.633, $p > .05$; quadratic = -0.508, $p < .001$). About 6% (n = 87) of human service organizations were classified in this group.

Table 5-4

*Characteristics of three groups in trajectories of commercial activity ratio*

| | | Commercial Activity Ratio | |
|---|---|---|---|
| Constant group (n=1296, 88%) | Intercept | 69.293 | *** |
| | Slope | 0.14 | |
| | Quadratic | -0.006 | |
| Increasing group (n=88, 6%) | Intercept | 19.03 | *** |
| | Slope | 8.333 | *** |
| | Quadratic | -0.247 | * |
| Decreasing group (n=87, 6%) | Intercept | 89.094 | *** |
| | Slope | -0.633 | |
| | Quadratic | -0.508 | *** |

*** $p < 0.001$ ** $p < .01$ * $p < .05$

Table 5-5 shows the sample characteristics of each group. The average organizational age among the group of increasing organizations was 29.3 years (SD = 31.7), while the groups of constant organizations and decreasing organizations were about 41 years (SD = 37.5; 39.8). The group of constant organizations had the highest total revenue both in 2000 (Mean = 16,481,127; SD = 57,455,093) and 2012 (Mean = 28,507, 223; SD = 117,240,457). The group of increasing organizations had the lowest total revenue both in 2000 (Mean = 9,999,825; SD = 23,269,129) and 2012 (Mean = 17,989,016; SD = 41,789,967). Also, the difference in asset size among three groups were found. The group of constant organizations had the largest asset size (i.e., 50.2% had more than $20,000,000), the group of decreasing organizations had the medium level asset size (i.e., 50.5% had between $1,000,000 and $20,000,000), and the group of increasing organizations had the smallest asset size (i.e., 52.2% had less than $5,000,000). Regarding mission area, 64% of the constant group (n = 830), 53.4% of the increasing group (n = 47), and 46% of the decreasing group (n = 40) were multipurpose human service organizations.

Table 5-5

*Sample characteristics of commercial activity groups*

| | Constant group (n = 1296) | | Increasing group (n=88) | | Decreasing group (n=87) | |
|---|---|---|---|---|---|---|
| | Mean | S.D. | Mean | S.D. | Mean | S.D. |
| Age (2000) | 41.3 | 37.5 | 29.3 | 31.7 | 41.7 | 39.8 |
| Total revenue (2000) | 16,481,127 | 80,032,593 | 9,999,825 | 23,269,129 | 14,533,476 | 31,268,086 |
| Total revenue (2012) | 28,507,223 | 117,240,457 | 17,989,016 | 41,789,967 | 22,924,180 | 44,423,987 |
| Commercial (2000) | 11,611,341 | 57,455,093 | 1,470,575 | 3,037,110 | 11,713,893 | 28,258,225 |
| Commercial (2012) | 19,943,635 | 73,031,299 | 14,800,653 | 35,215,294 | 4,123,466 | 14,753,056 |
| Government (2000) | 1,881,851 | 12,202,028 | 4,565,640 | 11,864,911 | 1,272,688 | 8,210,345 |
| Government (2012) | 2,970,544 | 18,068,254 | 1,026,769 | 3,336,222 | 13,741,608 | 34,353,902 |
| Donation (2000) | 2,804,198 | 22,890,867 | 2,180,635 | 6,578,570 | 1,430,080 | 3,041,279 |
| Donation (2012) | 5,308,161 | 60,798,632 | 1,811,071 | 6,318,550 | 4,786,589 | 10,452,622 |
| | Count | Percentage | Count | Percentage | Count | Percentage |
| Asset size (2000) | | | | | | |
| under $500,000 | 44 | 3.4 | 11 | 12.5 | 5 | 5.7 |
| $500,000 ~ $1,000,000 | 22 | 1.7 | 6 | 6.8 | 7 | 8 |
| $1,000,000 ~ $2,500,000 | 89 | 6.9 | 15 | 17 | 15 | 17.2 |
| $2,500,000 ~ $5,000,000 | 153 | 11.8 | 14 | 15.9 | 16 | 18.4 |
| $5,000,000 ~ $20,000,000 | 292 | 22.5 | 13 | 14.8 | 13 | 14.9 |

| | | | | | | |
|---|---|---|---|---|---|---|
| $20,000,000 ~ $50,000,000 | 259 | 20 | 14 | 15.9 | 16 | 18.4 |
| $50,000,000 or more | 430 | 33.2 | 15 | 17 | 15 | 17.2 |
| Mission Area | | | | | | |
| Multipurpose | 830 | 64.0 | 47 | 53.4 | 40 | 46.0 |
| Housing | 213 | 16.4 | 22 | 25.0 | 24 | 27.6 |
| Youth | 69 | 5.3 | 5 | 5.7 | 4 | 4.6 |
| Recreation | 60 | 4.6 | 6 | 6.8 | 6 | 6.9 |
| Employment | 58 | 4.5 | 2 | 2.3 | 6 | 6.9 |
| Crime | 31 | 2.4 | 2 | 2.3 | 3 | 3.4 |
| Food | 21 | 1.6 | 4 | 4.5 | 2 | 2.3 |
| Public Safety | 14 | 1.1 | 0 | 0.0 | 2 | 2.3 |

*Note.* Commercial = commercial revenue; Government = government grants; Donation = Private donation

**Change in the commercial activity ratio across human service mission areas**

Figure 5-5 shows the commercial activity ratio across different human mission areas during the period from 2000 to 2012. The results show that there was variance in commercial activity ratio among human service areas. First, nonprofit human service organizations that are mainly involved in the employment area had the highest commercial activity ratio. These organizations' commercial activity ratio was between 73% and 82% during the period from 2000 to 2012. Second, nonprofit human service organizations that are mainly involved in recreation, housing and shelter, and multipurpose human services also had high commercial activity ratios during this period. These organizations generally exhibited a commercial activity ratio of about 70% throughout the period from 2000 to 2012. Third, organizations with a mission of public safety and youth development had ratios between 50% and 60%. Fourth, organizations for crime and legally related purposes had rations of about 28% ~ 37% Fifth, organizations for food, agriculture, and nutrition had the lowest commercial activity ratios, between 17% to 24%.

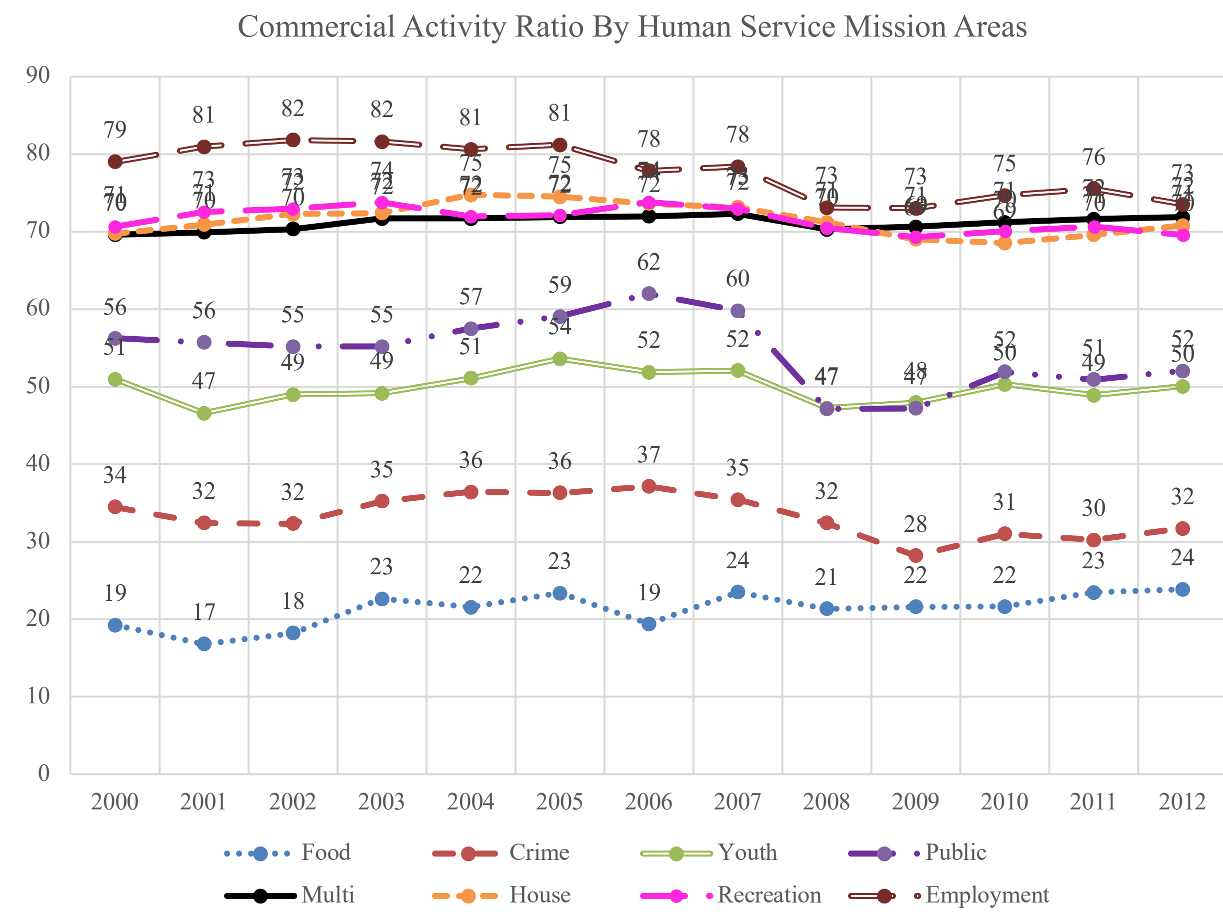



*Figure 5-5.* Commercial activity ratio by human service areas

In addition to this basic descriptive analysis, this study examined how many organizations in each human service mission area belong to the three commercial activity groups (i.e., constant, increasing, and decreasing groups). Figure 5-6 illustrates the results. Overall, most of the organizations in all eight areas belonged to the group that had constant commercial activity ratio during the period from 2000 to 2012. When examining organizations that increased their commercial activity ratio, 15% of organizations in food, agriculture, and nutrition area dramatically increased their commercial activity ratio over 12 years. The housing and shelters (9%), recreation (8%), crime and legally related (6%), youth development (6%), multipurpose human service (5%), and employment (3%) areas also had some organizations that dramatically increased their commercial activity ratio. However, the public safety area did not have any organization that showed a dramatic increase in commercial activity ratio. Rather, this area had 13% of organizations in which the commercial activity ratio dramatically decreased, which was the largest percentage among all eight human service areas.

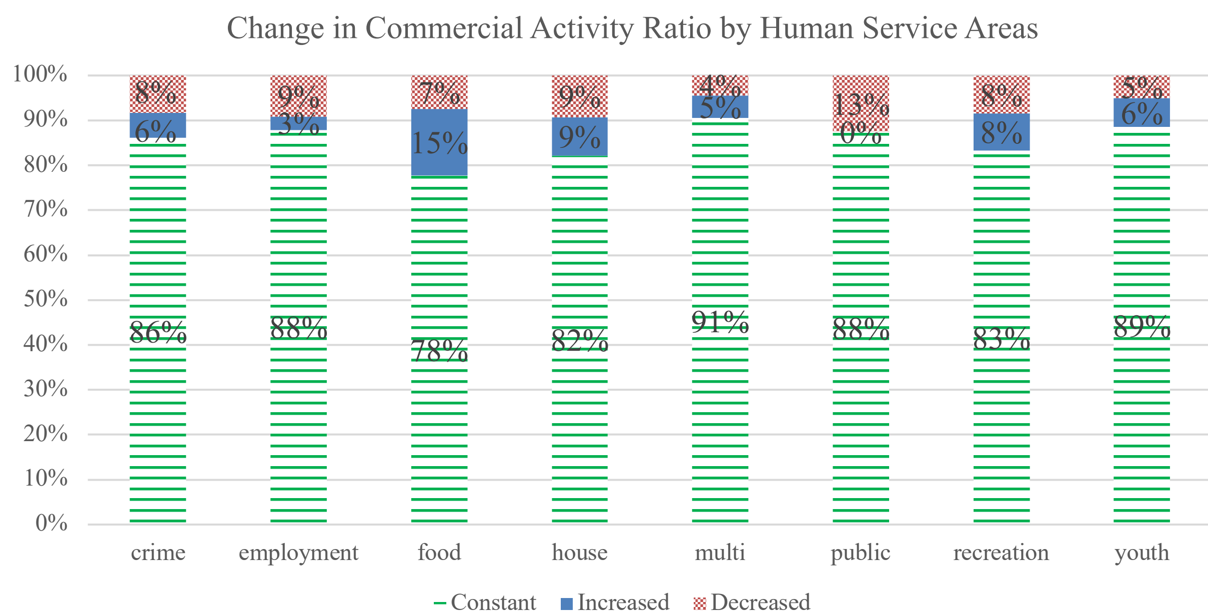



*Figure 5-8.* Change in commercial activity ratio by human service areas

## Research Question Two

This section reports the findings of research question two. The second research question is: Does a decrease in government grants and private donations between 2000 – 2012 increase human service nonprofit organizations' commercial activities during the same period? This research question consists of two parts: i) the association between a decrease in government grants and an increase in commercial activity ratio, ii) the association between a decrease in government grants and an increase in commercial activity ratio. Therefore, the results of research question two are constructed as follows. First, regarding the relationship between government grants and commercial activity ratio, this study first examines the average trajectory of government grants during the period from 2000 to 2012 through latent growth modeling. Second, this study identifies three different groups in the trajectories of government grants through latent class growth analysis: i) constant group, ii) increasing group, and iii) decreasing group. Third, this study examines whether these three different groups of organizations have different trajectories in commercial activity ratio. The same process is applied to the private donation ratio. Finally, in order to examine the statistical association between government grants, donation, and commercial activity, the result of a latent growth model is presented.

**Total revenue and revenue sources**

First, Table 5-6 shows the average total revenue and average revenue from commercial activity, government grants, donations and other sources from 2000 to 2012. In order to mitigate the effect of inflation, the rate of inflation was adjusted using the Consumer Price Index for all revenue. Also, in this analysis, one outlier organization that reported excessively high total revenue was excluded. This organization reported extremely high total revenue, from $3,217,628,804 to $6,857,965,970 for 12 years, that biased the average revenue of the entire body of organizations.

On average, the total revenue of human service organizations in 2000 was 18,663,090 dollars. This total revenue increased to 25,244,980 dollars in 2012, which indicated a 35% increase over 12 years. Also, on average, total revenue increased by 2.6% for each year. However, when examining the specific change for each year, this study found that during the

Great Recession period, from 2007 to 2009, the average annual increase in total revenue was only about 0.1%, much lower than other periods.

When examining commercial revenue, the revenue from commercial activity was increased from $12,786,885 in 2000 up to 17,197,952 in 2012, a 34% increase over 12 years. On average, commercial revenue increased by 2.5% for each year. However, during the Great Recession from 2007 to 2009, the amount of commercial revenue decreased by 4.5%.

