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**INNOVATION OR ILL-GOTTEN GAINS? INTERPRETATIONS OF  
NONPROFIT BUSINESS VENTURING IN AUSTRALIA, THE UNITED  
KINGDOM AND THE UNITED STATES<sup>1</sup>**

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**Abstract**

Many nonprofits have come to embrace the idea of participating in the market through business venturing to maximise their revenue. Yet debates continue about its place in nonprofit management. After an examination of the taxation status of charities' business activities in Australia, the United Kingdom and the United States the paper examines its treatment by scholars, nonprofit practitioners, and the business community. To gain some understanding of public opinion the paper then examines the treatment of nonprofit business venturing by the media in these countries. An analysis of this coverage reveals that much of the criticism appears in business media, which airs claims

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that tax exempt nonprofits are a source of “unfair” competition. It is important for nonprofits to understand the meanings and contestation surrounding their ventures into business generally, but to be particularly aware of how for-profit competitors may generate, exaggerate or manipulate concerns regarding business venturing to hinder nonprofits commercial operations such as influencing governments to change current tax exemption arrangements. One strategy is for nonprofits to promote the findings of a significant body of research that has found that nonprofit owned businesses are price takers not price makers.

### **Introduction**

The literature on business venturing provides us with few clues as to how people outside the nonprofit sector understand the concept and more generally form judgements about the commercial activities of nonprofits. However, some recent media reports suggest that there is a gap between the perceptions of the public and the nonprofits that undertake such activities. While many nonprofits have come to embrace the idea of participating in the market to maximise their revenue, the tone of these reports suggests that, at least in the eyes of some, such forays into the market are unjustifiable or even morally questionable. The paper argues that it is important that nonprofits understand the meanings and contestation surrounding their ventures into business not only to protect their reputation, but also if they are to apply it critically and reflectively in practice. Moreover, as many of the criticisms appear to come from the business community and centre on claims that nonprofits, due to their tax status and eligibility for other subsidies, are a source of unfair competition, it is particularly important for nonprofits to be aware of the findings of research on the effect of nonprofit market participation. This research questions assumptions that nonprofit business venturing

distorts markets. Nonprofits should cite such research as part of a strategic response to those who seek to revoke current nonprofit tax exemption and other subsidy arrangements.

### **Outline**

The paper begins by defining nonprofit business venturing and examining the degree to which it characterises nonprofit activities in Australia, the United Kingdom and the United States. The legal status, and in particular, the taxation arrangements affecting nonprofits' business activities in these countries is then briefly described. Then the paper discusses various interpretations of business venturing by practitioners, academics and the business community and presents the findings of survey of relevant media reports to provide some indication about public opinion regarding the issue. An analysis of these reports reveals that negative coverage of nonprofit business venturing appears principally in the business media and for the most part focuses on claims from businesses that they are victims of "unfair competition" from tax exempt nonprofit traders. The paper argues that a strategic response to such claims should involve citing the findings of a growing body of research which indicates that nonprofit business venturing has virtually no discernable impact on the operation of the market.

### **What is the difference between business venturing and social enterprise?**

Nonprofit associations draw their revenue from a wide range of sources. These sources include governments (in the form of grants and contracts), members and other users of their services who pay fees and revenue raised through fundraising activities. In recent times, however, one of the fastest growing sources of revenue has been from the returns made from commercial activities. Behind this trend are a wide range of motivations

from those non-profits who seek involvement primarily to secure a reliable revenue stream to others whose hope to achieve some social purpose.

The practice by which nonprofits engage in entrepreneurial activity as a means of raising revenue is generally referred to as business venturing, a term that will also be used in this paper. Business venturing can be defined as regularly conducted commercial activities that increase the reliance of nonprofit organisations' on "sales revenue rather than donations or government grants (and) the production of goods (or services) for sale that compete with goods provided by for-profits' (James 1998: 271).

