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Financing principles of non-profit organisations: A case of Slovakia

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Abstract

A non-profit organisation is an organisation that uses its surplus of the revenues to achieve its ultimate objective, rather than distributing its income to the organisation's shareholders, leaders or members. Thus, the main aim of this paper is to analyse and assess the system and structure of financing of non-profit organisation considering the economic, social and legislative conditions of the Slovak Republic. The results reveal that the basic principle of financing the non-profit sector in Slovakia is its multi-sourcing. Its essence is to use multiple sources of income in the non-profit organisations, in order to reach their own independence on one financial source, as well as to avoid negative consequences of its unexpected failure.

Keywords: Financing, non-profit organisation, public sources, self-financing.

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1. Introduction

Financing of non-profit organisations is a very complex activity, bearing not only economic and financial elements but also social. Like any other entities, non-profit organisations need to raise funds to finance their operating costs. A non-profit organisation can create both financial and non-financial sources by its own capacities or by external sources. When the organisation generates revenue by its own activities, it is a process of self-financing, which helps increase its sustainability and financial stability (Hraskova, 2007). However, neither these sources nor the profit can be used to enrich its owners or member, but they must be used for paying the costs associated with the mission of the organisation. However, non-profit organisations are more often reliant on seeking financial resources from external sources—fundraising. These activities rely on the philanthropy of addressed donors and ideally, they should have the ambition to build up the relation with this donor or eventually a long-term partnership. If the fundraising process is successful, its result is the acquisition of the necessary funds, material or non-material resources, or other support, for example, material gifts, volunteer work (Carvalho & Sampio, 2017), know-how, but also management experience or organisation reports, information, etc. (Marcek, 2010). As the donors provide sources, the organisations should have some moral obligation to them and use the financial and non-financial sources for purposes to which they were provided.

The principle of financing of non-profit organisations is a crucial topic in every national economy, considering the economic and non-economic factors and future economic development (Sedliacikova, Vacek & Sopkova, 2015). Thus, the main aim of this paper is to describe the system and structure of financing of a non-profit organisation considering the economic, social and legislative conditions of the Slovak Republic (SR) from various sectors (public sources, private sources, self-financing and doing business).

This paper is divided into three main parts. The first section is devoted to the Literature review depicting the most important and most relevant studies and research studies being conducted in the non-profit sector. The second part—Case study—describes and compares the ways and various sources of financing of non-profit organisations in conditions of the SR. The section Conclusions illustrates the results and finding as well as the role of non-profit organisations in the national economy.

1.1. Literature review

The issue of non-profit organisations is solved by a number of authors. According to Greiff and Ghaffari (2001), non-profit organisations have the prerequisites to implement their programmes effectively and have an irreplaceable place in the economy; the reason is the fact that the public requires the efficient use of available resources to meet the objectives set in the areas where non-profit organisations are substituting the state or the market. Michalski et al. (2018) claim that a non-profit organisation is an entity that is concerned with its activities about the realisation of social value adding mission. Non-profit and social economics entities have unique financing mechanisms, which do not affect the relative amount of debt and equity in their capital structures (Trussel, 2012). The research is being conducted in various spheres of the non-profit organisation operation. Elfving and Howard (2018) identify influences opportunity perception in non-profit organisations and found out, that collective identity is important. Bennett, Iossa and Legrenzi (2003) discuss the performance of non-profit organisations in terms of quality and costs, financial problems and the implications for risk taking. Kuvikova and Vacekova (2009) focus in their research on the diversification of financial sources in non-profit organisations and conclude that the strategy of financial sources diversification in non-profit organisations is beneficial as it ensures the independence and sustainability, and the decrease of risk (Kliestik, Misankova & Adamko, 2014; Kral & Janoskova, 2015). Svidronova and Vacekova (2012) state that the diversification of financial sources and their acquisition through self-financing are considered an appropriate way to achieve financial balance and thus long-term existential security of

non-profit organisations. However, a necessary presumption of financial stability is to reduce their dependence on one source of funding or in other words, the independence can be achieved by diversifying of the funding sources.

2. Methods

The status of non-profit organisations in national economies, which are transforming under various influences (Gratiela, 2018), depends on trust and interpretation of their social role (Santiago, 2018). If the meaning and the use of services of non-profit organisations increase, their ranking in the society will grow, and so their funding rate and number. In the awareness of citizens, non-profit organisations are close to the real interests of citizens, realise health, educational and social activities, which are not interesting for the political or economic spheres, and thus fill the space, which neither government nor the business sector provides. However, the policy they realised is found to be different for every sector (Kumar & Rao, 2018). To provide the intended activities, the organisations need enough financial sources.

