Money, Marketing, and Missions: Ethics and the Structure of Not-for-Profits

Karen Barbee
Council on Aging of West Florida, Inc

Stephen LeMay
University of West Florida

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Karen Barbee
Council on Aging of West Florida, Inc
MBA Student, University of West Florida

Stephen LeMay
University of West Florida

ABSTRACT
This article explores the relationship between the structure of not-for-profit organizations and the ethical issues, moral hazards, and public perceptions they are likely to face. It offers a preliminary taxonomy of organizations based on their structures and relates key ethical issues to each of those categories. It also ties these issues to the role that marketing plays in both creating and dealing with ethical issues.

INTRODUCTION

In the abstract, not-for-profit organizations convert the resources of benefactors into products and services for beneficiaries. For example, a faith-based charity might take donations in the form of money and food, and then open a kitchen to feed the homeless. In many regards, this is the image that many Americans have in mind when they think of not-for-profit organizations. Such organizations do exist, and they function in exactly this manner. But they are far from the only type of not-for-profit. The realm of not for profit organizations is far more complex, and it is fraught with a wide range of tax questions and a growing number of operational models. Moreover, it is clear that not-for-profit does not mean ‘not-for-money.’

The not-for-profit industry is defined by the biggest challenge to its financial stability: not making a profit. Such organizations vary in tax status. For example, the Professional Golfers Association of America (PGA) is a not-for-profit organization, but donations to it are not tax deductible. By contrast, Goodwill Industries International, Inc., runs a chain of retail stores that sell donated goods. In 2014, the Goodwill generated $5.59 billion in revenue, but donations to it are tax-deductible. It is a self-described ‘social enterprise,’ though one that is not without controversy.

This paper addresses this and other variations with the beginning of a taxonomy of organizations based on their not-for-profit or social involvement. It also associates the structures with a variety of marketing practices, including those that address benefactors and those that address beneficiaries. It then associates each structure with a range of ethical issues and moral hazards. The classification system itself is based on two basic dimensions, the source of revenue and the nature of the organizational mission.

At this stage in the development of our concept, we will largely ignore faith-based charities and government programs, although they certainly play a major role in the not-for-profit sector. We endorse a definition of social enterprise that borrows from Austin, Stevenson, and Wei-Skillern (2006): "We define social entrepreneurship as innovative, social value creating activity that can occur within or across the nonprofit, business, or government sectors." (p.2) Following this lead, we define social enterprise as the activity of not-for-profit, business, and government sectors that is intended to create social value. But for this work, we will concentrate on private sector businesses and not-for-profit organizations that are not faith-based.

Money, Marketing, and Missions

The not-for-profit industry is comprised of a wide range of mostly small and medium agencies at the local level as well as large, international agencies that compete on a global stage. Not-for-profits are difficult to define by traditional for-profit market structure terms such as monopoly or oligopoly because these terms are based on defining the number of sellers and buyers in a market. Not-for-profits are also difficult to align with foundational marketing theory, such as Porter's strategy, which compares a company's cost/profit strategy with efforts to differentiate (Shaw, 2012). As not-for-profits do not necessarily fit the traditional concept of sales, they also do not fit the traditional strategies based on cost.

Money

To develop the foundation for our taxonomy, we start with money. In particular, we will use the primary source of money as a way of distinguishing one class of not-for-profit organization from other classes, and also from for-profit organizations.

We start with the extremes: the 'pure' charitable organization that generates its revenue from donations and the 'pure' for-profit organization that generates its revenues from offering goods and services for sale in a market with the intention of generating a profit for its owners. The use of the word 'pure' in this instance is not intended as a judgment, but rather a statement of primary purpose and as a description of a business model. A 'pure' for-profit business might also operate a multi-national foundation that does a lot of good, but that is not part of its value proposition—what it offers to the market in exchange for revenues. A 'pure' not-for-profit might offer large donors a gift that recognizes their donation, but that is not part of its value proposition. That is, the for-profit's sales are not contingent on creating and operating a foundation, and the not-for-profit's donations are not contingent on the gift that recognizes donors.

