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Nonprofit Ventures

The good ones are profitable

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In the nonprofit world, "blending of the sectors" is a phrase that is often used.

Many use the catch phrase to talk about the growing cooperation between nonprofits and the public sector. Particularly in the areas of social service and education, there has been a growing tendency for the public sector to accomplish its tasks by contracting with nonprofits.

But, the sectors are blending in other ways, as well.

Faced with increasing competition for donations and public funds, a growing number of nonprofits are turning to commercial ventures. A number of hospitals have created small malls of shops and restaurants to serve patients and visitors. In West Chester, Ohio, the new hospital affiliated with the University of Cincinnati contains 75,000 square feet of retail space.

For some museums, like the Metropolitan Museum in New York, gift shops generate substantial revenues. Jumpstart, a Boston-based organization that provides early educational intervention and mentoring for at-risk preschoolers, has recently explored setting up a for-profit subsidiary marketing preschool educational materials.

In an ideal world, such ventures can build on the core strengths of the nonprofit and at the same time generate funds to support the organization's mission-related activities. Unfortunately, in the world of practice, these commercial ventures can also divert attention from the real work of the nonprofit, while adding little to the bottom line.

In what follows, some broad guidelines that nonprofits might keep in mind as they pursue these commercial ventures are outlined.

It goes without saying, but nevertheless must be said, that the foremost characteristic of the new commercial ventures must be that the venture is capable of generating a profit. This distinguishes such ventures from the more ordinary, mission-driven activities which may simultaneously generate program revenues.

For a commercial venture, there must not only be demand for the product or service of the venture, but demand must be strong enough to support a price that more than covers costs of production. For nonprofits that daily face the challenges of raising donations from an increasingly competitive philanthropic pool, it can often seem easier to generate revenues through a business.

It is wise to keep in mind that the failure rate in the United States for small business— and most of the businesses started by nonprofits will be small by design to preserve their nonprofit tax status— is very high. To succeed, the nonprofit must be able to offer the market something not proffered by the current competition. The nonprofit must have a competitive advantage.

So, where does the typical competitive advantage come for a nonprofit? For most groups, a new commercial venture will only be able to generate a profit if the new venture builds on the core mission and assets of the nonprofit. It is most typically the connection with the core mission that offers the nonprofit the possibility of a competitive advantage over its rivals.

Given that often times the rivals for the goods and services of the new venture will be for-profit, it is worthwhile thinking about what kinds of advantages and disadvantages nonprofits have vis a vis for-profits.

The advantages that the for–profit have compared to most nonprofits is access to equity markets. Thus, most for- profits can grow more quickly than the nonprofit. For this reason, ventures with a high minimum efficient scale are not good grazing grounds for the nonprofit, for they will not be able to scale up sufficiently quickly to make the venture work. These scale effects have increasingly cropped up in the health care markets and have contributed to the move away from the nonprofit form.

On the flip side, in markets in which goods and services are complex and hard-to-evaluate, the greater trustworthiness of the nonprofit can provide an important competitive advantage.

Nonprofit status and reputation can substitute for the costly marketing and public relations efforts that the for-profit must undertake in these kinds of markets. The nonprofit's reputation is most useful when the new venture is in the same broad product area as the core mission activity. So, a simple rule of thumb for nonprofits is to keep new ventures close to the mission activities. Notice the driver here is not ideology but economics.

For the nonprofit, a new earned–income venture must fit not only with the core business of the organization, but with the character of the nonprofit structure more generally. This rule holds true even when there are plans to spin off the new venture into a for-profit subsidiary, for even within this structure, the influence of the nonprofit heritage will remain.

As a general matter, decisions both about program and a staff will be affected by the nonprofit linkages. In licensing its characters, for example, public television imposes limits on itself. Yale University, like most of its sister organizations, has an office devoted to deciding to

whom the Yale name can be licensed. While licensing is certainly done for incremental revenues, the identity and purpose of the licensees is clearly of considerable import.

Imposing constraints on your choices in this way has some costs. Given that the nonprofit will face more constraints on its strategic options as it manages a new venture, it must have some countervailing competitive advantage if the venture is in fact going to deliver the hoped-for subsidies.

One of the challenges for the nonprofit to recognize that while for many of its core activities, it is enough to cover variable costs, with donations picking up overhead allocations, the right standard for a new commercial venture should be coverage of variable costs, incremental overhead (new fixed costs associated with the venture) and some profit margin. For new ventures that are linked to the core mission—and most good new ventures will be—allocating joint costs will be especially hard. Yet, new ventures cannot possibly help to cross subsidize the core mission of a nonprofit unless the subsidy is genuine. For a mission-driven nonprofit, calculating all of the real opportunity costs associated with launching a new venture and accounting for those costs can be quite challenging.

Despite the challenges of launching new earned income ventures, the promise of these ventures for bringing new money to the social table is considerable. In recognition of both the promise of these ventures and some of the difficulties in launching them, the Yale School of Management in partnership with The Goldman Sachs Foundation and The Pew Charitable Trusts, is initiating a business plan competition for nonprofit organizations. Beginning in May, 2002, The Yale SOM- Goldman Sachs Foundation Partnership on Nonprofit Ventures will launch a national business plan competition open to all nonprofits. The competition will assist promising nonprofit organizations to start or expand successful profit-making ventures. All nonprofits that submit plans will have them reviewed by a team of academics and consultants, who will provide feedback.

The top 20 organizations will be given on-site technical assistance in refining the plans. Finally, the four grand prize winners will each receive $100,000 in seed capital and hundreds of hours of technical business planning consultations to assist their organizations to move their ventures forward. Four semi-finalists will each receive $25,000 in seed capital as well as technical business assistance.

For more information about this competition, please go to the Web site at http://ventures.yale.edu.

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