

From the Business First

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Nonprofit Sector

Proctor: Time to rethink what makes nonprofits successful

Premium content from Business First by Allen J. Proctor

Date: Friday, April 20, 2012, 6:00am EDT

Over the past 25 years, the number of nonprofits grew threefold in the United States, and the nonprofit business model moved sharply toward being a contract provider of government services. Philanthropy filled the gap between what the government would pay and what it cost to provide the services. This worked fine in the 1990s and into the last decade.

[Peter Drucker](#) wrote almost 20 years ago, "What underlies the current malaise of so many large and successful organizations is that their theory of the business no longer works....When a theory shows the first signs of becoming obsolete, it is time to start rethinking the theory."

Here are the first signs that the theory of the nonprofit business no longer works. The government has turned out to be an unreliable customer. It abruptly cancels contracts. It pays late. It continually holds payments down even while costs increase. Even the assumption that philanthropy is ready to fill the gap turns out never to have been a reality. Philanthropy had expanded in dollar terms as the number of nonprofits surged, but philanthropy in its best years managed to rise to just above 23 percent of nonprofit revenue.

Now is the time to start rethinking how nonprofits can be sustainable. Here are some examples of what we should start looking for.

A clear identification of a nonprofit's most mission critical activities and of the upper bound of financial losses it will tolerate for these activities.

Entrepreneurial development of profitable activities that are lower in mission but based on the expertise and business model of the nonprofit's core activities.

Paring of marginally profitable and unprofitable activities that are not central to the nonprofit's key mission.

The last two actions are similar to what a for-profit business would do in order to remain viable. The key distinction, however, is that the nonprofit does all this in order to cover the financial losses necessary to preserve the quality and level of its most mission critical activities.

Here are three ways to rethink how corporations can help nonprofit sustainability:

We need to start looking at nonprofits as two businesses operating under one roof. The first business provides high quality services which cannot be operated profitably. We evaluate its success by how well it fulfills these community needs. The second business runs profitable activities whose profits are reinvested into both businesses. We evaluate it by its profitability.

We need to provide training and support to nonprofit executives to give them the skills necessary to develop and evaluate business plans for new, profitable activities.

We need to create new ways to provide investment capital to nonprofits that include equity and low-interest loans as well as grants. We need legislation to allow low-profit limited liability companies (L3C) in Ohio to expand the possible capital structures for new profit-making activities.

[Peter Drucker](#) warned us that "some theories...are so powerful that they last for a long time." I hope we don't have to wait a long time to start rethinking the theory of the nonprofit business.

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