When examining revenue from government grants, it increased from $2,591,939 in 2000 up to $3,457,121 in 2012, a 33% increase over 12 years. On average, government grants increased by 2.6% for each year. However, when examining the Great Recession period, the amount of government grants showed an extraordinary increase. It increased by 13.2% from 2007 to 2008, and by 16.6% from 2008 to 2009. After the Great Recession, the amount of government grants very slightly increased (i.e., 0.6% from 2009 to 2010) or decreased (i.e., -6.5% from 2010 to 2012).

When examining donation revenue, the revenue from private donation increased from $2,951,516 in 2000 to $4,337,078 in 2012, indicating a 47% increase over 12 years. On average, donation revenue increased by 3.4% for each year. The amount of donation revenue decreased by 3.0% from 2005 to 2007, before the Great Recession officially began in December 2007. Although there was a 2.2.% increase in donations from 2007 to 2008, 2008 to 2009 saw a decrease of 1.9%.

Table 5-6

*Change in average total revenue by revenue sources*

| | Commercial activity | Government grants | Donations | Other | Total revenue |
|---|---|---|---|---|---|
| 2000 | 12,786,885 | 2,591,939 | 2,951,516 | 332,749 | 18,663,090 |
| 2001 | 13,215,397(3.4%) | 2,616,709(1.0%) | 2,938,352(-0.4%) | 242,666(-27.1%) | 19,013,123(1.9%) |
| 2002 | 13,795,650(4.4%) | 2,618,595(0.1%) | 2,833,932(-3.6%) | 274,836(13.3%) | 19,523,013(2.7%) |
| 2003 | 14,632,568(6.1%) | 2,641,236(0.9%) | 2,955,378(4.3%) | 280,296(2.0%) | 20,509,478(5.1%) |
| 2004 | 15,472,466(5.7%) | 2,565,360(-2.9%) | 3,078,052(4.2%) | 318,450(13.6%) | 21,434,327(4.5%) |
| 2005 | 16,338,096(5.6%) | 2,639,670(2.9%) | 3,475,483(12.9%) | 308,650(-3.1%) | 22,761,898(6.2%) |
| 2006 | 16,792,879(2.8%) | 2,797,927(6.0%) | 3,406,029(-2.0%) | 328,732(6.5%) | 23,325,567(2.5%) |
| 2007 | 16,851,632(0.3%) | 2,779,026(-0.7%) | 3,373,365(-1.0%) | 342,359(4.1%) | 23,346,382(0.1%) |
| 2008 | 16,539,568(-1.9%) | 3,146,949(13.2%) | 3,448,297(2.2%) | 242,589(-29.1%) | 23,377,403(0.1%) |
| 2009 | 16,103,466(-2.6%) | 3,668,821(16.6%) | 3,381,954(-1.9%) | 232,407(-4.2%) | 23,386,649(0.0%) |
| 2010 | 17,033,325(5.8%) | 3,691,789(0.6%) | 3,818,932(12.9%) | 272,987(17.5%) | 24,817,032(6.1%) |
| 2011 | 16,816,325(-1.3%) | 3,527,474(-4.5%) | 4,044,402(5.9%) | 232,820(-14.7%) | 24,621,022(-0.8%) |
| 2012 | 17,197,952(2.3%) | 3,457,121(-2.0%) | 4,337,078(7.2%) | 252,829(8.6%) | 25,244,980(2.5%) |

*Note.* The rate of inflation was adjusted using the Consumer Price Index for all revenue.

Next, Figure 5-7 shows the graph of change in total revenue by revenue sources.

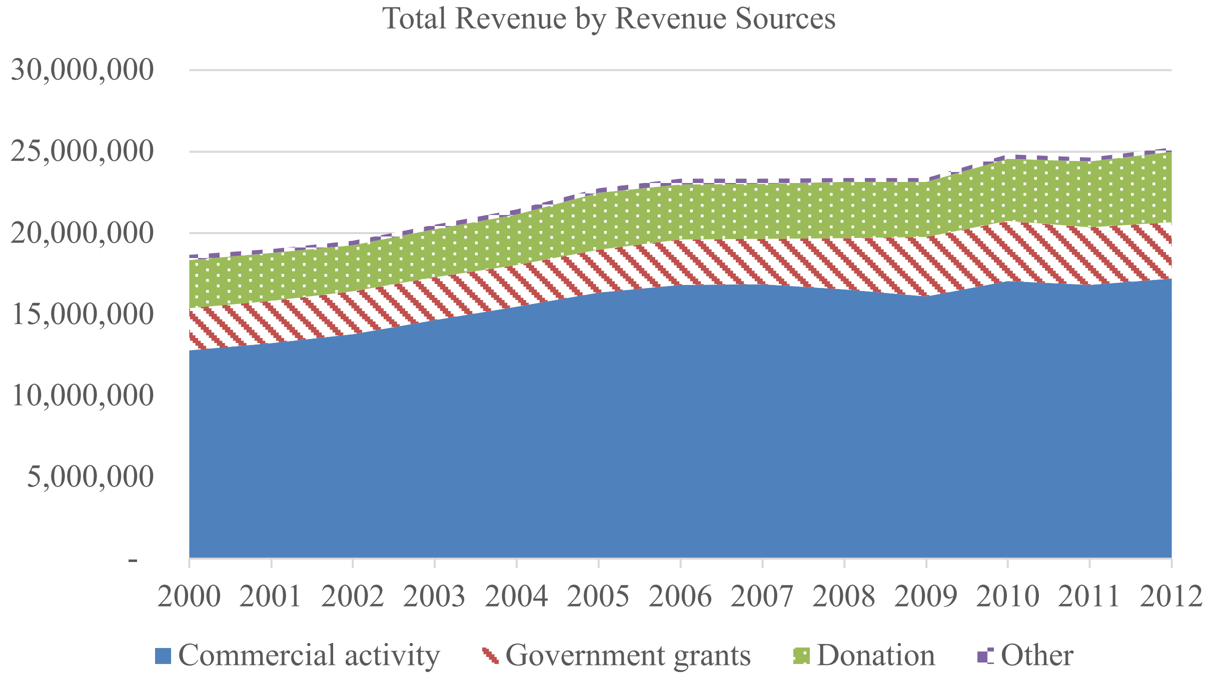



*Figure 5-9.* Total revenue by revenue sources. The rate of inflation was adjusted using the Consumer Price Index for all revenue.

**Government grants ratio and commercial activity ratio**

**Average trajectory of the government grant ratio.** Table 5-7 shows the results of the latent growth model that examined the trajectory of the government grant ratio of human service nonprofit organizations during the period from 2000 to 2012. The linear model showed that there was significant linear growth in the commercial activity ratio from 2000 to 2012 ($B = 0.122$, $p < .05$). However, a quadratic model showed that the change in the commercial activity ratio followed a non-linear trajectory. Also, the model fit indices showed that the quadratic model better explained the data. In the quadratic model, a negative slope ($B = -0.404$, $p < .05$) and a positive quadratic term ($B = 0.041$, $p < .05$) suggested that the government grant ratio decreased over time up to a certain year, but it increased over time after that year.

Table 5-7.

*Change in government grant ratio 2000 ~ 2012*

| | | Linear Model | Quadratic Model |
|---|---|---|---|
| Intercept | | 12.547 *** | 13.575 *** |
| Slope | | 0.122 * | -0.404 * |
| Quadratic | | | 0.041 * |
| Model Fit | $x^2$(df) | 5521.947(86) | 3925.953(82) |
| | CFI | 0.861 | 0.902 |
| | TLI | 0.874 | 0.906 |
| | RMSEA | 0.207 | 0.179 |
| | SRMR | 0.049 | 0.047 |

*** p < 0.001 ** p < .01 * p < .05

Figure 5-8 shows the mean government grant ratio and estimated trajectory of the government grant ratio through latent growth modeling. When examining sample means, which is presented as a blue dotted line, the result shows that on average, the government grant ratio of human service organizations decreased overall from 2000 to 2006. It began to rise in 2007, and there was a dramatic increase from 2007 to 2009. However, it decreased again from 2009 to 2012. On the other hand, the quadratic latent growth model represents the average trajectory of the government grant ratio for 12 years with a simple curved line, presented as a red solid line. When examining the estimated average trajectory of the government grant ratio via a quadratic latent growth model, the result shows that the government grant ratio gradually decreased during the initial period from 2000 to 2005 and it increased during the period from 2005 to 2012. This estimated trajectory is almost the opposite of the commercial activity ratio trajectory examined above (See figure 5-3).

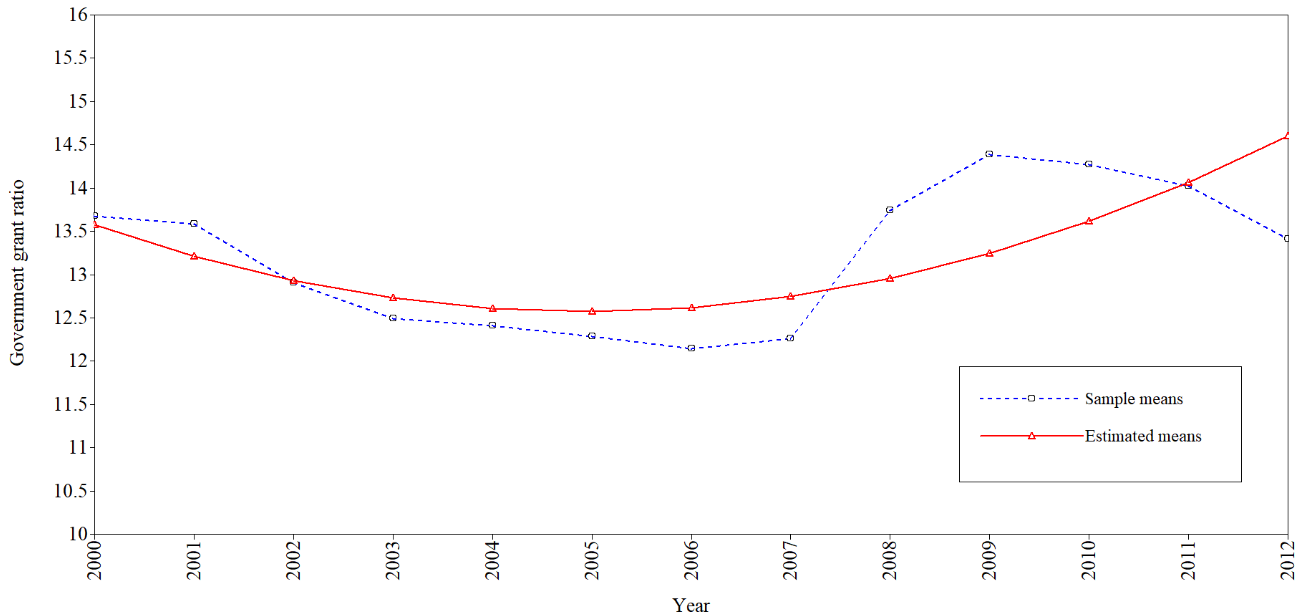



*Figure 5-10.* Estimated trajectory of government grant ratio

**Three groups in the trajectories of government grant ratio.** The latent class growth model identified three groups in the trajectories of government grant ratio based on fit indices including AIC, BIC, SSABIC, and LMR-LRT. Figure 5-9 presents the trajectory of each group: i) the group of organizations with a constant government grant ratio from 2000 to 2012 (n = 1361, 92.5%), ii) the group of organizations with a decreasing government grant ratio from 2000 to 2012 (n = 54, 3.7%), and iii) the group of organizations with an increasing government grant ratio from 2000 to 2012 (n = 56, 3.8%).

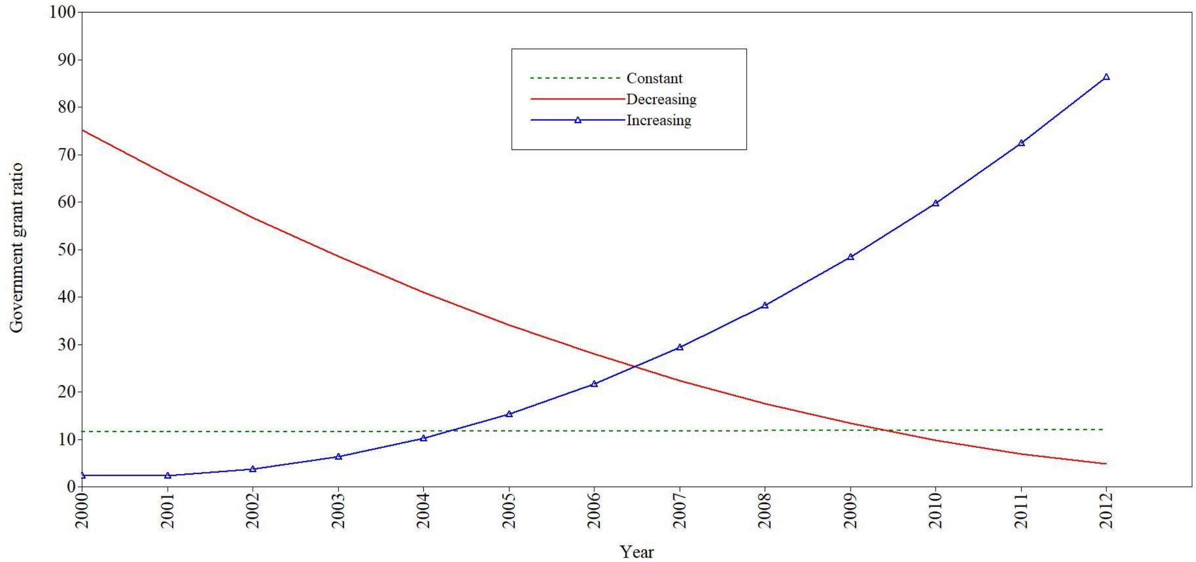



*Figure 5-11.* Three groups in the trajectories of government grant ratio

Table 5-8 shows the characteristics of each group. First, the group of constant organizations had a government grant ratio of about 12% in 2000 and it remained almost the same for 12 years (slope = 0.02, $p > .05$; quadratic = 0.002, $p > .05$). Of 1,471 human service organizations, 92.5% (n = 1361) of organizations were classified in this group. Second, the group of decreasing organizations had a government grant ratio of about 75% in 2000 and it dramatically decreased to about 5% by 2012 (slope = -9.872, $p < .001$; quadratic = 0.334, $p < .05$). 3.7% (n = 88) of human service organizations were classified in this group. Third, the group of increasing organizations had a government grant ratio of about 2% in 2000 and it dramatically increased to about 85% by 2012 (slope = -0.541, $p > .05$; quadratic = 0.629, $p < .001$). About 3.8% (n = 56) of human service organizations were classified in this group.