Business venturing is often addressed in literature on social enterprise or social entrepreneurship, in particular the strain that looks at elements of social enterprise as an earned income strategy for nonprofits (Dees 1998, 2001). Other terms used to describe these social enterprises include social purpose businesses, community-based businesses and community wealth enterprises (Emerson and Twersky 1996). The literature on social enterprise refers to a broad set of entrepreneurial strategies to address social goals (Boschee 2001; Borgaza and Defourny 2001; Simons 2000; Thompson 2002). Lyons (2002) refers to a social enterprise as "an organisation with primarily social goals that it pursues in an entrepreneurial and business-like manner." Thus, social enterprises are often characterised as having two major organisational goals, one, to generate earned income and the other, to expand the organisation's efficiency and impact through adoption of entrepreneurial modes of operation. Unlike social enterprise-related activity, business venturing does not necessarily involve the internalisation of entrepreneurial principles to reorganise existing activities to improve operational efficiency or to realise significant social change. Given that much of the business venturing-related literature

focuses specifically on social enterprises it is therefore important to note that this paper is about business venturing that nonprofits, and charities in particular, use as a way of building new revenue sources and *not about the development of a new organisational form.*

### **The rise and rise of nonprofit business venturing**

Nonprofits have been involved in commercial businesses for a long time. It was a key feature of the poorhouse system in Victorian England, in particular institutions known as workhouses (May 1997). However, for most of the 20<sup>th</sup> century, UK, US and Australian nonprofits, often affiliated with Christian denominations, raised donations from the public as well as relying on government grants rather than engaging in commercial businesses.

Until recently, most nonprofit business venturing involved low risk, small-scale activities such as operating second-hand clothing outlets (charity shops); and were often directly mission-serving such as a few specialist nonprofits that operated businesses to employ people with disabilities. In Australia, one well known exception was the non-woven goods business run by the Smith Family. Another significant source of revenue has been that generated from gambling and hospitality income of clubs, including those affiliated with Returned Services League (war veterans). In the US, well known examples are the business activities associated with Goodwill Industries and the Scouts movement, such as Girl Scout cookies as well as museum stores. In the UK the most visible entry of nonprofits has been in the retail sector with the rapid growth in the number of charity shops (in 1992 there were around 3,480 charity shops in the UK with sales of £183.3 million; by 2002 there were 6,220 shops with total sales of £426.5

million in 2002. By 2006 there was over 6,500 charity shops throughout the country. (Charity Finance 2002; *The Third Sector*, 20 April 2005).

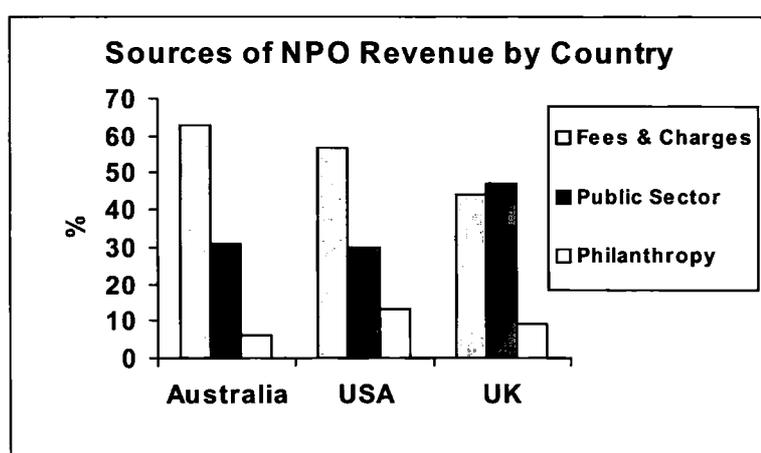
More recently, interest among nonprofits in commercial practices and the breadth of these nonprofits' commercial operations has grown significantly. This development has occurred in a context where the nonprofit sector has assumed many welfare service provision functions previously provided by the state and where state funding has moved to contracting and project-based models (Lyons 1997; Nowland-Foreman 1998). This role has stretched nonprofit organisations' resources and stimulated them to find new ways to increase their revenues. In particular, income generated from business activities has become valued as a source of "unallocated" funds that can be used in any area of charitable work. As stated by one of Australia's largest charities, the Smith Family, business venturing includes commercial activity that "supports our work in the community by generating untied funds and offsetting the costs of running the organisation" (Smith Family 2005).

