Video Transcript

ENTREPRENEURSHIP IN NONPROFITS

Academic insight: Elizabeth Searing

[Georg von Schnurbein] What are the differences in for-profit finance compared to nonprofit finance?

[Elizabeth Searing] There are four major differences in nonprofit and for-profit finance. The first, it is the variety of the different types of sources that you can bring in. You, especially in the US context, which is the one with which I'm most familiar, you can bring in earned revenues from selling T-shirts, you can bring in government grants for providing basic human services, you can bring in foundation money, you can bring in individual donations. There really is this huge variety that for-profits, it's really more straightforward because you have the market, you might have private investors, but it's much more complicated on the nonprofit side.

And really, it's more complex as well. There are more rules. And the example I always give to colleagues of mine that have for-profit backgrounds, is that if you walk into McDonald's, and you hand them $3 US for a cheeseburger, that would be normal. But then imagine saying something like: “you can only use this money to buy the meat. And I don't want to use any of this money to pay for the salaries of the managers and any other administrative expenses.” They would look at you like you were crazy. But if you were a nonprofit, that would actually be relatively normal to have to deal with donor stipulations. And so that makes, regardless of what type of revenue you're bringing in, it's often more complex when you actually bring it inside your organization.

And then there's access to capital, which is a little bit more difficult for nonprofits as well. I know that in Germany, Italy, England, not so sure about Switzerland, and the US, we have to deal with the asset lock, which means that you're not able to tempt investors by saying that you can own a part of the company because it's publicly owned. There are no technical owners. So this makes it difficult to raise capital like you would if you were a for-profit organization.

And that kind of brings us to the last one, which means that, really, the incentives are different when trying to convince someone to invest in your nonprofit organization. And I know this is allowed for a lot of growth in terms of social enterprise, whether that's for-profit or nonprofit or blended. But the ability to tell someone that you're both needing to make a go of it as an organization, meaning that you need to have enough money to pay your staff, to be sure you can deliver services tomorrow, and be able to play – not only play on, but rely on their faith in good, that they should be giving money to social services.

It means they are having to pull on both their business side and on their charity side. And you have to do both in order to get them to donate money to the nonprofit. And that makes it, I would say more complicated, but definitely richer and different than on the for-profit side, because there it's profit maximization, and it's relatively straightforward – much more complicated for nonprofits.

[Georg von Schnurbein] Can you please give a short explanation of the benefit theory of nonprofit finance?

[Elizabeth Searing] The benefit theory of nonprofit finance means that there is a connection between the type and characteristics of the good or service that you're offering and the ideal type of funding that would go into providing that service. And so when I talk about the characteristics of the good or service, I primarily mean whether it's rival and whether it's excludable. So excludable in that can I keep other people from consuming whatever this good is, and rival in terms of if I consume it is it going to disappear or can everyone have some.

So, for example, something that is both rival and excludable is a cupcake. So there's one cupcake, then I can keep everyone else from eating it. And once I eat it, it's totally gone. But something that is neither rival nor excludable would be sunshine. It comes down, everyone can have it, and it's really tough to keep someone from getting sunshine. It's possible, but generally, it's very, very difficult.
And so using these to describe your good or service helps lead you toward the right type of funding. So, for example, if you are offering a good or service that is available to absolutely everyone, and you can't keep anyone from consuming it, then it's going to be difficult to offer it on the private market. Things that are easy to get earned revenues for are things that are rival and excludable. You can sell these pieces of service. And so a lot of what we try and do as nonprofits when we try and venture into earned revenue, is we try and sell pieces of things.

But regardless of how much you might want to turn a good or service you have into something that you can take to the private market, sometimes you're going to be best fitted to a source of funding that is not an earned revenue. So, for example, if you were providing social safety net services, and you're unable to turn anyone away because that's not part of your mission, then it's going to be very difficult to charge individual people, individual consumers for that service.

And so this is, I think especially helpful, when we start thinking about the trend, especially in the US to push nonprofits into earned revenues. A lot of nonprofits will come to me and say, we don't want to be dependent on, for example, government grants. However, sometimes government grants are the ideal fit for what it is that you do and you shouldn't try and warp what it is that you want to provide to your service recipients in order to meet a certain type of funding.

[Georg von Schnurbein] Is there an ideal mix of financial sources for nonprofits?

[Elizabeth Searing] Well, the quick answer to that is 'no' because your financial portfolio is going to depend very much on the types of services you provide, the ecosystem that you exist in, what the individuals around you feel is appropriate for you to have as a funding source, whether or not these services you provide are, for example, providing mental health services, where it might be difficult to go out and talk about it, or are you providing something that – are you saving puppies, which everyone wants to talk about.

But that said, I do think there are things that are healthy. So it's very healthy to not concentrate on one particular source because then if something happens to that source, then you're going to find yourself in dire straits. I also think that it's healthy to have some component of earned revenue, not just because, at least in the US context, government funding can be hit or miss. But also, because for earned revenues they often give you less restrictions.
Remember we were talking earlier about complexity? Selling that t-shirt, generally you can do whatever you want with that income and it frees you up. So it's always easier, or it's healthier to have some of that in your income portfolio compared to maybe amounts of money where there are very, very specific restrictions on what has to be done with it.

So if an emergency comes your way, you're not going to be able to deal with it. So there is no definite "50% earned revenue, 50% something else", it'll depend very, very much on you. It's kind of like your own individual diet. There are certain things you probably shouldn't be eating, but the ideal diet is going to vary depending on each person, each situation. And it's just the same for your nonprofit organization.

[Georg von Schnurbein] Thank you for your time. It was a pleasure talking to you.