

# The Growing Role of Nonprofit Organizations as Society Matures

## — *Issues and Possibilities in the Next Century*

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### Introduction

As the next century approaches, Japan's economy and society are confronting a major transition period. Changes in population and household composition brought on by the declining birthrate and rapid aging are challenging the fundamental tenets of the social security system including pensions, health care, and long-term care insurance, as well as the education system. During the miracle years of rapid economic growth, the national objective was clear — to grow the economy and achieve material wealth — and government policies were keenly focused on this aim. But as the society matures and the public's needs diversify, the government is exhausting its capacity to meet these growing needs beyond the civil minimum level. Today, new approaches are being sought to recreate the individual and society, and replace the already overburdened conventional socioeconomic system.

In this light, the public long-term care insurance system initiated this April contains a significant shift in the approach to elderly welfare — from care that is publicly administered, to care that is provided by contract. To provide universal welfare services while accommodating diverse long-term care needs, services that have traditionally been provided by public entities will need to be relegated to private businesses and nonprofit organizations (NPOs). And as society continues to mature, it will be necessary to deregulate private businesses as well as to develop NPOs throughout society, including but not limited to elderly welfare, health care, education, community building, culture and the arts, and environmental preservation. Meanwhile, as the government pursues greater efficiency through administrative reform and decentralization measures, thereby better meeting the public's needs while improving public finances, NPOs will play a critical role particularly in meeting the needs of residents at the local level.

The implementation of the NPO Law in December 1998 (Law to Promote Designated Nonprofit Activities) has started a profound new era for NPOs. But NPOs will first need to gain acceptance among a public unfamiliar even with the concept, and will also have to confront many

issues that lie ahead. This paper examines the present status of NPOs in Japan, and contemplates the possibilities and issues for NPOs in their anticipated role of developing the mature society in the next century.

## 1. The Concept of NPO

### (1) Defining NPOs

#### 1. *The NPO Concept*

While no clear consensus exists on the definition of a nonprofit organization, below we briefly organize the concept.

The fundamental requirements of an NPO are that it be a (1) nonprofit, (2) private organization. Nonprofit means that the organization can earn a profit, but cannot distribute it to participants. Thus the NPO is “not for profit,” as distinct from “no profit.” Of course, if an NPO does uncover a profitable business opportunity, it would quickly be overtaken by private for-profit businesses. Thus NPOs are found in areas that private businesses shun, but are recognized to be socially meaningful.

Organization is another important feature that distinguishes NPOs from volunteer groups. While being nonprofit, they need to be incorporated and properly managed to serve a particular purpose, and often hire a paid staff of specialists.

