

**The Commercialization of Social Services: Toward an  
Understanding of Nonprofits in Relation to Government and For-profits**

Baorong Guo

GWB School of Social Work  
Washington University in St. Louis

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## **The Commercialization of Social Services: Toward an Understanding of Nonprofits in Relation to Government and For-profits**

### **Introduction**

There has been a view that social services, aroused by altruism in human nature or arisen from charitable organizations, aim to help the most disadvantaged people in our society. This long-established judgment, however, is apparently challenged by a profound transformation in the social services sector in the United States. Since the end of the 1970s, there has been “a creeping revolution” (Grønbjerg, 2001) in social services, represented by two trends: 1) nonprofit social service agencies become increasingly reliant upon services fees and charges for survival; 2) for-profits are entering the field of social services traditionally occupied by nonprofit organizations and account for a much greater proportion than ever before.

The social services sector as a whole (including nonprofits and for-profits) is oriented toward the economic market and has substantial income from commercial activities. According to Salamon’s (1999) estimation, fees and charges were about 50% of the total spending in social services in 1994. Looking from within, 43% of nonprofit social service agencies’ income in 1998 was from fees and charges (Salamon, 1999), exceeding government funding (37%) and private giving (20%)—the other two main sources of income. Notably, the income that nonprofit social service agencies received from fees, charges, and related business activities increased by more than 600% between 1977 and 1996 (Salamon, 1999).

In addition, the penetration of for-profits also markedly changed the composition

of the social services sector (Hodgkinson, 1996; Ryan, 1999). The dominant position of nonprofits in the social services sector has been challenged by for-profits in terms of the increasing number of institutions, a growing share of total revenues, and a larger employee body. In 1992, for-profits accounted for 47% of all establishments, 28% of the total revenues,<sup>1</sup> and 22% of the entire employment in social services (Hodgkinson, 1996). More strikingly, the growth rate of for-profits in terms of revenues and the number of establishments was almost twice that of nonprofits between 1982 and 1992, which indicates a relative decline of nonprofit share in social services (Salamon, 1999).

These changes in social services have brought out concerns among researchers (Adams & Perlmutter, 1991; Alexander, Nank, & Stivers, 1999; Felty & Jones, 1998; Grønbjerg, 2001; Lynn, 2002; Salamon 1993, 1995, 1999). If similar changes have already taken place in health and education domains where fees and payments account for 54% and 65% of the total revenues, respectively (Salamon, 1999), why does the commercial development in social services become a concern? The answer is perhaps implicit in the nature of social services. Social service programs “are intended to improve the basic social welfare status of individual lives” (Corbin, 1999, p.297). The provision of social services to a great extent reflects that social care is provided to disadvantaged populations who are in need. More specifically, social services are more welfare-based and probably more closely associated with the meaning of “charity” (Grønbjerg, 2001; Salamon, 1995). Therefore, the growing linkage between

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<sup>1</sup> Employment figure for 1995 (Salamon, 1999).

commercial activities and social services has caused numerous issues.

One of the ways to understand this phenomenon is to look at how changes in the relationships between nonprofits, government and for-profits shape the commercial development of social services. This paper, based on a review of the existing literature, aims to understand social service nonprofits in the United States from historical, theoretical, and empirical perspectives, respectively.

### **Social Services in the Historical Perspective: Independence, Interdependence and Commercialization**

Today's social services sector is enormously different from a century ago. When Frenchman Alexis de Tocqueville visited the United States, what was immediately obvious to him was that common Americans took initiative to form various civil associations. These associations were formed not for the purpose of commerce and industry but the morality and intelligence of people who tended to empower themselves by "the reciprocal action of men upon one another" (Tocqueville, 1835-1839/2000, p.213). Under private auspices, social service nonprofits were largely oriented toward helping the poor and needy. Primarily funded by private contributions, social service nonprofits were able to maintain their independent status from both government and the market. Some social service nonprofits, such as the Salvation Army and the Red Cross, even "operated against the backdrop of very limited poor relief or other forms of public spending for social welfare purposes" (Grønbjerg, 2001, p.276).

These agencies in the 19<sup>th</sup> century, however, were very limited in their overall capability of service delivery. As it turned out, funds from private giving available to social service nonprofits were “woefully inadequate” (Grønbjerg, 2001, p.276) to meet the needs of individuals, especially during economic recessions. Beginning in the 1930s, the American government dramatically expanded its role in social services in terms of not only public policies but also public funding channeled into nonprofits. During the Kennedy and Johnson presidencies, the booming economy made it possible for the American welfare state to promote individual welfare. Meanwhile, nonprofit organizations were viewed as an extension of welfare state engaging in service delivery. With the accelerating flow of government funding, nonprofit agencies were able to carry out a variety of social services where service delivery went beyond the immediate public assistance population to broader populations (Gilbert, 1983).

