# MUSEUMS, MERCHANDISING, AND NONPROFIT COMMERCIALIZATION[1]

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> Think of having two shops opposite the entrance [of the Metropolitan's Great Hall], instead of coat rooms. I have a feeling that a pair of attractive shops might earn each year an income equivalent to that from a ten-million-dollar endowment.
>
> Lila Acheson Wallace (quoted in Hoving, 1993, p. 190)

## INTRODUCTION

Auxiliary activities are activities that supplement the operation of cultural institutions. In the past, museums had small-scale book stands or stores selling exhibition catalogues, posters, postcards of art works and similar items; operated cafeterias catering to staff and visitors; and provided some parking facilities usually free of charge. In the more recent

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past, however, these activities have undergone a considerable transformation. Traditional cafeterias have given way to more up-scale restaurants catering to visitors and non-visitors alike. More likely than not, visitors now have to pay for parking and museums have invested in building new garages and expanding other parking facilities. And perhaps most visibly, museum merchandising has significantly increased over the past decade or so. In addition to the expansion of on-site and off-site shops and mail-order catalogues, many museums are now also adopting e-tailing technology to open virtual stores (e.g., MuseumShop.com).

In short, while many observers have viewed the museum of the past as a secluded space of education, edification and scholarly pursuit, museums have in fact begun to put greater emphasis on more pedestrian undertakings and objectives. There are of course a number of explanations for this trend. But the most intuitive is that these activities are providing much needed resources that allow the institution to grow and nurture its "core business." To do so has by now become accepted practices and there is not much critical reflection or dissent. By contrast, popular accounts reinforce the positive aspects of this development by reporting, for instance, on how much (gross) revenue accrues to museums through merchandising. Statements, such as the "Metropolitan Museum of Art alone does more than $80 million through its 16 stores around the world" (NPR, 1998), are rather the norm. Unfortunately, this does convey the impression that these activities earn significant resources for museums—which is, however, not truly the case, since these earnings are balanced by concomitant expenses of similar dimensions. The actual profits are typically of a considerably lesser scale.

While merchandising and other auxiliary activities have obviously taken on a new dimension over the last two decades, there has been surprisingly little discussion of this issue in the literature. Cultural economists have studied museum finances in-depth (Feldstein, 1991; Johnson & Thomas, 1998), but the focus, among other things, has primarily been on subsidies and "pricing," that is the setting of admission fees. Whether charging admissions is economic has thus been studied in great detail (Anderson, 1998; Bailey & Falconer, 1998; Bailey, Falconer, Foley, McPherson, & Graham, 1998;

Kirchberg, 1998; O'Hagan & Duffy, 1995), but whether merchandising is economic has not. Similarly, merchandising can also be viewed as an arts marketing and management function, but the marketing literature has paid scant, if any, attention to the issue (Kotler & Kotler, 1998; McLean, 1997).

Although merchandising thus appears to be largely a non-issue, there may be some reasons to pay closer attention. In fact, analysts concerned with the nonprofit sector at large have recently identified a trend of commercialization within the nonprofit sector that may have far-reaching implications for policies affecting the sector as well as the way these institutions operate (Salamon, 1993; Weisbrod, 1997; Weisbrod, 1998b). Although there has traditionally been little interchange between arts and nonprofit policy and management research, it can be argued that this trend and its potential ramifications is as applicable to the arts as to other fields of nonprofit activity and deserving of further inquiry and study (Toepler, 2001).

In this paper, we will attempt to shed more light on the prospects and perils of museum merchandising and auxiliary activity and do so against the background of the current commercialization debate. The following section outlines some key strands of the evolving commercialization theory and discusses the motivations underlying the rise of merchandising and other auxiliary activity in the museum field. After discussing the data and methodology of the study, we present the empirical findings derived from analyzing the financial structure of a small sample of museums over the 1990s and conclude with recommendations for further analysis and research.

## THE COMMERCIALIZATION THREAT AND THE RISE OF AUXILIARY ACTIVITY IN THE MUSEUM FIELD

In the second half of the 20th Century, the American nonprofit sector has grown from a small cottage industry to a veritable economic force. While nonprofit organizations numbered only a few thousands in the 1940s (Hall, 1994), the sector had grown to some

1.6 million organizations in the 1990s with $670 billion in revenues and a paid workforce accounting for 7% of total employment in the country (Salamon, 1999). This transformation was necessarily accompanied by significant shifts in the revenue structure. Although there is not much historical evidence to substantiate this assumption, it is commonly believed that nonprofit institutions used to be financed largely through private philanthropy until the 1950s or so. Beginning in the immediate post-WW II period and further amplified in the 1960s, however, new government programs began to make new sources of financing available to nonprofits and acted as catalysts for the expansion of the sector (Salamon, 1995). In the 1980s, direct and indirect government support began to decline across the board and private philanthropy—while continuing to grow—failed to close the emerging revenue gaps (Abramson, Salamon, & Steuerle, 1999).

As a result, nonprofits in fields as diverse as arts and culture, health, education and social services were increasingly forced to substitute fees, charges and other forms of earned income for public support and private contributions in order to sustain current programs and future growth. As analysts have come to recognize the apparent ubiquity and force of this trend over the past decade, concerns have grown that the nonprofit sector is currently undergoing a "commercial transformation" (Weisbrod, 1998b) that might fundamentally alter its character and the traditional roles these organizations have played in society. Although public subsidies for the arts had never reached the extent of government support for nonprofit institutions in other policy fields, the arts were subject to similar dynamics and had to face the same dilemma as the rest of the nonprofit sector: How to sustain expansion in light of declining public support and growth of philanthropic dollars that did not keep pace with the increased need for resources? Not surprisingly, the answer was to address the problem through earned income strategies—or in other words, to become more commercially oriented. Justifying the importance of commercial revenues (i.e. merchandising sales), one museum director described the dilemma quite succinctly in a 1998 National Public Radio interview:

> Even though philanthropy in general is up in this country, corporate support, in many instances, and certainly federal support and other municipal support has declined dramatically. And museums need to be able to stand on their own two feet (NPR, 1998).