Table 5-8

*Characteristics of three groups in the trajectory of government grant ratio*

| | | Government Grant Ratio | |
|---|---|---|---|
| Constant group (n=1361, 92.5%) | Intercept | 11.567 | *** |
| | Slope | 0.02 | |
| | Quadratic | 0.002 | |
| Decreasing group (n=54, 3.7%) | Intercept | 75.148 | *** |
| | Slope | -9.872 | *** |
| | Quadratic | 0.334 | * |
| Increasing group (n=56, 3.8%) | Intercept | 2.285 | *** |
| | Slope | -0.541 | |
| | Quadratic | 0.629 | *** |

*** p < 0.001 ** p < .01 * p < .05

**Trajectory of commercial activity by government grants groups.** Based on the group classification, this study examined how the trajectory of commercial activity ratio is experienced by different groups. Figure 5-10 shows the results of the trajectories of commercial activity ratio by government grant ratio groups. First, the organizations that had a constant government grant ratio, represented as a green dotted line, showed a trajectory of a constant commercial activity ratio during the period from 2000 to 2012. Second, the organizations with a decreasing government grant ratio, represented as a red solid line with triangle marks, showed a trajectory of an increasing commercial activity ratio during the same period. Third, the organizations with an increasing government grant ratio, represented as a blue solid line with circle marks, showed a trajectory of a decreasing commercial activity ratio during the same period.

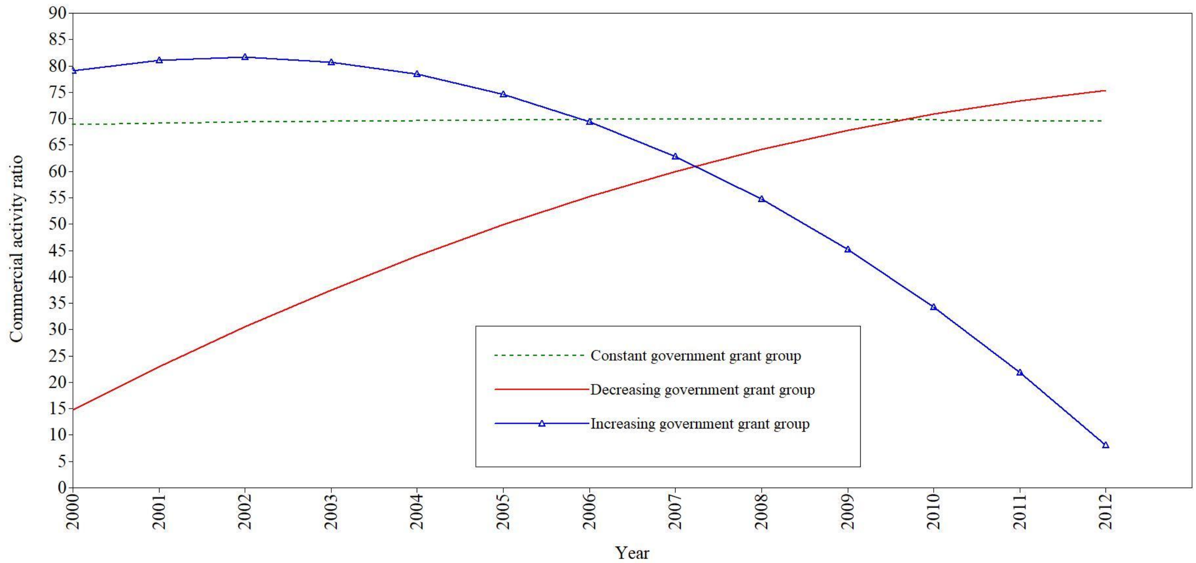



*Figure 5-12.* Trajectories of commercial activity ratio by government grant ratio groups

Table 5-9 presents the results of a latent growth model that examined the different trajectories of the commercial activity ratio by different government grant ratio groups. First, the constant group with a government grants ratio of about 12% over 12 years had a commercial activity ratio of about 70% constantly over the same period(intercept = 69.914, $p < .01$; slope = 0.251, $p < .05$; quadratic = -0.016, $p > .05$). Second, the decreasing group that decreased their government grants dramatically from 75% to 5% between 2000 and 2012 increased their commercial activity ratio from approximately 15% in 2000 to 75% in 2012 (intercept = 14.79, $p < .001$; slope = 8.419, $p < .001$; quadratic = -0.281, $p < .05$). Third, the increasing group that increased their government grant ratio from 2% to 85% between 2000 and 2012 decreased their commercial activity ratio from 79% to about 8% (intercept = 79.101, $p < .001$; slope = 2.699, $p < .05$; quadratic = -0.718, $p < .001$).

Table 5-9. Trajectory of commercial activity ratio by government grants ratio groups

| Government Grant Ratio Groups | | Commercial Activity Ratio | |
|---|---|---|---|
| Constant group (n = 1361, 92.5%) | Intercept | 69.914 | *** |
| | Slope | 0.251 | * |
| | Quadratic | -0.016 | |
| Decreasing group (n = 54, 3.7%) | Intercept | 14.79 | *** |
| | Slope | 8.419 | *** |
| | Quadratic | -0.281 | * |
| Increasing group (n = 56, 3.8%) | Intercept | 79.101 | *** |
| | Slope | 2.699 | * |
| | Quadratic | -0.718 | *** |

*** $p < 0.001$ ** $p < .01$ * $p < .05$; $x^2$(df) = 3071.577 (246), CFI = 0.929, TLI = 0.932, RMSEA = 0.153, SRMR = 0.076

**Donation ratio and commercial activity ratio**

**Average trajectory of donation ratio.** Table 5-10 shows the results of a latent growth model that examined the trajectory of the donation ratio of human service nonprofit organizations during the period from 2000 to 2012. The linear model showed that there was no significant linear growth in the donation ratio from 2000 to 2012 (B = -0.065, $p > .05$). However, the quadratic model showed that changes in the commercial activity ratio followed a non-linear trajectory. Also, the model fit indices in the quadratic model were better than in the linear model, which means that the quadratic model better explains the data. In the quadratic model, a negative slope (B = -0.242, $p < .05$) and a positive quadratic term (B = 0.014, $p < .05$) suggested that the donation ratio decreased over time up to a certain year, but increased over time after that year.

Table 5-10

*Change in donation ratio 2000 ~ 2012*

| Donation Ratio | | Linear Model | Quadratic Model |
|---|---|---|---|
| Intercept | | 17.246 *** | 17.574 *** |
| Slope | | -0.065 | -0.242 * |
| Quadratic | | | 0.014 * |
| Model Fit | $x^2$(df) | 2224.883(86) | 1877.547(82) |
| | CFI | 0.935 | 0.946 |
| | TLI | 0.941 | 0.948 |
| | RMSEA | 0.130 | 0.122 |
| | SRMR | 0.030 | 0.028 |

*** p < 0.001 ** p < .01 * p < .05

Figure 5-11 shows the average donation ratio and estimated trajectory of government grant ratio through latent growth modeling. When examining sample means, presented as a blue dotted line, the result shows that on average, the donation ratio of human service organizations decreased generally from 2000 to 2007. There was a dramatic increase in the donation ratio from 2007 to 2008. However, it decreased again from 2008 to 2010. After 2010, it slightly increased again until 2012. The quadratic latent growth model represents an average trajectory of the donation ratio for 12 years with a simple curved line, presented as a red solid line. When examining the estimated average trajectory of the donation ratio via a quadratic latent growth model, the result shows that the donation ratio gradually decreased during the period from 2000 to 2009 and increased during the period from 2009 to 2012.

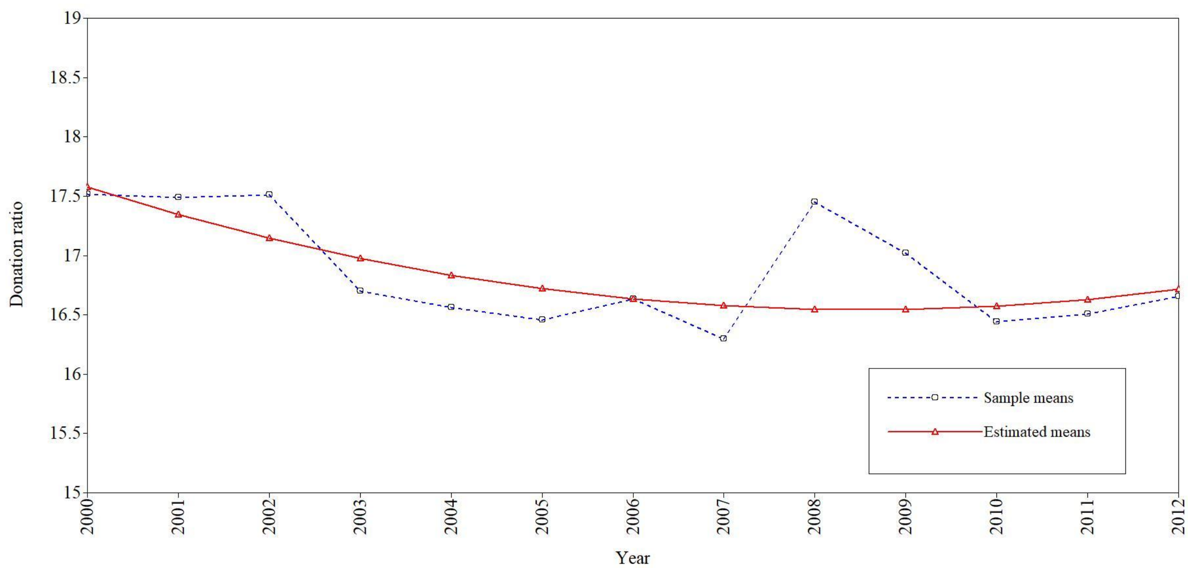



*Figure 5-13*. Estimated trajectory of donation ratio

**Three groups in the trajectories of donation ratio.** The latent class growth model identified three groups in the trajectories of the donation ratio based on fit indices including AIC, BIC, SSABIC, and LMR-LRT. Figure 5-12 presents the trajectory of each group: i) the group of organizations with an increasing donation ratio from 2000 to 2012 (n = 62, 4%), ii) the group of organizations with a constant donation ratio from 2000 to 2012 (n = 1311, 89%), and iii) the group of organizations with a decreasing donation ratio from 2000 to 2012 (n = 98, 7%).

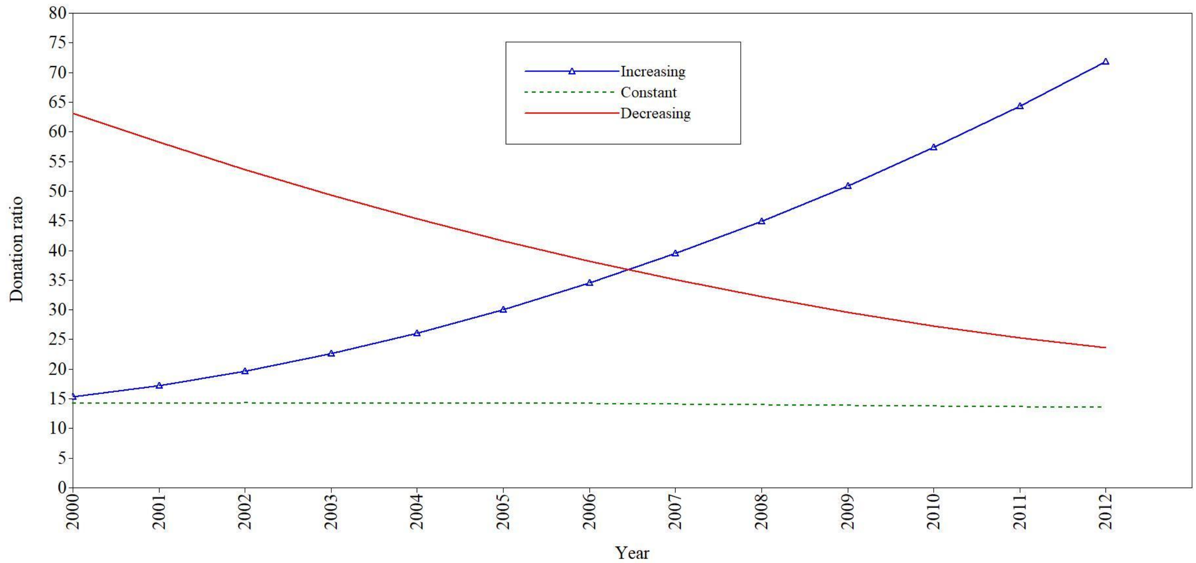



*Figure 5-14.* Three classes in the trajectory of donation ratio

Table 5-11 shows the characteristics of each group. First, the group of increasing organizations had a donation ratio of about 15% in 2000 and it dramatically increased to about 73% in 2012 (slope = 1.684, $p > .05$; quadratic = 0.253, $p < .01$). Of 1,471 human service organizations, 4% (n = 62) of organizations were classified in this group. Second, the group of constant organizations had a government grant ratio of about 14% in 2000 and it remained almost the same for 12 years (slope = 0.028, $p > .05$; quadratic = -0.007, $p > .05$). 89% (n = 1311) of human service organizations were classified in this group. Third, the group of decreasing organizations had a ratio of about 63 in 2000 and it dramatically decreased to about 25% by 2012 (slope = -5.004, $p < .001$; quadratic = 0.143, $p > .05$). About 7% (n = 98) of human service organizations were classified in this group.

Table 5-11

*Characteristics of three groups in the trajectory of donation ratio*

| | | Donation ratio | |
|---|---|---|---|
| Increasing group (n=62, 4%) | Intercept | 15.304 | *** |
| | Slope | 1.684 | |
| | Quadratic | 0.253 | ** |
| Constant group (n= 1311, 89%) | Intercept | 14.268 | *** |
| | Slope | 0.028 | |
| | Quadratic | -0.007 | |
| Decreasing group (n=98, 7%) | Intercept | 63.088 | *** |
| | Slope | -5.004 | *** |
| | Quadratic | 0.143 | |

*** $p < 0.001$ ** $p < .01$ * $p < .05$

**Trajectory of commercial activity by donation groups.** Based on group classification, this study examined how the trajectory of the commercial activity ratio is formulated for different donation groups. Figure 5-12 shows the results of the trajectories of commercial activity ratio by donation ratio groups. First, the organizations with an increasing donation ratio, represented as a blue solid line with circle marks, showed a trajectory of a decreasing commercial activity ratio during the period from 2000 to 2012. Second, the organizations with a constant donation ratio, represented as a green dotted line, showed a trajectory of a constant commercial activity ratio during the same period. Third, the organizations with a decreasing donation ratio, represented as a red solid line with triangle marks, showed a trajectory of an increasing commercial activity ratio during the same period.