As social service nonprofits were rapidly subsumed into the American welfare state, private philanthropy seemed “superfluous where social and charitable programs were funded by government” (Felty & Jones, 1998, p.193). This profound transformation, unfortunately, is somehow neglected. Social service nonprofits no longer insisted on their traditional role as independent service providers and became increasingly involved in a close relationship with government. For government, the financial dependence of nonprofits enabled the welfare state to achieve a number of welfare goals through the direct service delivery of a vast array of private nonprofit

agencies. The interdependence of government and social service nonprofits sustained the public-private partnership in promoting public welfare over the past decades.

Having been strongly tied to government for a long period of time, social service nonprofits, however, experienced a significant fiscal squeeze due to federal budget reduction at the beginning of the 1980s (Young & Salamon, 2002). In the Reagan experiment, it was believed that individuals, families, neighborhoods and communities were able to restore their own capacity and break the state monopoly in social welfare. To achieve this goal, the nonprofit sector was assumed to be able to regain financial independence by reverting to charitable giving.

However, “the level of private giving has been consistently declining as a share of national income in recent decades” (Young & Salamon, 2002, p.425): from an average of 1.86% in the 1970s to 1.78% during the 1980s and to 1.72% in the early 1990s. Meanwhile, nonprofit agencies had to encounter expanded demands for social services generated from social and demographic changes (i.e., aging population and increasing number of employed mothers). In the face of substantial shrinkage of public funding and pessimism toward private contributions, social service nonprofits reinvented themselves by turning to commercial income.

The commercial transformation is even more complicated and intensified by the multiplying number of for-profits entering social services. The 1996 welfare reform, with an emphasis on preparing welfare recipients for employment, left social service nonprofits in a comparatively disadvantaged position in terms of the availability of government funding. Given their greater supplies of working capital as an assurance

of being able to “cover the risk if they fail to deliver on their contracts” (Ryan, 1999, p.130), chances for for-profits to obtain government contracts become greater. Many states “moved early in the implementation of welfare reform to enlist for-profit companies...to assist them in managing the complex process of moving welfare recipients into jobs” (Grønbjerg & Salamon, 2002, p.458).

### **Theoretical Perspectives**

Traditional nonprofit theories, including the Market/government failure theory, the Contract failure theory, and the Voluntary failure theory, are basically sector-based functionalistic theories, each of which gives justification to intervention of a particular sector with the recognition of the limitations of the other two sectors. By concentrating on sectoral differences, particularly the unique characteristics of nonprofits, the comparison in each of the theories emphasizes the linear function transfer from one sector to another.

From the perspective of function transfer, what is implicit in the Market/government failure theory is that service function transfers from the market to government and then from government to nonprofits. The Contract failure theory has almost the same dimension, although slightly different. Therefore, Hansmann (1980) suggests that contract failure is in its nature a sort of “market failure.” In contrast, the Voluntary failure theory supplies an alternative explanation regarding the sequence of function transfer; that is, social services move from the market to nonprofits and then from nonprofits to government.

These theoretical interpretations reflect different views about the role of the market, government, and nonprofits as well as the relationships among them. The advantages and limitations of nonprofits are manifested by themselves in a comparative study of the three sectors. What is not adequately addressed by these theories is the complicated interactions and interdependence of the market, nonprofits and government. As noted earlier, the function transfer implied by the three theories, no matter whether it is “the market → government → nonprofits” or “the market → nonprofits → government,” is essentially a linear unidimensional movement, hardly showing any flexibility for the theoretical interpretation of commercialism in social services. The current development of social services, in fact, involves multiple-dimension interactions among nonprofits, government and the market.

Gilbert’s (1983) welfare capitalism theory seems of most relevance to the issue of commercialism in social services. The evolution of welfare capitalism, according to Gilbert (1983), has experienced three phases:

1) 1900-1930. Welfare capitalism carried almost similar meaning to industrial welfare which was an auxiliary to the industry. Mostly provided by employers, welfare at this time was a mix of “self-interests and altruistic desires to ameliorate the conditions of working people” (p.23).

2) The New Deal-1975. Government took over substantial welfare responsibility from business and local communities, consolidated welfare services and programs into the capitalistic society. Welfare capitalism is used to express “a symbiotic

relationship between a social and an economic market that represent two dissimilar modes for the production and distribution of benefits in society” (Gilbert, 1983, p.4).

