Nonprofit Revenue Portfolios: What Should Your Revenues Be?

DR. ELIZABETH SEARING

HELEN BADER INSTITUTE FOR NONPROFIT MANAGEMENT

FEBRUARY 3, 2020

https://tomremington.com/2018/08/27/bears-menu-for-fine-dining/

Agenda

- What's on the menu?
- What do I have (or have access to)?
- What should I be eating?

The Many Faces of Social Economy Revenues

The "Nonprofit" Diet

- Contributions
  - Individual
  - Related org
  - Govt grant
  - Private foundation
- Earned Income
  - Market exchange
  - Govt contracts
- Memberships
- Finance/investments

The "For-profit" Diet

- Private investors
  - Venture
  - Angel
  - Standard
- Earned Income
- Finance/investments
- Commercial banking

The Modern "Hybrid" Diet

- DAFs: donor or investor?
- New donation modes
- Earned income
- Hybrid funds
- Finance/ investments

What do we actually eat?

- What revenue types do you have?

- Which type is dominant?

What do we actually eat?

- What revenue types do you have?

- Which type is dominant?

- What is an example of a revenue type you've tried to acquire?

- Why did or did it not work?

What Should We Be Eating?

What do social enterprise and losing ten pounds have in common?

Approaches to Building a Revenue Portfolio

- Revenue-benefits theory (Wilsker & Young 2010; Prentice 2015)

- Revenue-beneficiary theory (Young 2017)

- Cross-subsidization (James 1983, 2013)

- Risk management and diversification (Chikoto & Neely 2014; Hung & Hager 2019)

What's so special about being *nonprofit*?