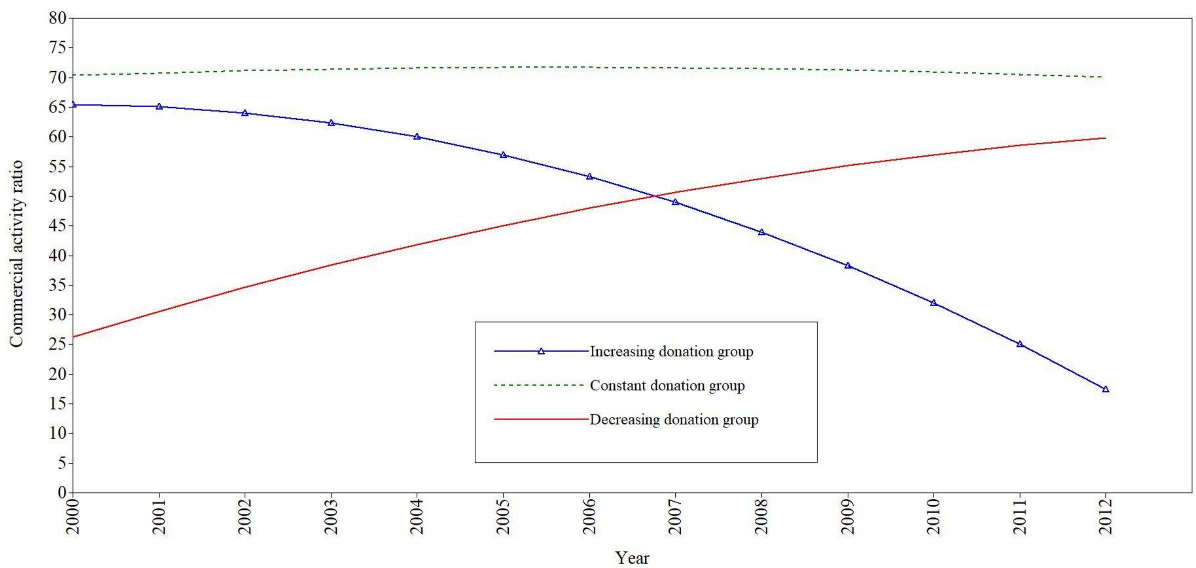



*Figure 5-15.* Trajectories of the commercial activity ratio by donation ratio groups

Table 5-12 presents the results of a latent growth model that examined the different trajectories of the commercial activity ratio for different donation ratio groups. First, the increasing group that increased their donation ratio from 15% to 73% between 2000 and 2012 decreased their commercial activity ratio from 65% in 2000 to about 20% by 2012 (intercept = 65.474, $p < .001$; slope = -0.062, $p > .05$; quadratic = -0.328, $p < .001$). Second, the constant group with a ratio of about 14% constantly over 12 years had a commercial activity ratio of about 70% of constantly over 12 years (intercept = 70.35, $p < .001$; slope = 0.47, $p < .001$; quadratic = -0.041, $p < .001$). Third, the decreasing group that decreased their government grants dramatically from 63% to 25% between 2000 and 2012 increased their commercial activity ratio from approximately 26% in 2000 to 60% in 2012 (intercept = 26.295, $p < .001$; slope = 4.426, $p < .001$; quadratic = -0.136, $p < .05$).

Table 5-12

*Trajectory of commercial activity by donation ratio groups*

| Donation Ratio Group | | Commercial Activity Ratio | |
|---|---|---|---|
| Increasing group (n=62, 4%) | Intercept | 65.474 | *** |
| | Slope | -0.062 | |
| | Quadratic | -0.328 | *** |
| Constant group (n= 1311, 89%) | Intercept | 70.35 | *** |
| | Slope | 0.47 | *** |
| | Quadratic | -0.041 | *** |
| Decreasing group (n=98, 7%) | Intercept | 26.295 | *** |
| | Slope | 4.426 | *** |
| | Quadratic | -0.136 | * |

*** $p < 0.001$ ** $p < .01$ * $p < .05$; $x^2$(df) = 3072.762(46), CFI = 0.927, TLI = 0.930, RMSEA = 0.153, SRMR = 0.054

**Government grant, private donation, and commercial activity**

Table 5-13 presents the results of a latent growth model that examined whether a decrease in the government grant ratio (coded as decreasing group = 1, constant and increasing group = 0) and a decrease in donation ratio (coded as decreasing group = 1, constant and increasing group = 0) are associated with the trajectory of the commercial activity ratio while controlling for age, size, and mission area. First, the decrease in the government grant ratio among human service organizations predicted the intercept, linear growth, and quadratic growth of commercial activity ratio. Human service organizations that decreased the government grant ratio between 2000 and 2012 were more likely to have a lower initial commercial activity ratio in 2000 (i.e., intercept; B = -51.791, $p < .001$) and higher growth of commercial activity ratio during the period from 2000 to 2012 (i.e., slope; B = 8.501, $p < .001$) (i.e., quadratic component

= -0.25, p < .001) than human service organizations that had a constant or increasing government grant ratio over time. Second, the decrease in donation ratio among human service organizations was also associated with the intercept, linear growth, and quadratic growth of the commercial activity ratio. Human service organizations that decreased their donation ratio between 2000 and 2012 were more likely to have a lower initial commercial activity ratio in 2000 (i.e., intercept; B = -39.740, p < .001) and higher growth of the commercial activity ratio during the period from 2000 to 2012 (i.e., slope; B = 3.630, p < .001) than human service organizations that had a constant or increasing donation ratio over time. In addition, human service organizations with greater assets were more likely to have a higher initial level of the commercial activity ratio in 2000 (B = 4.196, p < .001) and higher growth in the commercial activity ratio (B = 0.210, p < .01).

Table 5-13

*Effect of a decrease in government grant and donation on the trajectory of commercial activity*

| | Commercial activity | | | | | |
|---|---|---|---|---|---|---|
| | Intercept | | Slope | | Quadratic | |
| Decrease in government grant (1= decreasing group, 0 = constant, increasing group) | -51.791 | *** | 8.501 | *** | -0.25 | *** |
| Decrease in donation (1 = decreasing group, 0 = constant, increasing group) | -39.740 | *** | 3.630 | *** | -0.05 | |
| Age | -0.027 | | -0.005 | | 0.000 | |
| Size | 4.196 | *** | 0.210 | ** | -0.008 | |
| Mission area (1 = multipurpose human service, 0 = others) | 1.929 | | -0.191 | | 0.051 | * |

| | | |
|---|---|---|
| Model | $x^2$(df) | 3055.007 (132) |
| Fit | CFI | 0.923 |
| | TLI | 0.916 |
| | RMSEA | 0.125 |
| | SRMR | 0.034 |

*** p < 0.001 ** p < .01 * p < .05

**Sector difference in government grant, private donation, and commercial activity**

Additionally, further analysis was conducted to examine whether nonprofit organizations in different areas have different associations between commercial activity and donative revenues. Human service nonprofit organizations that operate in multi-purpose human services areas (NTEE Code = P) and other human service nonprofit organizations that operate in crime and legal (I), employment (J), food (K), housing (L), public safety (M), recreation and sports (N), and youth development (O) were compared. Table 5-14 presents the sector difference. The result shows that both groups had a similar coefficient for the effect of a decrease in government grants on the intercept of commercial activity (multi = -51.429, p < .001; others = -51.878, p < .001). The effect of a decrease in donations on the intercept of commercial activity was also quite similar (multi = -40.872, p < .001; others = -40.415, p < .001). However, when examining the slope of commercial activity, the result shows that a decrease in government grants in other human service organizations more strongly affected the increase in commercial activity over time than in multi-purpose human service organizations (multi = 6.566, p < .001; others = 10.724, p <.001). Similarly, a decrease in donation in other human service organizations more strongly affected the increase in commercial activity over time than in multi-purpose human service organizations (multi = 3.474, p < .001; others = 4.104, p <.001). This means that human service nonprofits that operate in a single-purpose area such as crime, employment, food, housing, public safety, recreation, or youth development increased their commercial activity more sharply than multi-purpose human service nonprofits when they experienced a decrease in government grants and donations. These results imply that multipurpose human service organizations are less sensitive to decreases in donative revenue than other human service organizations. Also, it implies that multipurpose human service organizations are more reluctant to increase commercial activity than other human service organizations when they experience a decrease in donative revenues.

Table 5-14

*Sector difference in the effect of decrease in government grant and private donation on commercial activity*

| | Sector = multi (n=894) | | | Sector = others (n=523) | | |
|---|---|---|---|---|---|---|
| | Commercial activity | | | Commercial activity | | |
| | Intercept | Slope | Quadratic | Intercept | Slope | Quadratic |
| Decrease in government grants (1= decreasing group, 0 = constant, increasing group) | -51.429*** | 6.566*** | -0.061 | -51.878*** | 10.724*** | -0.462 *** |
| Decrease in donations (1 = decreasing group, 0 = constant, increasing group) | -40.872*** | 3.474*** | -0.063 | -40.415*** | 4.104*** | -0.055 |
| Age | -0.034 | -0.005 | 0 | -0.035 | -0.004 | 0 |
| Size | 5.879*** | 0.223* | -0.008 | 1.512 | 0.173** | -0.006 |
| Model Fit $x^2$(df) | 3368.738 (244) | | | | | |
| CFI | 0.919 | | | | | |
| TLI | 0.914 | | | | | |

| | |
|---|---|
| RMSEA | 0.134 |
| SRMR | 0.036 |

*Note.* *** $p < 0.001$ ** $p < .01$ * $p < .05$; multi = multipurpose human services (NTEE code = P); others = crime & legal (I), employment (J), food (K), housing (L), public safety (M), recreation & sports (N), youth development (O)

## Research Question Three

This section reports the findings of research question three. The third research question is: Does a change in nonprofit human service organizations' commercial activities between 2000 – 2012 influence a change in organizations' financial performance during the same period? The results of research question three are constructed as follows. First, this study examines the average trajectory of the commercial activity ratio during the period from 2000 to 2012 through latent growth modeling. Second, this study identifies three different groups in the trajectories of commercial activity ratio through latent class growth analysis: i) constant group, ii) increasing group, and iii) decreasing group. Third, this study examines whether these three different groups of organizations have different trajectories in financial performance regarding profit, margin, solvency and liquidity. Lastly, in order to examine the statistical association between an increase in the commercial activity ratio and the trajectory of financial performance while controlling for other variables, the results of a latent growth model will be presented.

### Average trajectory of commercial activity ratio

Table 5-15 shows the results of a latent growth model that examined the trajectory of the commercial activity ratio of human service nonprofit organizations during the period from 2000 to 2012. The linear model showed that there was no significant linear growth in the commercial activity ratio from 2000 to 2012 ($B = -0.047$, $p > .05$). However, the quadratic model showed that changes in the commercial activity ratio followed a non-linear trajectory. Also, the quadratic model had a better model fit. In the quadratic model, a positive slope (B = 0.632, $p < .001$) and a negative quadratic term (B = -0.053, $p < .001$) suggest that the commercial activity ratio gradually increased over time during the early period, but then gradually decreased over time during the later period.

Table 5-15

*Latent growth model of commercial activity ratio*

| Commercial Activity Ratio | | Linear Model | Quadratic Model |
|---|---|---|---|
| Intercept | | 68.647 *** | 67.343 *** |
| Slope | | -0.047 | 0.632 *** |
| Quadratic | | | -0.053 *** |
| Model Fit | $x^2$(df) | 4089.370(86) | 3077.963(82) |
| | CFI | 0.895 | 0.921 |
| | TLI | 0.905 | 0.925 |
| | RMSEA | 0.178 | 0.158 |
| | SRMR | 0.044 | 0.041 |

*** $p < 0.001$ ** $p < .01$ * $p < .05$

Figure 5-14 shows the sample mean of commercial activity ratio and estimated trajectory of commercial activity ratio through latent growth modeling. When examining sample means, which is presented as a blue dotted line, the result shows that the commercial activity ratio has increased generally from 2000 to 2007, but there was dramatic decrease in the commercial activity ratio between 2007 and 2008. The following year (2009) also saw a slightly decreased commercial activity ratio. However, it began to increase again in 2009 and this increasing pattern continued during the period from 2009 to 2012. On the other hand, the quadratic latent growth model represents an average trajectory of the commercial activity ratio for twelve years with a simple curved line, which is presented as a red solid line. When examining the estimated trajectory of commercial activity ratio via a quadratic latent growth model, the result shows that the commercial activity ratio gradually increased during the initial period from 2000 to 2006 and it gradually decreased during the later period from 2006 to 2012.

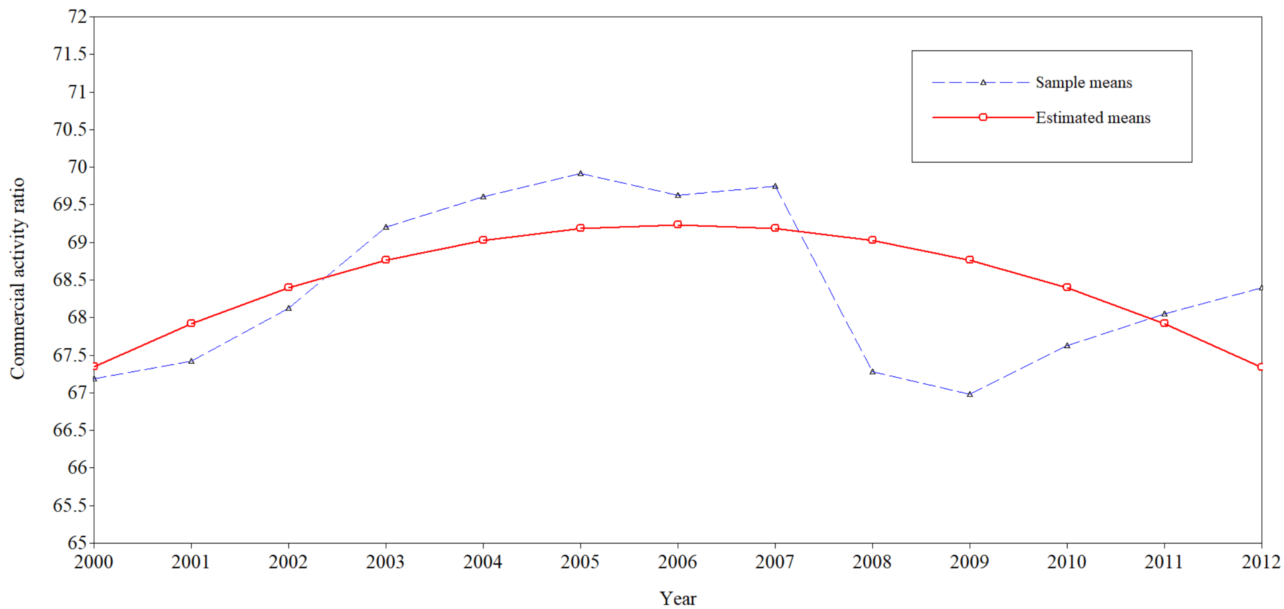



*Figure 5-16.* Estimated trajectory of the commercial activity ratio

**Three groups in the trajectory of the commercial activity ratio**

The latent class growth model identified three groups in the trajectories of the commercial activity ratio, and Figure 5-15 presents the trajectory of each group: i) the group of organizations with a constant commercial activity ratio from 2000 to 2012 (n = 1,296, 88%), ii) the group of organizations with an increasing commercial activity ratio from 2000 to 2012 (n = 88, 6%), and iii) the group of organizations with a decreasing commercial activity ratio from 2000 to 2012 (n = 87, 6%).

