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Nonprofit Sector

Proctor: A model for future nonprofit sustainability

Premium content from Business First by Allen J. Proctor

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Nonprofits must find a new business model. Earned revenue always has constituted the majority of nonprofit revenues, and it needs to remain so, but it must come increasingly from non-government customers. Too many government contracts now lose money and nonprofits need to accept only those with terms that come closer to covering the true cost of services.

And we cannot assume that philanthropy will rise to a more significant role than today. It always has remained in the narrow range of 18 percent to 24 percent of nonprofit revenue. If its share could not break out of that range in the go-go years of the mid-1980s and late 1990s, there is no basis to assume it will happen in the future.

Why we need nonprofits

Our society cannot thrive if nonprofits cannot develop a business model that is sustainable. We forget that nonprofits fulfill community needs that for-profit companies are unable to fulfill. The market system fails when for-profits cannot make a profit while still meeting the community's need for quality, volume or breadth of service. Economists refer to these shortcomings as public goods, externalities and market failure. Nonprofits step in to make sure the community gets what it needs.

Therefore, every responsible nonprofit has a key mission that loses money if done well: basic research; emergency rooms; public access to education, art, music, and theater; care and feeding of the unfortunate and disabled; and community development and neighborhood rehabilitation are a few examples. If we did not have nonprofits, we would not have these services.

We also want these services to be available regardless of the strength of the economy. In particular we don't want our nonprofits to use the option of service cutbacks and layoffs that helps for-profits to survive recessions. We want reliability and sustainability of these key services.

For a nonprofit to sustain its key services it needs to be financially viable. Here is what we should look for in a sustainable nonprofit.

A clear identification of its key mission activities and of the upper bound of financial losses it will tolerate for these activities.

Increasing reluctance to accept grants and contracts from government and foundations that do not cover the costs of the activities they fund. This ideally will come from education of governments and foundations that will induce these funders to pay all costs of a program. More likely, nonprofits will gain the courage to reject money-losing "gifts."

Maintaining the share of charitable contributions in its revenue mix. This share peaked nationally at 24 percent in 2001 and recovered to near that level in the latest data. Maintaining current shares by all nonprofits will require continued effort, particularly in light of trends in corporate philanthropy away from broad-based cash giving. The 2011 survey of the Committee Encouraging Corporate Philanthropy noted that one-third of its sample provided more than half of its philanthropy to just one program. Moreover, it found that cash giving has been flat with most growth from in-kind, particularly pharmaceutical donations of medicine.

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

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

Many of these 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.

While a for-profit would drop the money-losing activities, the nonprofit exists to sustain those activities. That role highlights the need for nonprofits to develop enough profitable activities to cover the losses which fundraising cannot cover and to acquire the cash flow necessary to reinvest in their businesses and build balance sheets strong enough to get them through a recession.

Ways to accomplish this

I see four ways we can foster a sustainable nonprofit sector.

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 be aware of the implications of how we support nonprofits. Unrestricted giving is the closest to how for-profits get capital. If we restrict our gifts to certain uses, we need to cover the fully-loaded cost of the activity we are funding, and consider adding a profit margin. And we need to support strong balance sheets by rewarding nonprofits who are building reserves to sustain their operations and growth.

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

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

Hopefully this will become our community's response to [Peter Drucker](#)'s admonition to start rethinking the nonprofit business model.

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