In the nonprofit context, commercialization means that organizations are increasingly willing to charge fees for their (charitable) services and/or act more entrepreneurially by developing business opportunities that may or may not be related to the organizational mission. In the museum case, this translates primarily into higher revenues from admission charges and auxiliary activities (Anheier & Toepler, 1998), but also includes other forms of earnings, such as royalties and the exploitation of copyrights.

In this paper, we are primarily concerned with the apparent expansion of museum auxiliary activities and merchandising in particular. More specifically, we are aiming at a better understanding as to why museums choose to invest significant resources into the development of what essentially is business activity as opposed to concentrating their efforts on more traditional income sources. The broad environmental forces that have set the stage for the apparent commercialization of the nonprofit sector, as described above, suggest that these activities are being undertaken for the more or less sole purpose of generating financial, or material, benefits. Prevailing behavioral models also tend to emphasize this aspect: It is assumed that nonprofit managers *dislike* commercial activities because of potential distractions from their core missions and goals. Managers will still engage in these activities, however, if preferred types of revenues (i.e. contributed, or donative, revenues) are insufficient to support the delivery of core, mission-related services. Commercial income is thus principally sought to cross-subsidize mission-related products and services (Weisbrod, 1998a).

While there is sufficient anecdotal evidence from the museum field to confer validity to this line of theorizing, the theory is nevertheless too uni-dimensional to fully capture the scope of the merchandising phenomenon and the rise of auxiliary activities. More specifically, a closer examination of arguments in favor of museum merchandising suggests that financial pressures and benefits are only part of a more complex set of potential managerial motivations. Indeed, immaterial benefits as well as isomorphic pressures may also lead museum managers to consider engaging in such activities. Accordingly, there are at least four sets of possible explanations:

**Financial Benefits**

As suggested by the cross-subsidization argument, museums engage in business-like activities (including merchandising, parking and food services) to help fund core museum functions, such as collection, conservation, exhibition and research, or even capital expansion. As exemplified by the NPR quote above, this is likely a result of declining government and municipal support and insufficient philanthropic resources. Statements testifying to the financial importance of auxiliary activities are not hard to come by. *Pars pro toto*: According to Thomas Hoving (1993), the then-director of the Metropolitan Museum of Art, the prime motivation behind constructing a parking garage in the 1970s was to

> guarantee a massive income for the museum" (p.245). "The garage still constitutes one of the most significant sources of revenue for the Metropolitan. Without it we couldn't have had either the Rockefeller Wing or the Paintings galleries … (p.246)

More recently, another museum executive—on Public Radio's *Marketplace* show of January 3, 2001—suggested that museum shops have "become increasingly crucial to the financial health of an institution." Although pressure from trustees and donors also encourage museum managers to pursue business opportunities,[2] the financial benefits deriving from these activities are thus likely a major draw. In addition, for cross-subsidization purposes commercial income has additional appeal, as these revenues are unrestricted and thus under the full discretion of the museum leadership. To be sure, the pursuit of this type of income is not without tensions and problems. Both the tensions and the perceived need are succinctly summarized in Metropolitan director Philippe de Montebello's account of the van Gogh in St. Remy and Auvers exhibition:

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[2] One museum director stated this as follows: "And that opportunity, the desire and hopefully, the accomplishment of the mission to earn more revenue, I think, puts museums in very good stead when they've looked at by corporations and even foundations, who are determining whether or not to support an institution that is in fact working hard to support itself" (NPR, 1998)

> [The exhibition] ended on the very moving set of the final pictures … in the next room were all the catalogs and postcards. We had a flurry of letters saying, "We walked out of the exhibition in tears, a great experience ruined by the shops." And I had to say: "Look, I'm sorry we had to have the shops. Would you have preferred not to have an exhibition at all?" Because without the shops, I couldn't have afforded to do the show. In the end, it's a matter of weighing public benefit with the evils. We are in a capitalistic society where earned income increasingly, as governments cut back, is an important part of our life. (New York Times, 2000)

**Immaterial Benefits**

Arguably, however, economics are not the only motivation and there are arguments that the financial aspects of merchandising may not even be the most important. A prominent museum store consultant thus stresses that

> In establishing the goals of a museum store, it is essential that the educational mission take precedence over income production. The goals might be listed in order of important as follows:
> 1. To contribute to the educational purposes of the museum.
> 2. To return to the museum the greatest possible dollar contribution.
> 3. To assist with the museum's marketing efforts by generating good publicity, attracting visitors, and treating customers in a professional, courteous, and hospitable manner. (Theobald, 2000, p.10)

A recognition of the educational purpose of selling products that relate to works in the collections of a museum is even found in the Internal Revenue Code, which explicitly exempts such products from the unrelated business income tax (UBIT) that is generally due on profits from business ventures of nonprofits that have no clear connection to the exempt purposes of the mission. Beyond this it is often argued that merchandising improves public relations and improves the visibility and name recognition of museums; and that gift shops and nice restaurants draw people into the museum who would otherwise not have come. Merchandise also constitutes tangible reminders of the museum experience. As one merchandising executive explains:

> In think that in a way, a lot of people go to museum shops after an exhibit or before an exhibit; and it's broadening of [*sic*!] their whole experience at the museum. For some people, it's the best part of their experience, because it's a way to actually put their hands on something (NPR, 1998)

**Institutional Isomorphism**

Finally, museums might decide to engage in, or expand existing, auxiliary activities for reasons that have only indirectly to do with the material and immaterial benefits that such activities might generate. In fact, it could be argued that museum customers (i.e. visitors) at this stage expect to find gift shops and museum-related merchandise at the time of their visit—leaving the museum little choice, but to provide this part of the "museum experience." Perhaps even more significantly, there may also be implicit peer pressure in existence, whereby museum managers feel that they have to engage in merchandising or re-vamping their restaurants because doing so has developed into a standard within the organizational field. Organizational theorists refer to such pressures as mimetic isomorphism (DiMaggio & Powell, 1991)—the tendency of organizations to respond to uncertainty by emulating, or mimicking, successful and legitimate models. In this case, the extent of apparently successful merchandising and other auxiliary activities of large and prominent museums, such as the Metropolitan Museum, the Museum of Modern Art, the Museum of Fine Arts, Boston, or the Art Institute of Chicago, might have encouraged other museums to view such activities as a legitimate response to financial uncertainty. That such institutional pressures and forces might indeed be at play and provide an alternative explanation of managerial motivations is borne out in the way one art museum described its decision to expand its auxiliary activities in its 1991 Annual Report:

> In pursuing various solutions [the museum] has in one way finally emulated its peers. During the 1980s America's museums aggressively pursued new sources of income to meet mounting operating costs. Museum stores became a major resource, merchandise based on the holdings of a collection burgeoned, parking fees were justified by the scarcity of space, and then, most dramatically, admissions were charged, at remarkably escalating prices. For the first time, in 1990, [the museum] too joined the parade—but fortunately still with one all-important exception: general admission remains free … Not surprisingly, given long-established habits, the announcement of parking fees and admission charges for major (i.e., exceedingly costly) exhibitions aroused some distress at the outset; on the other hand, the Museum Store, with a greater range of merchandise, clearly responded to many visitors' long-expressed desires.

**Hypotheses**

There are several empirically testable hypotheses that can be posited on the basis of the above considerations. Firstly, if it is true that nonprofit managers pursue commercial activities primarily for the sake of the financial resources that can be generated, and merchandising and other auxiliary activities have increased over time, it stands to reason that the income resulting from these activities will make up a substantial part of total museum revenues. What constitutes substantial in this case is of course open to debate. While warning of the volatility of the retail business in general, one observer suggested that "at best, a museum can only expect to make 10 percent of its income for [*sic*!] merchandising" (NPR, 1998). Thus:

**Hyp 1: Merchandising and other auxiliary activity constitute a significant source of income for museums.**

Secondly, if the overall commercialization scenario is correct, changes in the extent of auxiliary activities, including merchandising, should be correlated to changes in donative (contributed) income. Donative income in this case includes statutory revenues, i.e. municipal, state, or federal appropriations; public and private gifts and grants; as well as membership dues.[3] If museum managers truly dislike commercial activity, they would try to reduce auxiliary activities (to the extent possible) if donative income is on the rise. All else being equal, increases in auxiliary revenues by contrast should only be expected when contributed revenues decline. Hence:

**Hyp 2A: Auxiliary revenues will increase after a decline of donative revenues in the prior period.**

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[3] Whether to count membership dues as contributed or earned income is debatable. In most statistical accounts of the nonprofit sector, these revenues are considered as earned income. Museums, however, tend to view memberships as contributions. In most cases, member benefits are relatively insignificant, which would suggest that such dues are in fact of a more donative nature.

**Hyp 2B:** **Increases in donative revenues will slow the growth of auxiliary revenues if not lead to a decline.**

Thirdly, any immaterial benefits that may accrue to museums from merchandising and other auxiliary activity are hard to measure. Capturing such benefits would require extensive visitor as well as non-visitor studies. However, if it is true that the museum shop and restaurant do help attract new visitors to the museum, then there should be a measurable effect on the level of museum visits and admissions. Thus:

**Hyp 3:** **Increases in auxiliary revenues will lead to increased visitorship, measured admission revenues.**

Finally, institutional theory suggests that museums with little auxiliary activity will emulate the merchandising strategies of large, prominent and highly legitimate museums with more extensive auxiliary operations—independent of what may drive the strategies of these large museums. Hence:

**Hyp 4:** **Museums with less pronounced auxiliary operations will vary the extent of their own activities based on changes in the extent of auxiliary revenues of large museum with highly visible auxiliary activities.**

## DATA AND METHODOLOGY

Commercialization is a phenomenon that was empirically first observed through the analysis of macro data, such as the Census of Service Industries (e.g., (Salamon, 1993), and a growing body of anecdotal evidence, including a mounting number of press accounts on new approaches of nonprofits to generate resources (see, e.g., Weisbrod, 1997). Both types of evidence, however, do not lend themselves easily to a closer study of the phenomenon and its implications. Ideally, micro data, that is organizational level data, are needed to better understand any underlying dynamics. In addition, these data

need to be available over time. Generally, there are three potential data sources that would satisfy these requirements: Survey data; Internal Revenue Service (IRS) data, based on the Form 990 tax return that nonprofit organizations with revenues of more than $25,000 have to file annually; and data derived from published annual reports.

Fielding new surveys require significant time and resources and it is notoriously difficult to yield reliable data beyond the recent past. Occasionally, service and umbrella groups in the field conduct surveys of their members that are of potential use. In the museum field, both the American Association of Museums (AAM) and the Association of Art Museum Directors (AAMD) have fielded member surveys in the past. The AAM surveys, however, have been irregular to be of direct use and the AAMD surveys, while annual, are proprietary and not available for outside analysis. IRS 990 data are by now available with relative ease and are most typically used to analyze trends in the nonprofit sector. Anheier and Toepler (1998) used 990 data for an initial exploration of the commercialization issue among art museums. Segal and Weisbrod (1998) used these data to chart possible interrelationships between commercial and other revenues focusing on several nonprofit industries, including the arts. While these analyses provided useful insights, the data remain to limited in some respects to allow for a true testing of important assumptions of managerial motivations and organizational behavior. Hughes and Luksetich (1999, p.30) similarly conclude that 990 data are not detailed enough to study revenue interrelationships in necessary detail.

Financial information derived from published annual reports is however a viable alternative. Although there is some precedence in museum research (Alexander, 1996), annual reports are seldom used for research purposes for a number of reasons. Firstly, there is the issue of availability. Not all institutions publish annual reports and some that do only provide financial overviews rather than detailed statements. In addition, there are no central depositories of annual reports, meaning that reports would need to be collected from the individual organizations publishing them. For museums, this last problem is mitigated by the fact that some libraries do indeed collect reports on a regular basis. In our case, we were able to obtain most of the reports we needed through the Milton S.