Another driver may be the relationship between earned income and levels of government funding. According to the findings of separate studies by Schiff and Weisbrod (1993) and Salamon (1995, 2002) a drift toward commercial income strategies are associated with reductions in government funding. This suggests that, once embarked upon, strategies to increase earned income may be difficult to abandon.

Results from the Johns Hopkins Comparative Nonprofit Sector Project, which compares the scope, structure, financing and role of the nonprofit sector in 22 countries, highlights the significance revenue from sales of goods and services plays in financing nonprofits

throughout the world. In this project the category ‘fees and charges for services’ was used and included revenue generated from a range of activities including sales of goods, hospitality income of clubs, business sponsorships and membership dues. Figure 1 shows the major sources of revenue for nonprofits in Australia in comparison with those in the US and UK.

**Figure 1: Three country comparison of source of nonprofit revenue.**



Source: Kendall & Almond 1999; Sokolowski & Salamon 1999; Lyons Salamon 1999

Figure 1 shows that in 1995, revenue from fees and charges received by Australian nonprofits accounted for almost two thirds or 62.5% of total nonprofit income. In the US, the dominant source of income came from revenue from fees and charges (57%), followed by government funding (30%) and private donations (13%). In the UK, government funding is the dominant source of income (47%), followed by fees and charges (44%) and private donations (9%) (Kendall & Almond 1999; Sokolowski & Salamon 1999; Lyons Salamon 1999).<sup>2</sup>

<sup>2</sup> For Australia also see Cat no. 5256.0. The Satellite Account excludes Nonprofits that are classified to the general government sector, including universities and nonprofit hospitals, even where they are self-governing and institutionally separate from government. Handbook of Nonprofit Institutions in the

## **The legal perspective: nonprofit business venturing and tax exemption arrangements in Australia, UK and the US**

The issue of the tax status of nonprofits that engage in business venturing has prompted government inquiries (investigation into the tax status of charities have been conducted in Australia by the Commonwealth Department of the Treasury 2001, and Industry Commission 1995, and more recently in the UK with a major review of Charities in 2002 by the Prime Minister's Strategy Unit titled *Private Action, Public Benefit: A Review of Charities and the Wider Not-for-Profit Sector*) and remains a source of confusion notably within the nonprofit sector. This confusion has been a boon for the legal and tax consultancy industry that specialises in advising nonprofits. As one US consultancy states:

Of all the legal and public-perception problems faced by the nonprofit sector, probably no issue has caused more debate and confusion ... Many nonprofit organizations operate under a vague fear that commercial operations imperil their tax-exempt status (Hurwit and Associates 2005).

In Australia, there has been a longstanding debate about whether to tax revenue from commercial activities of nonprofits and the arguments for and against were highlighted by the 2001 *Government Inquiry into the Definition of Charities and Related Organisations*. Nevertheless Australian nonprofits are not required to pay tax on the profits made from engaging in commercial activity, a situation that is in stark contrast to

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System of National Accounts which was endorsed by the United States Statistical Commission in March 1992: Ibid 21.

international practice.<sup>3</sup> Under current arrangements, the only restriction regarding tax exemption is that the nonprofit organisations qualify as a “charity” and that the commercial enterprise not be used for non-charitable purposes such as lobbying or recreational activities, in the ATO’s words that the activity be “clearly part of or incidental to the charitable purpose” of the organisation (ATO 2005a, 2005b). If these tests are met then the revenue from business activity will not be taxed. Thus, as Scott has pointed out, Australian law and practice emphasises the destination of income and not its source (Scott 2003).

British law states there is a difference between charitable purposes for which fees are charged and business activities operated to generate funds for charitable purposes. The Charity Commission for England and Wales states that:

Charity law does not permit charities to exercise a trade on a substantial or regular basis simply for the purpose of raising funds. This is because of the general expectation that contributions made to a charity will be applied for its purposes or invested prudently, rather than being risked in trading activities which are undertaken simply to raise money (Charity Commission for England and Wales 2001).