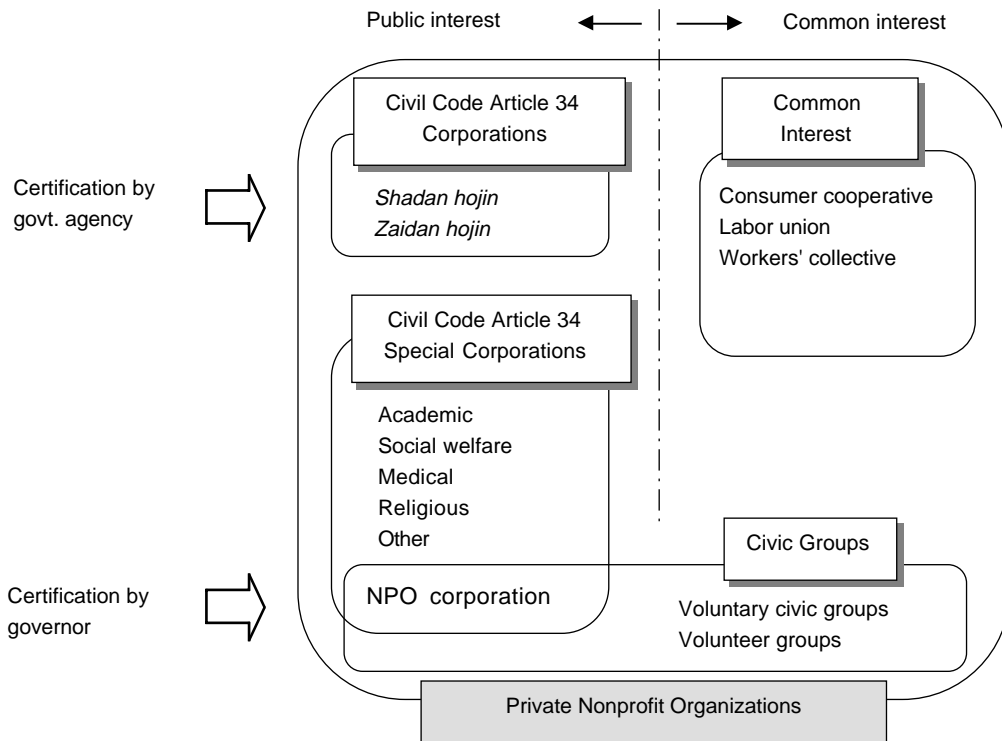
#### 2. *Scope and Legal Status*

The scope of NPOs is also defined in various ways. In Japan, Article 34 of the Civil Code contains stipulations for *koeki hojin* public interest corporations (including *shadan hojin* and *zaidan hojin*), which are certified by relevant government agencies. These public interest corporations have been approved by the state to serve the public interest. In addition, the broad definition of public interest corporation includes specific laws pertaining to academic, social welfare, medical, and religious corporations. Incidentally, for tax purposes, medical corporations do not qualify as a public interest corporation.

On the other hand, NPO corporations are certified either by prefectural governments or the Economic Planning Agency (when two or more prefectures are involved), and thus distinct from both the narrow and broad definitions of public interest corporations. Their purpose is not to serve the public interest as determined by the central government, but rather “to contribute to the interests of many and unspecified persons.” This means that NPO corporations

exclude nonprofit organizations that serve the common interests of a specified group of people. Thus the scope of NPOs can refer to voluntary organizations that conduct civic activities regardless of their status as an NPO corporation under the NPO Law or as a public interest corporation, or can also include public interest corporations under the broad and narrow definitions.

**Figure 1 Scope of NPOs**



Source: NLI Research Institute

## (2) The Law to Promote Specified Nonprofit Activities (NPO Law)

### 1. Passage of the NPO Law

The NPO Law is a special law under Article 34 of the Civil Code, and the legal equivalent of laws for social welfare and academic corporations. However, this law is different in important ways. First, it was drafted not by the bureaucracy but by Diet members, with substantial input from many civic organizations. In this sense, the law represents the dawning of a new civic society. It should be noted that its impetus came from civic relief activities following the Hanshin Earthquake of 1995, which culminated a nascent movement in civic activities up to that time. Thus the law was not simply a supplement devised by the government to promote volunteer activity.

Second, instead of the conventional certification system for public interest corporations by the central government, NPOs are certified by prefectural governors. In addition to assuring the independence of NPO corporations, this system conforms with the decentralization trend of government, and enables NPOs to respond more flexibly than public corporations to changes in social conditions.

Third, it reexamines the concept that nonprofit equals public interest. The defined objective of specified nonprofit activities “to promote the interest of many unspecified persons” is intentionally different from that of public corporations “to promote the public interest.” However, as a special law within the framework of Article 34, one shortfall of the NPO Law is its exclusion of nonprofit activities in the common interest such as workers’ collectives and consumer cooperatives. The NPO Law also contains a provision to reexamine possible special tax treatment within three years of implementation.

