Chapter 11

Alternative Revenue Sources: —Beyond Donor Contributions

By Michael J. Brown

Sustainability is a key concern for most charitable organizations. Often nonprofits experience declining charitable contributions, especially when the economy is unstable. Like for-profit businesses, nonprofit organizations are searching for ways to diversify the income needed to continuously fund their missions. That is why researching alternative sources of revenue is an increasingly important nonprofit strategy. Here we will consider three important sources:

- In-Kind Gifts
- Earned-Income
- Cause Marketing Sponsorships

In-Kind-Gifts

Although in-kind gifts are not actually money, we are considering them an alternative revenue source because they act like money. Generally, donations are classified as being either liquid assets or illiquid assets. Liquid assets are easily convertible to cash, which of course, tends to be the most versatile and easily used assets nonprofits receive. Illiquid assets are those that can be used as is, or through more involved management they can eventually be converted to cash. In-kind gifts are not cash, cash equivalents like stocks and bonds, or other securities. In-kind gifts can come in a multitude of forms. An individual may donate things like: computers, food, pro-bono services, cars, boats, houses, or land. Businesses may choose to donate things like: office supplies, office space, office equipment, or even staff time. In either case, it is almost always the donor that puts a value on the contribution for tax purposes.

Why are in-kind gifts so important? The primary reason is that they free cash to be used for situations in which only cash is accepted, such as making purchases or paying bills. Another reason they are so important is that they give people and businesses that may currently be unable to provide additional support through financial gifts, an opportunity to still show their support for you organization in a tangible way. In-kind gifts provide potential donors additional avenues for participating in giving to your organization. They make getting to “yes” easier for both the donor and the nonprofit.

The first step in the process is to take inventory of the non-cash needs, the illiquid assets your organization is planning to purchase to achieve its mission. These products and services may support the organization’s day-to-day operational needs. They may also be products and services needed to support on-going program needs like meeting space to conduct health and wellness classes or food items needed to serve the homeless as a community service outreach. The products and services may also help fill periodic special project needs. Backpacks filled with school supplies for a neighborhood back-to-school outreach program provide a perfect example. Another example may be volunteers needed for a tutoring program to support a local school. It is prudent to place an individual or committee in charge of systematically reviewing and updating the list on an ongoing basis.

The next step in the process is to ask your network of friends and family whether they know of any businesses, from individual entrepreneurs to large corporations, that may have an interest in supporting the cause through in-kind gifts. To affectively engage your network, you will need to ensure that the gift needs are well understood and remain top-of-mind for your entire organizational leadership, closest supporters, and constituency at large. The broader the net cast, the more likely your efforts will reap success. Even better is if someone in your network has a personal connection with the prospective donor. They may be friends. They may be employees. They may be business industry contacts. Having someone who has a personal relationship with the prospective donor allows people in your network to lend their credibility to the organization and soften the process of asking for a donation.

Also remember that research librarians, especially in the main branches of public libraries, can be an excellent source to help get you started in searching for possible corporate donors and sponsors. Local public libraries and university libraries often have multiple directories of corporate giving in their reference sections. These resources are extremely helpful in that they profile corporate organizations, often listing the type of cause or causes they support through corporate giving, identify regional restrictions, list contact information, and so on. Research librarians can also point you toward fee-based online databases, like the Foundation Center's Foundation Directory Online, which are selectively offered for free for public use within main branch public libraries. Librarians are usually willing to show you how to access such databases and may be able to assist you in doing a limited amount of simple queries. Understanding the corporate profile of corporate donors and grantors can help your organization understand how your in-kind needs align with the prospective donors' business needs. Remember, corporate philanthropy is a socially responsible business decision, not simply an emotional appeal. That means you must know and be able to clearly articulate the business reasons and the set of benefits each prospective donor organization will receive by supporting your specific cause, project, or event.

Having completed the above, you are now in the position to make the ask. Ideally you will have your network contact with you if the ask is done in person or by phone. If the ask must be done by mail or email, you will want your contact to have touched base with their contact within the prospective donor organization. The least salient option, although better than not asking at all, is to do a cold ask—meaning one in which there is no pre-established personal relationship or personal referral available. In the latter case, both you and your cause will likely need to cross a higher credibility bar because your organization is likely an unknown quantity. That is why growing and tapping into your network is the efficient and effective option for cultivating in-kind gifts.