Eisenhower Library of the Johns Hopkins University, the library of the National Gallery of Art, and the Smithsonian Institution's American Art/Portrait Gallery Library.[4]

Secondly, financial accounting standards and reporting practices tend to change and may cast doubts on the comparability of financial information over time. In the period that we studied, significant accounting changes did indeed take place with the Financial Accounting Standard Board's (FASB) issuance and subsequent implementation of the Statements of Financial Accounting Standards (SFAS) Nos. 116 (*Accounting for Contributions Received and Contributions Made*), 117 (*Financial Statements of Not-for-profit Organizations*) and 124 (*Accounting for Certain Investments Held by Not-for-Profit Organizations*). For our purposes, SFAS No. 117—issued in 1993 and taking effect in fiscal year 1995/96—proved to be particularly problematic and required substantial adjustments to 1996-1999 data to make them comparable to pre-1996 financial information.[5]

All in all, we collected annual report information for a total of 15 museums for an eleven year period from 1989 to 1999. For some of these museums, one or two fiscal years were missing and accordingly estimated. Table 1 shows the museums in our sample as well as the years for which we were able to obtain financial information from the annual reports. These reports provide, *inter alia*, data for auxiliary revenues, gifts and grants, endowment income, admission revenues, and statutory revenues. Six museums report only total auxiliary revenues and expenses; nine museums differentiate between merchandising and other auxiliary revenues. All revenues analyzed here are gross figures

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[4] The helpfulness and willingness of the librarians in these institutions to put up with the high volume of our requests was greatly appreciated and is gratefully noted.

[5] Robin Denning and Maxine Given of the Johns Hopkins General Accounting Office gracefully agreed to take the time to discuss the implications of these changes and the problems and pitfalls associated with various ways of adjusting the data. Their help was invaluable, although they bear no responsibility for any shortcomings of our approach from an accounting point of view.

(before expenses) and in nominal dollars.[6]Although the sample is not representative across the whole museum, or even art museum, field, it is diverse in terms of size of the institutions as well as geographically. In addition, it is also diverse in terms of the extent of merchandising and other auxiliary activities the museums are engaged in. The sample includes five museums with extensive merchandising activities, as evidenced by their operation of mail-order catalogues (Art Institute of Chicago, Metropolitan Museum, Museum of Fine Arts Boston, Museum of Modern Art, NY, and Smithsonian Institution) as well as larger and smaller museums with less pronounced merchandising. As a caveat, many museums do not break out merchandising from other auxiliary revenues and expenses. In much of the discussion below, we will therefore focus on all auxiliary activity.

**Table 1: Museums in Sample and Fiscal Years for which Information was Collected** (Fiscal Year Ending in …)

| | 89 | 90 | 91 | 92 | 93 | 94 | 95 | 96 | 97 | 98 | 99 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Art Institute of Chicago | X | X | X | X | X | X | X | X | X | X | X |
| Cleveland Museum of Art | X | X | X | X | X | X | X | X | X | X | X |
| Denver Art Museum | X | | X | X | X | X | X | X | X | | X |
| High Museum of Art | X | X | X | X | X | X | X | X | | | X |
| Metropolitan Museum of Art | X | X | X | X | X | X | X | X | X | X | X |
| Museum of Modern Art (NY) | X | X | X | X | X | X | X | X | X | X | |
| Museum of Fine Arts, Boston | X | X | X | X | X | X | X | X | X | X | X |
| National Gallery of Art | X | X | X | X | X | X | X | X | X | X | X |
| Philadelphia Museum of Art | X | X | X | X | X | X | X | X | X | X | X |
| San Francisco Museum of Modern Art | | X | X | X | X | X | X | X | X | X | X |
| Smithsonian Institution | X | X | X | X | X | X | X | X | X | X | X |
| Toledo Museum of Art | X | X | X | X | | | X | X | X | X | X |
| Virginia Museum of Fine | X | X | X | X | X | X | X | X | X | X | X |

[6] We also gathered data about public subsidies and private support, revenues through membership programs, and a category “other income”. For some museums we also gathered net revenues. However, these net figures are rarely documented in a straightforward way by most museums; therefore, we had to rely on their documentation of gross figures.

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Arts | | | | | | | | | | | |
| Walker Art Center | | X | X | X | X | X | X | X | X | | X |
| Walters Art Gallery | X | X | X | X | X | X | X | X | X | X | X |

Beyond the development of basic statistics on the scope and financial contribution of merchandising and auxiliary activity more generally, we were particularly interested in conducting a time series analysis of museum revenue sources to gain a more detailed understanding of possible interdependencies between merchandising/auxiliary and other types of revenues.

We use time series analysis to inquire about the relationships between these main sources for museum income because we assume that changes of one revenue type have significant impacts on other revenue sources. Did a change of one source has a positive, a negative, or no impact on other sources? Time series analysis is an appropriate tool to uncover these potential relationships. This statistical method yields regression coefficients controlled for heteroskedasticity (unequal variance in the regression errors), multicollinearity (linear dependence between any of the independent variables) and first-order autocorrelations (high degrees of correlation between neighboring data observations in a time series). If not controlled, heteroskedasticity, multicollinearity and autocorrelation would inflate regression coefficients. In addition, by adding a time lag of one year between the occurrence of a potential independent variable and the potential variance of the dependent variable, one can test statements of causality (cf. Kirchberg, 1999). Using this one-year time lag, we can test causal relationships by switching independent to dependent variables and vice versa in a two-step regression analysis. The change of the dependent variables is always measured one year after the change of independent variables. This is especially valuable for analyzing potential crowding out phenomena among the observed types of revenue. The time series module used for this analysis has been provided by ALMO statistical system (Holm, 2000).

## EMPIRICAL RESULTS

In this section, we test the hypotheses posited above, by asking whether auxiliary activities do make significant contributions to the financing of art museums; whether the extent of auxiliary revenues depends on changes in donative revenues; whether increased auxiliary activity might lead to increased admissions; and whether mimetic forces might help explain the development of auxiliary revenues.