- We provide public goods using private tools

- The characteristics of these goods help determine what types of revenues are best
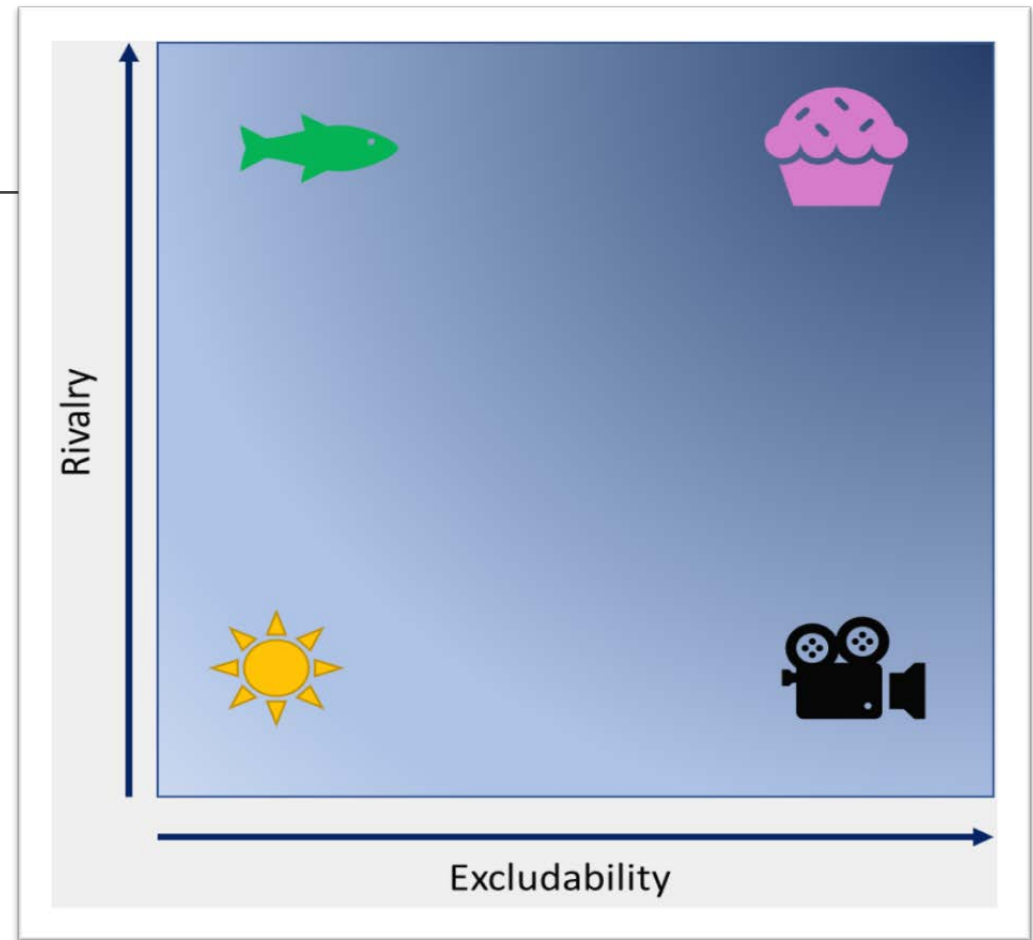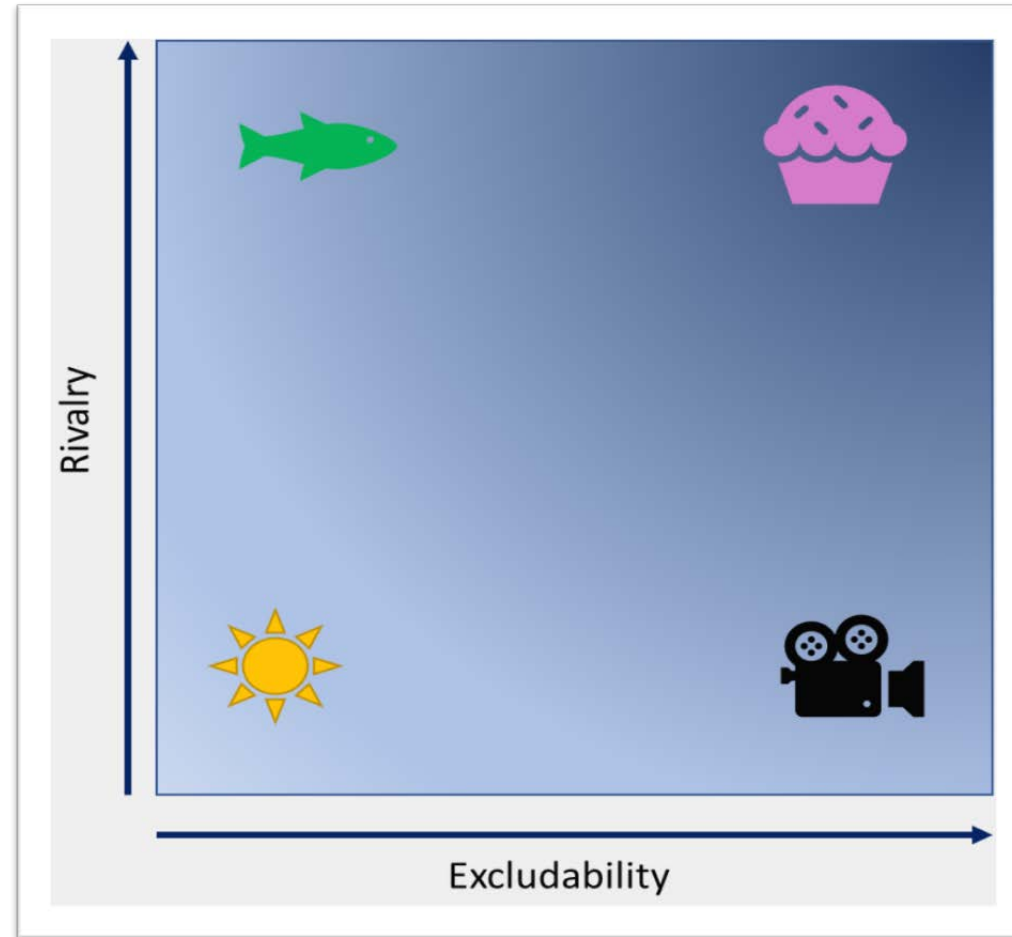
Benefits Theory: Goods

Type of good		Distinctive source of income
Private (market) goods		Earned income, fees
Public and common pool goods		Government grants and contracts
Group (club) goods		Philanthropy and volunteering; membership dues
Redistributive goods		Fees plus government and philanthropy
Exchange goods		Miscellaneous including fees, gifts, volunteering

Benefits Theory: Goods and Beneficiaries

Type of good	Beneficiaries	Distinctive source of income
Private (market) goods	consumers	Earned income, fees
Public and common pool goods	general public	Government grants and contracts
Group (club) goods	limited communities of interest	Philanthropy and volunteering; membership dues
Redistributive goods	needy consumers	Fees plus government and philanthropy
Exchange goods	organizational partners and special supporting groups	Miscellaneous including fees, gifts, volunteering

Benefits Theory: Examples

Income combination	Example	Why?
Fees only	Tracing family tree	Consumer benefit only
Gifts only	Rare disease research	Benefits those afflicted or at risk
Gov't only	Offender rehab services	Increases public safety
Fees & gifts	Performing arts	Private benefits to attendees; collective benefits to art lovers
Fees & gov't	Pre-school care	Private consumer and general public benefits
Gov't & gifts	Monitoring environmental quality	Benefits to outdoor enthusiasts and general public
Fees, gifts & gov't	University education	Private student, collective alumni, gen'l public benefits

Table 4.2, p. 71 from Young, Dennis (2017). *Financing Nonprofits and Other Social Enterprises: A Benefits Approach*. Cheltenham: Edward Elgar Publishing.

