

Unrestricted funding and nonprofit capacities: developing a conceptual model

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Author contributions

PW and AdW contributed equally to the paper. PW and AdW designed the study and conducted the fieldwork, in collaboration with MA Sociology student Olivier van Hunnik; AdW did the coding and initial data analysis; AdW and PW did the second and third rounds of data analysis; PW and AdW wrote the article.

Funding statement

The work by Pamala Wiepking at the Lilly Family School of Philanthropy is funded through a donation by the Stead Family, and her work at the Vrije Universiteit Amsterdam is funded by the Dutch Charity Lotteries.

Acknowledgements

The authors would like to thank the Dutch Postcode Lottery for supporting their work, and especially Laura Santacreu, Margriet Scheuders, Odiel Evenhuis, Dorine Manson and Jonne Arnoldussen for their help throughout the project. They would also like to thank the respondents and the grantee organizations for their participation. Pamala Wiepking additionally thanks the Stead family for supporting her work. The authors are extremely grateful to Olivier Hunnik and Pelin Zenginoglu for his help in data collection and processing.

Open Science Statement

The authors conducted this work based on Open Science Principles, and all study information, materials and data are publicly available at the OSF site for this study: <https://osf.io/mkzns/>.

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ABSTRACT (189 words)

Unrestricted or flexible funding practices are increasingly popular among funders. There is initial empirical support for the assumption that fewer donor-imposed restrictions on funding have positive outcomes for nonprofit capacities, including the ability to better deal with external shocks such as presented by the COVID-19 crisis. In this article, we develop a conceptual model to assess how unrestricted funding relates to nonprofit capacities and consequently effectiveness. This model is derived by a review of the academic and grey literature as well as a theory-based analysis of twenty in-depth interviews with grantees receiving multi-year unrestricted funding as a substantial part of their funding portfolio. By combining and contrasting novel empirical insights with existing theoretical ideas about resources, capacities and effectiveness from the nonprofit literature, we come to a proposed conceptual model that captures how unrestricted funding relates to seven different nonprofit capacities: (1) financial management; (2) operational capacity; (3) staff management; (4) adaptive capacity; (5) strategic planning; (6) mission orientation; and (7) innovation. This conceptual model can function as a much-needed starting point to support academics and nonprofit leaders to better understand how unrestricted funding relates to nonprofit capabilities and consequently nonprofit effectiveness.

KEYWORDS

Nonprofit capacity, nonprofit capacities, nonprofit effectiveness, grantmaking, donor-imposed restrictions on funding, unrestricted funding, flexible funding.

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1. INTRODUCTION

Philanthropic funding takes many forms. While institutional funders almost always attach some contractual terms to their funding, the nature and extent of such conditions vary widely. Recent developments in the United States (U.S.) and Europe show a trend where large foundations move towards more unrestricted and trust-based funding practices. In 2019, leaders of five large U.S. foundations pledged to implement more unrestricted grant-making practices “to address chronic underfunding of nonprofits’ indirect costs” (Eckhart-Queenan, Etzel, & Silverman, 2019). The COVID-19 crisis has since then led over 600 U.S. Foundations to sign a pledge promising to loosen or eliminate restrictions on grants, mirrored by a similar statement by foundations and umbrella organizations across Europe (Council on Foundations, 2020; European Foundation Centre, 2020). While in 2005 an estimated 26 percent of the grants provided in the U.S. were in the form of unrestricted general operating support (Grantmakers for Effective Organizations, 2007), in 2021, data from the Center for Effective Philanthropy (CEP) show that 61 percent of the 284 U.S. foundation clients they surveyed are providing some form of unrestricted funding. At least 65 percent plans to continue this unrestricted funding moving forward (Buteau, Orensten, & Marotta, 2021).

Despite these recent developments towards more flexible funding, restrictive funding is still the norm. Both governments and institutional philanthropic funders typically provide funding through short-based restricted project funding (Buteau, Marotta, Martin, Orensten, & Gehling, 2020a; Gibson, O’Donnell, & Rideout, 2007). By imposing restrictions, donors try to avoid inefficiency and make sure their grants align with their own organization’s

objectives. Donor-imposed restrictions typically occur when nonprofit governance is weak and “when information asymmetry between donors and nonprofit managers is high”, and donors consequently have difficulty knowing if the nonprofit is actually providing the services the funder intends to support (Hung & Berrett, 2021, p. 582; Yermack, 2017). Yet, these restrictions on funding may come with drawbacks, especially related to the capacity of nonprofits to work towards their mission. Donor-imposed restrictions can lead to mission drift (Henderson & Lambert, 2018; Surysekar, Turner, & Wheatley, 2015), may increase paperwork (Gronbjerg, 1991; Kender-Jeziorska, 2019; Zihnioğlu, 2019) and may hamper organizations’ abilities to respond to changing needs (Elbers & Arts, 2011). Restrictive funding can also cause pressure to cut on core operational costs, which may threaten organizational stability and survival, leading nonprofits to enter the so-called “starvation cycle” (Altamimi & Liu, 2022; Gregory & Howard, 2009; Lecy & Searing, 2015; Schubert & Boenigk, 2019; Wing, Hager, & Rooney, 2004).

In the nonprofit literature there is a substantial discussion relating to nonprofit capacity – or: capacities – and nonprofit effectiveness (Benjamin & Campbell, 2020; Bryan, 2019; Despard, 2017; Lecy, Schmitz, & Swedlund, 2012; Liket & Maas, 2015; Shumate, Cooper, Pilny, & Pena-y-lillo, 2017). As far as we know, in the academic literature there has been no attempt to examine how forms of unrestricted funding affect nonprofit capacity and effectiveness. There are a handful of empirical studies on the consequences of donor-imposed restrictions on nonprofit finances or output (Hung, 2021; Hung & Berrett, 2021; Mensah & Werner, 2003; Surysekar et al., 2015; Thornton, 2010; Wright & Bocarnea, 2007). While empirical work on the consequences of unrestricted funding appears absent in the academic literature, the topic has received considerable attention in practitioner reports (see for example Ayer & Anderson, 2022; Cairns, Firth, & Hopgood, 2021; Grantmakers for Effective Organizations,

2007; Reich, 2018; Unwin, 2004). This article fills this gap by theorizing how unrestricted funding relates to nonprofit capacities, as a multidimensional operationalization of nonprofit capacity, and consequently nonprofit effectiveness.