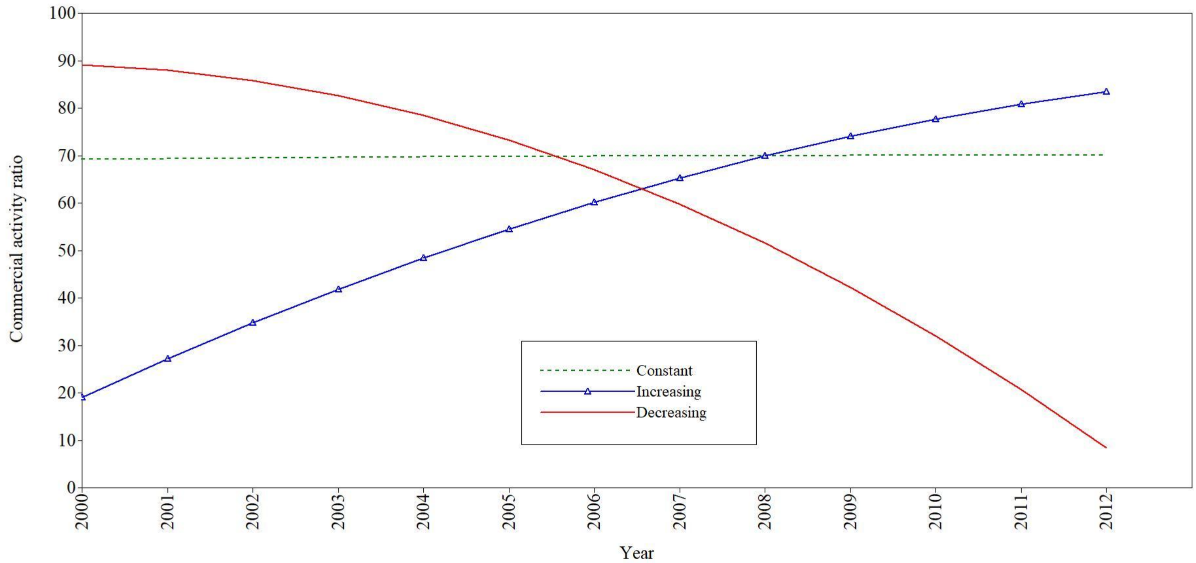



*Figure 5-17.* Three groups in the trajectory of commercial activity ratio

Table 5-16 shows the characteristics of each group. First, the group of constant organizations had a commercial activity ratio of about 69% in 2000 and this remained almost constant for 12 years (slope = 0.14, $p > .05$; quadratic = -0.006, $p > .05$). 88% (n = 1,296) of human service organizations were classified in this group. Second, the group of increasing organizations had a commercial activity ratio of about 19% in 2000 and this dramatically increased to about 83% by 2012 (slope = 8.333, $p < .001$; quadratic = -0.247, $p < .05$). Of 1,471 human service organizations, 6% (n = 88) of organizations were classified in this group. Third, the group of decreasing organizations had a donation ratio of about 89% in 2000 and this dramatically decreased to about 10% by 2012 (slope = -0.633, $p > .05$; quadratic = -0.508, $p < .001$). About 6% (n = 87) of human service organizations were classified in this group.

Table 5-16

*Characteristics of the three groups in the trajectory of commercial activity ratio*

| | | Commercial activity ratio | |
|---|---|---|---|
| Constant group (n=1,296, 88%) | Intercept | 69.293 | *** |
| | Slope | 0.14 | |
| | Quadratic | -0.006 | |
| Increasing group (n=88, 6%) | Intercept | 19.03 | *** |
| | Slope | 8.333 | *** |
| | Quadratic | -0.247 | * |
| Decreasing group (n=87, 6%) | Intercept | 89.094 | *** |
| | Slope | -0.633 | |
| | Quadratic | -0.508 | *** |

*** $p < 0.001$ ** $p < .01$ * $p < .05$

**Average trajectory of financial health**

Table 5-17 shows the results of a latent growth model that examined the trajectory of the financial health of human service nonprofit organization during the period from 2000 to 2012. The linear model showed that there was significant linear change in four financial health indicators. Specifically, on average, profit (intercept = 0.048, $p < .001$; slope = -0.001, $p < .001$), margin (intercept = 0.091, $p < .001$; slope = -0.002, $p < .001$) and liquidity (intercept = 0.975, $p < .001$; slope = -0.008, $p < .01$) among nonprofit human service organizations decreased during the period from 2000 to 2012. However, solvency of human service organizations (intercept = 1.958, $p < .001$; slope = 0.034, $p < .01$) increased during the same period.

Table 5-17

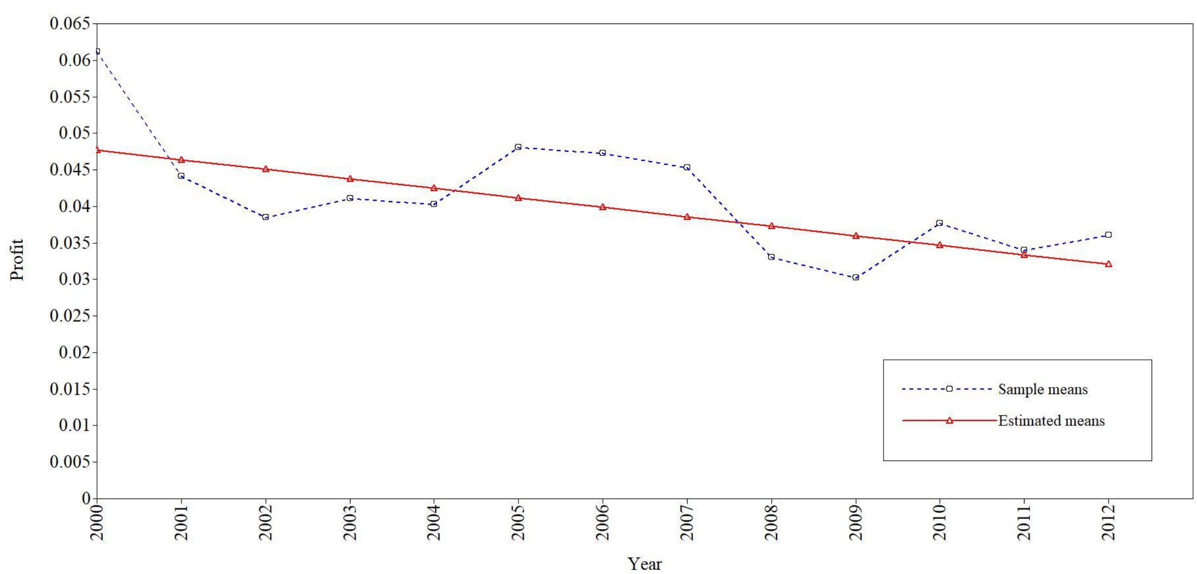
*Trajectory of financial health*

| | | Profit | | Margin | | Solvency | | Liquidity (log) | |
|---|---|---|---|---|---|---|---|---|---|
| Intercept | | 0.048 | *** | 0.091 | *** | 1.958 | *** | 0.975 | *** |
| Slope | | -0.001 | *** | -0.002 | *** | 0.034 | ** | -0.008 | ** |
| Model Fit | $x^2$(df) | 412.349(86) | | 1758.485 (86) | | 6394.519 (86) | | 3164.434 (86) | |
| | CFI | 0.821 | | 0.810 | | 0.720 | | 0.884 | |
| | TLI | 0.838 | | 0.828 | | 0.746 | | 0.895 | |
| | RMSEA | 0.051 | | 0.115 | | 0.223 | | 0.156 | |
| | SRMR | 0.047 | | 0.088 | | 0.158 | | 0.065 | |

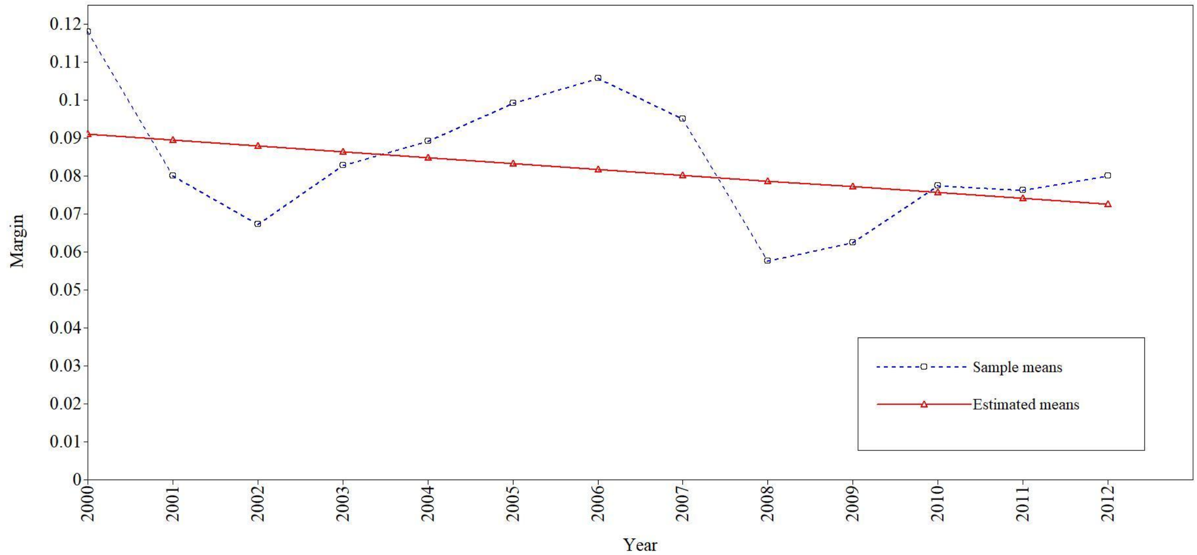
*** $p < 0.001$ ** $p < .01$ * $p < .05$

Figure 5-16 shows the sample mean of financial health and estimated trajectory of financial performance through latent growth modeling.

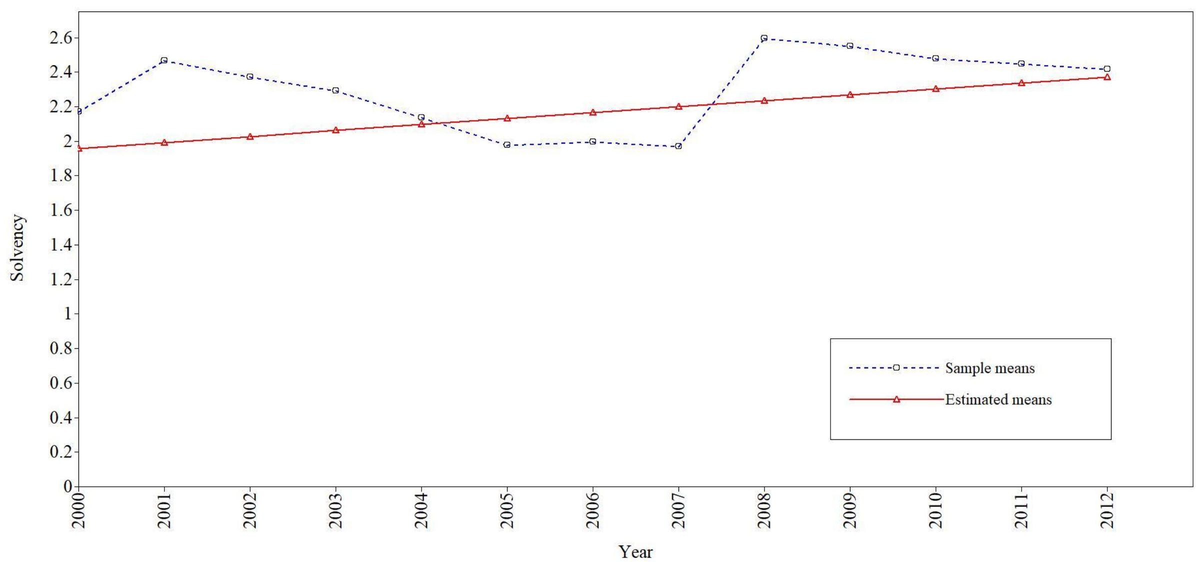
Profit



Margin




Solvency



Liquidity (log)

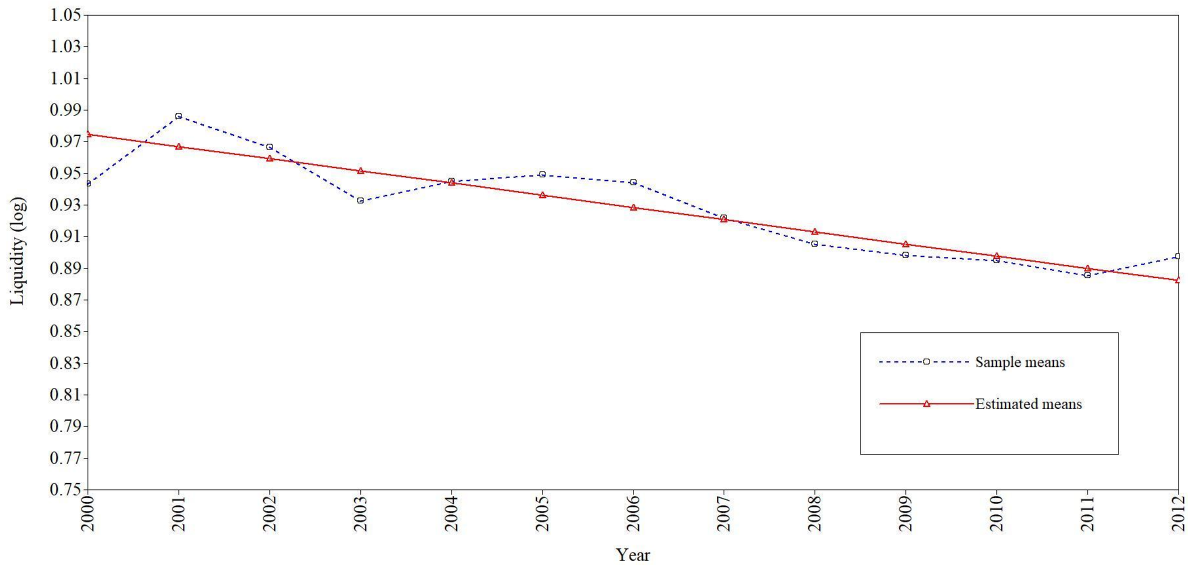



*Figure 5-18.* Trajectory of financial health

**Trajectory of financial health by commercial activity groups**

Based on the group classification, this study examined how the trajectory of financial health is formulated for different commercial activity groups. Figure 5-17 shows the results of the trajectories of financial health (i.e., profit, margin, solvency and liquidity) by commercial activity groups.