In contrast with the economic market that is “the sum total of self-interested individual choice” and that “responds to individual initiative, ability, productivity, and the desire for profit,” the social market is “a response to the inherent economic market deficiencies” and “it responds to need, dependency, and charitable impulses” (Burch, 1999, p.222). The two markets have similarities in having both consumers and providers. Ideally, in the social market, a consumer (service user) obtains a needed or wanted service that is not related to his/her ability to pay, and service providers “are subsidized to provide free (or below-cost) service to persons with qualifying need” (Burch, 1999, p.224). The social market assumes care for consumers’ well being, which is different from the economic market where productivity and efficiency are priority of concern,

3) 1970s-present. With the development of the American welfare state, there is an emerging view of the welfare state as “a market with profit-making potential, which “is ready for conversion to capitalist doctrine” (Gilbert, 1983, p.6).

According to this welfare capitalism theory, the market mechanism is deemed overwhelmingly powerful and subsumes all institutions into capitalism including nonprofits. “With the apparent triumph of capitalism worldwide, market forces are being widely celebrated” (Dees, 1998, p.56). Welfare and capitalism—the two parallel institutions in the past—tend to be absorbed into an integrated process of capitalistic production (Gilbert, 1983). The welfare reform in 1996 marked an even further step

towards welfare capitalism because government is more likely to award contracts to for-profit service providers. It is recognized that “the new tolerance of for-profits undoubtedly reflects an increasingly conservative political climate that values the power of markets and the profit motive to create efficiency” (Ryan, 1999, p.130).

Since economic institutions are conventionally and presently the best representation of capitalism, by differentiating the economic market and the social market, Gilbert (1983) was able to recognize the distinct function of welfare institutions from that of economic institutions. The commercialization of social services precisely reflects the third phase of the development of welfare capitalism. The encroachment of for-profits is not only a feature of the commercial trend in social services but also a signal of the commercialization of the social market (welfare system).

Gilbert does not think that nonprofits are superior to for-profits in providing social services. For him, nonprofit agencies are not necessarily better than for-profit enterprises in providing services. Regardless of their respective advantages and disadvantages, nonprofits and for-profits are similar in many ways including organizational management and policy-making process.

According to Gilbert, the emergence of for-profits in the social market is not the only indication of this trend. The increasing demand for social welfare professionals, service quality and efficiency, and more consumer choice, all “imbues the social market with the spirit of capitalism (economic market)” (Gilbert, 1983, p.23).

Consequently, social welfare, in appearance as well as in essence, becomes part of the

capitalistic economy system.

### **Empirical Perspectives**

Empirical studies of this phenomenon mainly focuses on identifying factors leading to the commercialization of social services and consequences associated with commercialism in nonprofits.

#### *Causal Factors of Commercialization*

*Reduction of Government Funding.* In a descriptive study of welfare agencies in the greater Philadelphia area, Adams and Perlmutter (1991) found that the increase in commercial activities by social service agencies was a direct result of cutbacks of government funding. By commercial sales of services and products, voluntary social agencies generated additional income as a compensation for lost federal revenues.

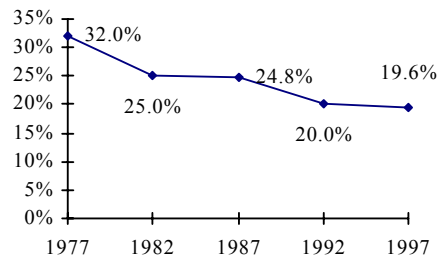
What is more, it seemed that large organizations were more likely to succeed in venturing and at the same time still stay close to the service mission. Or put differently, the size of an organization was found to be a crucial variable associated with successful commercial venturing. A possible explanation for this is that small agencies lack the capacity and resources in leadership, long-range planning and experienced staff, to achieve success in venturing (Adams & Perlmutter, 1991).

*Relative Decrease of Private Contributions.* If the retrenchment of government funding is viewed as an important contributor to nonprofit venturing, then can nonprofit social service agencies turn to private contributions for compensation? It was expected that tax cuts during the Reagan administration would create policy

incentives for larger charitable contributions and voluntary support to the nonprofit sector (Salamon & Abramson, 1982).

The study by Weitzman et al. (2002) shows an increase in the total amount of private giving in the American nonprofit sector over the last two decades. However, private giving as a percentage of nonprofit current operating expenditures has continued to decrease due to the dramatic expansion of the nonprofit sector in terms of its revenues from other sources, while supports from government, as a percentage of the total revenues, has stayed almost the same level over the years.<sup>2</sup> Their study also shows that private contributions as a percentage of revenue for nonprofit social service agencies have dropped steadily since the 1970s (Figure 1).

Figure 1: Percentage of revenue from private contributions<sup>3</sup>



Source: Weitzman et al. (2002)

Private contributions decreased not only in relative terms, but also in absolute terms in that government spending crowded out private donations. Steinberg (1993) reviewed 18 studies on the relationship between government funding and private

<sup>2</sup> According to Weitzman et al. (2002), support from government is 54.4% in 1977, 54.9% in 1982, 48.1% in 1987, 50% in 1992, and 52.1% in 1997 (p.112).