To start answering this question we develop a conceptual model illustrating the relationship between unrestricted funding and nonprofit capacities. To this aim, we first surveyed the existing nonprofit literature and grey literature to understand how different levels of funding restrictions may support or hinder nonprofit capacities. Next, we supplemented these theoretical ideas with the lived experience of grantees receiving unrestricted funding as part of their funding portfolio. To this end, we conducted in-depth interviews with twenty grantees of two large institutional funders in the Netherlands, which all have received multi-year unrestricted organizational funding (and sometimes also additional unrestricted project funding), some since 1989. This allows us to capture not just immediate perceived effects of unrestricted funding, but also longer-term perceived benefits and drawbacks. By comparing and contrasting findings from our literature synthesis with our interviews we conclude the article with the discussion of a conceptual model that can function as a much-needed starting point to support academics and nonprofit leaders to better understand how unrestricted funding relates to nonprofit capacities and consequently nonprofit effectiveness.

2. THEORY AND LITERATURE REVIEW

Theoretically, the relationship between unrestricted funding and nonprofit capacity and effectiveness has not received much attention. Funding restrictions however, are not a dichotomy – they are a continuum ranging from highly restricted project funding to funding without any conditions. The relationship between donor-imposed restrictions on funding and nonprofit capacity and effectiveness has been studied in different contexts and in different

academic disciplines. We argue that the consequences of having access to different types of (un)restricted funding can best be understood as a matter of resource dependency. Therefore, to better understand the possible mechanisms that may explain the relationship between unrestricted funding and nonprofit capacity and effectiveness we start by reviewing the more general literature on resource dependency and nonprofits' strategies to cope with resource uncertainty.

2.1 Resource dependency and the restrictiveness of funding

Resource dependency theory argues that organizations are continuously adapting to their environment in order to acquire resources, which makes them sensitive to the requirements from those providing the resources (Malatesta & Smith, 2014; Moulton & Eckerd, 2012; Pfeffer & Salancik, 2003). Especially organizations which are dependent on a few sources for survival may experience issues with power expressed by their funders. This can lead organizations to experience revenue volatility, mission drift, and – in the case of corporate donors – undue influence of corporate public relations objectives (Froelich, 1999; Henderson & Lambert, 2018; Surysekar et al., 2015). As Froelich writes: “[...] an organization must manage rather than be controlled by its resource dependencies, and continually adapt its strategies to the resource environment” (Froelich, 1999, p. 261).

Moulton and Eckerd (2012) state that there are two strategies that nonprofits can use to mitigate these negative consequences of resource dependency: revenue diversification and resource alignment. *Revenue diversification* relates to the strategy of nonprofits to expand the different types of funding they rely on to include for example a mix of government funding, foundation and corporate grants, individual contributions, as well as earned and investment income. By diversifying revenue, organizations limit their dependence on one or a small

group of funders, thus limiting their vulnerability to external pressure and the risk of financial shocks (Froelich, 1999). The second strategy for an organization is to select their funders based on alignment between the core roles and values of their own and their funder's organizations. This strategy is called *resource alignment*: "aligning nonprofit organizations with the appropriate demands in their resource environments to bring about the desired end roles to be pursued by the organization" (Moulton & Eckerd, 2012, p. 665).

Following Shon et al. (2019) we argue that an additional important aspect of understanding the effects of resource dependency on nonprofits is to understand the role of donor-imposed restrictions in funding models. When considering revenue diversification as a mitigation strategy, it is important to know how (un)restricted the different funding sources are, and how this mix of funding types relates to nonprofit capacities and effectiveness. The same holds for resource alignment as a mitigation strategy: we should not just look at the alignment between the roles and values of funding and grantee organizations, but also consider how restrictions on funding models affect nonprofits and the way they are able to fulfil their missions.

As noticed by nonprofit scholars for decades, different types of funding are associated with varying levels of donor-imposed restrictions on funding (Froelich, 1999; Grønbjerg, 1993; Shon et al., 2019). A helpful continuum of restrictions on funding is provided by Ayer and Andersson (2022), who identify six different gradations of restrictions on funding, ranging from "Fully restricted project funding", "Full-cost, project based funding", "Flexible project funding with capacity building", "Unrestricted program funding", "Unrestricted organizational funding" to "Unrestricted asset transfer", in which "Funders give away parts of their endowment to other funders with greater expertise, representation, and knowledge of the areas they fund" (Ayer & Anderson, 2022, p. 10).

Individual contributions may allow for more flexibility in spending (Broce, 1986; Grønbjerg, 1993), but can also come with (perceived) donor-imposed restrictions, largely driven by a strong public norm that overhead costs should be minimized (Shon et al., 2019). Government funding is typically highly restrictive and often does not cover full organizational costs (Grønbjerg, 1993; Hung, 2021; Shon et al., 2019; Thornton & Lecy, 2022). Institutional funders such as (corporate) foundations typically provide (fully) restricted project funding, although as mentioned at the start of this article, there has been a recent trend towards more flexible funding models, amplified by the COVID-19 pandemic (Ayer & Anderson, 2022; Buteau et al., 2021).

The main question in this article is how unrestricted funding relates to capacities of grantee organizations. In the next section (2.2) we discuss the concepts of nonprofit capacities and nonprofit effectiveness. Then (section 2.3) we review existing evidence studying the relationship between different types of (un)restricted funding and different nonprofit capacities.

2.2 Nonprofit capacity, capacities, and effectiveness

Bryan (2019, p. 887) notes that existing definitions of capacity refer to (financial and nonfinancial) resources, but also ~~the~~ “the internal operational activities an organization performs to accomplish its mission” and the organization's ability to mobilize the available resources. Capacity thus is not a static description of financial health or other resources, but something that exists only when it is enacted. While many studies have examined financial statistics to evaluate capacity (Kaplan, 2001; Liket & Maas, 2015), a dynamic definition pleads for an assessment that takes the organization's mission performance into account.