## *2. Status of NPO Certification*

In the 16 months since the NPO Law was implemented in December 1998, 2,247 applications have been submitted, of which 1,746 have been approved. Seven applications have been rejected: four in Tokyo and three by the EPA (as of April 7 on the EPA web site at <http://www.epa.go.jp/98/c/19981217c-npojuri.html>). Based on these results, we can say that the approval rate is almost 100%.

NPO corporations can designate several areas of activity, and applications on average specify three areas. With the introduction of public long-term care insurance this April, over one-half of the certified NPOs have specified social welfare as an area of activity.

## *3. Significance of Incorporation*

The corporation status granted under the NPO Law is significant in that it increases the NPO’s level of trust in society, and makes their activities and existence more visible to the public. At the operating level, it allows NPOs to act like a company in renting office space, setting up bank accounts, and owning land and other assets. In addition, there are advantages on the financing side involving subsidies and contributions. Volunteer groups and voluntary organizations engaged in nonprofit activities can clarify responsibilities and achieve stable, sustained operations by protecting clients and avoiding personal business risks. Disclosure of operating activities and financial condition are important matters regardless of corporate status. The merits of corporate status will expand in the future, including the reexamination of possible special tax measures.

#### *4. Range of NPO Activity*

In line with their designation to promote special nonprofit activities, NPOs are restricted to the following twelve areas: (1) health, medical treatment, and welfare, (2) social education, (3) community development, (4) promotion of culture, arts, or sports, (5) environmental conservation, (6) disaster relief, (7) community safety, (8) human rights protection, (9) international cooperation, (10) gender equality, (11) nurturing of youth, and (12) administration or support of organizations engaged in the above activities. Thus NPOs address a broad range of civic activities to meet diverse needs, including areas once reserved to the government.

## **2. Status of NPOs in Japan and Future Issues**

### **(1) NPO Management**

#### *1. Organizational Characteristics*

Compared to private companies, NPOs are often characterized by a small, horizontal organizational structure. The small size often means that the division of functions is minimal and the organizational management is absent. This is in sharp contrast to private companies, who seek economies of scale through growth and efficiency through an extensive hierarchical structure.

In contrast to the profit motive of for-profit companies, the primary objective of NPOs is to realize their stated mission. The customers of NPOs are individuals, companies, government agencies and others who both buy services as well as supply funding. In addition, the fact that NPOs rely heavily on unpaid volunteers — as opposed to paid employees at companies — also causes significant differences in organizational management.

#### *2. Marketing*

As mentioned above, NPOs conduct two types of marketing. One is marketing of services, where they must respond to customers' needs and set prices for those services. The other type of marketing involves fundraising through contributions from individuals and companies, grants from organizations, and government subsidies. To obtain funding, NPOs need to convince these entities of the value of their operations. Thus unlike for-profit companies, the flow of funds in NPOs involve more than the interactions with customers who buy its services. The two types of marketing peculiar to the NPO call for advanced management capabilities.

### *3. Management of Volunteers*

NPO staffs usually consist of paid staff and volunteers. The paid staff are professionals whose management expertise is critical for managing operations, while the volunteers are needed to carry out the NPO's mission. These volunteers consist of two types: board volunteers, who participate in management, and service provider volunteers, who perform the actual operations. While board volunteers play an important role in decision making as board members, under the NPO Law, no more than one-third of the directors can receive compensation.

Since service provider volunteers as a rule receive no compensation, the management of volunteers must above all ensure that volunteers are properly motivated and aligned with the NPO's mission. Volunteers perform important duties and are not intended to replace paid workers as a cost reduction measure. This is a fundamental difference from the wages-for-work premise of labor management at for-profit companies.

Whereas volunteers used to consist mainly of housewives whose children had grown up and retired persons, the age of volunteers has gradually diversified. In addition, since motivation is based on strong convictions, participation is becoming increasingly casual.