Thus UK charity law only permits that nonprofit trading activities be conducted through a separate non-charitable (i.e. taxable) entities. However, from 1 April 2000, a major change was introduced when it was made legal under the Gift Aid Scheme for a trading company to donate all its taxable profits to the parent company and receive a tax deduction equal to the amount of profits. The Charities Commission publication *CC35 - Charities and Trading* (Version July 2001) recommends that a charity’s profits from

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<sup>3</sup> The only exceptions are Hungary and Israel where income from a commercial activity is income tax exempt so long as it used for exempt purposes. See B Weisbrod, 'Tax Policy Toward Non-Profit Organisations on 11 Counts' (1991) 2(1) *Voluntas* 3: 19.

trade “be passed to the charity in a tax-efficient way under the Gift Aid Scheme...Such a trading company may be wholly owned by one charity, or may be owned jointly by a number of charities.”<sup>4</sup> Hence, no tax is payable if the company donates all of its profits to the parent charity. The trading company must pay income tax on retained profits, however, provided that retained profits are less than £10,000, income tax is payable at the reduced rate of 10%. Therefore, the treatment of income derived by commercial activities carried on by UK charities is similar to the Australian system as it has come to emphasise the destination of income, rather than the source (Scott 2003).

Until 1950 the tax arrangements in the US were similar to those in Australia, however, after 1950, Congress enacted the Unrelated Business Income Tax (UBIT) which imposed a tax on the unrelated business activities carried on by nonprofits and denied exemption to ‘feeder organisations’ operated for the primary purpose of carrying on a trade or business to pass profits to a nonprofit. This unrelated business income is taxed as if earned by a comparable for-profit entity at a regular corporate rate. Consequently the Internal Revenue Code distinguishes between two ‘types’ of commercial activity (under section 501(c)(3) ). According to the Internal Revenue Regulations:

An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization’s exempt purpose or purposes (Reg. 1.501(c)(3)-1(e)).

Despite this variation in tax arrangements, very few nonprofits that engage in business activity in the UK, US and Australia pay tax each year and only a fraction of nonprofit

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<sup>4</sup> See the Charities Commission publication CC35 - Charities and Trading (Version July 2001) available at <http://www.charity-commission.gov.uk/publications/cc35.asp#11>

organisations have lost their tax exemption status on the grounds of engaging in business activity (and this is in stark contrast to growing size and complexity of nonprofit business venturing).<sup>5</sup> While this is to be expected in Australia (where nonprofits are not required to file a tax return or pay taxes on revenue earned from commercial activity) it appears contrary to the spirit of UK and US tax law. In a recent study by Omer and Yetman (2003) which examined the cross-sectional distribution of taxable income as reported on IRS form 990-T, it was found that near zero taxable income was reported by US nonprofit organisations in the 2001-2 financial year. This is largely because the US courts have not been able to give a rigorous and consistent definition of just what constitutes an “unrelated” business activity which has allowed nonprofits to take an extremely expansive view of what constitutes a related purpose. This situation, in turn, has led to widespread under-reporting or non-reporting of revenues and, in particular, the growing popularity of the practice of shifting the expenses of mission-related activities to nonprofits’s for-profit subsidiary’s books. Other studies provide evidence of how UK nonprofits are using the recently introduced Gift Aid Scheme to significantly reduce their taxable income by converting all the profits of their separate taxable subsidiaries to the nonprofit parent. It appears the relatively lax Australian requirements achieve the same outcome as the notably different tax regimes of the US and UK - that is virtually no tax take - but without nearly the same administrative and compliance costs.

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<sup>5</sup> It appears that when a penalty for business activity is incurred it is primarily due to failure to show adherence to basic charitable purposes, intentional malfeasance or evidence that profits were distributed to private individuals. For example, the US’ IRS processed more than 800,000 returns during the 2002 calendar year, but examined only 5,754 tax-exempt organisations and related taxable returns during fiscal year 2003. Form 990s, 990Ezs, and 990PFs are among the type of returns the IRS listed under this heading. *The Nonprofit Times* June 1, 2004.

