

Nonprofit organizations

Definition:[1]

A nonprofit organization (NPO) or non-profit organization, also known as a non-business entity, or nonprofit institution, is a legal entity organized and operated for a collective, public or social benefit, in contrary with an entity that operates as a business aiming to generate a profit for its owners. A nonprofit is subject to the non-distribution constraint: any revenues that exceed expenses must be committed to the organization's purpose, not taken by private parties. An array of organizations are nonprofit, including some political organizations, schools, business associations, churches, social clubs, and consumer cooperatives. Nonprofit entities may seek approval from governments to be tax-exempt, and some may also qualify to receive tax-deductible contributions, but an entity may incorporate as a nonprofit entity without securing tax-exempt status.

Key aspects of nonprofits are accountability, trustworthiness, honesty, and openness to every person who has invested time, money, and faith into the organization. Nonprofit organizations are accountable to the donors, founders, volunteers, program recipients, and the public community. Theoretically, for a nonprofit that seeks to finance its operations through donations, public confidence is a factor in the amount of money that a nonprofit organization is able to raise. Supposedly, the more a nonprofit focuses on their mission, the more public confidence they will gain. This will result in more money for the organization. The activities a nonprofit is partaking in can help build the public's confidence in nonprofits, as well as how ethical the standards and practices are.

What is a non-profit organization? [3]

The most distinguishable feature of a non-profit organization is rooted in its title: it does not work for profits. That is, all funds generated from the organization is directed towards the beneficiaries of their social issue focus. Non-profits are generally funded through charitable donations from companies, individuals, or even governments. Because of this, nonprofits must put a lot of their time in creating compelling reasons for donations.

Non-profits are exempt from income tax and donations from outside sources are tax-deductible, unlike all other profit-generating ventures. However, they are still liable for employment taxes for their employees.

A non-profit works toward some sort of social good, such as poverty eradication or improving healthcare. Non-governmental organizations (NGOs), charities, civil society organizations (CSOs) all work under the term 'non-profit organization.'

Non-profits range in size and reach, from smaller localized and grassroots organizations to international initiatives and globalized campaigns.

How are NPOs and social enterprises different different?

The fundamental difference between non-profits and social enterprises is the *source of funding*. Non-profits rely on public funding through donations. Social enterprises are businesses; they generate their own profit to keep themselves running.

Social enterprises also have a product or service that they sell to a consumer base that helps them in some way; whereas non-profits operate more directly with the social issue through areas like advocacy, direct aid, food relief, and empowerment.

Non-profits operate in a unique manner, seeking support from governments and donors. Social enterprises, on the other hand, use the same methods and disciplines as for-profit businesses, working to establish big margins and generate high revenue.

The return on investment (ROI) is also a divergent point for the two types of firms. For every firm there is a spectrum of ROI: from 100% financial return, to 100% social return. Non-profits operate with an almost absolute social ROI, putting almost all revenue towards its mission statement. Social enterprises have traditionally operated on a blended ROI, which is a mix of social and financial ROI. They put part of their revenue towards a social cause, and part of their revenue towards furthering their good or service.

With all that said, they are only textbook definitions and the divergent factors can vary a lot based on each individual company. For example, one social enterprise might operate with 75% financial ROI, whereas another might operate with 20% financial ROI.

How are they the same?

Non-profit organizations and social enterprises are often grouped together- and for good reason! They both are efforts by organized groups of people to work towards the betterment of some social issue. Within both these types of organizations, the *cause is the focus of their actions*.

Though social enterprises generate revenue, all profits go back into the business. So, while they do create a profit, they operate like a non-profit by directing all funds towards the social, economic, or environmental cause.

The lines between non-profit organizations and social enterprises are often blurred, and the differences between the two are both quite clear and yet frustratingly nuanced. In the end, both types of organizations operate to create a better world, and that's what really counts.

Nonprofit and not-for-profit organizations [4]

What is a not-for-profit organization?

Similar to a nonprofit, a not-for-profit organization (NFPO) is one that does not earn profit for its owners. All money earned through pursuing business activities or through donations goes right back into running the organization.

However, not-for-profits are not required to operate for the benefit of the public good. A not-for-profit can simply serve the goals of its members. A good example is a sports club—the purpose of the club is to exist for its members' enjoyment. These organizations must apply for tax-exempt status from the IRS, including exemptions from sales tax and property taxes. That also means that money donated by an individual to an NFPO cannot be deducted on that person's tax return.

