Trend Reporter Special Report: Nonprofit Earned Income

In a survey completed in August 2014, 56 Trend Reporters\(^1\) offered their perspectives on nonprofit earned income. These perspectives, reported here, are not expected to provide definitive or exhaustive discussion of the complexities of nonprofit earned income; however, they do offer food-for-thought for nonprofit leaders and ideas for future inquiry and research.

Overall, data suggest Trend Reporters see the possibility for earned income activities to diversify funding sources, create potentially stable streams of revenue, and help nonprofit organizations become self-sustaining. As one Trend Reporter summarized, “The future of non-profits includes the blending of for-profit activities with nonprofit. Nonprofits can no longer rely solely on financial donations.” However, it was also clear that earned income initiatives pose challenges that must be carefully considered.

**Background and Definitions**
Earned income is not a new phenomenon to the nonprofit sector. In fact, 73 percent of all nonprofit revenue is currently generated through program services (National Center for Charitable Statistics, n.d.). Sources of revenue vary greatly by subsector. In San Diego, for example, program revenue comprises 86 percent of income generated by higher education nonprofits and, at the other end of the continuum, only eight percent of income generated by international nonprofits (Schumann, Jones, Hunt, Krasymska, & Deitrick, 2014, p. 7).

Nonprofit earned income can take a variety of forms. For example, revenue generating initiatives can be undertaken within the structure of the 501(c)3 organization, through partnerships with other entities, or by forming a separate corporation (Jones & Donmoyer, *in press*). Earned income is typically categorized as either related to the nonprofit’s mission (and, thus, tax-exempt) or unrelated to the mission (and, thus, taxable).

This report does not address the legal distinctions in types of earned income but, rather, attempts to understand Trend Reporters’ perceptions about earned income in general. Earned income appears to be increasing in popularity among funders and the general community (see, for example, Chhabra, 2013; Fruchterman, 2011; & Tait, 2011). Recently, for example, a San Diego-based community foundation made the decision that in order for nonprofits to be highlighted on its website, they must have earned income. And, on a similar note, the New York Times recently

\(^1\) The Trend Reporters participating in the Caster Center’s State of Nonprofit Quarterly Index are not a representative sample.
highlighted the story of how one nonprofit founder decided to convert the organization into a for-profit company in order to, among other desired results, change the revenue structure (Chhabra, 2013). Anecdotes such as these one may signal important shifts in how society: 1) approaches nonprofit revenue generation; 2) views the nonprofit sector; and 3) makes decisions about funding/donating to nonprofits. Given the potential impact of these shifts, it is important to explore and research this topic, and nonprofit leaders (i.e., Trend Reporters) can provide invaluable “on the ground” perspectives of these changes and trends.

Trend Reporters and Earned Income
Of the 56 Trend Reporters surveyed, 25 (45%) engaged in one or more types of earned income activities. As can be seen in Table 1, one-half (52%) charged clients for services and one-third (34%) sold products to clients. Twenty-nine percent sold products or services to the general community and 27 percent partnered with corporations in cause marketing. Additionally, 16 percent engaged in Checkout Charity campaigns and 11 percent licensed their brand or trademark. Other earned income opportunities included renting facilities and receiving developer fees as part of developing affordable housing. Seven organizations (29%) indicated they were currently exploring earned income initiatives.

Table 1. Earned Income Initiatives in Trend Reporter Organizations (n=25)

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<table>
<thead>
<tr>
<th>Initiative</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Charging clients</td>
<td>52%</td>
</tr>
<tr>
<td>Selling products/services to clients</td>
<td>34%</td>
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<tr>
<td>Selling products/services to the general community</td>
<td>29%</td>
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<tr>
<td>Partnering with a corporation in cause marketing</td>
<td>27%</td>
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<tr>
<td>Engaging in Checkout Charity campaigns</td>
<td>16%</td>
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<tr>
<td>Licensing your brand or trademark</td>
<td>11%</td>
</tr>
<tr>
<td>Other</td>
<td>29%</td>
</tr>
<tr>
<td>Not applicable</td>
<td>18%</td>
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</tbody>
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The Benefits of Earned Income
There are many potential benefits to earned income activities. Specifically, Trend Reporters suggested that earned income might help a nonprofit organization:
- Diversify income
- Stabilize and control income
- Generate unrestricted funds
- Strengthen the nonprofit’s brand
- Provide employment training opportunities for clients
- Offer clients an opportunity to contribute to (i.e., pay for) part of what they receive, thus giving them an opportunity to, as one Trend Reporter described, have “skin in the game”