### **Practitioner and academic perspectives**

For many nonprofits and those that study them, business venturing has become the new orthodoxy – accepted as the most logical response to a situation that calls for them to stretch limited resources. A recent statement by Dan Bader, CEO of the Helen Bader Foundation, typifies the attitude in the sector:

Non-profits have no choice but to create business-like enterprises if they are to survive...These days most non-profits rely on the money they make through their business activities (quoted in Murphy 2004).

It also appears that nonprofits believe this approach is widely accepted. According to Australia's St Vincent de Paul Society:

There is a wide acceptance within the Australian community that charities and related organisations conduct commercial activities to support their core services...What differentiates this type of “commercial” activity from that undertaken by for-profit organisations is that the profits are used directly for the core purpose of the organisation, that is, the relief of poverty, destitution, suffering or misfortune rather than distribution to shareholders (quoted in the Commonwealth Department of the Treasury 2001 Ch 27)

This support for business venturing has occurred in a broader context characterised by the legitimising of the business model within the nonprofit sector (Kenny 2002; Frumkin 2003). This business-orientation is evident in much of the academic literature. Morales, for example, emphasises the increased autonomy and flexibility gained by earned-income strategies:

Earned income can provide funds that [Community Service Organisations] can allocate without any conditions or constraints: it helps groups overcome the pitfalls of becoming a donor-driven organisation or a mere implementer of donor's pre-determined programs. CSO's will be free to design and implement programs that are more responsive to the needs of their members or beneficiaries. They will also be free from the reporting and accounting requirements of donors (Morales 1997: 23).

Positive assessments of business venturing are particularly prominent in the social enterprise literature where it is often assumed that social problems are best solved through a dose of "market medicine" (Deakin & Walsh, 1996). For example, the well-known social enterprise advocates Dees and Anderson note that:

Increasingly we are turning to business methods and structures in our efforts to find more cost-effective and sustainable ways to address social problems and deliver socially important goods (Dees and Anderson 2003: 16).

In a similar vein, much of the fundraising and resource development literature is focussed on resource mobilization that targets the market sector rather than donors or the state, activities often described as "venture philanthropy" (see, for example, recent editions of the journal *New Directions for Philanthropic Fundraising* e.g. Reis & Clohesy 2001 and Frumkin's 2003 discussion of this trend ).

In both the social enterprise and fundraising literature the ability to simultaneously fulfil charitable and commercial roles is not generally problematised and, in the case of the social enterprise literature, "going commercial" is often treated as a tenet of the social

entrepreneurial approach. A consequence of this interpretation is that activities such as developing partnerships with business or establishing social enterprises are reinforced within the sector as good practice. In this way many nonprofit executives feel they must meet expectations that their organisations will be considered to be more disciplined and effective if they appear more business-like.<sup>6</sup> In a 2003 survey by the Bridgespan Group of US nonprofit executives, over 50% of respondents said they believed earned income would play an important or extremely important role in bolstering their organisations' revenue in the future (Bridgespan Group 2005).

Not everyone, however, has welcomed the increased business framework of nonprofits. There is a significant literature about mission/market tensions in nonprofits. Frumkin (2003) has observed how this new focus on commercial activity and the related move towards the adoption of business terminology - from funder to investor, evaluation to measurement, grant proposal to business plan - is sometimes a case of adopting new words for old ideas. Frumkin describes "the construction of an elaborate semantic infrastructure" where business jargon is used to re-badge arrangements that have existed for many years (Frumkin 2003: 14).