The Benefits Approach

- Revenue Type

- Problem & Activity

- Benefit Fit

- Mission Alignment

- Implementation

- Possible Issues

The Benefits Approach

- Revenue Type – what broad category of revenue or support are you referring to?

- Problem & Activity – what activity or program are you trying to fit funding to, and to solve what problem?

- Benefit Fit – what about the activity or good provided through the program makes it a good fit to the revenue? For example, who are the recipients and what type of good is it (public, private-redistributional, etc.)?

- Mission Alignment – does this activity or good fit in with the nonprofit's mission?

- Implementation – how would this resource be gathered? Would anything significant need to happen or change in order for this activity to occur, such as new materials, new audience, or new advertising?

- Possible Issues – what possible complications might occur?

The Benefits Approach: An Activity Example

Revenue Type - Donation

Problem & Activity – Food pantries have a lack of produce, so we need to solve the issues regarding access to produce for those accessing the food pantry

Benefit Fit - The good is one that is private (a head of lettuce is both rival and excludable), but it is not accessible to the target audience. This means that it should be a good fit for revenues that fit either a market, redistributional, or exchange good.

Mission Alignment - This activity does fit in with the nonprofit's mission because it provides healthy produce to those who may need it.

Implementation - As a redistributional good, then donors will be willing to donate to provide access to this private good. This can be through a direct donation of produce by individual or corporate donors (such as the donation of food by restaurants and grocery stores.) Donors can also give cash to support the purchase of produce from vendors. This purchase could also be done at a reduced price. The exchange good approach may work well if the names of the donors (especially the corporate ones) are mentioned prominently.

Possible Issues - This approach assumes the existence of extra produce on behalf of either individual or institutional producers. There may also be quality control issues if this extra produce is no longer fresh or has decreased in market value for some reason. As a market good, the produce could also be subsidized to an extent where the pantry patrons can pay a nominal charge for it (but still pay something.)

Cross-Subsidization

Mission   **Complementary**   **Cross-subsidizing**

Ticket sales

Art prints

Soft drinks

Cross-Subsidization

- One of the first revenue portfolio strategies

- Should you cross-subsidize?

  - Benefits: income smoothing, synergies with mission goods

  - Issues: tax issues, mission drift

- Always involve board, accountant/CFO, and lawyer

- What are some ideas for your nonprofit?

Risk Management and Diversification

- Protections against dependency

- Protections against revenue shocks

- Diversification

  - Benefits: shock protection, protection against "financial vulnerability"

  - Issues: HR and revenue management needs, tax issues

The Herfindahl-Hirschman Index (HHI)

$$HHI = \left(\frac{Revenue\ Type\ A}{Total\ Revenues}\right)^2 + \left(\frac{Revenue\ Type\ B}{Total\ Revenues}\right)^2 + \left(\frac{Revenue\ Type\ C}{Total\ Revenues}\right)^2 + \ldots$$

Nonprofit #1 $\quad HHI = \left(\frac{95}{100}\right)^2 + \left(\frac{3}{100}\right)^2 + \left(\frac{2}{100}\right)^2$

$$HHI = .9025 + .0009 + .0004$$

$$HHI = .9038$$

Nonprofit #2 $\quad HHI = \left(\frac{50}{100}\right)^2 + \left(\frac{40}{100}\right)^2 + \left(\frac{10}{100}\right)^2$

$$HHI = .2500 + .1600 + .0100$$

$$HHI = .42$$

Risk Management and Diversification

- What is your HHI? How does it compare to others that do similar things that your nonprofit does?

- What risks does your current revenue portfolio expose you to?

- What would be the ideal revenue source to diversify into, based on where your risks are?

Takeaways from Today

- You now know how to describe and analyze your revenue portfolio, dependencies, advantages, and risks

- Your revenue portfolio reflects several different characteristics, some of which are easier to change (staff knowledge, risk tolerance) than others (characteristics of goods or beneficiaries)

- There are several ways to evaluate whether your portfolio is a good fit – know them all, and remember that it never stops evolving!

Thank you!

Elizabeth A.M. Searing, PhD, CNP

Assistant Professor

Rockefeller College of Public Affairs & Policy

University at Albany -- State University of New York

esearing@albany.edu