### Does Merchandising Make Money or is the Tail Wagging the Dog?

Since merchandising typically accounts for the lion's share of auxiliary activities, we will begin to pursue this question by first looking at auxiliary activities as a whole. Table 2 shows the revenue structure of the museums in our sample over the eleven-year period from 1989 to 1999. While total operating revenues increased significantly, from approx. $900 million to some $1.5 billion, there was very little fundamental change in the overall composition of museum revenues. Membership dues, admissions, endowment income, auxiliary gross revenues and other income all showed some degree of fluctuation—generally of about two percentage points, but none of these sources either increased or slipped in any significant way. The exceptions are gifts and grants, which jumped from 17% to 21% between 1995 and 1996, and statutory revenues (i.e. government appropriations) showing a slight decrease in the last half of the 1990s. The strong increase in gift and grant income may, at least in part, be a artifact of the data and does not necessarily indicate a broader trend.[7]

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[7] In the past, nonprofit organizations generally recorded contributions at the time of payment. Taking effect for FY 1996, SFAS No. 116 requires that contributions are recorded at the time the pledge is made independent of when the pledge is actually fulfilled. This means that nonprofit institutions have to record in the current year all pledges of contributions for future years as well as multi-year grants. From the data we had, we were not able to determine what share of the recorded increase in gifts and grants in 1996 is due to promises to make contributions in the future. For at least some museums in our sample, we did observe a notable increase in gifts and grants prior to 1996—indicating that the overall increase in this revenue source is not solely due to the changes in the accounting guidelines.

**Table 2: Revenue Structure of Museum Sample, 1989-1999**

| | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Statutory Revenues | 20% | 20% | 21% | 21% | 20% | 21% | 20% | 18% | 18% | 19% | 17% |
| Gifts & Grants | 17% | 17% | 17% | 16% | 16% | 18% | 17% | 21% | 21% | 22% | 21% |
| Membership | 9% | 9% | 8% | 8% | 8% | 8% | 8% | 7% | 7% | 7% | 8% |
| Admissions | 6% | 6% | 5% | 5% | 6% | 5% | 6% | 6% | 7% | 6% | 6% |
| Endowment | 21% | 19% | 19% | 19% | 19% | 19% | 19% | 18% | 17% | 17% | 19% |
| Auxiliary Activities, gross | 21% | 23% | 22% | 23% | 24% | 23% | 23% | 24% | 25% | 23% | 22% |
| Other Income | 8% | 8% | 9% | 9% | 10% | 10% | 11% | 9% | 9% | 9% | 10% |
| Total Operating Revenues* | $902 | $957 | $1,030 | $1,066 | $1,132 | $1,158 | $1,220 | $1,374 | $1,411 | $1,444 | $1,534 |
| Adjusted Op Revenues* | $699 | $738 | $798 | $825 | $872 | $889 | $935 | $1,071 | $1,104 | $1,141 | $1,206 |
| Auxiliary Revenues, net as % of Adj. Op. Revenues | 3% | 3% | 2% | 3% | 3% | 2% | 3% | 4% | 5% | 3% | 3% |

Notes: Adjusted Operating Revenues = total operating revenues minus gross auxiliary revenues plus net auxiliary revenues.
* in million, nominal dollars

For the purposes of this paper, the relative share of gross auxiliary revenues is of particular interest. Primarily comprising merchandising, restaurant, and parking operations, auxiliary gross revenues accounted for slightly more than one-fifth (21%) of total revenues in 1989 and slightly increased thereafter, reaching a high of one quarter of all revenues in 1997 before dropping off again to 22% in 1999. Importantly, throughout the decade, auxiliary activities remained the single-largest source of revenues, generating more dollars for the museums than either statutory funders; other institutional funders and

private patrons; and the endowment. These more business-like activities have thus gained a quite important role in the organizational life of the museum.

However, as noted before, while gross revenues are an indication of the emphasis that museums put on this type of activity, they are not a good indicator of the actual contributions of auxiliary activities towards financing the core functions of the institution. This is so because museums also incur substantial expenditures in running auxiliary activity. To get a better understanding of the true contribution of these activities to the financing of museums, we first calculated auxiliary net revenues by subtracting reported expenditures from gross revenues and then calculated adjusted operating revenues as the sum of statuary revenues, gifts and grants, memberships, admissions, endowment and other income plus net auxiliary revenues.[8] Adjusted operating revenues (AOR) thus represent the funds available for running the museum proper. Table 2 also shows the total AOR for the museum sample as well as the percentage share of net auxiliary revenues of AOR. Adjusted operating revenues grew from ca. $700 million in 1989 to $1.2 billion in 1999—or at a slightly lower rate than total operating revenues.

Seen from this perspective, it becomes apparent that auxiliary activity may not be as lucrative a proposition as the extent of gross revenues might suggest. The share of net results of AOR generally ranges around 3%, with a s little as 2% in 1991 and 1994 and a high of 5% in 1997. What this indicates is that in an era of growing needs and tighter budgets, auxiliary activities are not a "magic bullet" that will solve the financial pressures on museums in fundamental ways. On the other hand, even a relatively small source of income, whose used is under their full discretion, will give museum managers some

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[8] To be sure, this indicator is not perfect. Museums also incur expenditures to generate other types of revenues. Lobbying expenses may be necessary to maintain levels of statutory funding,; securing gifts and grants requires fundraising costs; and expenditures are also needed to retain members and produce membership benefits. A more appropriate way to portray auxiliary revenues would therefore be to show gross profits, i.e. revenues net of costs of goods sold. In our current sample, however, not enough museums report costs of goods sold.

degree of freedom to fill short term funding gaps and help support needs and tasks not covered by more restrictive sources of revenue.