Other authors have described how business venturing can have the potentially negative consequences in terms of nonprofits' mission, capability, financial impact, legal aspects, community relations and public image (Chetkovich & Frumkin 2003; Frumkin & Andre-Clarke 2000; Ryan 1999; Keating 1998; Gunn 2004). Gunn, for example, warned about potential for "mission drift" and that any "assessment of whether or not to take the road of for-profit ventures must include attention to where the internal resources will

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<sup>6</sup> Frumkin (2003) describes how the Silicon Valley Dotcom millionaires are one of the major groups driving this trend as they pressure recipients of their charitable donations to succumb to the discipline of the market.

come from to build a new venture, how the potentially different culture of the two parts of the organisations will fit together, and whether the incentive and compensation structures of the organizations might clash, among other issues.” (169) In *The State of Nonprofit America project* led by Lester Salamon (2002) made a special point of highlighting growing mission/market tensions in the nonprofit sector of the early twenty-first century. The relevant trends include growing reliance on, and pervasiveness of, fee revenues, an increasingly entrepreneurial culture within the nonprofit sector, growing involvement of nonprofits with corporate partners, and intensifying competition with for-profit service providers. With these forces in play, Salamon observes: “The move to the market may thus be posing a far greater threat to the nonprofit sector’s historic social justice and civic mission than the growth of government support before it.” (p.47).

### **Perspectives from business: funding good works or a source of unfair competitive advantage?**

Nonprofits compete with for-profits in a number of key industries, most recently in areas such as child care, education and nursing homes. In Australia, there is fierce competition between the two breakfast cereal makers Kelloggs and the nonprofit Seventh Day Adventist Church-owned company Sanitarium.<sup>7</sup> As noted, in the UK, charity shops compete with major clothing stores. In the United States, local YMCAs compete with for-profit health clubs; the American Association for Retired People vies for market share with for-profit insurance product providers and National Geographic is pitted against Discovery Channel in the competitive cable television market.

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<sup>7</sup> Sanitarium holds 25 per cent of Australia’s breakfast cereal market and has a turnover of around \$300 million per year.

Accompanying the expansion of nonprofits into the market have been complaints about nonprofits being a source of unfair competition. In August 1986, delegates to the White House Conference on Small Business alleged that “unfair competition” was being waged by nonprofit organisations and called for government to give preference to private enterprises when awarding government contracts (Gomes and Wends 1988). In 1989 James Bennett and Thomas Dilorenzo published their book *Unfair Competition: The Profits of Nonprofits* which argues that nonprofits enjoy a whole host of advantages - chief among them being tax-free status and reduced postal rates - that give them an unfair advantage in the marketplace:

The effect of these special privileges is that governmental policy not only reduces the costs of nonprofit organizations, but it also raises the costs of doing business for their for-profit competitors. Profit-seeking firms must pay higher taxes and postal rates to offset the subsidies accorded non-profits. Thus, because of this preferential treatment, competition between nonprofits and for-profits is inherently unfair (Bennett and Dilorenzo 1989: 21).

In Australia, Kelloggs and a consortium of for-profit health care related companies commissioned reports submitted to the Industry Commission inquiry into *Charitable Organisations in Australia* in 1995. The submissions argued that charitable groups had an unfair advantage when competing with for-profit organisations due to the taxation concessions which extend to their commercial operations. For example, the submission on the health industry commissioned by a group of private healthcare companies argued that not-for-profit hospitals enjoy a tax advantage over for-profit hospitals equivalent to

at least 5% of total costs (Allan Consulting Group 2001).<sup>8</sup> The submission prepared by Access Economics on behalf of Kelloggs Pty Ltd, argued that the tax exemption of Sanitarium Health Foods allowed it to significantly under-cut competitors. The report argued that:

The market share scale of Sanitarium's operations in Australia is virtually unprecedented internationally... This speaks volumes for the distorting effects – and tax revenue losses – incurred as a result of the Australian type concessions (Access Economics 2001).