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2 For brevity, the terms “clients” is used to describe clients, patients, patrons, and/or any relevant constituents.
In general, the trend toward earned income was seen as positive. As one Trend Reporter wrote, “I would like to see the nonprofit sector strengthen by diversifying their revenue and not relying solely on donations. I think a revenue model can also make our products and services better -- when clients pay they expect a new level of professionalism, and I think that’s a good thing. My concern is that people (funders, orgs, etc.) will see it as one or the other, not both/and.” To that end, another Trend Reporter hopes “that the hype will die and [earned income] will be looked at realistically for the nonprofit sector.”

**Funders’ Influence**

Funders often have tremendous influence over how nonprofits are managed. A shift in how funders think about earned income would be an important signal to note. Thirty-nine percent of responding Trend Reporters had not observed a shift in how funders think about earned income, 28 percent had observed a shift, and 33 percent were uncertain (i.e., “don’t know”).

Of the 15 Trend Reporters who had observed a shift, many indicated there are increasingly more funders who evaluate earned income as a positive sign, and are asking nonprofits to provide information about it. As one Trend Reporter indicated, “there is a conversation about the topic which was not present in the past.” This suggests that nonprofits with earned income initiatives may be more competitive in the eyes of potential funders.

There is a learning curve for funders interested in earned income initiatives. Trend Reporters suggested that funders often don’t, as one wrote, “understand the complexities and cultural differences of operating such services in a nonprofit.” Another Trend reporter suggested that, “business leaders expect to teach nonprofits how to generate earnings, but [those same business leaders] also need to be taught more comprehensively about how and why the nonprofit sector works well without it.”

While Trend Reporters recognize the learning curve for both funders and nonprofits, they seem optimistic about the future of earned income as an increasingly significant revenue source for nonprofits. One Trend Reporter hopes, “that the discussion continues, and that funders are willing to invest in helping nonprofits take the startup risk.”

**Removing the Rose Colored Glasses**

While the idea of earned income appealed to many Trend Reporters, responses suggested that there is still much to be considered, and earned income is not, as one Trend Reporter commented, the “silver-bullet” it may be perceived to be. Many of these challenges have been documented by scholars and pundits (see, for example, Andersson, 2011), but this report focuses specifically on the perceptions of these challenges articulated by Trend Reporters.

**Round Peg in a Square Hole?**

A number of Trend Reporters cautioned that earned income initiatives are a good fit for some nonprofit organizations, but are not appropriate for every mission. As one Trend Reporter wrote, “Not all programs can be turned into revenue generating activities. If they could, for-profit businesses would undertake them and nonprofits would be unnecessary.” For example, another Trend Reporter contended that earned income activities might not be practical for nonprofits serving low-income communities that cannot afford services or products, or if they could afford...
to pay even a nominal fee, those fees might not be enough to sustain the organization. For such nonprofits, the organization’s core work is, essentially, not profitable.

On the other hand, revenue generation is a good fit for many nonprofits. For example, theater companies can sell tickets and hospitals can charge patients for services. Animal shelters can offer behavior training classes or sell pet food and other related supplies. In deciding whether or not to pursue earned income, it is important, as one Trend Reporter noted, for “nonprofits to understand their market and their strengths, and play to it accordingly.”