To see whether these findings hold true when looking at merchandising in particular, we performed a similar analysis for the sub-sample of nine museums that regularly report specific merchandising data. Aggregating the more donative types of revenues (e.g., statutory, gift and grant, and membership revenues), Table 3A shows the overall revenue structure of these nine museums. With minor variations over the eleven year time period, contributed (i.e. donative) income accounts for approx. two-thirds of total operating revenues, or slightly less; merchandising and other earned income account for one-third; and miscellaneous other income makes up the small difference. While total and adjusted operating revenues have grown in dimensions similar to the larger sample (Table 2), the balance between contributed and earned income has remained essentially the same. However, there has been a slight shift within the broad earned income category. As borne out in Table 3A, the share of merchandising gross revenues of total operating revenues shows some decline from 20% in the early 1990s to 18% in the late 1990s. At the same time, other earned income, including admissions, endowment and other auxiliary activities show a small, but pronounced increase from 13% in 1989 to 15% in 1999.

Significantly, the slight decrease in merchandising gross revenues is accompanied by a similar decrease in net revenues. The share of merchandising net revenues of AOR was generally about 2% in the early 1990s, dropped to zero in 1994, and then stagnated at one percent for the second half of the decade. Although merchandising gross revenues in this sub-sample held almost as high a share of total operating revenues as all auxiliary revenues in the larger sample (approx. one-fifth), the net returns are considerably lower. What is more, while this is not always fully apparent from the annual reports, the majority of museums appear to report only direct expenditures attributable to merchandising rather than also reporting support service (i.e. indirect) charges.[9] To the

[9] The same is of course true for total auxiliary activities, as reported above.

extent that this is true, the question does arise whether museums—in the aggregate—made any money at all on merchandising in the last half of the 1990s.

**Table 3A: Shares of Contributed, Merchandising and Other Revenues of Revenue Structure, 1989-1999 (n=9)**

| Revenues | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Contributed | 64% | 63% | 66% | 66% | 64% | 65% | 64% | 64% | 65% | 66% | 65% |
| Merchandising, gross | 20% | 20% | 19% | 20% | 20% | 19% | 19% | 18% | 18% | 18% | 18% |
| Other Earned | 13% | 13% | 12% | 12% | 14% | 14% | 14% | 13% | 14% | 14% | 15% |
| Other | 3% | 3% | 2% | 2% | 2% | 2% | 3% | 4% | 3% | 2% | 2% |
| Total Operating* | $767 | $815 | $880 | $919 | $956 | $983 | $1,043 | $1,148 | $1,181 | $1,197 | $1,268 |
| Adj. Operating* | $592 | $627 | $681 | $712 | $739 | $753 | $797 | $895 | $924 | $945 | $992 |
| Merchandising, net as % of adj. operating | 2% | 2% | 1% | 2% | 1% | 0% | 1% | 1% | 1% | 1% | 1% |

Notes: Contributed Revenues = statutory revenues, gifts and grants, membership. Other Earned Revenues = admissions, endowment and investment income, other (i.e., non-merchandising) auxiliary revenues. Adjusted Operating Revenues = total operating revenues minus gross merchandising revenues plus net merchandising revenues.
* in million, nominal dollars

**Table 3B: Annual Change of Main Revenue Groups, Operating Revenues, and Net Merchandising Results, 1989-1999 (n=9)**

| Revenues | 1989/90 | 1990/91 | 1991/92 | 1992/93 | 1993/94 | 1994/95 | 1995/96 | 1996/97 | 1997/98 | 1998/99 | 1989 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Contributed | 6% | 13% | 5% | 0% | 4% | 4% | 10% | 5% | 3% | 5% | 6 |
| Merchandising, gross | 7% | 3% | 6% | 3% | 1% | 5% | 5% | 4% | -1% | 5% | 3 |
| Other Earned | 7% | -4% | 2% | 25% | 2% | 8% | 5% | 4% | 3% | 13% | 6 |
| Other | 12% | -17% | -3% | 18% | -13% | 54% | 59% | -33% | -25% | 9% | 1 |
| Total Operating | 6% | 8% | 4% | 4% | 3% | 6% | 10% | 3% | 1% | 6% | 5 |
| Adjusted Operating | 6% | 9% | 5% | 4% | 2% | 6% | 12% | 3% | 2% | 5% | 6 |
| Merchandising, net | -7% | -46% | 52% | -8% | -67% | 98% | 5% | 43% | -45% | 36% | -6 |

Notes: See Table 3A

What might be the case though is that merchandising in general is loosing ground. This is borne out further in Table 3B showing the annual growth of revenues during the period under consideration. While stagnant at the height of the economic recession in 1992 and 1993, the growth of contributed revenues (62%) has generally outpaced total operating revenue growth (56%); and the same is true for other earned income which grew by 64% from 1989 to 1999. Merchandising gross revenues also continued to grow (with one year of actual decline from 1997 to 1998), with a 39% change over the period, merchandising growth was considerably slower than overall growth. Interestingly, there is apparently no stable relationship between the development of merchandising gross and net revenues. In fact, merchandising net revenues seem to be subject to highly erratic fluctuations (Table 3B). A possible explanation for these fluctuations could be that new product development (conceivably in conjunction with special exhibitions) sporadically increases merchandising costs without immediate effects on total sales volume. This might explain the observable pattern of significant decreases in net revenues followed by sharp increases. Overall, however, while gross revenues have grown, net revenues actually declined not insubstantially over the whole period and net revenues from merchandising do not appear to be a stable source of revenue.

**Are Commercial Revenues Preferred or Non-Preferred?**

While, so far, we have shown the overall development of the revenue composition, we will now examine how these different revenue sources have affected each other, if at all. More specifically, the question is, whether, and if so how much, developments of other types of revenues have had an impact on, or—perhaps phrased in a somewhat less deterministic way—have influenced changes of commercial revenues in museums. A sequence of time-series regression analysis models with auxiliary revenues, and merchandising revenues, respectively, as dependent variables, and the development of other revenue sources as independent variables is the basis for answering this question. Outputs of these time-series analyses are common regression equations, and they have to be interpreted in a similar way by looking at the strength and positive or negative sign of

the regression coefficient B, and the significance level of the t-statistics. The general explanatory value of the *whole* model can be inferred from the F-value of the tested regression model.