This is where the concept of organizational effectiveness comes in. While capacity is “the means by which organizations achieve effectiveness” (Bryan, 2019: 886), effectiveness can be defined as “the extent to which an organization has achieved its goals” (Benjamin & Campbell, 2020, p. 199). Effectiveness may be the ultimate goal of nonprofit organizations and their stakeholders, and there is much discussion on its definition and measurement. Operationalizing organizational effectiveness is challenging, because there is not a single dimension or criterion that is applicable across all contexts (Lecy et al., 2012; Mitchell & Calabrese, 2022). Previous operationalizations have focused on goal attainment, organizational resources or legitimacy, which resulted in indicators such as financial ratios, self-rated effectiveness and measures of organizational reputation (Bryan, 2019). It is striking that similar financial statistics, like revenue growth, are used as indicators for both capacity and effectiveness (Berrett, 2022; Chikoto & Neely, 2014; Provan, 1980), emphasizing the conceptual unclarity around the two terms (Liket & Maas, 2015). For the purposes of this paper, we follow Bryan (2019) in the sense that capacity are the means to achieve effectiveness, i.e., the extent to which an organization achieves its goals. In this causal chain, we expect restrictions on funding to affect capacity, which in the end may impact nonprofit effectiveness.

Most scholars agree that nonprofit capacity is a multidimensional concept, which lead Shumate et al. (2017) to speak of eight ‘nonprofit capacities’, being financial management, adaptive capacity, strategic planning, external communication, board leadership, operational capacity, mission orientation, and staff management.

Wu (2021) additionally developed a multidimensional conceptual framework to assess community leadership capacities, which is applicable to nonprofit organizations in a broader sense. This framework includes strategizing, convening, knowledge building, capacity building, partnering, and policy engagement. In her analysis of the occurrence of different dimensions, Wu finds that community leaders "tend to specialize in one or a few leadership capacities, but not necessarily all six components" (Wu, 2021, p. 48). This is an important observation which applies to the understanding of nonprofit capacities in a broader sense. While different dimensions of capacity are relevant for each nonprofit organization, the importance of each of them depends on the organization's mission, structure and funding portfolio. For example, policy engagement and external communication may be more important for a small-staffed advocacy organization primarily funded by grantmaking foundations than for a large service provider in humanitarian development funded through government grants, while knowledge building and operational capacity are relatively important for the latter. Different nonprofit capacities can serve as a framework to identify the areas in which unrestricted funding may affect grantee organizations.

2.3 How does (un)restricted funding affect nonprofit capacities?

In this section we review the existing academic and grey literature -including popular science publications and practitioner reports- for evidence for how (un)restricted funding relates to nonprofit capacities. We structure the results in line with the operationalizations for nonprofit capacities by Shumate et al. (2017), supplemented with the leadership capacities developed by Wu (2021).

2.3.1 Financial management

When donor-imposed restrictions are studied in the academic literature, it often concerns how these restrictions influence a nonprofit's financial management. Financial management refers

to how well a nonprofit manages their accounts (Shumate et al., 2017a, p. 159). In nonprofit and public administration studies, scholars have examined the effects of restrictions associated with different revenue sources on financial performance and operational expenditures. Government grants, which often come with restrictions on how the money is spent, are found to be negatively related with operating reserves (Cortis & Lee, 2019) and administrative spending (Shon et al., 2019), although a recent study by Thornton and Lecy shows that government grants “improve operating margins, and increase financial reserves for recipient organizations” (Thornton & Lecy, 2022, p. 1). Many case studies describe the operational costs that are necessary for acquiring government subsidies and reporting to the funder (Elbers & Arts, 2011; e.g., Kender-Jeziorska, 2019; Zihnioğlu, 2019). Donor-imposed restrictions often require extensive planning, implementation and reporting, which can be a large financial burden especially for smaller organizations (e.g. Elbers & Arts, 2011; Gin, Casey, Quarles, & Dobalian, 2019; Kender-Jeziorska, 2019). On the other hand, high administrative costs are framed as ‘financial inefficiency’ in the accounting literature (Mensah & Werner, 2003; Surysekar et al., 2015). Parsons et al. (2017) show that higher amounts of restricted donations exert pressure on organizations to present ‘favorable’ accounting ratios showing more efficiency. This may threaten financial stability in the long run, as is hypothesized by the ‘nonprofit starvation cycle’ in which nonprofits are confronted by unrealistic expectations on ‘overhead’ expenses (Gregory & Howard, 2009; Lecy & Searing, 2015; Schubert & Boenigk, 2019).

In the grey literature the relevance of unrestricted funding for healthy financial management is expressed clearly. For example, in an evaluation of the Ford Foundation BUILD initiative, it was emphasized that BUILD grantees receiving unrestricted funding became more financially secure over time (Niras, 2019, p. 36). The Center for Effective Philanthropy

evaluated the first few years of unrestricted gifts provided by MacKenzie Scott, and found that 73% of the grantees used this funding to strengthen their organization's financial stability, indicating they perceive this to be a core capacity to invest unrestricted funding in (Buteau, Buchanan, Lopez, Malmgren, & Im, 2022, p. 25).

2.3.2 Operational capacity

Shumate et al. (2017a, p. 160) define operational capacity as relating to an organization's internal procedures, and its ability to set program goals and assess their outcomes. Peer-reviewed literature mostly deals with the benefits and challenges of donor-imposed restrictions. Project funding often causes administrative burden in terms of grant writing, implementing restrictions and reporting to funders, which deteriorates the efficiency and effectiveness of organizational staff (Elbers & Arts, 2011; Gin et al., 2019; Kender-Jeziorska, 2019). In the international development literature, restrictions from overseas funders have been linked to 'professionalization' of local civil society organizations, although these processes are also contested due to undesired side effects like the loss of accessibility and local legitimacy (Banks, Hulme, & Edwards, 2015; Clark & Michuki, 2009; Elbers & Schulpen, 2013; Markowitz & Tice, 2002; Zihnioğlu, 2019).

Discussing different accountability mechanisms, Ebrahim (2005) suggests that flexible and mission-oriented accountability is more likely to engender organizational learning than upward accountability to donors. This would imply that funding with fewer reporting restrictions contributes to organizational learning. Operationalized as inquiry and critical self-reflection with staff and other stakeholders, organizational learning aligns with the 'knowledge building' capacity in Wu (2021).