Between the extremes, the classification becomes more difficult. Young and Lecy (2014) argued that, at a high level of abstraction, some consensus exists on the nature of a social enterprise. But in their taxonomy, described as a zoo, all social enterprises are deemed for-profit. That is, social enterprises combine social purpose with the pursuit of profits. In their view, the consensus ends here. There is no agreement on how large a role the social purpose must play in the enterprise and no agreement on how much the organization must depend on market-based earnings to support that purpose.

Saunders (2013) explains how and why charities have diversified in their fundraising efforts over time, contributing to Yong and Lecy's (2014) "zoo." Unmet needs always extend beyond the supply of available charitable funding, and not-for-profits have had to diversify over time to find new sources of revenue. To survive financially and often to expand, not-for-profits have adopted Smith's strategy of differentiation by changing their marketing mix to attract more of the donor market that is homogeneous (Shaw, 2012). In for-profit terms, differentiating means positioning the product or brand as different from competitors, but not-for-profits differentiate by seeking new methods of attracting resources.

We argue here that those problems can be partially resolved by examining the value propositions of the organizations. This leads us to the next topic, marketing.

Marketing

Fundamentally, value propositions describe how one organization's offer differs from others and why customers or donors should hand their money to the organization (adapted from Lindic and da Silva, 2011). This also means that the value proposition drives the content of an organization's marketing communications, as well as the contents of its inventory and ability of its capacity to fulfill the proposition. Value propositions are specific to target markets, so the value proposition for beneficiaries will differ from the value proposition for benefactors.

Marketing communications serve to call the attention of a target market to a value proposition, so the value proposition remains at the center of the communications. In simplest terms, marketing communications say, "Hey, look what we have over here! Here's how and where you can get it." And, of course, they also convey, "You should get it, and here's why."

Marketing also deals with the last mile of the relationship between those who offer value propositions and those who offer resources. A for-profit organization takes money in exchange for a good or service, presumably a good or service that meets some need of the buyer. A not-for-profit may also engage in such exchanges, like selling Girl Scout cookies or used goods at a thrift store, but the transaction is assumed to benefit clients of the organization, not owners of the organization. So a factor that distinguishes one kind of organization from another in this taxonomy would be what the marketing communications say about the beneficiaries of the transaction. Another distinguishing factor is the context in which the value proposition is offered.

For-profit organizations, in their marketing communications, rarely point out that a customer's purchase will increase a stock price, company profits, or owner's wealth. For some not-for-profits, that the essence of the message is the benefit to the client: "Save an animal," "save a child," and "cure an illness" are common messages. As defined by Lindic and Da Silva (2011), social enterprises would include some element of both.

We will make these identifying factors more explicit with examples as we develop the outlines of the taxonomy.

Mission

The stated mission of an organization should be taken seriously, especially in not-for-profits. The mission statements of for-profit organizations have often been criticized, usually for their emptiness, but some research has shown that they have a significant impact on performance (Bart, Bontis, & Taggar, 2001; Bartkus, Glassman, & McAfee, 2000). Mission statements are supposed to communicate with and motivate employees, as well as retain them (Bart, et al., 2001). We also suggest a strong tie between the mission of an organization and its value propositions. If an organization offers a value proposition to its stakeholders, then that value proposition should reflect the organization's mission. Otherwise, something is wrong either with the value proposition or the mission.

For not-for-profit organizations, mission statements and attachment to the mission have other important implications, particularly tax implications. In many instances, the mission statement overlaps the value proposition for a not-for-profit.

Ethical Considerations

The not-for-profit industry has changed significantly over the past century (Saunders, 2013). Competition for funding has increased the complexity of the industry, and in many ways has blurred the lines between the private and public sectors (Ryan, 2002). In some ways, government regulation and policies are trying to keep pace with the changes in the industry, such as with the Tax Form 990 (Keating & Frumkin, 2003).

On one end of the spectrum, not-for-profits are becoming more business-like and as such are challenged to be financially sustainable while maintaining a dedication to their missions. Some not-for-profits have even gone so far as to sell goods that compete in for-profit markets, leaving questions about unfair advantages because of their tax exemptions.

The Girl Scouts, for example, sold $776 million worth of cookies in 2015 (Wieczner, 2015). Some of those cookies were sold by scouts with tables set up outside Publix grocery stores, on Publix property and with permission. This probably cannibalized some sales for cookies inside Publix, but the organization sees public relations benefits from allowing such sales. The public face of the Girl Scouts is a nine-year-old girl, not a large, revenue generating institution.