Using the indicators of commercial activities (auxiliary revenues and merchandising revenues) as dependent variables assumes that the focus on commercial activities of a museum is not independent from developments of other, more traditional revenue sources. In Hypotheses 2A and 2B we have essentially posited that there will be a negative relationship between donative revenues (e.g., statutory revenues, gifts and grants, and memberships) and auxiliary and merchandising revenues. Since admission fees are also typically seen as a "commercial" income source, we would expect a positive relationship—since admissions can be adjusted much more immediately than auxiliary activities. The following time-series analysis looks at the impact of revenue sources such as admissions, endowment funds, gift and grants, membership revenues and statutory revenues on the development of commercial, i.e., auxiliary revenues in the following year.

**Table 4: Time-series analysis of potential influencing revenues sources on auxiliary revenues**

| Variable | Non-standardized coefficient | Standardized coefficient | Level of Significance |
|---|---|---|---|
| **Admission revenues** | **2.205** | **0.4014** | **96.9134** |
| **Endowment revenues** | **1.045** | **0.4043** | **99.0692** |
| **Gifts and grants** | **-0.801** | **-0.7346** | **96.3808** |
| Membership revenues | 0.051 | 0.0071 | 10.8758 |
| **Statutory revenues** | **0.630** | **0.9546** | **99.2777** |
| Constant | 587.424 | | |
| (F-value for entire model = 758.838) | | | |

As borne out in Table 4, almost all other types of revenues affect auxiliary revenues in a positive (i.e., analogous, not substitutive) way. An increase (alternatively: a decrease) in admission revenues, revenues from endowment funds, and statutory revenues lead to an increase (alternatively: a decrease) in auxiliary revenues (in the following year). The positive relationship between admission fees and auxiliary revenues is in line with our expectations, as is the highly significant negative relationship between gift and grant income and auxiliary activity that was suggested in Hypotheses 2A and 2B. Apparently, when successful in raising gifts and grants, museum managers seem indeed willing to at least decrease their (non-preferred) commercial ventures in favor of these more amenable sources, and vice versa.

However, there is an unexpected, but equally significant positive relationship between statutory revenues, which are also donative, and auxiliary revenues. A possible explanation for this finding may lie in the increasing pressure on museums from municipal funders in particular to demonstrate greater financial accountability and develop strategies for higher levels of economic self-sufficiency in order to justify subsidies.[10] Museums may thus choose to show their willingness to satisfy these demands through increasing earned revenues in the form of auxiliary activity and statutory funders may reward compliance with increased levels of subsidy.[11]

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[10] An example of such pressures was one city's decision to drastically cut annual appropriations to its art museum in the mid-1990s and request outside studies to assess marketing opportunities and cost structures. As the museum's 1995 annual report stated: "The Museum has been advised that if the studies to not show significant untapped marketing opportunities and also conclude that the Museum has an appropriately balanced cost structure, then the City will restore the services provided to the Museum to the level needed to keep the institution operating as it has in the past."

[11] Replacing the variable of auxiliary revenues with the more specific variable of merchandising revenues, we get a similar, however, less distinct picture. The only significant relationship is between statutory revenues and merchandising.

**Auxiliary Activities and Admissions**

Table 5 documents the influence of auxiliary revenues–now as an independent variable together with and controlled for the influence of other revenue sources such as endowment, gifts and grants, memberships, and statutory support – on the development of admission revenues.

Changes of auxiliary revenues have a significant influence on changes of admission revenues (a level of significance of 99.67 can be translated to a very small error probability of 0.33 %). The plus sign in front of the regression coefficient also indicates that this influence is analogous and not substitutive. The higher the auxiliary income the higher are the revenues from the admission booth. Also, the revenues from statutory sources are positively related to admission revenues at a high level of statistical significance. It seems that an increase in statutory income yields more museum visitors in the next year (measured by an increase in admission revenues). This might be explained by a heightened attractiveness of the museum due to more statutory funds. Higher subsidies may be granted to support additional exhibitions or, more generally, allow the museum to use additional resources to expand activities that draw visitors to the museum. As visitation (i.e., the degree of utilization of the museum by the local population) is likely an important argument to argue for (local) public subsidies, the observed relationship seems logical. It is important to note though that we did not measure the yearly attendance, i.e. the actual number of visitors. Therefore, an increase in admission revenues may instead be due to an increase in entrance fees rather than in attendance.

**Table 5: Time-series analysis of potential influencing revenues sources – including auxiliary revenues – on admission revenues**

| Variable | Non-standardized coefficient | standardized coefficient | level of significance |
|---|---|---|---|
| **Auxiliary revenues** | **0.394** | **0.9647** | **99.6713** |
| Endowment revenues | -0.022 | -0.0246 | 12.8446 |
| Gifts and grants | 0.090 | 0.44908 | 8.8558 |
| Membership revenues | 0.664 | 0.5412 | 93.4576 |
| **Statutory revenues** | **0.123** | **0.8349** | **99.4867** |

| | |
|---|---|
| Constant | -7131.846 |
| (F-value for entire model = 25.805) | |

In view of Hypothesis 3, of particular interest here is the positive and statistically highly significant relationship between auxiliary revenues and admissions, which indicates that increases (alternatively: decreases) in auxiliary revenues are followed by increases (alternatively: decreases) in admission revenues. Keeping the important caveat in mind that the increase in admission revenues does not necessarily indicate an actual increase of visitors but may be due to an increase in entrance fees, the finding may be taken to suggest that auxiliary activities might indeed contribute to museum attendance. Even if this finding can be validated, however, the question still remains as to whether shop and restaurant customers in fact decide to come back to see museum exhibitions in later years, or whether any increased attendance is rather a result of greater convenience dues to enlarged parking facilities, which are also part of auxiliary activity.

