

Nonprofit Revenue Streams: Finding the right mix

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Background: how do nonprofit organizations support themselves?

- Earned (fee) income
- Charitable giving by individuals
- Institutional philanthropy
- Government grants and contracts
- Membership Income
- Investment income
- Commercial ventures
- Volunteering
- In-kind donations
- Barter and collaborations
- No one way!!



What is unusual about this array of support?

- The fact the nonprofits rely on so many different sources of income
- The fact that certain sources are fairly unique to the sector, e.g. *giving and volunteering*
- The fact that nonprofits rely on widely varying *income mixes*



Questions for research and practice

- What factors explain a nonprofit organization's reliance on specific types of income?
- What factors explain a nonprofit organization's particular mix of income support?
- What guidance can be given to help nonprofit organizations in given circumstances design appropriate income portfolios for themselves?



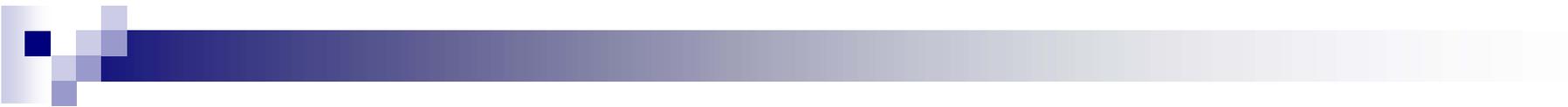
Research strategies

- Synthesize a theory that logically explains why nonprofits pursue particular income strategies
- Investigate empirically what factors appear to influence nonprofits' choices of income mixes
- Derive principles from theory and empirical observation to help nonprofits adjust their practices to achieve greater efficiency and effectiveness



Current status of nonprofit finance theory and research

- Various fragments of theory exist, but require supplementation and integration
- A research project has been organized to synthesize a comprehensive theory of nonprofit finance
- Empirical research is just beginning on the nature and determinants of nonprofit revenue portfolio composition



The Research Project: synthesizing a theory of nonprofit finance

■ Background

- An initiative of the National Center on Nonprofit Enterprise
- Participating scholars (economists and others) from more than a dozen universities in the U.S.

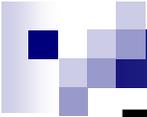
■ Purposes

- Clarify the appropriate role of different sources of income
- Understand the purposes served by diversification and alternative mixes of income
- Develop normative guidelines for designing nonprofit income portfolios
- Synthesize a comprehensive theory of nonprofit finance



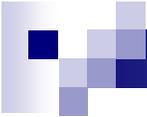
What do we know about the numbers?

- Aggregate income composition, by broad categories of income, for the sector and broad sub-sectors
- Measures of revenue concentration (diversification) by broad sub-sectors
- Measures of variance of revenue concentration within broad sub-sectors



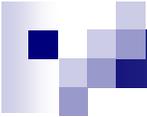
Revenue composition, Salamon, 1996: U.S. public benefit nonprofit organizations

	Excluding volunteering	Including volunteering	notes
Government	36%	25%	incl. gov't insurance programs
Fees	54%	45%	includes investment income
Private Giving	10%	30%	



Nonprofit revenue by subsector – Salamon, U.S., 1996

	Fees	Government	Private Giving
Health	54%	41%	5%
Education	65%	20%	15%
Social & Legal	43%	37%	20%
Civic	27%	51%	21%
Arts & Culture	45%	14%	41%



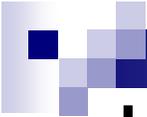
A measure of revenue concentration (Greenlee)

- $\sum_j (\text{Revenue } j / \text{Total Revenue})^2$
- equals 1 if there is just one source of revenue
- approaches 0 as the distribution of revenue is spread over more and more different sources (j)



Revenue concentration by subsectors (Greenlee)

Subsector	Revenue Concentration
Arts, Culture, Humanities	0.46
Education	0.58
Human Services	0.13
Health	0.85
ALL	0.41



How much variation in revenue concentration within subsectors?

(Greenlee, early '90s data)

	Std dev as % of mean revenue concentration
Arts, Culture, Humanities	43%
Education	31%
Human Services	33%
Health	18%
ALL	30%



Examples in the Arts/Cleveland

(special events, sales, other, not shown; source: Guidestar)

	Contrib	Govt grants	Progrm Fees	Investmt	TotRev \$000s	Concntr
MOCA	78%	3%	3%	2%	1397.5	0.62
Cleve Orch	44%	3%	43%	8%	29820.5	0.38
Apollo's Fire	46%	0%	46%	0%	643.5	0.43
Cleve Play Hse	43%	10%	34%	12%	7202.6	0.32



Examples in Human Services/Cleveland

(special events, sales, other, not shown; source: Guidestar)

	Contrib	Govt grants	Program Fees	Investmt	TotRev \$000s	Concntr
Beech Brook	6%	2%	81%	10%	20483.5	0.67
Center for F&C	25%	63%	9%	2%	17842.3	0.48
Free Clinic	45%	50%	0%	1%	3168.4	0.45
Eliza Bryant	0%	0%	99%	0%	8907.1	0.98



What does this (very) preliminary data suggest?