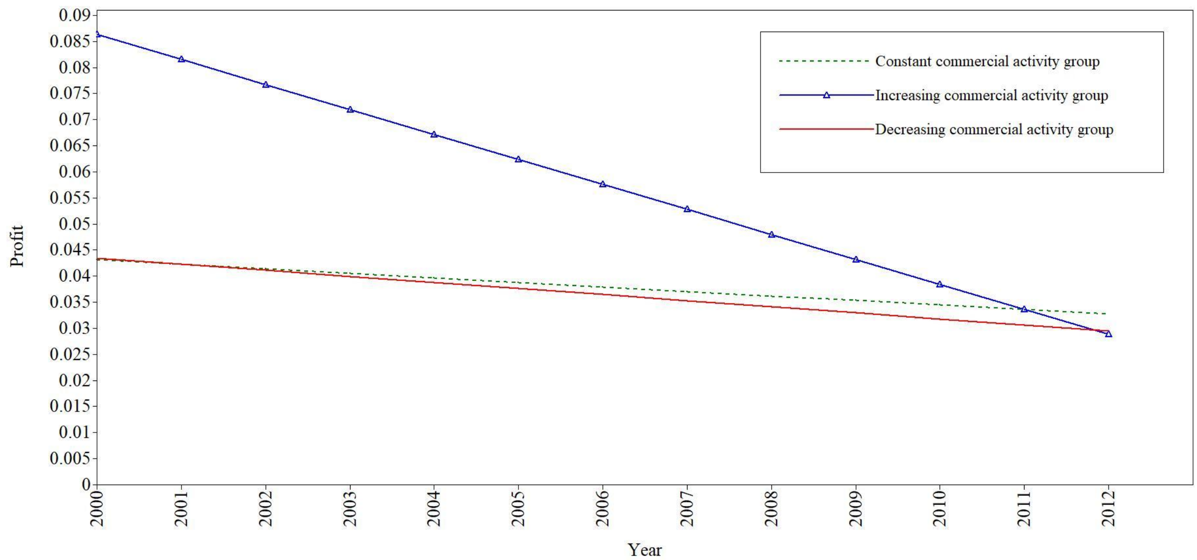
When examining profit, all three organizations that had a constant, increasing, and decreasing commercial activity ratio showed a decreasing trajectory in profit. The organizations that increased their commercial activity ratio over time, represented as a red solid line, had the highest profit in 2000 but experienced the most dramatic decrease in profit among three groups. These organizations that increased their commercial activity ratio had 0.085 of profits in 2000, but this fell to about 0.03 by 2012.

When examining margin, a similar pattern was found. The organizations that increased their commercial activity ratio showed the most dramatic decrease in margin among the three groups, although the highest margin was found in 2000. These organizations had 0.2 of margins in 2000, but this fell to about 0.05 by 2012. However, the other two groups that had a constant and decreasing commercial activity ratio had almost same margin over time.

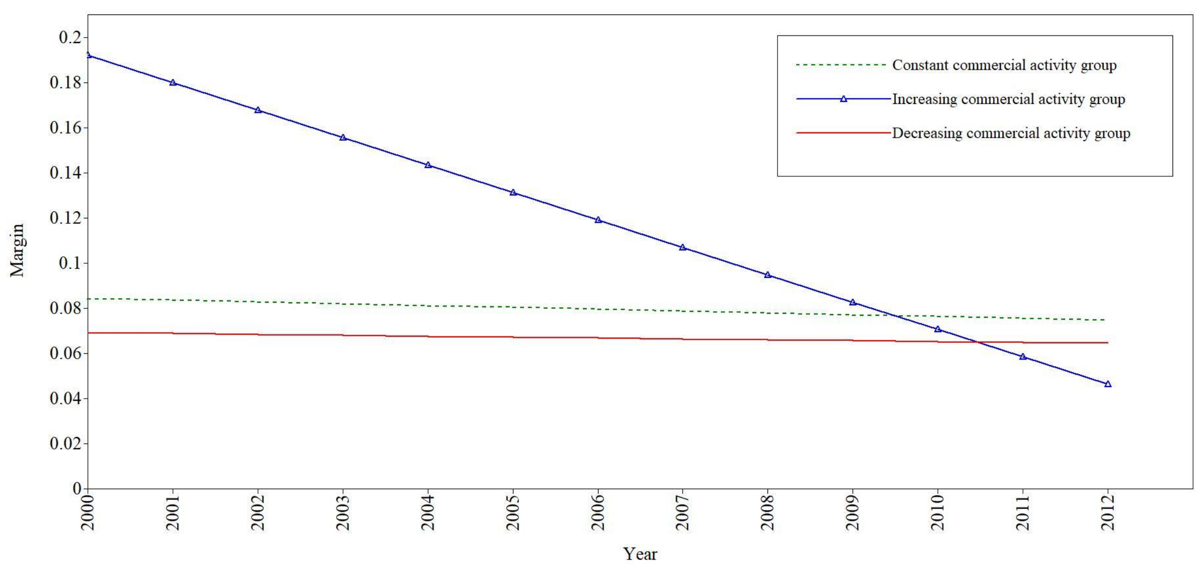
When examining solvency, the three groups exhibited different directions in trajectory. The organizations that increased their commercial activity ratio showed an increase in solvency. The organizations with a constant commercial activity ratio also showed an increase in solvency. However, the increasing commercial activity group had a greater increase in solvency than the constant commercial activity group over 12 years. On the other hand, the organizations that decreased their commercial activity ratio showed a decrease in solvency.

When examining log-transformed liquidity, all three groups that had constant, increasing, and decreasing commercial activity showed a decrease in liquidity. However, although the differences were slight, the organizations with an increased commercial activity ratio showed the most dramatic decrease in liquidity.

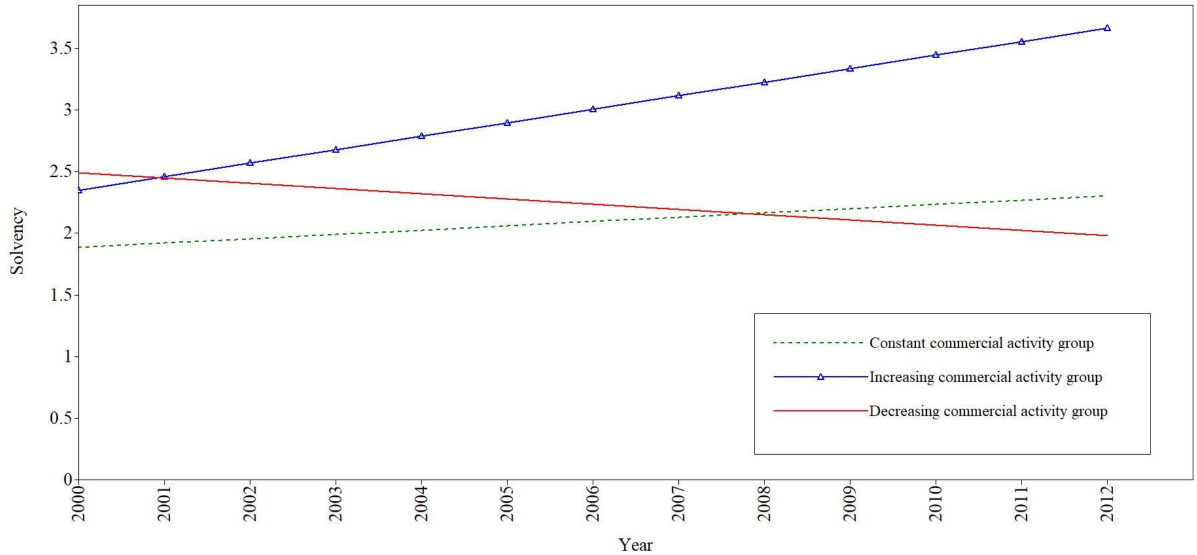
Profit




Margin



Solvency




Liquidity (log)

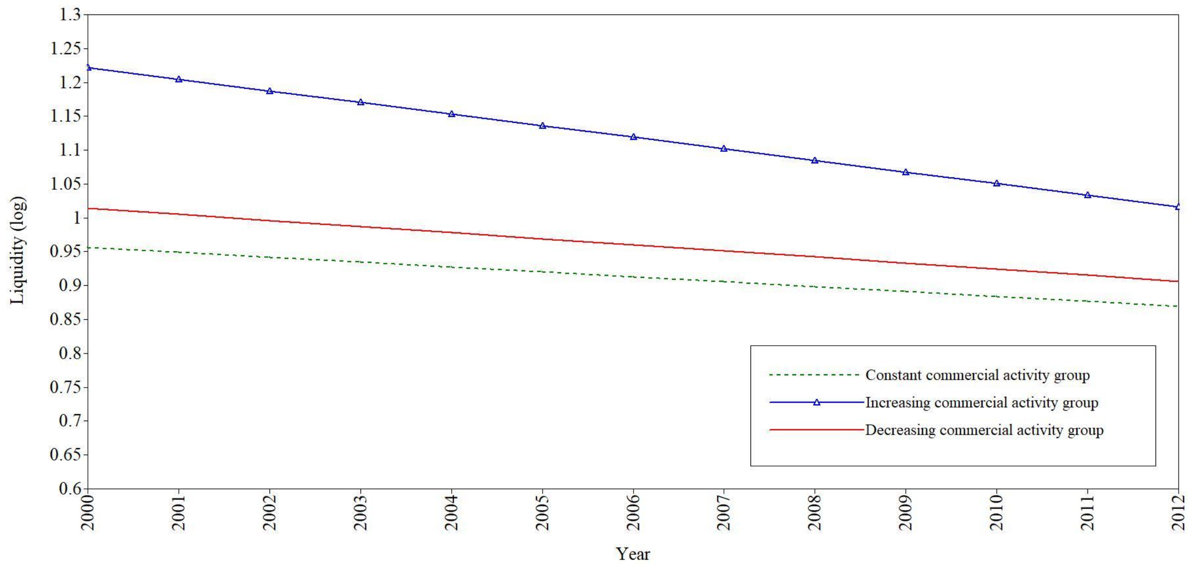



*Figure 5-19.* Trajectories of financial health by commercial activity ratio groups

Table 5-18 shows the intercept and slope of four financial health indicators across different commercial activity groups based on latent growth modeling.

When examining profit, the increasing group that increased their commercial activity from 19% to 83% between 2000 and 2012 experienced dramatically decreasing profit, from 0.086 in 2000 to about 0.03 in 2012 (intercept = 0.086, $p < .001$; slope = -0.005, $p < .001$). On average, profits decreased every year by 0.005 from 2000 to 2012. The constant group with about 69% of commercial activity constantly over 12 years and the decreasing group that decreased their commercial activity ratio from 89% to 10% had about 0.043 of profit in 2000, but this slightly decreased to 0.04 by 2012 (intercept = 0.043, $p < .001$; slope = -0.001, $p < .001$). On average, profits decreased by only 0.001 every year from 2000 to 2012.

When examining margin, the group that increased their commercial activity from 19% to 83% between 2000 and 2012 saw a dramatically decreasing margin, from 0.192 in 2000 to about 0.05 by 2012 (intercept = 0.192, $p < .001$; slope = -0.012, $p < .001$). On average, margins decreased by 0.012 every year from 2000 to 2012. The constant group with about 69% of commercial activity constantly over 12 years had profits of 0.084 in 2000 but this decreased slightly to 0.08 by 2012 (intercept = 0.084, $p < .001$; slope = -0.001, $p < .05$). On average, margins decreased every year by only 0.001 from 2000 to 2012. The group that decreased their commercial activity ratio from 89% to 10% had a margin of 0.069 in 2000 but this remained almost constant over 12 years (intercept = 0.069, $p < .001$; slope = 0.000, $p > .05$).

When examining solvency, the group that increased their commercial activity from 19% to 83% between 2000 and 2012 had increasing solvency, from 2.349 in 2000 to about 3.7 in 2012 (intercept = 2.349, $p < .001$; slope = 0.109, $p < .001$). On average, solvency increased every year by 0.109 from 2000 to 2012. The constant group with about 69% of commercial activity constantly over 12 years had solvency of about 1.887 in 2000 and this slightly increased to 2.3 by 2012 (intercept = 1.887, $p < .001$; slope = 0.035, $p < .01$). On average, solvency increased every year by 0.035 from 2000 to 2012. The group that decreased their commercial activity ratio from 89% to 10% had solvency of 2.491 in 2000, but this slightly decreased to about 2 by 2012 (intercept = 2.491, $p < .001$; slope = -0.042, $p > .05$).

When examining log-transformed liquidity, the group that increased their commercial activity from 19% to 83% between 2000 and 2012 saw dramatically decreasing liquidity, from 1.222 in 2000 to about 1 in 2012 (intercept = 1.222, $p < .001$; slope = -0.017, $p > .05$). On average, liquidity (log-transformed) decreased every year by 0.017 from 2000 to 2012. However, this slope was not statistically significant. The constant group with about 69% of commercial activity constantly over 12 years had liquidity of about 0.956 in 2000, but this slightly decreased to 0.872 by 2012 (intercept = 0.956, $p < .001$; slope = -0.007, $p < .01$). On average, liquidity (log-transformed) significantly decreased by 0.007 every year from 2000 to 2012. The group that decreased their commercial activity ratio from 89% to 10% had margins of 1.014 in 2000, but this was slightly decreased to about 0.9 in 2012 (intercept = 1.014, $p < .001$; slope = -0.009, $p > .05$). On average, liquidity (log-transformed) decreased by 0.009 every year from 2000 to 2012. However, this slope was not statistically significant.

Table 5-18

*Trajectories of financial health by commercial activity groups*

| Commercial Activity Group | | Profit | Margin | Solvency | Liquidity (log) |
|---|---|---|---|---|---|
| Constant group | Intercept | 0.043*** | 0.084*** | 1.887*** | 0.956*** |
| (n=1296, 88%) | Slope | -0.001*** | -0.001* | 0.035** | -0.007** |
| Increasing group | Intercept | 0.086*** | 0.192*** | 2.349*** | 1.222*** |
| (n=88, 6%) | Slope | -0.005*** | -0.012*** | 0.109* | -0.017 |
| Decreasing group | Intercept | 0.043*** | 0.069*** | 2.491*** | 1.014*** |
| (n=87, 6%) | Slope | -0.001*** | 0.000 | -0.042 | -0.009 |
| Model fit | $x^2$(df) | 857.403 (258) | 2178.684 (258) | 8585.328 (258) | 3825.365 (258) |

| | | | | |
|---|---|---|---|---|
| CFI | 0.723 | 0.788 | 0.673 | 0.871 |
| TLI | 0.749 | 0.808 | 0.703 | 0.883 |
| RMSEA | 0.069 | 0.123 | 0.257 | 0.168 |
| SRMR | 0.069 | 0.104 | 0.175 | 0.080 |

*** $p < 0.001$ ** $p < .01$ * $p < .05$

**Effects of increases in the commercial activity ratio on the trajectory of financial health**

Table 5-19 presents the results of latent growth models that examined the effects of increases in the commercial activity ratio on the trajectory of financial performance. The government grants ratio in 2000, the donation ratio in 2000, age, size, and sector were included as control variables.

When examining profit, the result shows that the human service organizations that increased commercial activity over time showed significantly higher profits in 2000 than other organizations with a constant or decreasing commercial activity ratio (intercept = 0.206, $p < .001$). However, these commercialized organizations had a more dramatically decreasing profit trajectory over 12years than did non-commercialized organizations (slope = -0.247, $p < .001$). This implies that commercialization of human service organizations predicted a greater decrease in profit.

When examining margin, the result shows that the human service organizations that increased commercial activity showed significantly higher margins in 2000 than other organizations with a constant or decreasing commercial activity ratio (intercept = 0.218, $p < .001$). However, these commercialized organizations had a more dramatically decreasing margin trajectory over 12 years than did non-commercialized organizations (slope = -0.250, $p < .001$). This implies that commercialization of human service organizations predicted a greater decrease in margin.

When examining solvency, the result shows that the human service organizations that increased commercial activity did not have statistically different intercept and slope from other organizations with a constant or decreasing commercial activity ratio (intercept = 0.027, p > .05; slope = 0.027, p > .05).

Also, when examining liquidity, the result shows that the human service organizations that increased commercial activity did not have statistically different intercept and slope from other organizations with a constant or decreasing commercial activity ratio (intercept = 0.028, p > .05; slope = -0.018, p > .05).