Several practitioner reports reflect on the benefits of unrestricted funding for aspects of operational capacity. A 2013 U.K. report sums up the benefits of providing unrestricted funding in terms of, amongst others, creating and maintaining strong organizations by “supporting strong ‘back office’ functions, facilitating organizational development and improving efficiency” (Cairns, Mills, & Ridley, 2013, p. 18). According to Grantmakers for Effective Organizations (GEO), general operating support enables nonprofits to “build a strong and sustainable infrastructure”, easing “fundraising pressure on nonprofit executives, reducing burn-out and allowing them to focus on their mission” (Grantmakers for Effective Organizations, 2007, p. 13). A strong organizational infrastructure can bolster the knowledge and skills of employees, volunteers, recipients and community members, which relates to capacity building and knowledge building in Wu’s (2021) framework. Summarizing key benefits of multi-year general operating support, Buteau et al. (2020b) argue that it “fosters grantee stability” and “allows nonprofits the time to develop, evaluate, and improve programs that address systemic and complex social issues.” (Buteau et al., 2020b, p. 4). Especially for service provision organizations, unrestricted funding is of crucial importance for consistency and continuation of their operations. When nonprofit’s “full costs” are not funded, their services may get interrupted, with detrimental consequences for their clients (Knowlton, 2019; Krauskopf & Putnam, 2006).

2.3.3 Staff Management

Staff management in the NCI relates to how well an organization’s staff and management are equipped to do their jobs effectively (Shumate et al., 2017). To some extent this is also captured in Wu’s (2021) capacity building, which reflects the ability to improve skills and knowledge of people within and around the organization. Evidence of the consequences of unrestricted funding for staff management is limited. In an evaluation of the core funding

provided by the U.K. based Esmée Fairbairn Foundation, key results include that core funding supported grantees to strengthen internal processes and allowed them to take a long term view on organizational needs (Esmée Fairbairn Foundation, 2019, p. 6). It was also observed that grantees from Mackenzie Scott's gifts and grantees in the BUILD initiative often used their unrestricted funding to improve conditions for current staff and to attract new staff (Buteau et al., 2022, p. 26; Niras, 2019, p. 33/34).

2.3.4 Adaptive capacity

Adaptive capacity in the NCI refers to how nonprofit organizations are able to adapt to changes in their environment (Shumate et al., 2017, p. 159). While project funding typically comes with restrictions on spending, timing and geographic location, unrestricted funding allows grantees to re-allocate money in response to changing needs. This is described as a constraint for service provision organizations that receive restricted project funding (Elbers & Schulpen, 2013; Kender-Jeziorska, 2019) and often mentioned as a key benefit in practitioner reports on the perceived consequences of unrestricted funding (see for example Cairns et al., 2021, 2013; Grantmakers for Effective Organizations, 2007). The benefits of unrestricted funding in terms of being able to flexibly respond to changing environment have been well documented during and following the recent COVID-19 health crisis. Specifically organizations that had access to unrestricted, flexible funding were able to shift their priorities quickly to address the newly emerging social needs during this time of crisis (Buteau et al., 2020a, 2021).

2.3.5 Strategic planning

Strategic planning in the NCI refers to “a deliberative, disciplined approach to producing fundamental decisions and actions that shape and guide what an organization (or other entity)

is, what it does, and why” (Bryson, 2011, p. 8, in Shumate et al., 2017a, p. 160). This aligns well with ‘strategizing’ in Wu’s (2021) framework. Donor-imposed restrictions are reported to hamper organizational autonomy and the capacity to develop long-term strategic plans (Elbers & Arts, 2011; Kender-Jeziorska, 2019). Practitioner reports make the case that “unrestricted funding gives grantees flexibility and freedom, especially to invest in ‘less glamorous work’” (Wallace & Saxton, 2018a, p. 11). With ‘less glamorous work’ Wallace and Saxton (2018b) mean those projects or organizational developments that are important to advance the grantees’ mission, but challenging to fund otherwise. Strategic planning is instrumental for the next nonprofit capacity, mission orientation.

2.3.6 Mission orientation

Mission orientation in the NCI refers to the common orientation of donors, community members, clients or beneficiaries towards an organization’s mission (Shumate et al., 2017). We recognize the capacity of mission orientation in academic literature that describes how donor-imposed restrictions on funding may limit an organization working towards their mission, causing mission drift (Elbers & Arts, 2011; Froelich, 1999; Henderson & Lambert, 2018). On the other hand, donor influence on an organization’s mission can also positively affect nonprofit effectiveness. Davis (2019) argues for example that Canadian international development organizations are forced by government priorities to target populations that experience most need.

In the grey literature, there is ample discussion of the positive relationship between unrestricted funding and an organization’s mission orientation. Saxton and Lindström (2012, p. 8) for example state that unrestricted funding allows organizations to spend their funding where they think it is most needed, and through this contribute most to their mission.

Unrestricted funding allows grantees to focus on what is most important to them rather than on what can be funded through project funding or would be most attractive to funders (Cairns et al., 2013; Institute for Philanthropy, 2009). Finally, Brest (2003) explains unrestricted funding is beneficial to nonprofits, because it allows them to operate towards their mission independently and autonomous from funders. This is in particular important for organizations working on controversial or politicized issues.

2.3.7 Other capacities

In the academic literature nor in the grey literature we recognized much related to the dimensions of external communication, board leadership (Shumate et al., 2017) and partnering (Wu, 2021). One thing however which is often mentioned in practitioner reports is the role of unrestricted funding in improving funder-grantee relations. Buteau et al. (2020, p. 4) argue that multi-year general operating support “encourages stronger, trust-based relationships between funders and grantees”. The Esmée Fairbairn Foundation (2019, p. 6) noted that core funding allowed receiving organizations to invest in communication, which lead to increased understanding of the organization’s work, and better outcomes.

Another recurring theme in practitioner reports is (social) innovation. While not being a separate dimension in the nonprofit capacity literature, innovation surfaces in the grey literature as something which is perceived to be particularly encouraged by unrestricted funding. With innovation we refer to an organization’s capacity to develop potentially high-risk and innovative solutions to address existing or emerging societal needs (Anheier & Toepler, 2019). In different practitioner reports, general operating support is perceived to create space for innovation and risk-taking, “providing nonprofits with resources to take

advantage of new opportunities that arise” (Buteau et al., 2020b; Grantmakers for Effective Organizations, 2007, p. 13).