<sup>3</sup> Other sources of income include rental income, investment income, sales of products, and membership dues.

donations. According to his estimation, decreases in donations indeed occur and the “crowd out” estimate is usually between 1/2¢ and 35¢ per dollar of government spending.

#### *Government Grants, Private Contributions and Commercial Income*

To understand commercialism in nonprofit social service associations, Young (1998) proposed a model in which membership revenues, external donations, and operating surplus/deficit were used as independent variables, and commercial income was used as a dependent variable. A number of extraneous variables, such as the size of the organization and geographic location, were controlled. Longitudinal data (1992-1994) for 81 Jewish Community Centers were collected to test the model.

It was found that donative revenue (including private donations and public funding) is negatively related to commercial income and that surplus is positively related to mission-unrelated income. This suggested that the downsized private donations and public funding led to growing commercialism in nonprofits. According to Young (1998), commercial activities may contribute to an agency’s mission by constituting mission-related services, generating surplus revenues, or both. Therefore, it can be assumed that the profit motivation is driven by a combination of desires to promote mission-related services and to generate surplus revenues for survival.

#### *Outcomes of Commercialization*

*Financial Harm.* Schiff and Weisbrod (1993) used tax returns (IRS Form 990) from over 11,000 social service nonprofits to examine commercial behaviors of nonprofits. In their analysis, commercial activities were an intermediate factor

affected by government spending, which in turn influence total contributions a nonprofit service agency received. The findings suggested that decreases in government spending resulted in a significant increase in commercial income. Given that commercial activities, especially mission-unrelated activities, can generate income as well as negative impacts on private giving, total contributions (including private contributions, gifts and grants) received by social service nonprofits decrease.

Young (1998) had similar findings in his study. Although program fees (commercial income) in his research served as a dependent variable that was negatively related to external income (public funding and private donations), this does not necessarily mean program fees were an “effect factor.” In fact, the two factors (the dependent and independent variables) could form a causal relationship. In other words, it can also be true that the increase in commercial income causes the decrease in external income and that the decrease in external income in turn causes the increase in commercial income.

*Shift of Client Focus.* In addition to the possible adverse impacts of commercial activities on nonprofits’ revenues from contributions, commercial development affects the client focus of social service nonprofits. According to Adams and Perlmutter (1991), nonprofit organizations that had successful venturing shifted their emphasis to a more affluent clientele. More specifically, Salamon (1995) estimated to what extent sources of income affect an agency’s client focus. Results of multiple regression analyses showed that revenues coming from fees and charges were negatively related to poverty focus, indicated by percentage of poor clients. By

contrast, government support (representing public grants) and the United Way support (representing private contributions) were both positively related to poverty focus. Organizations that lost funding were more likely to decrease than to increase targeting to the poor (Cordes, et al., 1999).

### **Discussion**

In an era full of fiscal uncertainty for nonprofits, social service agencies exhibit resilience in reclaiming the market front and looking for alternative sources of revenues. The above three perspectives, historical, theoretical and empirical, provide insights into our understanding of this phenomenon. The historical perspective allows us to look at the dynamic evolution of social service nonprofits over time. The theoretical perspective is limited in that the traditional nonprofit theories are essentially based on the assumption that the three sectors are clearly different from each other. As the differences between nonprofits and for-profits become blurred, these sector-based theories are hardly able to provide a satisfying framework for understanding nonprofits in transformation toward the market. Regarding the empirical perspective, most of the empirical research in studying factors associated with the commercialization of social service nonprofits adopts a static statistical model which makes it difficult to identify and understand the structure underlying a dynamic process. In this regard, longitudinal data and the system dynamics approach can be promising in the research about the commercialization of nonprofits to answer such questions as “how does the venturing behavior affect an organization’s ability to

attract and retain donors, staff and volunteers?” and “how does the venturing behavior affect the mission and service delivery of an organization?”

Regarding the role of public policies, there are basically two views. One of them suggests that the process of commercialization of social services need to slow down because commercialization will finally change the nature of nonprofit organizations and harm social service provision. The other view sees the commercialization of social services as more opportunity than risk for the development of social service nonprofits; the focus, therefore, is more about how public policies can shape the social services sector in a way to promote service quality rather than simply oppose the commercialization itself. Nonetheless, commercialization is indeed a double-edged sword because it brings infinite opportunities for nonprofits and simultaneously imposes enormous risks on nonprofits. Policy leverage is essential to help nonprofits capture commercial opportunities and avoid unnecessary risks. The focus, therefore, is on facilitating nonprofit social service agencies to reach service goals in the process of marketization. In other words, policy development should transcend the dichotomous thinking in terms the advantages and disadvantages of commercialization and turn to a more active, open position to assist nonprofits improve service provision.

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