Table 5-19

*Effects of an increase in the commercial activity ratio on the trajectory of financial health*

| | Profit | | Margin | | Solvency | | Liquidity (log) | |
|---|---|---|---|---|---|---|---|---|
| | Intercept | Slope | Intercept | Slope | Intercept | Slope | Intercept | Slope |
| Increase in CR (1=increase, 0=constant, decrease) | 0.206*** | -0.247*** | 0.218*** | -0.250*** | 0.027 | 0.027 | 0.028 | -0.018 |
| GR (2000) | -0.014 | -0.009 | -0.081** | -0.018 | -0.052 | -0.040 | -0.124*** | 0.040 |
| DR (2000) | 0.230*** | -0.168*** | 0.236*** | -0.166*** | 0.172*** | 0.021 | 0.141*** | -0.073* |
| Age | 0.036 | -0.037 | -0.054 | -0.051 | 0.051 | -0.060 | -0.013 | -0.012 |
| Size | -0.454*** | 0.157*** | 0.042 | -0.009 | 0.094** | 0.040 | -0.251*** | 0.045 |
| Sector (1=multipurpose, 0=others) | 0.055 | -0.078 | -0.070* | -0.024 | -0.075* | -0.014 | -0.053* | -0.005 |
| Model Fit $x^2$(df) | 549.695 (152) | | 1914.628 (152) | | 6498.358 (152) | | 3339.603 (152) | |
| CFI | 0.833 | | 0.799 | | 0.713 | | 0.877 | |
| TLI | 0.829 | | 0.794 | | 0.706 | | 0.873 | |
| RMSEA | 0.043 | | 0.090 | | 0.172 | | 0.122 | |
| SRMR | 0.042 | | 0.072 | | 0.116 | | 0.051 | |

*Note.* *** p < 0.001 ** p < .01 * p < .05; standardized coefficient; CR = Commercial activity ratio, GR = Government grants ratio; DR = Donation ratio

**Sector difference in the effects of increases in the commercial activity ratio on the trajectory of financial health**

In addition, whether there is a sector difference between commercialization and financial health was examined. Organizations that operate in multi-purpose human service areas (NTEE Code = P; n=894), and other organizations that operate in other human service areas, including crime and legal (I), employment (J), food (K), housing (L), public safety (M), recreation and sports (N), and youth development (O) were compared. Table 5-20 presents the result of the group differences. The results show that the negative effects of an increase in the commercial activity ratio on changes in profit and margin was more severe in the nonprofit organizations that operate in other areas (slope of profit = -0.313, $p < .001$; slope of margin = -1.137, $p < .001$) than in multipurpose human services nonprofit organizations (slope of profit = -0.197, $p < .001$; slope of margin = -0.934, $p < .001$). This implies that commercialized organizations that operate in a single-purpose human service area experienced a greater decrease in profit and margins compared to commercialized organizations in a multi-purpose human service area. For both groups, the association between an increase in the commercial activity ratio and changes in solvency and liquidity was not statistically significant.

Table 5-20

*Sector difference in the effects of an increase in the commercial activity ratio on the trajectory of financial health*

| | | Profit | | Margin | | Solvency | | Liquidity | |
|---|---|---|---|---|---|---|---|---|---|
| | | Intercept | Slope | Intercept | Slope | Intercept | Slope | Intercept | Slope |
| Multi (n=894) | Increase in CR (1=increase, 0=constant, decrease) | 0.144*** | -0.197*** | 0.736*** | -0.934*** | 0.026 | 0.020 | -0.009 | -0.014 |
| | GR (2000) | -0.010 | 0.012 | -0.005*** | 0.000 | -0.093** | -0.021 | -0.168*** | 0.044 |
| | DR (2000) | 0.200*** | -0.214*** | 0.013*** | -0.008*** | 0.312*** | 0.062 | 0.233*** | -0.124** |
| | Age | 0.044 | -0.088 | -0.001 | -0.002** | 0.109** | -0.105** | -0.032 | -0.025 |
| | Size | -0.570*** | 0.262*** | -0.004 | 0.003 | 0.094* | 0.037 | -0.269*** | 0.038 |
| Other (n=523) | Increase in CR (1=increase, 0=constant, decrease) | 0.283*** | -0.313*** | 1.068*** | -1.137*** | 0.006 | 0.055 | 0.060 | -0.020 |
| | GR (2000) | -0.014 | -0.036 | -0.001 | -0.002 | -0.046 | -0.033 | -0.076 | 0.038 |
| | DR (2000) | 0.255*** | -0.149* | 0.006*** | -0.006** | 0.040 | -0.009 | 0.061 | -0.030 |
| | Age | 0.054 | -0.002 | -0.004* | 0.001 | -0.079 | 0.008 | 0.024 | 0.008 |
| | Size | -0.296*** | 0.057 | 0.059* | -0.012 | 0.116* | 0.052 | -0.201*** | 0.032 |
| Model Fit | $x^2$(df) | 822.695 (282) | | 2297.439 (282) | | 8027.516 (282) | | 3849.173 (282) | |
| | CFI | 0.792 | | 0.778 | | 0.697 | | 0.865 | |
| | TLI | 0.789 | | 0.774 | | 0.692 | | 0.863 | |
| | RMSEA | 0.052 | | 0.100 | | 0.197 | | 0.134 | |
| | SRMR | 0.053 | | 0.083 | | 0.120 | | 0.060 | |

*Note.* *** $p < 0.001$ ** $p < .01$ * $p < .05$; standardized coefficient; CR = Commercial activity ratio, GR = Government grants ratio; DR = Donation ratio; multi = multipurpose human services (NTEE code = P); others = crime & legal (I), employment (J), food (K), housing (L), public safety (M), recreation & sports (N), youth development (O)

## Conclusion

In this chapter, three research questions were examined: i) How have the commercial activities of human service nonprofits changed over a 12-year period from 2000 to 2012? ii) Does a decrease in government grants and private donations between 2000 – 2012 increase human service nonprofit organizations' commercial activities during the same period? iii) Does a change in nonprofit human service organizations' commercial activities between 2000 – 2012 predict a change in organizations' financial health during the same period?

This study found that over half of human service nonprofit organizations earned more than 80% of their total revenue through commercial activities, and the percentage of commercial human service nonprofit organizations slightly increased during the period from 2000 to 2012. When examining average commercial revenue, it was found to have increased from $14,534,194 in 2000 to $18,700,306 in 2012 in constant dollars, which presented an increase of approximately 30% over 12 years. Regarding the different types of commercial revenue throughout the whole period, program service revenue accounted for about 91.4% of total commercial revenue. Investment income (6.8%), sales of inventory (1.4%), income from special events (0.3%) comprised the remainder of total revenue. When examining the average trajectory of the commercial activity ratio of human service nonprofits, due to the dramatic decrease in the commercial activity ratio between 2007 and 2009, this ratio followed a non-linear trajectory from 2000 to 2012. The commercial activity ratio that gradually increased from 67% in 2000 to 70% in 2007 sharply decreased during the Great Recession (67% in 2009). However, it began to increase again after 2009 and reached 68% in 2012. When examining how organizations in each human service mission area changed over 12 years, most organizations in all eight areas had a constant commercial activity ratio. However, 15% of organizations in the food, agriculture, and nutrition area dramatically increased their commercial activity ratio over 12 years. In the areas of housing and shelters (9%), recreation (8%), crime and legal (6%), youth development (6%), multipurpose human service (5%), and employment (3%), some organizations also dramatically increased their commercial activity ratio.

This study also found that changes in the government grants and donations ratios were associated with the trajectory of the commercial activity ratio. The constant government grant group with a government grants ratio of about 12% constantly over 12 years had a constant commercial activity ratio of about 70% over 12 years. The group that decreased their government grants dramatically from 75% to 5% between 2000 and 2012 increased their commercial activity ratio from approximately 15% in 2000 to 75% in 2012. The group that increased their government grant ratio from 2% to 85% between 2000 and 2012 decreased their commercial activity ratio from 79% to about 8%. Similarly, the group that increased their donation ratio from 15% to 73% between 2000 and 2012 decreased their commercial activity ratio from 65% in 2000 to about 20% in 2012. The group that had a donation ratio of about 14% constantly over 12 years had a commercial activity ratio of about 70% constantly over 12 years. The group that decreased their government grants dramatically from 63% to 25% between 2000 and 2012 increased their commercial activity ratio from approximately 26% in 2000 to 60% in 2012. In addition, when controlling for age, size, and mission area, human service organizations that decreased their government grant ratio or donation ratio between 2000 and 2012 were more likely to have a lower initial commercial activity ratio in 2000 and higher growth of commercial activity ratio during the same period than other human service organizations with constant or increasing government grant or donation ratios. Additionally, this study found that there is a sector difference in the association between commercial activity and donative revenue. Human service organizations that operate in single-purpose areas such as crime, employment, food, housing, public safety, recreation, or youth development increased their commercial activity more sharply than multi-purpose human service nonprofits when they experienced a decrease in government grants and donations.

Finally, this study identified three different groups (constant, increasing, and decreasing groups) regarding changes in commercial activity between 2000 and 2012 and examined how these three groups had different trajectories in profit, margin, solvency, and liquidity over 12 years. When examining profit, margin, and liquidity, the organizations that increased their commercial activity ratio over time had the highest profit, margin, and liquidity in 2000, but experienced the most dramatic decreases in the three indicators among the three groups. However, when examining solvency, the organizations that increased their commercial activity ratio over time experienced the most dramatic increase in solvency among three groups. In addition, when controlling for government grant and donation ratios in 2000, age, size, and sector, human service nonprofits that increased their commercial activity ratio between 2000 and 2012 showed significantly higher profits and margins in 2000 but significantly greater decreases in profits and margins during the same period compared to human service organizations that had constant or decreasing commercial activity ratio. The increase in the commercial activity ratio was not significantly associated with solvency and liquidity when controlling for government grants, donations, age, size, and sector. In addition, this study found that there was a sector difference in the association between commercialization and financial health. Commercialization among human service organizations that operate in a single area (i.e., crime and legal, employment, food, housing, public safety, recreation and sports, youth development) predicted a greater decrease in profits and margins compared to organizations in a multi-purpose human service area.

# CHAPTER 6

# DISCUSSION

Since the 1980s, the commercial activity of nonprofit human service organizations has been increasing in the United States. Although nonprofits in the United States have a long history of using commercial income to supplement government grants and private donations, numerous socio-economic pressures and the shift to neoliberal social policies have pushed many nonprofit organizations to generate more commercial income. The dollar amount of commercial revenue among nonprofit human service organizations increased by 270% from 1982 to 2002, and the proportion of commercial income to total revenue also increased from 50% in 1982 to 59% in 2002 (Kerlin & Pollak, 2011). The most recent study of the revenue structure of nonprofits shows that commercial revenues (i.e., the sum of program fees charged by individuals and the government and investment income) accounted for 76.8% of the total revenue of public charities in the United States in 2013 (McKeever, 2015). These nonprofits' efforts to generate income through sales and fees have attracted the attention of many researchers who see such actions as innovative revenue strategies to respond to the lack of federal funding and unstable private contributions.

The reason that the commercial activity of nonprofit human service organizations should be considered seriously in the field of social work and social welfare is that such commercialization fundamentally alters how social workers provide services to clients. Clients are perceived as customers rather than citizens with social rights (Hasenfeld & Garrow, 2012), and the role of social workers are changed. Although the commercial activity of nonprofit human service organizations has been justified and expanded by belief in the neoliberal paradigm that competition and market-driven strategies can solve all social problems and increase financial sustainability, the problem is that this argument has not been fully tested on human service nonprofits via empirical studies. How does commercial activity work for human service nonprofits that deliver social services to disadvantaged people? Are market mechanisms compatible with the operational rules of human service nonprofits? Despite warnings about the commercial activity of nonprofit organizations, such as mission distraction (Cornforth, 2014; Tekula, 2009) and the weakness of civil society (Eikenberry & Kluver, 2004), why are so many nonprofit human service organizations involved in commercial activities? There are a number of questions that need to be addressed before simply accepting the commercial activities of nonprofit human service organizations as normative.

This study was guided by three research questions regarding the commercial activity of human service organizations in the United States, which are as follows: i) How have the commercial activities of human service nonprofits changed over a 12-year period from 2000 to 2012? ii) Does a decrease in government grants and private donations between 2000 – 2012 increase human service nonprofit organizations' commercial activities during the same period? iii) Does a change in nonprofit human service organizations' commercial activities between 2000 – 2012 predict a change in organizations' financial health during the same period? To answer these questions, this study utilized 1,471 human service organizations' Statistics of Income data from the Internal Revenue Service for the 2000 – 2012 period and used latent class growth analyses and latent growth curve analyses. This sixth chapter summarizes the major findings of this study and articulates its implications for social work research, practice, and policy.

Moreover, this chapter provides suggestions for future research based on these implications and several limitations of this study.

## Major Findings

The major findings of this study are as follows. First, except for the period of the Great Recession from 2007 to 2009, the proportion of commercial revenue to total revenue increased among nonprofit human service organizations during the period from 2000 to 2012. Before the Great Recession, the commercial activity ratio generally increased from 67% in 2000 to 70% in 2007. Although this rate sharply decreased for the two years of the Great Recession (67% in 2009), it started to increase again after 2009 and reached 68% in 2012. Also, nonprofit human service organizations increased commercial revenue in constant dollar terms by about 34% from 2000 to 2012. These findings are consistent with previous studies demonstrating that the dollar amount of commercial revenue has been increasing since the 1980s (Kerlin & Pollak, 2011; Salamon, 2015). However, the important thing is that during the same period, private donations have also increased by 47%, and government grants by 33%. These findings indicate that the increases in commercial revenue should be understood as a part of the overall revenue growth of nonprofit human service organizations.

Second, this study found that the number of commercial human service nonprofit organizations that earned more than 60% of their revenue from commercial activity slightly increased over twelve years except for the period of the Great Recession. This is consistent with the finding that showed the commercialization of nonprofit human service organizations in the United States (Salamon, 2015; Guo, 2006; Young, 1998). However, the latent class growth model found that 88% of human service organizations had a constant commercial activity ratio of 69% from 2000 to 2012. These findings lend support to previous research stating that nonprofit organizations have had stable revenue sources strategies over time throughout the 2000s (Teasdale et al., 2013). Only 6% of organizations increased commercial activity on average, from 19% in 2000 to 80% 2012. Interestingly, 6% of human service organizations decreased their commercial activity ratio on average from 89% in 2000 to 10% in 2012. These findings imply that while some human service nonprofits were commercialized between 2000 and 2012, a similar number of organizations experienced non-commercialization during the same period. Also, the sample characteristics of identified commercial activity groups showed that small and young organizations tended to increase their commercial activities. This result is opposite to the previous study that larger organizations have more access to commercial income (Cortis, 2017).