3. INTERVIEWS WITH GRANTEES RECEIVING MULTI-YEAR UNRESTRICTED ORGANIZATIONAL FUNDING

3.1 Data and Methods

Practitioner reports on grantee perceptions of unrestricted funding are explorative and inductive, while peer-reviewed studies mostly focus on a single case and/or a single dimension of nonprofit capacity. In order to gain insights from grantee perceptions on the effects of donor-imposed restrictions on nonprofit capacity in the broadest sense, we supplement our literature review with in-depth interviews with twenty grantees of the Dutch Postcode Lottery (DPL) and the FriendsLottery (FL), which all have received multi-year unrestricted organizational funding (and sometimes also additional unrestricted project funding) as a substantial part of their funding portfolio. This is a convenience sample, and we acknowledge that this is a very specific sample of grantees, which does not allow for assessment of how grantees experience different restrictions on funding imposed by different funders. However, these interview data do contribute to our understanding of the mechanisms through which access to unrestricted funding relate to organizations' capacity and consequently effectiveness. The organizations under study have received substantial amounts of unrestricted funding, some since 1989. This allows us to capture not just immediate perceived effects of unrestricted funding, but also longer-term perceived benefits and drawbacks.

Founded in 1989, the DPL is possibly the largest institutional donor in the Netherlands, donating 347 million Euros in 2020, which is approximately 6.2% of the total share of philanthropy in the country (Gouwenberg, Koolen-Maas, Schuyt, & Bekkers, 2022). In 2002, the DPL parent company Novamedia took over an existing charity lottery, the FL. Both the DPL and the FL sell lottery tickets in order to raise funds for philanthropic organizations. The Dutch market for lotteries is strictly regulated. The DPL and FL have a legal status as a charity [algemeen nut beogende instelling; anbi] and, by legal requirement, are required to provide 40% of their revenues as funding to charitable causes. DPL and FL grantee organizations are active in the areas of international development, environment, social causes (DPL), and sports, health and well-being, and culture and arts (FL).

There is no formal application procedure to become a 'DPL or FL Grantee'. Prospective grantees are proposed by the 'Charities department' of the DPL and FL and approved by the board. Upon becoming a DPL or FL Grantee, DPL or FL funding can make up a maximum of 33% of a grantee's total revenue. The DPL funds approximately 150 long-term beneficiaries every year. The FL supports around 60 long-term beneficiaries. Long-term beneficiaries receive a yearly fixed amount of unrestricted organizational funding, ranging between 100,000 and 23 million euro, and their funding is typically renewed every five years for an additional five years (Nationale Postcode Loterij, 2022). Long-term beneficiaries can also qualify for additional one-off unrestricted project funding. The DPL and FL conduct yearly informal and five-yearly formal evaluation meetings and long-term beneficiaries are required to complete brief evaluation forms, in which they provide a narrative for funding decisions and their plans for the future. The contract between the DPL, FL and long-term beneficiaries includes formal agreements on marketing and communication.

In order to collect insights from different types of long-term DPL and FL beneficiaries we used a heterogeneous (or maximum variation) sampling approach (Patton, 2002; Saunders, Lewis, & Thornhill, 2009) with cases that vary on two dimensions: sector and organizational role. We selected grantees which are primarily active in one of the following four sectors: health, environment, societal and social causes, or international development and human rights. In terms of role, we distinguished service provision, advocacy and spokespeople, innovator, and agitator and maverick. The last category consists of organizations with as a key objective to “pick up on, pursue, and spread unconventional ideas and approaches. They take on a new position, critically question proven concepts and approaches, shine a light on issues from a different angle, provoke others to think differently, and demonstrate alternatives.” (Robert Bosch Stiftung, 2014, p. 39). Except for maybe the “agitator and maverick” role, these roles align well with the roles for nonprofits in the U.S. as defined by Moulton and Eckerd, who specify the following roles: service provision; innovation; individual expression; social capital creation; political advocacy; and citizen engagement/democratization (Moulton & Eckerd, 2012, p. 658). Within each sector, we selected two organizations that represented each role. With two cases in each cell of the 4 (sector) x 4 (role) matrix, our final selection of organizations consisted of 32 organizations. These were supplemented with four special cases that were selected for reasons that cannot be shared without violating their anonymity. More detailed information on the sampling procedure can be found in the Online Appendix.

Even though we started our fieldwork ahead of the COVID-19 crisis in January 2020, from March onwards we experienced significant difficulty making appointments to interview representatives of selected grantees. Our final sample consists of interviews with representatives of twenty grantee organizations. We provide a complete anonymized

overview of the twenty grantee organizations in Table 1. It is clear that the final sample misses three cells in the role of ‘agitator and maverick’. Despite repeated attempts to make appointments with organizations that we selected in these cells as well as replacement organizations that were initially outside our selection, we did not succeed in interviewing organizations in these cells. We believe this is largely due to the fact that these were mostly small organizations that needed all staff to cope with the consequences and demands of the COVID-19 pandemic.

There was large variation in the funding portfolios of the organizations included in our study. As stated, funding by DPL and FL is always part of a broader revenue portfolio, as they do not allow their funding to exceed 33% of a grantee’s total revenue. Our respondents typically stated that the income from the DPL or FL and from individual donors were their primary, often only, source of unrestricted income.

<<Insert Table 1 here>>

For the purpose of the current study we aimed to better understand what grantees perceive to be the effects of this source of unrestricted funding for their organizational capacities and effectiveness. To this end, we developed a theoretically informed topic list for semi-structured interviews which would cover a comprehensive range of areas where unrestricted funding could play a role in organizational decision making, nonprofit capacity and eventually organizational effectiveness. More information on the topic list, coding strategy and data analysis can be found in the Online Appendix. Below we discuss the most important insights that emerged from our interviews. Our findings can be clustered in seven perceived effects of unrestricted funding, relating to six of the capacities identified by

Shumate et al. (2017) and Wu (2021): (1) financial management; (2) operational capacity; (3) staff management; (4) adaptive capacity; (5) strategic planning; and (6) mission orientation, supplemented with a new capacity, (7) innovation.

3.2 Perceived grantee effects of multi-year unrestricted funding by DPL and FL

3.2.1 Financial management

Many respondents shared the perceived benefits of unrestricted funding on financial management. Unrestricted funding is described as a “buffer”, a “bottom” or a “reserve”. The long-term nature of the DPL and FL funding was mentioned as very important in that respect.