On the other end of the spectrum, for-profit companies have begun winning government social service contracts that have been traditionally held by not-for-profits (Ryan, 1999). Also, for-profits are becoming increasingly aware of their social responsibility, which is the foundation of the not-for-profit business model. Some for-profits have even adopted a benefit corporation tax status complete with their own social missions to fund.

TOMS Shoes is an often-cited example of a for-profit organization with a social element in its value proposition. On its website, TOMS states the value proposition in simple terms: “With every product you purchase, TOMS will help a person in need” (TOMS, 2017). This is a part of TOMS’ commercial, for-profit market offering. It includes a commitment to a social contribution with every purchase.

Businesses and not-for-profits both collaborate and compete in a variety of ways. Ultimately, the lines between not-for-profit and for-profit are becoming increasingly blurred, leaving many ethical questions in the gray areas, tax status among them.

IRS Form 990 and Tax Status

Public trust in the not-for-profit industry was shaken by several scandals in the 1990s, and not-for-profits responded by focusing on the accessibility of the IRS Form 990 (Keating & Frumkin, 2003). Not-for-profits (except churches) are required to submit financial information via the Form 990 annually and must make these documents available to the public either on their website or upon request (Keating & Frumkin, 2003). The Form 990 has been the centerpiece of conversations about not-for-profit accountability and is used to generate the “fundraising ratio” which can impact donations (Weisbrod, 2009).

However, Form 990 is a frequently unreliable and irrelevant source of information, and government oversight of the system is minimal (Keating & Frumkin, 2003). Independent agencies such as auditing services and “charity watchdog” organizations serve to facilitate donor interest in not-for-profit accountability. In an industry where trust is essential to survival, improving the not-for-profit sector’s accountability system could facilitate better funding decisions (Keating & Frumkin, 2003).

An important part of IRS Form 990 is the Form 990-T, which is tied to ‘unrelated business income.’ Many not-for-profits engage in business activities that might be regarded as unrelated to their respective missions. This suggests two dimensions that should concern policy-makers, marketers, donors, and clients: the source of revenue and the nature of the organizational mission.

The next section lays out the details of Form 990-Unrelated Business Income Tax. It should be noted that many not-for-profits pay nothing on this tax.

Form 990-T: Unrelated Business Income Tax

The Unrelated Business Income Tax (UBIT) is another aspect of not-for-profit tax law that is both controversial and confusing. When not-for-profits engage in businesses activities that are unrelated to their mission, they are charged taxes for those goods or services, under UBIT, filing the Form 990-T. The UBIT law came about in 1950, as not-for-profits started to sell goods and for-profit companies argued that the competition was unfair (Hines, 1999). However, the definition of “related” versus “unrelated” is vague, so it is difficult to decide what activities to tax (Hines, 1999).

Also, it is relatively easy for non-for-profits to avoid UBIT. If we continue to use the Girl Scouts as an example, we find that one exception to UBIT is that if the unrelated activity is carried out by volunteers, it can be exempt (Strefeler & Miller, 1996). Girls Scouts sell their cookies via their girl scouts, thus exempting them from paying the tax in almost every state.

UBIT law is critical because income from sales is a large and growing source of revenue for private not-for-profit organizations (Dees, 1998), proportionally larger than donations or government sources (Young, 1998). Many ethical questions arise from not-for-profit commercial activities. As not-for-profit commercial enterprises grow, how much should be taxed? If commercial activities divert the not-for-profit from its social mission, what are the limits to retain their tax-exempt status? Currently, the UBIT law raises little revenue for the government but still serves to discourage not-for-profits from pursuing commercial endeavors (Hines, 1999**).**

For-Profit Social Service Providers

However, the encroachment goes both ways. For-profits are winning government social service contracts that have traditionally been administered by not-for-profits (Ryan, 1999). As such, a debate has begun regarding the roles of the not-for-profit and for-profit industries. As Ryan (1999) stated it, "Not-for-profits are no longer considered automatically entitled -- or even best qualified -- to provide social services in the United States." Social services administration is a $21 billion market, and the political climate is increasingly valuing profit as a motive to create efficiency (Ryan, 1999). Ultimately, the danger is that in the short-term, not-for-profits may compromise their values to compete for those contracts.