Organizational Capacity
Profitable earned income initiatives may require a very different set of skills than those traditionally found in nonprofits. One Trend Reporter wrote, “I love the idea of creating my own income and transferring profits to make my agency self-sustaining. There are several challenges in making this happen: 1) identifying the right business, 2) development of a business plan, 3) investment funds. It is a noble idea but it is very difficult to implement without securing outside expertise.” More specifically, one Trend Reporter who was already heavily engaged in earned income activities discussed the challenges of keeping up with demand for the products sold by the nonprofit: “Shipping and maintaining inventory is a challenge. We also need to establish a better online store.”

Clearly, in order to develop a profitable business venture, nonprofits must have sufficient expertise on staff or available either through outside consultants or the Board of Directors. In some cases, this may be challenging. As one Trend Reporter commented, “The skill set required for revenue generating activities is generally different from those generally found in the nonprofit arena.” Moreover, nonprofit leaders must find ways to fund staff during the initial startup phase. One Trend Reporter cautioned that, “Nonprofits are generally very under staffed, so moving into this type of venture could stretch an already overextended staff.”

Risky Business
There is always risk in starting any business venture, and Trend Reporters are fearful of those risks “bleeding into” the mission of the organization. One risk, of course, is failure. One Trend Reporter expressed concern that, “because the reality is that most businesses fail … and if the expectation is that a nonprofit director is to rely on the development of a business to support their work, then they are risking the future of the organization in a way that I do not think we have fully grasped.”

Failure isn’t the only risk; even successful business ventures bring unanticipated consequences. Trend Reporters expressed concern about the effects of earned income on philanthropic giving. As one Trend Reporter noted, “My biggest concern is that the successful implementation of earned income efforts will be misinterpreted to mean that our organization will need less or no community support.”

There is also the risk, as many Trend Reporters commented, of being successful but not profitable. In some cases, the nonprofits’ businesses provide deep mission-related value but do not generate a profit. This type of situation is easy to imagine for organizations working with high-risk or developmentally disabled clients. In such situations, leaders are faced with a difficult
situation. As one Trend Reporter commented, “We already do some programs with earned income and they are successful but just barely cover their real expenses and are a very small percentage of our agency-wide budget ... [However,] the activity does support the mission ... and will be sustained."

**Mission Drift**
Nonprofits must also consider issues of mission drift when the board and senior leadership turn their attention to income-generating activity and, potentially, away from the core activities of the mission. This could lead to the provision of what one respondent described as “inferior service.” As another Trend Reporter noted, “The concern I have is that organizations get consumed with running a non-core business, off their core mission, and eventually running the business for earned income becomes their mission rather than the reason for their creation and service.”

**The Power of Giving**
Even as Trend Reporters expressed an excitement about earned income activities, they also indicated that philanthropy would, likely, always be an important part of the sector’s revenue. As one Trend Reporter wrote, “On balance, nonprofits will always be reliant on contracts, grants and charitable contributions. It is critical that the larger civil sector continues to give charitable support so that nonprofits are permitted to focus on the business of doing good work versus generating earned income.”

One Trend Reporter expressed a concern that earned income was a trend at all, commenting, “I believe it’s a bad sign. What’s going on with philanthropy in this country that we have THIS conversation?”

**Conclusions**
Overall, it is clear that earned income is an important topic to Trend Reporters and an important trend to follow. More than half of the respondents were either already engaged in such activities or currently exploring their options. The issues weighing on their minds reflect the complex challenges of organizations that, as McCambridge and Salamon (2003) suggest, operate in a market economy but are not completely market institutions. There are no easy answers regarding what nonprofits should or should not do. It is likely that the decision to pursue earned income activities is dependent upon both the organization’s internal capacity and the degree of relationship between their mission and an earned income activity. The comments of many Trend Reporters can be summarized by one: “Generally, we need to continue to work towards community support in the form of financial contributions. And, concurrently, we need to continue to explore opportunities around earned income. I don't see it as an ‘either/or’ thing. Ultimately, both are important. Considering the realities of limited resources and opportunity cost, each organization can determine from experience where to best invest such efforts.”
References


www.stateofnonprofits.org