NONPROFIT *Fiscal Fitness*

your newsletter about issues in the nonprofit business world

Blackbaud.

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Editor's Note

With the economy still shaky, nonprofits are looking for alternative, reliable sources of revenue. Many are weighing the benefits and challenges of collaborating with for-profit entities. In this month's issue of *Nonprofit Fiscal Fitness*, Tom Triplett of Fieldstone Alliance breaks down the most common forms of nonprofit/for-profit collaboration and addresses some of the pitfalls to avoid with this type of collaboration.

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NetWits Summer Camp — It's Free

Sorry, you won't find s'mores here (on the other hand, there are no mosquitoes, sunburn, or near-death experiences on a zip-line, either). But you will find plenty of opportunities to learn what every nonprofit professional needs to know about websites, email marketing, online fundraising, social media, and related metrics.

"Camp counselor" extraordinaire **Steve MacLaughlin** will lead campers through five free web seminars designed to demystify some of the Web's most profound topics. The fun starts August 24, and while live sessions are full, recordings and slides will be made available on demand. **Sign up today** for a recording and other materials from the session that interests you the most.

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Collaborating with a For-Profit: Some Risks but Huge Potential

By Tom Triplett

Collaboration with for-profit entities can provide access to sources of capital that are not typically available, making it an attractive option for nonprofits. However, if the partnership is not properly structured it can lead to failure, compromised mission, and dissatisfied employees. How do you know if a nonprofit/for-profit collaboration is for you? The following are examples of the variety of forms such collaborations can take.

Organizational collaborations

These are situations where a nonprofit and its for-profit partner come together for a shared enterprise that complements the missions of both. There are a few variations worth noting:

- **Licensing arrangements** — This is when a company enters into an agreement with a nonprofit for the right to use aspects of the nonprofit's brand identity on its products or services. A well-known example of this is the Girl Scouts, who use licensing arrangements with a consortium of bakers to bake and distribute their cookies. The cookie sales offer a learning experience for the Scouts, while the bakeries satisfy their mission of making a quality product that generates a profit.

- **Supplier contractual relationships** — A second model looks like a classic supplier contractual relationship, but it is really much more. Pioneer Human Services, a Seattle-based nonprofit, has a manufacturing division, Pioneer Industries, which manufactures precision sheet metal. The Boeing Corporation has contracted with Pioneer for over two decades to produce parts for its cargo airliners. An important characteristic of the contractual relationship between Pioneer and Boeing is that the collaboration is a business one. Boeing buys from Pioneer not because Pioneer is a nonprofit, but because Pioneer produces a quality product at a market rate.
- **Smart lease** — A third type of innovative relationship between a for-profit and a nonprofit is a smart lease. These leases go beyond a typical landlord/tenant relationship; they are structured in a way that helps achieve the missions of both entities. A good example of this is the relationship that the Minnesota Children's Museum has with St. Croix Marketing, a for-profit that sells high-quality, developmentally-appropriate toys for kids on the first floor of the museum. Both entities partner in respect to toys tied to particular Museum shows, and above a certain level, both entities share in the profits.

Financial Collaborations

Relationships between nonprofits and for-profits can be more specifically financial in nature. This is particularly true in the field of community development, where nonprofits have learned how to access traditional sources of private capital through collaborations with for-profit entities. Nonprofit organizations like LISC (the Local Initiatives Support Corporation), the Community Reinvestment Fund, the Nonprofit Finance Fund, and the Nonprofit Assistance Fund have all learned to leverage their own financial resources (often generated from foundation grants) with the resources of for-profit entities.

Nonprofit entities seeking non-traditional revenue sources have been forced to become extremely creative by U.S. laws which maintain a bright line between the nonprofit and for-profit sectors. By using "quasi-equity" and other nontraditional sources, these creative nonprofits have been able to move beyond the usual philanthropic and earned income revenue sources and have greatly expanded their access to capital.

"Reverse" Investments

Another example of nonprofit/for-profit collaboration is a "reverse" investment. In these situations, the nonprofit invests in the for-profit enterprise.

The Cystic Fibrosis Foundation is a national nonprofit dedicated to finding a cure for the inherited chronic disease. But because the number of individuals afflicted is relatively small (approximately 30,000 in the U.S.), big pharmaceutical companies have little economic incentive to work in this field; there simply would not be enough profit for them.

So the Cystic Fibrosis Foundation invests a portion of its assets into for-profit corporations that are willing to take risks and find a cure for this "orphan" disease. For example, the Foundation has taken a strong equity position in a Cleveland-based biotechnology firm that is seeking a cure using a novel biotech approach. This is an excellent example of a nonprofit using its financial resources to help support a for-profit enterprise in a way that will ultimately benefit both entities.

What to Avoid

The examples cited above are all situations where collaborations have succeeded. But there are many examples of failure in the field. Failure can occur for a variety of reasons; some of the main ones include:

- The collaboration is not equally balanced. One party or the other is substantially stronger than the other, causing the mission of the weaker party to be compromised.
- The profit motivation becomes too overwhelming, and the nonprofit begins to lose sight of the mission for which it was granted nonprofit status in the first place.
- The nonprofit finds it is not as entrepreneurial or hard-nosed as its for-profit partner, and the collaboration and the business suffer.

- The nonprofit's leadership becomes so entrepreneurial that a culture gap is created within the nonprofit's own staff and its core programming suffers.
- The business plan that the parties have adopted proves inadequate in that it relies too heavily on roles to be played by the parties that are foreign to their basic culture and personalities.
- While the business enterprise generates substantial revenues, it also has high costs, making the net "profit" small.
- The nonprofit's traditional philanthropic funders begin to question why they should continue to finance the nonprofit when it acts so much like a business.

An important legal issue will arise if the income-generating enterprise is not related to the mission for which the nonprofit received its tax-exempt status. At the least, the nonprofit may be subject to the federal Unrelated Business Income Tax which would reduce its total "profits." At the worst, if the unrelated business income is too large a portion of the nonprofit's total income, it may jeopardize its nonprofit status. If such a situation arises, the nonprofit should consider spinning off the income-generating entity into a for-profit structure.

There is one more issue that needs to be noted. The Internal Revenue Service has recently become concerned with for-profits that seek to use a relationship with a nonprofit to inappropriately shelter the for-profit's income. The new 990 tax forms require more information about such relationships. Be sensitive to this issue and be sure to make your partnership a truly balanced, business-like relationship that does not try to circumvent the tax laws. As with most of the points noted above, consult with a knowledgeable attorney or accountant on these issues before cementing anything.

None of the above factors should be seen as deal-breakers if recognized and anticipated early enough. Each of them can be handled. For major enterprises that are not tied to mission, the activity can be spun off to a taxable subsidiary. And for some issues, there are countervailing arguments, e.g., many philanthropic funders encourage their grantees to develop alternative revenue sources as a way to reduce future reliance on grants and contributions.

For more information, please contact Tom Triplett at 651.556.4504 or email him at ttriplett@FieldstoneAlliance.org.

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