There are four key differences between a nonprofit and a not-for-profit:

- Nonprofits are formed explicitly to benefit the public good; not-for-profits exist to fulfill an owner's organizational objectives.
- Nonprofits can have a separate legal entity; not-for-profits cannot have a separate legal entity.
- Nonprofits run like a business and try to earn a profit, which does not support any single member; not-for-profits are considered "recreational organizations" that do not operate with the business goal of earning revenue.

- Nonprofits may have employees who are paid, but their paychecks do not come through fundraising; not-for-profits are run by volunteers.

What are the challenges that NPOs face?

They often rely on the dedication of employees who believe in their cause because it's hard for them to compete with private-sector wages in lower-level and mid-management positions.

However, executive salaries are often quite high as a means of competing with equivalent positions in the private sector.

Fundraising and sponsorship can be an issue for nonprofits as well, as they often rely on external sources, such as donations.

Scrupulous accounting, transparency and accountability are essential to the continuation of operations, as mismanaged or misdirected funds could result in the loss of funding from both public and private sources and loss of status.

From nonprofit to for-profit

There are a few reasons why you may wish to change from a nonprofit to a for-profit. Maybe you believe you can get better access loans or other funding by becoming a for-profit. Or maybe you prefer to operate without the regulations that govern nonprofits.

Regardless, once you've carefully considered this option and all shareholders are in agreement, you will need to notify the IRS by writing a "statement of nonprofit conversion." This statement will include:

- The reason for nonprofit termination;
- A certified copy of a liquidation plan;
- The fair market value of the organization;
- A list of all asset recipients if assets will be distributed.

You will also need to contact your state and local representatives to fill out any forms required in your specific jurisdiction.

From for-profit to nonprofit

Converting a for-profit to a nonprofit is a little more difficult, as the IRS wants to discourage businesses from making this move to avoid paying taxes. It can be done, however, through a process that isn't so different from starting a nonprofit from scratch.

"While you may be able to retain the for-profit organization name for use by your nonprofit, a nonprofit organization requires you to use the money you raise to suit a purpose other than distribution to shareholders or business owners, and it needs to fulfill the mission and goals of the nonprofit," explained [Small Business Chronicle](#). "Transitioning to a nonprofit organization requires you to do some planning prior to registering the nonprofit with the state in which it operates."

This transition includes writing a mission statement, establishing bylaws, and filing articles of incorporation with your Secretary of State, among other things. It's at the articles of incorporation step that you will need to let the Secretary of State know you're keeping the same name as your existing for-profit.

Is it easier to manage a nonprofit or for-profit?

It's also worth considering how your leadership style could gel or clash with the management structure of either entity. In a for-profit, the founders, investors, and C-suite leaders typically have a financial stake in the company's success. It's a win-win for you, the business owner, to see the company profit and succeed. This can lead to many business owners taking a more hands-on approach to the day-to-day management of the company.

At a nonprofit, leadership is often structured as a board of directors who gain no financial benefit from their governance role. As the founder, you may still be involved in running the operational side of things, but the ultimate outcome is to ensure the organization meets its mission—rather than earning a profit. Leaders who are skilled at community outreach, fundraising, and are passionate about a cause are often a better fit for nonprofit organizations.

Accordingly, the company culture can be quite different at a nonprofit vs a for-profit. While it's difficult to generalize, the culture at most for-profit companies tends to focus on how best to improve sales and profit. KPIs will be set to achieve benchmarks related to productivity, profit, and market share.

“In a nonprofit organization, by contrast, the culture is often more community-minded. Instead of discussing ways to make more money, employees, volunteers and leaders spend time brainstorming ways in which they can further benefit their community and increase the social effectiveness of their organization's efforts,” wrote [Indeed](#).

References:

- [1] https://en.wikipedia.org/wiki/Nonprofit_organization (last accessed: 2023. 06. 25.)
- [2] <https://www.techtarget.com/whatis/definition/non-profit-organization-NPO> (last accessed: 2023. 06. 25.)
- [3] <https://blog.insightgloaleducation.com/non-profits-vs-social-enterprises-whats-the-difference> (last accessed: 2023. 06. 25.)
- [4] <https://www.uschamber.com/co/start/strategy/nonprofit-vs-not-for-profit-vs-for-profit> (last accessed: 2023. 06. 25.)
- [5] <https://www.finelinesolutions.com/academy/blogs/16-donor-series/66-social-enterprises-vs-nonprofits-understanding-the-%20world-of-nonprofits.html> (last accessed: 2023. 06. 25.)