Table 1. Structure of non-profit organisations

Activities/services provided	% share
Education	40
Social care	32
Leisure time activities	30
Culture	19
Defence of human rights	17
Environment protection	13
Charity	12
Health	10
Housing	9
Funds and foundations	9
Sport	7
Research	7
Recreation	6
Exchange of volunteers	6

Table 1 shows the structure of activities covered by non-profit organisations in the conditions of the Slovak national economy (Statistical Office of the SR). It is evident that more than half of all Slovak non-profit organisations provide educational activities. The main aim of this paper is to analyse and assess the system and structure of financing of a non-profit organisation considering the economic, social and legislative conditions of the SR. To provide the intended activities, the organisations need enough financial sources. The legislation and principles of financing in Slovak conditions enable the use of various sources—public, private, self-financing and doing business. The study focuses on the use of basic scientific methods of analysis, synthesis, induction, deduction and abstraction to accomplish the determined goal.

3. Findings and discussion

To assess the system of financing of non-profit organisations in the conditions of the Slovak environment, it is important to follow the legislation, social and economic conditions enabling various ways of financing of non-profit organisations.

As part of the state budget expenditures, subsidies and grants are provided in the form of direct ordinary transfers, which can only take the form of contributions, subsidies and other financial relations. The rationale of allocating subsidies and grants by individual ministries is to support the state goals of policies in a particular area under which a non-profit organisation operates. It can be

seen from the above data that the largest donors are the Ministry of Education, Science, Research and Sports of the SR and the Ministry of Culture of the SR. Provision of grants from municipal budgets is usually managed by generally binding regulations of the relevant region. Each self-governing region has its own priorities of support and development, based on which it decides on the volume and system of allocation of subsidies from its budget. Subsidies and grants allocated both from the state and municipal budgets, and the system of their allocation, are accompanied by many imperfections and problems. There is neither the system that would define the precise conditions of grants allocation nor the rules for reallocation of subsidies based on the priorities of the given sector. The quality of the project and its contribution to the group are often ignored which lead to the non-transparency of grant allocation, their volume and allocation power.

The category of direct public sources includes not only the grant of state and municipal budgets but also the redistribution of revenues from lotteries, public collections and similar games. These sources may be used only for a strictly determined purpose—to ensure the performance of the generally beneficial services, which are the provision of health care, the provision of social services care and help and humanitarian care, creation, development, protection and revitalisation of cultural values, support of artistic creation and cultural activities, education, development of sport, creation and protection of the environment and protection of the health of the population. The Ministry of Finance of the SR manages the volume of subsidies from the gambling-related revenues for the current financial year.

Payments and grants arising from contracts represent another way of financing of non-profit organisations. However, it is clear, that providing the public services by non-profit organisations is cheaper and more advantageous than by public administration institutions, experience shows that the economic and legislative principles are not ready to enable the financing from public budgets. The result is that non-profit organisations are limited in obtaining the financial sources by the contracts. The contract may only be between the non-profit organisation and the subject of the private sector.

Indirect public sources are divided into two categories, the assignment of 2% of the paid income tax and the tax exemption. It is possible to donate 2% of the tax paid from income and the opportunity to assign the share of the tax is given to both natural persons and legal entities. The tax exemption is the form of support for the non-profit sector, which is not typical only of Slovakia, as the previous forms of financing, but also of other democratic countries. Income taxes, property taxes, value added taxes, import taxes or sales tax might be exempt from taxes. The tax exemption may exist at national, regional or local levels. As the organisations are involved in public-services activities beneficial for the society and they use their profits to achieve publicly beneficial objectives, governments grant tax exemptions or other preferences to such organisations. These preferences are referred to as revenues received as grants and subsidies from state and municipal budgets and from endowment funds, donations to non-profit organisations, grants, membership fees, but also interest, dividends and royalties.

Non-profit organisations seek also other sources of financing, not only from the public sector, to ensure their independence on the state. Private sources are also characterised by variety and multi-sourcing. The reason is to maintain the independence of non-profit organisations and also the fact that it would be difficult to find a donor who would be willing to pay the total financial costs of a project. The Slovak legislative distinguishes several types of private sources, foundation sources, entrepreneurial sources, individual sources and church sources.

Foreign foundations do not act only directly in Slovakia by providing financial sources by grants. In most cases, they choose a partner—the Slovak foundation or they establish their own branches and support the Slovak third sector according to their own priorities. Most foundations operating in Slovakia are operational, they focus on support of own activities and programmes. However, there are also grant foundations, which provide finance to other entities or individuals. Many non-profit organisations, sooner or later after their establishment, are trapped in financial problems, proving that there are only a few well-functioning grant providers. Many foundations lack the capital for their

development, and many, after a few years of operation, act only formally. In the last decades, the community foundations have begun to appear in Slovakia, whose main task is to obtain resources that convert to a base. Their role is to increase the value of the base and provide it in the form of small grants to support the existence of their own community. In particular, they seek to obtain and raise capital from community sources and thus to achieve better ability of financial support for their own activities.