### *4. Revenue Structure*

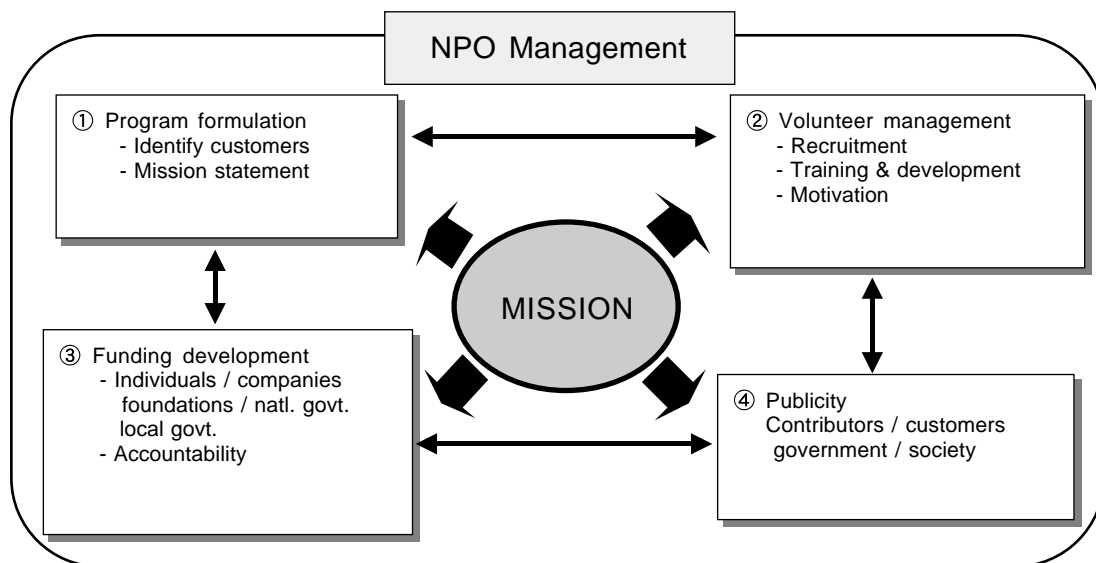
NPO revenue sources consist mainly of membership fees and operating revenue, followed by public subsidies and private contributions. The composition of revenue varies by area of activity, membership fees and operating revenue play a large role in education, culture, and religion, while public subsidies in medical and social services. Moreover, the proportion from private contributions remains low, partly due to the lack of deductibility (Naoto Yamanouchi, ed., *NPO Handbook*, p. 8). This sharply contrasts with the situation in the U.S., where total revenue is usually derived evenly among operating revenue, subsidies, and individual contributions.

This difference can be attributed to the fact that approximately one-half of the 1.2 million NPOs in the U.S. qualify as IRS code 501 (c)-3 organizations that enjoy (1) tax exempt operations (2) tax deductible contributions. To qualify, an organization must pass the public support test, which requires that at least one-third of operating costs be funded by individual contributions, corporate grants, or government subsidies. The test is designed to elicit society's endorsement that the organization indeed serves the public interest.

## 5. Management Strategy

As shown in Figure 2, there are four major components of NPO management: (1) program formulation, (2) management of volunteers, (3) development of funding sources, and (4) publicity. First, after clarifying its mission and customer base, the NPO must compose an operating program, and recruit and train volunteers. To accomplish its mission, the NPO must motivate volunteers and develop stable funding sources among companies and individuals. In addition, to exercise accountability in the use of contributions, it must conduct adequate publicity activities to inform all stakeholders regarding the NPO program's effectiveness and significance.