Third, the Great Recession that began in December 2007 and ended in June 2009 impacted the revenue structure of nonprofit human service organizations. The proportion of commercial revenue to total revenue that increased gradually between 2000 and 2007 sharply decreased during the Great Recession. However, it began to increase again after the Great Recession ended. Government grants followed a trajectory exactly opposite to commercial revenue. The proportion of government grants to total revenue decreased gradually between 2000 and 2007, but radically increased between 2007 and 2009. After the Great Recession ended in 2009, it started to decrease again. Private donations exhibited a similar pattern. They constantly decreased from 2000 to 2007, sharply increased between 2007 and 2008, and began to decrease again between 2008 and 2012. This change in revenue structure is related to the finding that the dollar amount of government grants dramatically increased by 30% between 2007 and 2009, while the dollar amount of commercial revenue (-5%), private donations (-0.9%), and other revenue (-33%) decreased. These results are consistent with a previous study demonstrating that the commercial revenue of nonprofit organizations decreased while the government grants ratio increased during the Great Recession (Salamon, 2015). Safety net government programs such as Medicaid, Medicare, food stamps, and diverse social service programs during the Great Recession (Burtless & Gordon, 2011) helped nonprofit human service organizations maintain their total revenue. However, these findings are inconsistent with a study by Morreale (2011) that found that contributions by the government and private donors declined during the Great Recession from 2007 to 2010. Furthermore, these findings are also partially consistent with a study by Gassman et al. (2012) that examined the revenue structure of nonprofit organizations from 2009 to 2012, immediately after the Great Recession. As Gassman et al. (2012) found, the amount of government grants and the proportion of government grants to total revenue decreased in 2009 and 2011.

Fourth, human service organizations with different missions displayed different commercial activity ratios over the 12 years. Organizations related to employment, recreation, housing, and multipurpose human service had a high commercial activity ratio (approximately 70%), organizations related to public safety and youth development had a mid-level of commercial activity ratio (approximately 50 ~ 60%), and organizations related to food, agriculture and nutrition showed the lowest commercial activity ratio (approximately 20 ~ 30%). In addition, although most organizations of all eight areas had a constant commercial activity ratio over the 12 years, 15% of organizations in the food area dramatically increased their commercial activity ratio in the same period. These findings are consistent with the previous study that mission area was related to commercial activities (Cortis, 2017). Also, these results shed light on the usefulness of Young's benefits theory, which states that revenue proportions are determined by the kinds of services organizations offer and the nature of their benefits (Young, 2017). Nonprofits in the health care and educational fields are more heavily financed by fees because "their services are consumed by individual clients who can be charged directly or indirectly for the benefits they receive" (Young, 2017, p.45). On the other hand, nonprofit organizations in the environment sector are mainly financed by private donations and government grants because the beneficiaries of their services are the public rather than certain individuals. The findings of this study support Young's benefits theory. The human service organizations that provide services to individual clients directly, such as employment, recreation, housing, and multipurpose human service showed the highest commercial activity ratio. On the other hand, human service organizations that mainly focus on the general public, such as public safety and food, agriculture and nutrition, showed a lower commercial activity ratio.

Fifth, an increase in the commercial activity ratio was associated with a decrease in government grants and donations ratios. Compared to organizations with constant or increasing government grants and donation ratios between 2000 and 2012, organizations with decreasing government and donations ratios showed an increasing trajectory of commercial activity. In addition, when controlling for age, size, and mission area, human service organizations that experienced a decreased government grants or donations ratio between 2000 and 2012 were more likely to see more growth in their commercial activity ratio during the same period than were other human service organizations with constant or increasing government grants or donation ratios. These results lend support to a previous study conducted by Guo (2006) that found that commercial revenues were negatively associated with donative revenues, including government funding and private giving. The finding of this study is inconsistent with that of Kerlin & Pollak (2011), who found little evidence that the commercial revenue of human service nonprofits is associated with other revenue streams. The longitudinal findings of this study clearly show that the commercial revenue of nonprofit human service organizations is closely related to government grants and private donations in terms of the dollar amount of revenue and its proportion to total revenue. Furthermore, these findings verify the utility of resource dependence theory (Pfeffer & Salancik, 1978). According to resource dependence theory, nonprofit organizations started to increase commercial revenue due to the growing uncertainty and scarcity associated with the traditional revenue sources, government grants and private contributions (Froelich, 1999). Although this study did not examine the causal relationship between commercial revenue and donative revenue, the findings of this study confirm that a decrease in donative revenues, particularly government grants, is associated with an increase in commercial revenue.

Sixth, an increase in the commercial activity ratio was generally associated with a decrease in financial health. Basically, this study found that the financial health of nonprofit human service organizations deteriorated from 2000 to 2012. This finding supports a recent study suggesting that a number of nonprofit human service organizations in the United States are not financially sustainable (Morris & Roberrts, 2018). When examining whether the decrease in financial health was associated with commercial revenue, nonprofit human service organizations that increased their commercial activity over 12 years experienced a decreasing trajectory of profit, margin, and liquidity. In addition, human service nonprofits that sharply increased their commercial activity ratio between 2000 and 2012 showed a greater decrease in profit and margin compared to organizations that had a constant or decreasing commercial activity ratio when controlling for the government grants ratio in 2000, the donations ratio in 2000, age, size, and mission area. These findings lend support to a previous study that revealed a negative association between commercial activity and financial health among human service organizations (Prentice, 2016a). Additionally, this negative relationship might be explained by a previous study showing that commercial revenues did not make a significant contribution to an organization's ability to attract donors and volunteers (Guo, 2006). In addition, it might be explained by Weisbrod's theory of a nonprofit as a multiproduct firm, which asserts that nonprofits ultimately prefer donations over commercial revenue, and their commercial activities have a directly negative effect on an organizations' mission and financial health (Wiesbrod, 2004).

Finally, this study found that there was a sector difference in the relation between donative revenues and commercial activities and in the relationship between commercial activities and financial health. Human service nonprofit organizations that operate in a single-purpose human service area such as crime, employment, food, housing, public safety, recreation, or youth development increased their commercial activities more sharply than organizations in multi-purpose human services areas when they experienced a decrease in donative revenues. Furthermore, commercialized organizations in a single-purpose human service area experienced a greater decrease in their profits and margins compared to commercialized organizations in a multi-purpose human service area. These results imply that the extent to which the decline in donative revenues affects commercial activity and the extent to which increased commercial activity affects financial health may vary depending on the organizations' mission area. Although there have been a few studies that examined the effect of commercial activities on the financial health of nonprofit organizations (Carroll & Starter, 2008; Guo, 2006; Prentice, 2016a), little study has been examined how such relationship varies across the mission area of the organization. This study extends previous knowledge on the association between commercial activity and financial health of nonprofit human service organizations.

## Limitations

There are several limitations of this research. The SOI database developed by NCCS skewed samples towards large nonprofit organizations that have more than $25,000 revenue. Therefore, the results may not represent the entirety of human service nonprofits in the United States. Similarly, among 7,551 available human service nonprofits, this research analyzed only the 1,471 human service organizations that could provide information for every year from 2000 to 2012 to create a balanced panel data. This means that the organizations in question here have survived at least for 12 years with more than $25,000 in gross receipts. Indeed, the 1,471 human service organizations possessed $15,978,204 in total revenue on average in 2000. The sample included an organization that had an extremely high total revenue of $2,720,042,706. Therefore, the findings may not be applied to smaller, less sustainable, and newer human service organizations like those excluded from this study. Also, since the IRS Form 990 that was utilized in this study does not provide separate information about commercial revenue from private sources and government sources, the commercial revenue discussed in this study includes both service fees from private sources and governmental sources. Therefore, the findings are limited in how clearly they can explain the relationship between government and human service organizations. Another limitation is that to measure financial health, only four financial measures were employed for each construct: solvency, liquidity, profitability, and margin. However, since the constructs of financial health could be multidimensional (Prentice, 2016b), these four measures might place limits on this study's ability to capture the entire concept of financial health. Lastly, changes in revenue sources (government grants, donations, and commercial revenue) and changes in financial health were measured and examined based on the period from 2000 to 2012. Therefore, the findings of this study do not provide absolute evidence about the causal relationship regarding i) whether a decrease in donative revenue caused an increase in commercial revenue and ii) whether an increase in commercial revenue caused a decrease in financial health. Although the causal relationship between those variables was assumed based on theories and previous studies, this study can only provide clear evidence of the correlation between those variables.

## Implications for Social Work and Social Welfare

The commercial activity of nonprofit human service organizations has in recent years received much attention from scholars all over the world. An increasing number of social work studies have argued that social workers should utilize earned income by learning market-oriented skills to support their clients more effectively (Germak & Signh, 2009; Gray, Healy, & Crofts, 2003) and social work education embraces the market-driven resource strategy as an important component of social work skills (Ferguson, 2016; Hoefer & Sliva, 2016). In the United States, most of these arguments are based on two important historical developments: i) decreasing federal grants and private donations since the 1980s, and ii) work-focused welfare reform in 1996. In response to a decline in federal government funding since the 1980s and fluctuating private donations, generating commercial revenue has been often considered to be an innovative solution that can promote sustainable and autonomous revenue (Reilly, 2016; Defourny & Nyssens, 2006). Also, the neoliberal incarnation of antipoverty social policy that emphasizes the responsibility of individuals and employment stimulated the pursuit of commercial revenue. This is because social workers should enhance the employability of their clients and provide them the means to obtain a quality job to eliminate poverty. This new approach involves providing job training and a transitional job, referring clients to a corporation in the for-profit, nonprofit, and public sectors, launching an enterprise, and making a profit to maintain the jobs of client-employees. Many social workers should be directly involved in this economic area by providing clients a transitional job (Mallon & Stevens, 2011; Redcross et al., 2009), and social enterprise interventions (e.g., Ferguson & Islam, 2008; Ferguson & Xie, 2008; Ho & Chan, 2012; Haugh & Talwar, 2016). Through this process, social workers have been more exposed to commercial activities that sell products made by client-employees to the public. Many empirical studies in social work have examined how market-driven strategies, especially work integration and social enterprise intervention, have improved the lives of clients (Caplan, 2010; Ho & Chan, 2012; Ferguson & Islam, 2008; Seddon, Hazenberg & Denny, 2014; Rotz, Maxwell & Dunn, 2015).

However, very few empirical studies have adopted an organizational perspective. Few studies have explored whether the commercial activity of a nonprofit human service organization helps the financial health of that organization. How the commercial activity of human service nonprofits actually works within the organization by affecting social workers and operational rules has not been examined. The commercial activity of nonprofit human service organizations has been supported and expanded normatively in the social work field without strong empirical evidence on the organization. In this vein, this study contributes to expanding upon prior knowledge associated with the commercial activity of human service organizations in the United States. The findings of this study have many implications for social work, social welfare research, social work practice, and social work policy.

**Commercialization in progress**

This study found that except for the period of the Great Recession from 2007 and 2009, the proportion of commercial revenue to total revenue increased among nonprofit human service organizations during from 2000 to 2012. The average commercial activity ratio of 67% in 2000 continuously increased by 0.4% annually before the Great Recession. Although it decreased by

1.5% annually for two years of the Great Recession, the commercial revenue ratio began to increase again at a 0.3% annual rate after the Great Recession ended. These findings imply that the commercialization of nonprofit organizations started in the 1980s is still in progress in the human service area. Also, these findings suggest that nonprofit human service organizations are more and more exposed to market-oriented management.

Although some scholars promote the commercialization of nonprofits as an innovative revenue strategy that can supplement declining government grants and inconsistent private donations (Oster et al., 2004; Young, 2017), there also have been warnings about the unintended consequences of commercial activities such as mission distraction (Tekula, 2009; Cornforth, 2014) and weakening the role of organizations in a  civil society (Eikenberry & Kluver, 2004). Also, the increase in commercial activity among human service nonprofits implies a shift of these services' target population from the poor to those who are able to pay (Salamon, 1993). However, the commercial activity of nonprofit organizations has been accepted and expanded normatively without strong evidence regarding the utility of market-driven strategies. Very few studies have examined how commercial activity has affected nonprofit human service organizations. More studies that examine the effect of commercial activity on diverse stakeholders including clients, social workers, volunteers, donors, government agencies, and other organizations are needed. Further study is especially necessary of how increased commercial activity affects social workers. According to Jaskyte & Lee, (2009), low role conflict is important in order for for social workers to have organizational commitment. When considering the fact that social workers' work value is different from that of employees in the for-profit sector (Jaskyte, 2014), the increasing commercial activity might increase role conflict among social workers, which can lead to excessive burnout. In this vein, the commercialization of nonprofit human service organizations should be examined with a more integrative perspective.

**Doubts about the need for commercial activity**

The finding of this study that an increase in commercial activity among nonprofit human service organizations was associated with a general decrease in financial health casts doubt on rosy expectations for the commercial activity of an organization. Throughout the history of the United States, human service nonprofit organizations have played an important and unique role wherein they pursue social justice for vulnerable and marginalized people in society. Due to this unique position, the operation of these organizations has been distinctly differentiated from for-profit organizations (Weisbrod, 1998, 2000). Basically, the government supports nonprofit organizations not only directly through grants but also indirectly through diverse tax exemption laws (Seaman & Young, 2018). Individuals and private organizations make contributions to nonprofit organizations based on whether or how well a nonprofit organization pursues its mission. Weisbrod (2004) argues that nonprofit organizations can derive advantages purely from financing themselves through donative funding such as government grants and private donations.

The finding of this study does not establish a clear causal relationship between commercial activity and financial health. The reason that organizations with an increased commercial activity ratio showed decreasing financial health might be because the commercialization of nonprofits negatively affects the financial health of the organization, or inversely, that the organizations that experienced a greater decline in financial health chose to increase their commercial activity ratio. However, these findings provide important evidence about how increases in commercial revenue might deteriorate the financial health of an organization.

**Government and civil society**

This study emphasizes the importance of government as a revenue source of nonprofit organizations. Commercial revenue has been changed through its close relationship with government grants. Particularly, when human service nonprofits examined here suffered from financial crisis, they could barely maintain their total revenue and were able to do so due to increased government grants. If government funding had not increased during the Great Recession, more nonprofit human service organizations would have struggled with balancing their revenue and expenses to provide services for clients in need. Increasing demands on social services after the Great Recession also request the government support human service organizations through direct and indirect support.

## Future Research

Based on the limitations and implications of this study, the following future studies are suggested. Additional studies of smaller and/or younger human service organizations are suggested. These smaller and/or younger human service organizations could have different revenue strategies compared to large human service nonprofits. Diverse measures of financial health could be applied in examining the relationship between commercial revenue and financial health. Future studies using data that include separate information about commercial activity from private sources and governmental sources would be able to provide more comprehensive implications for social work practice and social welfare policy. Fourth, employing a research design that could examine the causal relationship between commercial revenue and financial revenue is suggested. In this vein, the impact of nonprofit human service organizations' commercial activity should be examined using a more integrative perspective that includes not only clients, but also social workers and the organization as a whole.

## Conclusion

This study expands upon prior knowledge associated with the commercial activity among human service organizations in the U.S by employing a longitudinal study using latent growth models. This study provided a detailed description of the commercial activities of human service nonprofits from 2000 to 2012 with various indicators. Also, this study examined the association between donative revenue and commercial revenue and the association between commercial revenue and financial health among human service nonprofits through latent class growth models. The findings of this study provide various implications for social work research, social work practice, and social work policy. Following future studies that overcome the limitations of this study were suggested.

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