The cooperation of non-profit organisations with business entities (private sector) is based on the need of non-profit organisations to diversify their resources, and also on the belief that the mission of companies is not just the profit-making but the concept of social corporate responsibility, which also includes economic performance and environmental responsibility. Socially responsible companies contribute by their activities to sustainable development and try to maintain a balance in the society. Their activities constantly change life in the community, drive forward new trends in education, science, research, contribute to the improvement of the facilities in hospitals and health care centres, motivate to volunteering, create space for the realisation of new and untraditional projects, help weaker and disabled citizens to integrate and improve their prospects for the future. Therefore, some Slovak companies establish their own foundations to support their own employees, either current or former, or organise public projects. There are different ways how businesses can support the non-profit sector despite the fact that there is an inherent conflict between the interest of investors and creditors (Tumpach, Manova & Meluchova, 2014). One of them is the business donation, which is the willingness of the business to pay financial or non-financial value for a public purpose without any repayment. The strategic partnership, charity marketing, is working on a commercial principle when a business entity donates some equipment to any public institution. But one of the most popular strategies is sponsoring, which is the direct cooperation of the non-profit organisation and the private company.

Some non-profit organisation operates with individual sources, which are resources obtained from individuals donors, specific people and individuals. This method of fundraising is the most stable (apart from self-financing) for non-profit organisations but also the most difficult as it requires a demanding preparation to address people as it requires a very large number of small donors. The research of Hladka, Hyanek and Spalek. (2017) in the Czech Republic demonstrates that this type of financing (crowdfunding or fundraising) a crowding-out effect for public resources and the rise of individual sources (e.g., fundraising or crowdfunding). However, the stability is given by the fact that even in the case of several failures, there is no threat to the organisation. Only the organisations with the best economic conditions (Biernacka & Sedliacikova, 2012) and diversified financing have the stable position in the market. In the conditions of Slovakia, the most frequent forms of individual financing are public collections, deductions from salary, charity events and membership contributions.

Often it is very challenging for non-profit organisations to finance their programmes, activities and organisation operations only from external sources and therefore they are forced to get finances even by its own activities—by self-financing. It is a process in which a non-profit organisation uses its capacities (human, material, financial, know-how, etc.) for the creation and acquisition of resources (mainly financial) while fulfilling its mission. While doing some public or mutually beneficial organisation mission is a key element that distinguishes it from a business entity (Marcek, 2010). Making a profit is primary, not acceptable for a non-profit organisation. However, just as a business entity, also a non-profit entity can make a profit from its own activities. The difference is that in the case of a business entity, the profit is determined to enrich the corporate owners, while non-profit organisations use the profit to achieve for non-profit goals. In the financial practice of Slovak entities, the attention is paid to profit usually only in financial analysis and not as a managerial concept (Salaga, Bartosova & Kicova, 2015).

Theory and practice of non-profit organisations distinguish several self-financing methods; from membership contributions to the sale of own production (books, publications, shirts, postcards, craft products, etc.), charging the services provided (training, consultancy, translation, interpretation,

accommodation, boarding, etc.), the use of material goods (rental of own buildings, use of facilities for payment), the use of non-material goods (patents, methodologies, procedures, branding, logos, etc.) and the income from realised investments (Marcek, 2010). In addition, non-profit organisations can do business, take responsibility and make a profit. However, the non-profit organisation must use the profit only to finance the purpose for which it was established. The opportunity of doing business does not have all forms of non-profit organisations, as the Slovak legislation allows it only to voluntary associations, non-profit organisations providing in generally beneficial services, interest associations of legal entities, special purpose church associations and religious societies, and minimally to foundations. Non-investment funds and organisations with an international element are not legally permitted to do business, the other must be licensed.

4. Conclusions and future directions

Non-profit organisations operate in the environment of a market economy and their activity requires material, technical and financial equipment, which cannot be based solely on volunteering, external sources and donation. The sustainable development of these organisations is hurting financial problems that are specific to them and their nature is based on their mission. Searching the financing principles of non-profit organisations is an important issue not only for non-profit organisations themselves but also for the whole society. So far, this area has been searched only minimally, which limits the findings, there is almost no literature dealing exclusively with the theory of the multi-source financing of non-profit organisations. The reason is the historical development and the practice of non-profit organisations, for which grants and subsidies from large, especially foreign foundations, were the main source of financing until recently. Nowadays, the existence of non-profit organisations is endangered by exhaustion or a loss of financial resources. It is necessary not to rely only on state and municipal grants and subsidies, but to look for alternative ways of financing their activities and endeavour to diversify the structure of financial resources. The multi-source financing of non-profit organisations may ensure their independence on one source, financial equilibrium from both short and long term and, finally, their long-term existence.

We attempt to analyse and assess the structure of financing of a non-profit organisation considering the unique country sample, which is a possible limitation of the study. Thus, it would be beneficial to unveil the systems of financing of a non-profit organisation in other national economies or in wider scope considering the economic groupings (Eurozone, Visegrad countries, transition economies, etc.). It would be also useful to verify the impact of the ownership and legislation and taxation changes on the financing of non-profit organisations, which could be the scope of our future research.

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