**Figure 2 Overview of NPO Management**



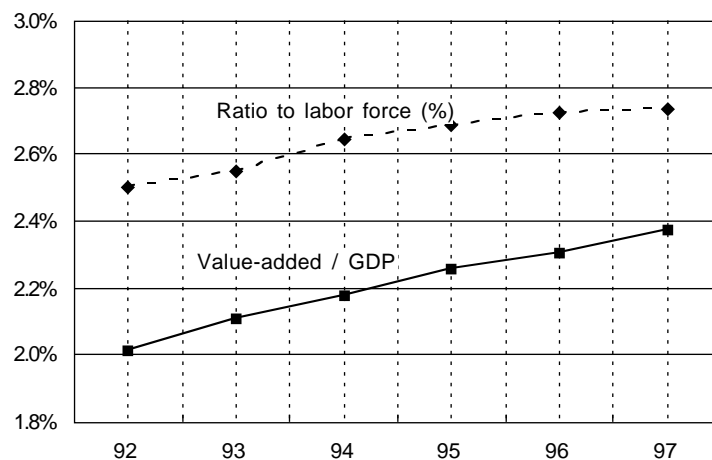
Source: Compiled from U.S. NPO seminar materials (October 1999).

## (2) NPOs and Employment

### 1. Economic Scale of NPO Activity

One measure of the scale of NPO activity in the economy is contained the EPA's *Annual Report on National Accounts* under the category of "final consumption expenditure of private nonprofit institutions serving households." In fiscal 1997, NPOs accounted for 2.4% of GDP (¥12.1 trillion in nominal value-added), and 2.7% of the employed labor force, both of which are growing every year (Figure 3). These are low levels compared to the U.S., where both numbers are approximately 7%. But part of the difference may be attributed to the narrower definition of NPO activity in Japan, where an entity is classified in the household sector if only one person is employed (*NPO Handbook*, p. 4).

**Figure 3 Value-Added to GDP Ratio of NPOs**



Source: EPA, *Annual Report on National Accounts*, FY 1999.

### 2. Job Growth by NPOs

Job growth due to NPOs — either directly or indirectly in other industries — has been minor thus far. In July 1999, the government compiled a supplemental budget of ¥200 billion as an emergency employment measure. While a sizable part of this was expected to flow to NPO services, the actual amount is reportedly only about ¥2 billion (1%). This result indicates the lack of adequate ties between NPOs and local governments, as well as problems with execution. Future growth in NPO employment and size will depend on the adequate development of human resources to upgrade overall performance.



### *3. NPOs as a Career Option*

As Japanese style management moves away from traditional practices such as seniority, lifetime employment, and new graduate hiring, the values of selfless sacrifice and company loyalty are declining in significance. As a place to work, NPOs take this trend further by offering voluntary work conditions, horizontal relationships, and more opportunities for self expression in pursuing the stated mission. Thus compared to the organizational constraints of private employment, persons working at NPOs have greater opportunities for fulfillment and self expression.

In the past, NPO activity was regarded as being appropriate for people with spare time and money such as retired persons. However, NPO work will appeal to more people in the future as a source of valuable career experience. In the U.S., the number of employed persons at NPOs supposedly increases in recessions. While this is partly due to greater demand for NPO provided services during recessions, another reason is that people who are seeking work believe that work experience at NPOs can be valuable for their careers.

In the future, as labor mobility expands not only among companies but across sectors of the economy, it will play a critical role in transferring management expertise among government, private and NPO sectors.

### **(3) NPO Partnership with the Government**

#### *1. Government Decentralization and NPOs*

While Japan has depended heavily in the past on the centralized national government, as the public's needs diversify, social systems will need to be decentralized to better meet local needs. This means that local governments will need to accurately grasp local conditions and provide administrative services appropriate for these conditions. But for decentralization to be meaningful, local governments will need to collaborate with NPOs who are more attuned to local conditions.

#### *2. Partnership with Government*

Two types of partnerships are envisioned between the government and NPOs. While NPOs are in the early stage of development, the government can play a supporting role in their development. As NPOs gradually mature, they will be called on to collaborate with local governments in dealing with common social issues.

However, the government needs to exercise prudence in its support. At the present early stage of NPO development, intermediary NPOs have an important role to play in supporting other NPOs. If the government intervenes too far in supporting NPOs, it could risk hindering the development of these intermediary NPOs.