- Sub-sector (the business you're in) seems to make a difference in where you get your revenue and how diversified it is
- Substantial variation both among and within sub-sectors – other factors are at work:
 - Different conditions?
 - Different business models?



What further empirical work is needed?

- Estimates of income concentration and its variation within narrower sub-sectors
- Investigation of factors that may influence choice and mix of income sources:
 - Nature of good or service (mission, fields within sub-sectors)
 - Organizational parameters such as size, age and initial capitalization (e.g., endowment)
 - Organizational context such as location and the competitive, political and regulatory environment



What theories help us understand the variations in source dependence and revenue mixes?

- Theories offering *rationales* for pursuing different types of nonprofit revenue
- Theories underlying *diversification* of nonprofit revenue sources



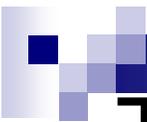
Theory for different types of nonprofit revenue: puzzle pieces

- ***Contract failure theory*** explains how nonprofits can compete efficiently in the marketplace where trust is important
- ***Theory of markets*** suggests that nonprofits may have other competitive advantages in producing certain private goods and in attracting corporate support
- ***Price theory*** suggests various ways in which charging for services can improve the efficiency/effectiveness with which nonprofit services and resources are utilized
- ***Public goods theory*** explains why government and philanthropic financing, or profits from sales, may be needed to produce some nonprofit services; and why government sometimes provides inadequate support, or chooses to support nonprofits rather than provide services directly
- ***Organization theory*** suggests that nonprofits require independent forms of income to maintain mission focus, hedge against risk and pursue innovation



How do these theories help us understand the roles of various streams of nonprofit income?

- **Fee income**
 - To finance trust goods
 - To finance profitable commercial goods where the nonprofit has a competitive advantage
 - To encourage more effective use of services and resources
- **Charitable Contributions**
 - To subsidize public goods and *externalities* (where government support is insufficient)
- **Government funding**
 - To support public goods and compensate for externalities where government programs are consistent with mission
- **Corporate support**
 - To finance public goods and externalities, and pursue mission-related objectives consistent with corporate interests
- **Investment income**
 - To underwrite public goods and externalities
 - To support flexibility and autonomy, and manage risk



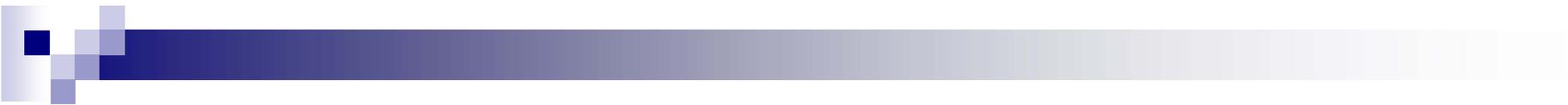
Theories supporting diversification of income sources: more pieces to the puzzle

- *Theory of nonprofits as multi-product firms* suggests the need for a balance of profitable and loss-making activities in order to maximize mission impact
- *Theory of public goods (specifically externalities)* suggests the need for a mix of private and public or philanthropic sources of revenue
- *Portfolio theory* suggests the value of diversification to manage risk by hedging against the volatility of any given source of income
- *Organization theory* suggests that multiple sources of income may enhance flexibility to experiment, innovate and adjust in response to changes and complexity in the environment (requisite variety)
- *Theory of analysis at the margin* suggests that mixes are often more *productive* than singular solutions and that finding the best mix of revenues may involve analyzing the *trade-offs* between one source of funds and another, “at the margin” (including “crowd-out”)



Where do we go from here?

- Integrate and extend the theory
- Analyze the determinants of choice of dependence and mix of income sources through empirical research
- Develop practical guidelines for nonprofit practitioners to design their revenue strategies based on state of the art knowledge
- Write the text book on nonprofit finance



Summary

- We are breaking new ground: a theory of finance specifically for nonprofits
- Holistic theory will require tying many pieces together and finding some missing pieces
- Plan to publish a book on nonprofit finance theory in 2006
- This work is of practical importance to sector decision makers as well as to researchers, teachers and students
- Mandel Center is a partner with NCNE in this effort
- This kind of research contributes to the Mandel Center as a cutting edge learning environment featuring faculty and students engaged in research and faculty who design their teaching around state of the art knowledge