Finally, you will need to carefully coordinate the logistics of how the gifts should be acquired, who the main point-of-contact is, and the preferred means of communication throughout the gifting process. And as with any other form of donation or partnership, you must also ensure that you thank and recognize the donor. By law, recipients of in-kind-donations must now include the nonprofit organization's name, EIN number, and good faith estimate of the market value of any goods or services provided, if applicable, in exchange for the donated item. Besides a personal thank you, especially for those made available by tapping your network and their network of connections, you should also list the standard "tax deductible donation" language such as the following:

"Thank you for your generous contribution of **$____________** to **The Happy Foundation (EIN# 12-3456789)** on **July 15, 2014.**

The Happy Foundation is a nonprofit organization. Your contribution is tax-deductible to the extent allowed by law. No goods or services were provided in exchange for your generous contribution."

In-kind-gifts can be an open door to future additional in-kind gifts and even future cash contributions, so effective follow up, thanks, and recognition are critical. Even if there isn't a good match between your prospective donor's philanthropic interests and actually making an in-kind-gift to support your cause today, remember that people may move to other organizations. It may be helpful for you to have established a mutually beneficial relationship. Continuing to cultivate the relationship, even after a "no," may very well be the key that opens the door to future gifts.

For more information on the topic of recognition, see the Thanks & Recognition chapter in this volume.

Earned Income

Another important category of alternative revenue is earned income. Many times, nonprofits carry a higher than necessary level of risk by limiting their income to a single source of revenue. In order to more easily survive periodic or seasonal downturns in contributions, many organizations are exploring non-philanthropic income sources such as fees for service and product sales. Note, however, that doing so is not a panacea to economic sustainability for the nonprofit organization. In fact, it could even become a distraction to your core mission and core competency. Earned income, when the process of generating it actually strengthens the mission, can be a powerful buffer against economic uncertainty. It does, however, take the nonprofit into the foreign territory of the for-profit, commercial business sector.

Earned income can be as simple as a bake sale or proceeds of a health food store. It can also be as complex as creating a social enterprise—a commercial business venture whose proceeds are plowed back into the nonprofit organization to do social good. The creation of a day care is a good example of the latter. Because of the risk of moving off mission, and due to the hard facts that 80% of new businesses fail with the first 5 years of operation, it is highly recommended that organizations and their affiliated organizations focus on earned income opportunities that strongly align with their current mission focus. So increasing the use of the organizations building by renting space during periods of nonuse is a common earned income approach that can be adopted by organizations. The sale of purchased and hand-made products is also a very viable, easily implementable, low risk means of diversifying revenue sources by increasing earned income. Using your existing physical plant to begin providing grant-funded community services is also a means of increasing earned income. Activities like launching a new vegetarian restaurant, whether in rented space or on sight, however are highly risky ventures for nonprofit organizations.

Taxation is another area of consideration. Nonprofit organizations often have multiple sources of revenue that usually includes some mix of:

1. Charitable contributions including in-kind gifts.
2. Program revenue from products or services rendered in pursuit of the nonprofit mission.
3. Government grants from federal, state, or municipal sources.
4. Private grants from foundations and corporations.
5. Investment income from savings accounts, simple securities, and endowments.

Unlike for-profit businesses, nonprofit organizations are generally exempt from federal and state income taxes. The exception occurs when the income is earned from business activity deemed to be "unrelated" to the mission of the nonprofit organization. When each nonprofit was established, each set out its purpose in its Articles of Incorporation. The nonprofit's organizing documents specifically outline the types of business activity that the nonprofit was requesting tax exemption status for. Once the state awarded the nonprofit charity status, the nonprofit filed for federal income tax exemption status for all activity related to its nonprofit mission. Doing so does not mean that public charities cannot earn income outside of its not-for-profit purpose. It does, however, mean that such unrelated business income is taxed at standard corporate rates. The unrelated business income must be appropriately declared on the nonprofit's tax returns filed with both the state and federal government each fiscal year.