If organizations only have very few sources of unrestricted income, that may lead them to become too dependent on this long-term flow of unrestricted funding. Many respondents think their organization should strive for a variety of income sources, echoing the benefits of revenue diversity (Froelich, 1999; Hung & Hager, 2019). Although the DPL and the FL are cautious to let their grants be too large a share of the total income, some recipient organizations finance a large part of their daily operations with the funding received from DPL or FL. “We count on this money”, a relationship manager of a long time (≥ 20 years) DPL beneficiary states, and: “we don't expect it, but if the Lottery says yes we'll stop it, then we'll have to change our organization very drastically. That would be a tragedy for us” [E_AS_b1].

Financial stability seems especially beneficial for organizations that primarily operate project based. Multi-year unrestricted funding allows them to cover the costs of their core organization in-between projects. This is what Bowman (2011) refers to as short-term

financial resilience, “resilience to occasional economic shocks while making progress toward meeting long-term objectives” (Bowman, 2011: 39).

Another perceived consequence in the area of financial management is that long-term unrestricted funding helps organizations to acquire other sources of funding. When another funder allows only limited overhead costs, organizations can fund their overhead with unrestricted funding they already have. Oftentimes funders require matching funds or co-financing, for which DPL or FL money can be used.

3.2.2 Operational capacity

Unrestricted funding allows organizations to fund any expenses associated with core costs or ‘overhead’ (Gregory & Howard, 2009; Lecy & Searing, 2015; Schubert & Boenigk, 2019).

Many respondents indicate that, because they received unrestricted funding, their organization has more room to pay salaries. A respondent from an environmental organization talks about being able to hire qualified staff:

Then [...] when the project is finished, he has to leave again. While that person has built up a lot of knowledge during the project, but you can't keep him. I think that if you are purely a project organization, so that you don't have any unrestricted money, [...] yeah, then you might just become a kind of lobby club for communication without really having the knowledge. While that is exactly our strength.

[E_AS_b2]

She thinks that having a sustainable organization with a lot of in-house knowledge has multiple benefits, including being able to quickly react to a changing context and being able to acquire extra funding. One respondent speaks of “quality development” or a “quality base”, which is hard to fund with project financing [I_AS_b1]. Also, developing knowledge

within the organization, for example in administrative work, is perceived to lead to increased financial efficiency [I_IN_b2].

Other organizations, however, choose to spend the unrestricted funds, or at least a part of it, on direct costs. A couple of respondents indicate that the overhead of their organizations is so small, that basically all revenues go to campaigns [E_AM_b2 and S_AS_b1]. Another respondent says:

And we know that we use most of the DPL contribution for our goals. So hardly any for overhead.

[Interviewer:] - So actual project expenses?

Yeah, that's what we got it for and use it for. We are very conscious of that. [I_IN_b2]

This respondent, the director of a human rights organization, justifies his choice by referring to what he thinks is the purpose of the funding (“That’s what we got it for”). This shows that the funding, although it is formally unearmarked, is not always perceived without presumptions (Van Hunnik, de Wit, & Wiepking, 2021). What people at grantee organizations perceive as ‘the purpose of the funding’ may depend on the organization. Also, different respondents had different conceptions of what is counted as ‘overhead’.

3.2.3 Staff management

Some respondents mention a better atmosphere among staff after being selected as a recipient on long-term unrestricted funding – because there are more means to accomplish things [I_IN_b2], because it has led to less need to ask permission for small decisions [I_AS_b1], or because there is a feeling of take oneself more seriously [H_SP_b1]. One respondent explicitly talks about “more fulfilment and job satisfaction” [I_IN_b2].

On the other hand, our respondents are not uniformly convinced that unrestricted funding contributes to things like better job training and management.

Yeah... those are things that we all do too, training and education, but I don't know if that's necessarily because of the DPL money. I don't know. If it wasn't there, I don't think we'd be saying no more training or anything like that [E_AS_b2].

In sum, our data provide mixed signals on the role of unrestricted funding for staff management. There is wide agreement on organizational development and the recruitment and retainment of high-quality personnel (see § 3.2.2 on operational capacity), but internal procedures like job training may not be affected by resource dependency. Being selected as a DPL or FL grantee can improve the organizational culture and atmosphere. This may also be fueled by the fact that these funders typically renew their partnerships for years, even decades, which gives staff a long-term prospect of having more room to maneuver within their jobs.

3.2.4 Adaptive capacity

Echoing observations in practitioner reports (Reich, 2018; Wallace & Saxton, 2018a), some respondents indicate that unrestricted funding allows their organizations to quickly respond to a changing context. Such changes can involve (natural) disasters, emergencies or crises, including the COVID-19 pandemic that emerged during our fieldwork. Obviously, the importance of such unforeseen events very much depends on the work of the organization. The COVID-19 pandemic illustrated this very well. Organizations in our sample specifically affected were those that depend on volunteers who could not work (or did not feel safe to do so), organizations that work with vulnerable groups in development aid, and organizations that partly depend on earned income derived from in-person events.

While the COVID-19 pandemic was very manifest during our fieldwork, this is only one of many contextual changes organizations have to cope with. The director of an international service provision organization gives some examples:

When something happens, there is an immediate crisis. If it doesn't rain for six months, the yield from the vegetable gardens will dry up. Or if there is suddenly a plague of grasshoppers, you have a disaster. If corona comes, yeah, that just can't be handled. If you are in a slum where suddenly gangs come, you have a security problem from one day to the next where you immediately have to free up a lot of money for surveillance, alarm systems... And then, because you often have to jump into crisis mode, it is incredibly nice to have free money. [I_SP_b1]

While the work of advocacy organizations is quite different, their perception of the benefits of unrestricted funding can be surprisingly similar. Flexibility is perceived to be important for organizations that work in quickly changing social, economic and political realities. Similarly, a communication officer of an environmental organization states that part of the organization's work is "reactive", in which they have to act upon actions of others:

One year very little of that happens, and another year you suddenly have three such threats coming at you. Then you want to be able to act and not be like: oh, then we first have to apply for a project to see... then you're too late! Or you have to let it go completely because you don't have people with knowledge. [E_AS_b2]

This respondent refers to two aspects of being flexible. She mentions the time it costs to apply for projects, which is a large burden if organizations want to respond quickly to unexpected events. She also refers to "people with knowledge". Being able to jump in new

projects requires in-house knowledge which is not bound to a predefined project but can be capitalized if necessary, which relates back to operational capacity and knowledge building.