**Do Mimetic Forces Shape the Development of Commercial Revenues?**

Our fourth hypothesis posits that other museums follow the lead of a small number of nationally prominent museums with extensive merchandising and other auxiliary operations, such as the Boston Fine Arts Museum, the Metropolitan Museum and the Museum of Modern Art in New York City, the Chicago Art Institute and the Smithsonian Institution. The preceding acts of larger museums (e.g., the expansion of museum shops or mail-order departments) will be closely observed by smaller museums that might imitate the strategies of the former. Thus, an antecedent increase in auxiliary income in the sub-sample of larger museums will be followed by a subsequent increase in smaller museums; they, too, will aim at expanding their auxiliary revenues. Using a one-year time lag between the initial actions of the larger museums and the posterior actions of the smaller museums, we can indeed observe this link between these two events. The high level of significance (last column of Table 6, = 98.9483) can be translated into a very minuscule error probability of only 1.05%). Higher auxiliary income for large museums

*in the past* causes higher auxiliary income for small museums in the present.[12] Similar results are gained using the more specific merchandising revenue numbers instead of the auxiliary income numbers. The level of significance is still quite high (97,7561 = error probability of 2.44%); however, the sample with data about this specific revenue source is rather small.[13]

**Table 6: Time-series analyses of influences of revenue changes of larger museums on revenue changes of smaller museums (lag of one year)**

| Variable | non-standardized coefficient | Standardized coefficient | level of significance |
|---|---|---|---|
| 1st time series analysis: one-year lagged influence of larger museums' **auxiliary income** changes on smaller museums' auxiliary income changes | 0.094 | 0.7957 | 98.9483 |
| Constant 1st time series analysis | -2487.842 | | |
| 2nd time series analysis: one-year lagged influence of larger museums' **merchandizing income** changes on smaller museums' merchandizing income changes | 0.125 | 0.7434 | 97.7561 |
| Constant 2nd time series analysis | -4540.628 | | |
| 3rd time series analysis: one-year lagged influence of | 0.036 | 0.6410 | 93.5651 |

[12] This time lag is important: A comparison of auxiliary income levels *for the same year* between these two museum sub-samples reveals no significant coefficients.

[13] As a control, we also tested whether the increase (alternatively: decrease) of statutory income to the larger museums had an subsequent effect on the statutory income numbers of the smaller museums of our sample. Since the subsidizing public authorities are a part of the negotiation process, and of course the change of this revenue source is not an autonomous decision of museums to make (as it is *more* the case with respect to an increased commercialization effort), the occurrence of a similar effect would have indicated that the results for auxiliary and merchandising revenues are a statistical artifact. However, there is no correlation between changes in statutory income between both sets of museums.

| | | |
|---|---|---|
| larger museums' **statutory income** changes on smaller museums' statutory income changes | | |
| Constant | 3rd time series analysis | +4620.761 |

The strength of this result is somewhat surprising, since it essentially suggests that other museums indeed follow developments at a few large museums very closely and make concomitant adjustments in the following year. On the other hand, most museums have specialized staff in charge of stores and other auxiliary operations who may indeed use the "industry leaders" as benchmarks. Relatively quick adjustments can also be the result of close professional networks of specialized staff. Since all museums in our sample—despite substantial variations in size—are drawn from a relatively small group of prominent museums, this assumption may not be too far-fetched.

## CONCLUSION

While limited, the research presented here yields a number of interesting findings. Firstly, while business-like activities of museums, like retailing, food service and parking operations, are of substantial economic proportions, they do not appear to generate net revenues that would allow museums to become more self-sustainable in fundamental ways. While producing much needed income, auxiliary activity does not seem likely to get museums beyond "the state of perpetual deficit" (Temin, 1991, p.179) that they seem to be in. This seems particularly the case for merchandising operations. Moreover what our data may indicate is that museum merchandising at large has already reached the limits of future growth. This is consistent with recent evidence from the field. The Smithsonian Institution re-organized its business ventures, including the museum shops and mail-order operations, in 1999 due to shrinking profits. Then-Secretary I. Michael Heyman stated at the time: "Our enterprises have gone down 25 percent in the value of what we net since about 1985"(Trescott, 1999). In its annual report for the year 2000, one large museums similarly acknowledged that the "Museum, like many museums

across the country, spent months examining its retail division and its effects on the budget. Catalogue sales were down and some suburban stores were not performing well." Finally, a recent *Economist* article (April 21, 2001) cited evidence that retail revenues were also down for New York area museums.

In interpreting these results, it is exceedingly important, however, to avoid ecological fallacies, that is attributing aggregate level findings to the level of the individual organization. Our results do not imply that an individual museum cannot successfully generate net revenues from merchandising. In fact, some museums in our sample have done so, while others have not. A determination of what factors might influence success in expanding merchandising operations is beyond the scope of the current study and a fruitful area subject to future research.

What our findings suggest quite strongly is that museums managers do indeed look at merchandising and similar operations as a "necessary evil" rather than a welcome change of pace from the usual museum business. Although the financial investments in retailing are very significant in some cases and might prove distracting if things do not go well, there is no evidence that museum managers are pursuing business opportunities opportunistically (James 1998) and that mission or goal displacement is a clear and present danger. On the other hand, we found some evidence that there may be a Catch 22 situation with museum mangers feeling the need to keep up commercial operations (even if they might prefer to reduce them) to satisfy demands from statutory and perhaps some private funders as well.

We found that auxiliary activity might have some positive effects on other museum operations, particularly in terms of attracting visitors, although the evidence is weak. At any rate, claims that these activities strengthen educational, public relations and outreach goals of museums cannot be refuted with our data. Whether the pursuit of these goals justify the substantial investments in merchandising activities is, however, another question.

Finally, another potentially important finding is that alternative explanations for the rise of business-like activities may have a high degree of validity. The assumption that smaller museums and other cultural institutions are drawn to engage in or expand merchandising operations – more or less solely based on the example and apparent success of a few visible, large museums – may provide a more reasonable explanation for the rise of commercial activity than the assumption that museums expand their activities based on very clear notions of the actual prospects and limits drawn from their own past experience.

To be sure, while demonstrating the usefulness of the approach, the current study remained to be limited in scope to provide definitive answers to the questions we have posed. Future research requires a larger sample, ideally over an even longer period of time. Some of the effects that we have detected are likely to emerge more clearly with a lag time of two or three years. In addition, our current findings also indicate the need for constructing a broader model. Such as model would also take external variables, such as retail industry trends, as well as additional internal variables into account, including attendance and expenditure developments (Anheier & Toepler, 1998).

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