Benefit Corporations

Benefit Corporations are a new, and growing, social hybrid of for-profit and not-for-profit sectors that is encroaching on the not-for-profit sector in a more positive way (Rawhouser et al, 2015). Benefit Corporations are taxed as for-profits, yet are required to meet social and environmental standards and make reports of their efforts public (Rawhouser et al, 2015). The decision to offer the benefit corporation filing status is at the state level (Rawhouser et al, 2015). Not-for-profits are restricted in raising and using funds, while for-profits tend to value maximizing profits over their community impact. The new trend of Benefit Corporations has arisen from a complex marketplace, but offers one solution to combining social missions with a sustainable business model.

THE MATRIX

Prior to the 19th century, the black and white taxonomy of "pure" not-for profits and "pure" for-profits sufficed to provide legislation, or boundaries, for how each organization need to operate. Today, not-for-profits and for-profits are far more complex. Some for-profits seek to prioritize social missions over profit gains, while some not-for-profits have sought financial stability through product or service sales. Better classifying the "zoo" or gray area that has arisen over the last century could help guide ethical boundaries for those organizations.

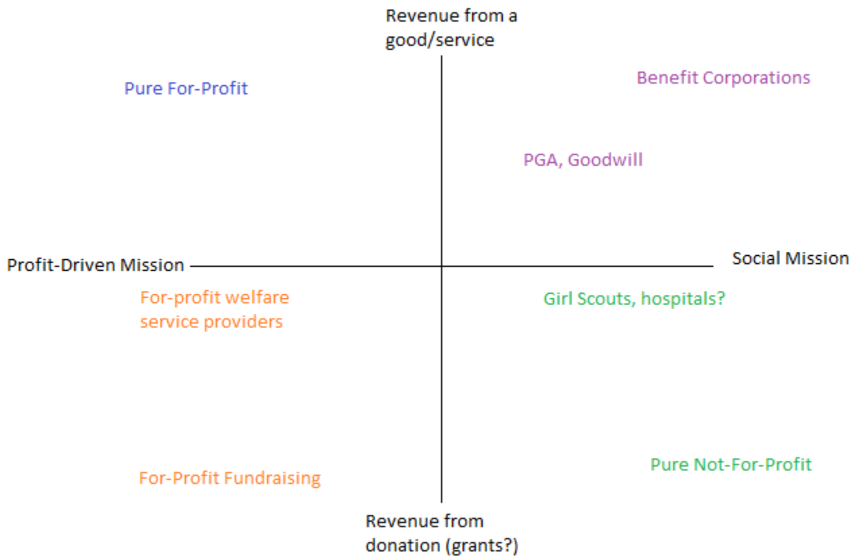
At this point, many of the regulations are outdated. The rules government not-for-profits have not changed, even though the not-for-profit economy has changed substantially. The federal government approaches this economy with regulations and laws that were created for a different era, literally a different century. It often seems confused, both promoting and limiting the not-for-profit and for-profit sectors in ways that work against the accomplishment of social missions. These missions can be difficult to monitor (Weisbrod, 2009), but that is at least partly because monitoring is expensive and the classification system is inconsistent. We propose a new way of classifying the zoo, using two scales or gradients to determine in which quadrant the organization falls.

The first gradient is the source of revenue, ranging from those organizations that entirely rely on the sale of a good or service to those who rely entirely on donations, not exchanges for products or services. Grants would fall into the category of "donations" as the benefactor is not the recipient of the good or service provided by the company, but instead the beneficiary. Donations to not-for-profits can be affected substantially by reporting requirements. Four factors have been found to affect donations, three of them from reporting: efficiency of the organization in allocating resources, financial stability, and information available to donors. The fourth factor is influenced by the other three: the reputation of the organization (Trussel and Parsons, 2007).

The second gradient is the degree to which the organization is profit-driven or mission-driven. Although an organization's mission statement is qualitative, requiring organizations to publish a report of their social gains could better determine the degree to which their funding serves a social purpose as opposed to a private one. Benefit corporations must file reports with the State Department on their social impact. Other organizations, while not technically benefit corporations, may also include social goals and effects.