3.2.5 Strategic planning

Strategic planning is a core nonprofit capacity and is defined by Bryson “as a deliberative, disciplined approach to producing fundamental decisions and actions that shape and guide what an organization (or other entity) is, what it does, and why” (Bryson, 2018, p. 8). Multi-year unrestricted funding allows grantees to follow a long-term strategic plan and gives organizations a wider choice-set, allowing them to fund projects that other large funders do not easily fund.

We can nowhere apply for money for lobbying. That's what people think: we're not going to give money for that.

[Interviewer:] - That's something that doesn't directly contribute to the goal.

Actually it is, but it's not a head and tail project where you say: this has so much... You can't really measure the impact very well. [H_IN_b2]

This quote shows the preference of many funders for clearly defined projects with measurable impact. ‘Impact’ is a hot topic among foundations, but some of our respondents argue that part of their work is not easy to measure. Furthermore, respondents mention they are only able to conduct “strategic projects” for their organization [S_IN_b3, I_AS_b1] or “things that are not sexy” [H_IN_b2] because they receive unrestricted funding.

A possible downside of having access to long-term unrestricted funding is that organizations may become less critical of their own work. Our data does not allow for close analysis of this

argument, because respondents may not recognize inefficient processes and/or may not admit it in an interview. Still, one respondent states:

Let me put it this way: the way of financing, restricted and unrestricted, should not have any impact on the projects you do [...]. But if I'm honest, I think that if we have earmarked project-based funding, [...] we are more critical of ourselves: what are we actually achieving with this project? If only because the funder asks for it and it forces us to be much more critical of the impact. [...] But maybe it's a bit tricky what I'm saying, but I think that this, well, does happen, unconsciously.

[Interviewer:] - Why is that tricky?

If I were to say this to my colleague who is responsible for projects and programs, he would not agree at all, I think.

[Interviewer:] - And why would he disagree with that?

Because he thinks that what he does... that every project he does absolutely has an impact.

[S_AS_b2]

This quote shows how sensible and difficult this topic is. Many nonprofit professionals tend to believe in the work they are doing, and probably believe that they can decide for themselves how to organize impactful projects. The question to what extent efficiency and effectiveness can be increased by imposing restrictions is hard to answer, and the side effects of predefined output, tight regulations and more accountability have to be taken into account. One minute after the previous quote, when talking about finding a balance between restricted and unrestricted funding, the same respondent admits that “the reporting requirements of [...] foundations sometimes drive you crazy” [S_AS_b2].

3.2.6 Mission orientation

Increased independence, or autonomy, is particularly important for lobby organizations that are critical of governments or companies. Respondents state they need unrestricted money to

“fight for that independent position” [I_AS_b2] and to “not to be curtailed in what we do” [E_AS_b1]. For these organizations, mission alignment means finding as much resources as possible that do not tie them to the governments and companies they criticize. Although we labeled and coded this topic as ‘independence’ during our initial analyses, reviewing it against the nonprofit capacities, we realized it converges with the capacity of mission orientation as specified by Shumate et al. (2017). Unrestricted funding allows grantees to avoid mission drift (Froelich, 1999; Henderson & Lambert, 2018). The DPL and FL's funding philosophy is explicitly trust-based: “[Our grantees] are in the best position to judge for themselves where the money is most needed and are given the freedom to do so” (Nationale Postcode Loterij, 2022, p. 28).

Indeed, multiple respondents state that their organization wants to avoid becoming donor-driven. This is echoed by more respondents, not only from advocacy organizations but also from service providers, like this international aid organization:

Yes, I think you get maximum results. Because you're really doing what's necessary and that you're not donor driven. The fact that you do listen to the funder, who often has an agenda and who often to a smaller or larger extent, depending on the funder, determines where the money goes. So that you don't do what is necessary. I think this form of funding really enables us to do what we think is best on the ground. [I_SP_b1]

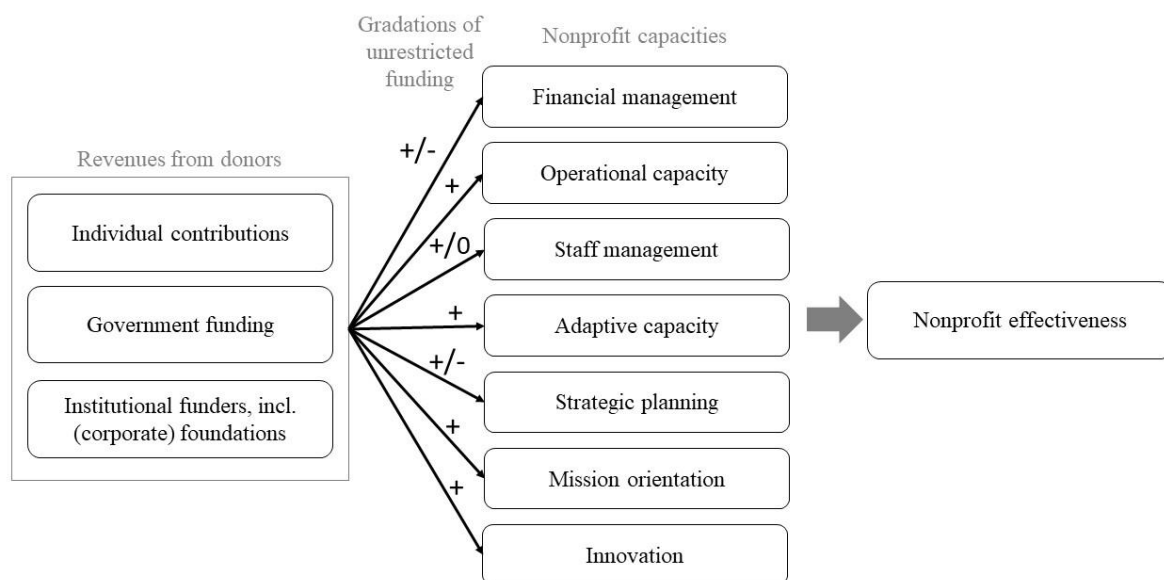
3.2.7 Innovation

Another benefit that proved to be important during the interviews is innovation and risk-taking, which has been mentioned in the grey literature on unrestricted funding as well (Buteau et al., 2020; Grantmakers for Effective Organizations, 2007) and can be perceived as

a separate capacity which is not defined as such in the nonprofit literature. Unrestricted funding can be used to invest in research and development, even if the outcomes of new ideas are uncertain. This is exactly what Anheier, Toepler and Frumkin (and others) argue is a key role for philanthropy in Western societies: social innovation or social entrepreneurship (Anheier & Toepler, 2019; Frumkin, 2002). The director of a relatively new organization focused on providing social services talks about the kind of new projects his organization can develop, saying: “There's not always funding for that research phase either, so it also means that you can simply provide a wider range of social services” [S_IN_b3]. A respondent from an environmental organization calls this “venture capital”, necessary for projects that need some research first [E_SP_b2]. Such ‘venture capital’ is not only perceived to be important in the first stage of innovations but can also play a role in the implementation and diffusion phase.