### *3. Partnership Issues*

Since government services cannot keep up with the pace of change in modern society, the original mission of NPOs was to address social issues at an early stage. However, collaboration of NPOs with vertically segmented government bureaucracies creates difficulties. To build a genuine partnership between NPOs and the government, these vertical partitions must be done away with, and locally informed decentralization promoted. Furthermore, to build a collaborative relationship of equals with the government, NPOs must elevate the level of accumulated data and management skills.

In the past, due to the administrative oversight of central bureaucracies under Article 34 of the Civil Code, public interest corporations have sometimes continued to exist even after losing relevance. In contrast, NPO corporations have the ability to adapt their activities flexibly to the conditions of the times.

## **3. Toward the Development of NPOs**

### **(1) Development of Human Resources**

The first condition for the successful development of NPOs in Japan is to develop human resources capable of running NPOs. While the U.S. has NPO management training programs at the university level, Japan has almost no systematic training programs that address NPO management. Presently, there is an intermediate support center that has undertaken human resources development as part of its NPO support activities. Due to the highly specialized skills and knowledge needed to operate NPOs, paid staff persons need to be trained and provided with an adequate work environment. In particular, the transfer of management expertise to NPOs must be facilitated by exchanging human resources with private companies and the government. In the U.S., people frequently transfer from NPOs to private businesses and are warmly received. This clearly shows that work experience in NPOs is regarded as a career asset.

## **(2) Funding Development and Evaluation of Operations**

The most prominent feature of NPOs is their ability to meet society's diverse needs. As society changes, NPOs need to reexamine their mission constantly and recreate themselves accordingly. This type of flexible response is precisely the edge that will enable NPOs to fulfill their mission. Mission evaluations need to be made by NPOs themselves as well as by others. While no quantitative evaluation methods presently exist, one example of a self-evaluation is the "operational evaluation system 99" of the Mie NPO evaluation group (<http://www.mienpo.net/hyouka/>). Since NPOs are susceptible to overstepping their funding constraints, they need to review their funding situation and to optimize programs within their means.

In addition, since the financing needs of NPO corporations cannot be met by investments, loan programs targeted at NPOs need to be established. The Labor Bank (*Rodo Kinko*) appears to be moving in this direction, with the Tokyo Labor Bank and Kinki Labor Bank inaugurating an "NPO operation support loan" program in April (*Nikkei Shimbun*, March 27 evening edition). As the number of NPO operations increases in the future, the increased demand for startup and working funds will necessitate more NPO loan programs and third-party credit evaluations of NPO operations.

Since individual contributions are an important source of operating funds, an amendment containing tax breaks is being considered for the NPO Law. In addition, Japan also needs to arouse an awareness toward tax breaks as in the U.S., where individual contributions to NPOs are considered as an alternative form of tax payment that can be directed to specified areas.

## **(3) Building an NPO Information Infrastructure**

As we mentioned earlier, the small size and horizontal structure of NPO organizations make them insensitive to economies of scale. But they can still take advantage of network effects to create synergies. Thus similar to the Internet's impact on society, NPOs can expand their presence by optimizing the network infrastructure.

However, since NPOs are not capable of making the large investments that local governments and private companies can, the information infrastructure's hardware and software remain underdeveloped. Local governments and intermediary NPOs thus need to step in to provide the necessary assistance.

## Conclusion

In an intriguing cover article in its January 2000 issue of *NPO no Hiroba*, the Japan NPO Center's journal redefines NPO as "new public organization." While in the past, "public" used to refer to the government bureaucracy, the article points out that its original meaning is derived from the "people." The article proposes that rather than focusing on the nonprofit aspect of NPOs, we can better grasp the true social significance of NPOs in the future through the concept of a new public or civic organization. NPOs are thus equal in importance to the government and corporate sectors, and represent the optimal means to develop the civic sector (or "third sector").