Both of these gradients require measures, and those measures are not entirely clear at this juncture. These gradients define a grid that includes organizations that are required to file reports on their social impact, but also includes some that are not. Adequate measures would allow an organization to be shown as a bubble, based on its revenue size and positioned on the gradient according to the sources of revenue and the content of its mission statement. We would even consider using value propositions as a better measure for positioning on that gradient; either mission or value proposition would require some qualitative analysis and some judgment to position an organization on this gradient.

We turned these two gradients into a matrix, a common modeling practice for analyzing business strategies and concepts. In the sections below, we describe each quadrant of the matrix in greater detail and give examples for each. These classifications cannot be considered definitive at this point, since they are based purely on judgment, with no data. But these examples serve to explain the matrix and to direct further research toward propositions and testable hypotheses.



THE QUADRANTS

Each quadrant is described in terms of its boundaries and its extreme corners. We have included categorical examples of organizations in each quadrant, but we have not incorporated any real organizations because we have not assessed any of them fully at this stage in the development of the concept**.**

QI: Pure For-Profit, majority of revenue from sales of good/service, profit-driven mission

At the upper extreme end of the revenue gradient, in the upper left corner of the matrix, we would place organizations whose mission is creating shareholder value and whose revenue comes from sales. These are the organizations that have adopted some version of Milton Friedman's dictum that a corporation's only social responsibility is to obey the laws of the country and make a profit for the shareholders. We would expect their value propositions to be consistent with this mission. A big box retail store or an oil company might fit in this corner.

Q2: Benefit Corporations, majority of revenue from sales, social goals driven mission

At the other upper extreme end of the revenue gradient, in the upper right hand corner of the matrix, we would place organizations that depend on sales of goods and services for revenue, but whose mission is largely social. Benefit Corporations would be the most clearly defined organization in this sector. Benefit Corporations are generally unable to apply for grants due to their tax status and typically do not accept donations.

Q3: For-profit fundraising, majority of revenue from donations but profit driven
At the lower extreme end of the revenue gradient, in the lower left hand corner of the matrix, we would place organizations that use donations or grants to generate a profit, or private benefit. This would include for profit social welfare providers who have won government contracts traditionally given to for-profit companies. Another example of an organization in this category would be for-profit fundraising companies that take a portion of funds raised by their fundraising campaigns.

Q4: Pure non-profit, majority of revenue from donations, social goals driven
At the lower extreme end of the revenue gradient, in the lower right hand corner of the matrix, we would place the "pure" non-profit. These are the organizations who provide a good or service to beneficiaries on behalf of the benefactor, the donor or grantor. Their missions are socially drive, for the public good, as opposed to a privatized purpose or benefit.

IMPLICATIONS

The current definitions of the non-profit industry are confused at best because they fail to recognize how the industry has changed in the last century. The Form 990 and exempt status criteria provide parameters to not-for-profits, regarding how they can both raise and use their funds. Improving the definitions and the reporting factors related to those definitions could not only provide a more ethical framework for the industry, but also improve transparency to donors.

The next step in research would be to apply an analytical framework for defining non-profit financials and social impact, the two gradients on the matrix. The Form 990 has been criticized and many have suggested changes to improve it, but most of those suggestions are still based on current government definitions of a not-for-profit. Further research could provide a formula for determining where each organization falls on each gradient, and suggest ways to develop more applicable and usable financial reporting from not-for-profits.

Not-for-profit does not mean "not-for-money," and if better definitions and guidelines are provided for how fund can be raised and used, there will be fewer ethical gray areas in the industry.

FUTURE RESEARCH

Several issues suggest themselves for future research in this area. The first is to operationalize the matrix using quantitative and qualitative data. The second is to evaluate the nature of the available data and refine the nature of the data to be collected, especially on the financial gradient of the matrix. The third would be to develop more consistent, readily available qualitative information to better inform the mission gradient. All of this would serve to better inform donors, policy makers, and clients on the activities and effectiveness of not-for-profits.

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ABOUT THE AUTHORS

Karen Barbee is Director of Community Relations at The Council on Aging of West Florida and an MBA student at the University of West Florida. She is concentrating her graduate studies on not-for-profits and social enterprise.

Stephen LeMay is Associate Professor of Marketing and Logistics at the University of West Florida and Professor, Emeritus at Mississippi State University. He has co-authored three books and numerous article in academic journals. His research interests are eclectic, but focus on human factors in supply chains and the development of human resources in logistics.