4. DISCUSSION

In this article we reviewed the literature and provided a theory-based analysis of interview data from nonprofit organizations receiving substantial multi-year unrestricted funding. We combined and contrasted our empirical insights with existing theoretical ideas about revenues, capacities and effectiveness from the nonprofit literature as well as previous findings from other (grey) literature. Based on our analysis we conclude the article with a conceptual model (see Figure 1) which captures the relationship between (different forms of) unrestricted funding and different key nonprofit capacities, consequently affecting nonprofit effectiveness.



Grantees are dependent on the resources provided by their funders, who all impose varying levels of restrictions on funding. Following Shon et al. (2019) we argued that an additional important aspect of understanding the effects of resource dependency on nonprofits is to understand the role of donor-imposed restrictions in funding models. Through our literature review and interviews with grantees of two institutional funders we learned that seven nonprofit capacities are possibly affected by fewer donor-imposed funding restrictions.

Financial management can be increased when organizations use multiyear, unrestricted funding to fill gaps between projects and to acquire other (project) grants, showing the importance of having at least some share of unrestricted funds in the revenue mix. A possible downside, reflected by the minus sign in Figure 1, is organizations becoming too dependent of multiyear, unrestricted funding. There is relatively strong support for the relationship between unrestricted funding and *operational capacity*, because unrestricted funding contributes to hiring and retaining high-quality personnel. The evidence on *staff management* is somewhat weak. Being selected as a grantee of unrestricted funding may improve organizational culture and atmosphere, especially when the prospect is to maintain this

resource stream for a longer term. However the role of unrestricted funding in things like job training and management practices is unclear, which is reflected by the zero sign in the model. Unrestricted funding can play an important role in developing *adaptive capacity*, enabling both service provision and advocacy organizations to quickly respond to changing needs. *Strategic planning* is reported in the literature to be hampered by donor-imposed restrictions. Our interview data indeed support the idea that organizations can plan more strategically and use unrestricted funding to develop projects which are uncertain or difficult to fund at other funders. There is the danger of becoming less critical about strategic choices, however, which we include in the model as a minus sign depicting a possible drawback of unrestricted funding. In terms of *mission orientation*, unrestricted revenues make organizations less donor-driven and allows them to be critical towards funders, especially governments and companies. Interestingly, this not only holds for several advocacy organizations in our sample but also for some service providers. As a final capacity we add *innovation* to the model. Both in practitioner reports and our interview data, innovation and risk-taking surfaced as a theme in which unrestricted funding can play a key role.

We show how the choice set of nonprofit organizations is fundamentally altered by having access to unrestricted funding, even when it accounts for only a relatively small share of the organization's financial portfolio. Donor-imposed restrictions should not be ignored when evaluating the benefits of revenue diversification. A healthy mix of different types of funding and associated donor-imposed restrictions will likely enhance nonprofit capacities. *How* this will work depends on many aspects of an organization, including their organizational role(s), funding portfolio's and development stage. Some advocacy organizations strive for unrestricted funding only, because they find it crucial to remain independent. Other organizations have a strong infrastructure to manage project funding, but use unrestricted

funding to fill gaps and/or bridge periods in between projects. Unrestricted funding seems especially beneficial for younger organizations, who need relatively large budgets for core costs, including building the organization and hiring employees that are not directly linked to specific projects. Funders in the philanthropic sector may use the conceptual model from this paper as a framework to assess the needs of different types of organizations and increase the effectiveness of their grantmaking. Researchers can study different aspects of the model to increase understanding of its proposed mechanisms in different contexts.

There are several limitations to this study, the most salient being that we only interviewed grantees of two specific Dutch institutional funders. Not only may grantees of different funders perceive different effects of fewer restrictions on funding, it may also be that the context of the Netherlands is influencing our results. Throughout the academic and practitioner literature, as well in our interview data, the most important nonprofit capacities that surfaced time and time again is that of financial management and operational capacity. It seems likely that this result is not context dependent.

Future studies should examine both perceived and measured consequences of unrestricted funding, for different funder-grantee combinations and in different contexts. A funder-grantee relationship is also about much more than formal donor-imposed restrictions on funding; it is also about trust, power, management, and accountability (Ebrahim, 2005; Trust Based Philanthropy Project, 2020; Van Hunnik et al., 2021). Future research could systematically compare the consequences of unrestricted funding to other types of grantmaking that may have similar benefits, like high-engagement philanthropy (Herrold, 2006), trust-based philanthropy (Trust Based Philanthropy Project, 2020), participatory grantmaking (Wojcik, Ford, Hanson, Boyd, & Ashley, 2020) or capacity building programs (Minzner, Klerman,

Markovitz, & Fink, 2014). Further, unrestricted, multi-year funding may also have a dark side when only a selective group of organizations benefits from its advantages, which leads to inequity in access to economic and social capital in the philanthropic sector (Walton, 2021). Our sample of long-term beneficiaries did share some potential negative outcomes of long-term unrestricted funding but further study into negative outcomes is warranted, as respondents in our sample may have been hesitant to share negative opinions about unrestricted funding. Furthermore, we only interviewed directors, fundraisers and relationship managers, not people at nonprofit organizations who are actually involved in the projects, who may have been able to shed more light on possible negative effects of unrestricted funding.

Among institutional philanthropic funders there is increasing interest in providing long-term unrestricted organizational funding, which should provide sufficient study material for scholars worldwide. It is our hope that our conceptual model can function as a much-needed starting point to support academics and nonprofit leaders to better understand how unrestricted funding relates to nonprofit capacities and consequently nonprofit effectiveness.

DATA AVAILABILITY

Anonymized transcripts of the interviews (in Dutch) are available at [*URL omitted for blind review*].

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