It is also important to note that when receipting donors, products and services received for unrelated business activity are not charitable contributions. They actually represent purchases and therefore are NOT tax deductible. Since the purchases are not charitable donations, those purchases are NOT tax deductible. Moreover, the nonprofit must charge sales tax on these items at the time the products or services were purchased. Unrelated business income is for-profit income and is treated the same as it would be if it had been generated by any other for-profit, commercial business. This principle of equal treatment ensures that nonprofits organizations are not unfairly given tax advantage over commercial businesses when engaging in for-profit business. That is why it is so important to clearly understand what types of activities the Internal Revenue Service (IRS) considers related business activity verses unrelated business activity. Tax on the latter is commonly termed Unrelated Business Income Tax (UBIT).

It should be noted that capital income is usually not subject to Unrelated Business Income Tax (UBIT). For instance, suppose an organization established an endowment fund. Doing so would allow individuals and businesses to contribute to a fund in which some pre-determined percentage of the principal would continuously be saved. Income from the interest on the principal would be used for some pre-determined operations or program services purpose. The interest income from endowment funds are usually not subject to UBIT, but you should always consult your accountant.

Related business income is very common for certain types of ministries. Academies and universities charge tuition. Hospitals charge for healthcare services. Almost every organization has an opportunity to develop mission income streams. It is only prudent to do so, however, if doing so enhances the attainment of your mission.

Determining related versus unrelated business income can be very tricky. See IRS publication 598, "Tax on Unrelated Business Income of Exempt Organizations," for more details. Most importantly, seek the advice of a certified public account or tax attorney as you consider adopting these revenue streams.

Cause-Related Marketing

Cause-related marketing (CRM) is the final area of alternative revenue sources that will be briefly discussed. It is a collaborative agreement between a nonprofit organization and a for-profit business to increase the visibility of the for-profit brand among nonprofit constituents and supporters. The nonprofit receives a negotiated mix of product and or financial contributions in return for the nonprofit's prominently promoting and advertising the cause-driven relationship to the nonprofit's constituents, supporters, and community at large. The goal of the nonprofit is to position itself within the community as a socially responsible, good corporate citizen. There is a definite value exchange relationship with clear quid pro quo benefits for both the nonprofit and the for-profit business.

Depending on the nature of the relationship, the nonprofit may encourage its clients, community, and the general public to purchase or utilize the businesses goods and services. As with in-kind gifts, the relationship is not solely philanthropic. It is the result of calculated, strategic business intent. Although CRM relationships can and do take on many forms, most can generally be classified as one of three broad types of relationships:

1) Event or Program Sponsorships

2) Affinity Program Referral Payments

3) Profit Sharing of Product Proceeds

Event or Program Sponsorship is the most prevalent type of CRM initiative. These are most often event-driven, one-time or limited-time partnerships. The nonprofit organization commits to prominently displaying the sponsors' logos during promotion, execution, and post-event celebrations. The lead sponsor receives the greatest logo placement and verbal mentions, with other sponsors receiving advertising proportionate with the pre-defined benefits levels tiered at different support levels. Some common sponsorship events include walk-a-thons, bike-a-thons, annual golf tournaments, and annual benefit auctions. These are most often heavily promoted through social media campaigns that are executed in conjunction with other online and offline integrated marketing campaigns. These social media campaigns often involve a mix of "like" campaigns, link sharing campaigns, and vote-based viral campaigns.

Affinity Programs are payments based solely on the number of people either viewing the for- profit brands advertisements and or completing the purchase of products, most often through online websites with product listings, although offline partnerships are possible. Quite often the nonprofit acts as a sales agent on either a temporary or longer-term basis. As is common with event sponsorships, peer-to-peer fundraising is a common component of these campaigns.

Profit Sharing is the least frequent type of CRM effort of those discussed. Occasionally, the sponsor will pledge to commit a proportion of its traditional product sales to a certain nonprofit partner. Increasingly, profit sharing programs are executed as part of a shopper loyalty program that donates a small percentage of proceeds to one of several, pre-approved nonprofit organizations from a list of eligible nonprofits that the shopper can choose from. A good example of this kind of CRM relationship is grocery store programs. Shoppers associated with certain schools are able to donate their loyalty points or a small percentage of their total purchases to participating schools through a pre-existing grocery store loyalty program. In very rare cases, retailers may commit to sharing a small percentage of its profits from the sale of its normal, or some specially created product, to one very fortunate nonprofit organization.

As you can see, there are several options for developing alternative revenue sources to help cushion the nonprofit from vacillating economic conditions. Individual charitable contributions continue to represent the lion's share of nonprofit donations.