In the US, the International Health, Racquet & Sportsclub Association (IHRSA) has run an ongoing campaign against nonprofit health and racquet clubs operators such as the YMCA and the Jewish Community Centre (JCC) (IHRSA 2003). In the UK throughout 2006, the UK's Federation of Small Businesses complained that regulators have taken a soft approach to the UK's 6,500 charity shops, which get relief on business rates and argued that this amounted to unfair competition. Charity shops move into retail of new goods has proved a particular bone of contention. The UK-based Forum of Private Business (2005) website has devoted a section of its website to advocating a change in the tax arrangements for charity shops declaring that: "We believe that the new breed of professional charity shops selling new goods are undercutting small businesses and should no longer benefit from tax breaks."<sup>9</sup>

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<sup>8</sup> Note that this figure represents the combined effects of exemption from income tax, fringe benefits tax concessions and State tax concessions. The value of the income tax exemption alone is estimated to be 2.1-3.0% of operating costs.

<sup>9</sup>It is interesting to note that while this group describes itself as a company limited by guarantee it is registered as a charity. The UK-based Forum of Private Business (2005) website [http://www.fpb.co.uk/aJWz\\_fw.html](http://www.fpb.co.uk/aJWz_fw.html)

These arguments by businesses raises two important questions. First, is the business view of nonprofit business venturing shared by the public? Second, are claims that nonprofits are a source of unfair competition supported by evidence-based research? We look at this first question presently, the second question will be addressed in the context of developing a strategic response to accusations that nonprofits enjoy an unfair advantage vis-à-vis for-profit competitors..

### **What does the public think? Analysis of media coverage of nonprofit business venturing**

Ascertaining public opinion throws up major methodological challenges relating to how to examine public discourse. One approach has been to examine how an issue is dealt with by the mass media. William Gamson argues that the mass media plays a central role in modern societies because it is the most generally available forum for debates on meaning and it is the major site in which contests over meaning must succeed. This latter point refers to how the mass media not only indicates but influences cultural changes (Gamson 1988). Given this role it is important to be at least aware of media constructions surrounding an issue as a way of not only understanding wider discourse on an issue but also how the media or other groups may distort this discourse in ways that serve their interests.

We sought to collect reports published in all major news and business publications in the UK, US and Australia over an 18 month period (from 1 September 2003 - 30 March 2005) that significantly focus on nonprofit organisations' involvement in commercial activities. To identify relevant articles we used the specialist media search engine *Factiva*<sup>TM</sup> and searched major publications in each country by using - in different

combinations – a variety of search words. The search terms were designed to cover a whole range of topics relating to business venturing and included terms such as nonprofits, not-for-profits, charities, NGOs, business venturing, social enterprise and social entrepreneurship along with terms such as community, economy, development and finance.

After examination of the relevant media articles relating to nonprofit business venturing we collated 11 articles that met our criteria. We readily acknowledge that these articles are indicative rather than definitive of recent media coverage. The coverage can be separated almost equally into positive (5) and negative (6) assessments of the practice of business venturing. There were many other articles that made reference to business venturing but they focussed on issues related to transparency (or lack thereof), corruption, or some other kind of possible malfeasance and not business venturing per se.<sup>10</sup>

A brief summary of these articles categorised according to positive / negative tone in the coverage of business venturing appears in Table 1.

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<sup>10</sup> There is also considerable press in the US about more explicit unlawful activity. A recent survey by Fremont-Smith and Kosaras (2003) identified 158 cases of criminal and civil wrongdoing involving nonprofits between 1995 and 2002. These activities included theft, bribery and misuse of funds for personal benefit. In 2003 *The Boston Globe* published several articles as part of a so-called “Spotlight series” on charities. According to one of these articles “The Globe’s investigation of hundreds of foundations turned up cases of foundation executives using tax-exempt assets to propel for-profit businesses for their own benefit.” It went on to state that “High pay and perks are the rule at foundations across the country. There are million-dollar salaries, luxury cars, generous pensions, health care benefits allotted for part-time trustees, and even private jets financed by organizations that, in exchange for significant tax benefits to their founders, support charitable causes.” *The Boston Globe*, 3 December 2003.

**Table 2. Media articles relating to nonprofit business venturing as reported in all major news and business publications in the UK, US and Australia accessed via *Factiva* 1/9/ 2003 - 30/3/ 2005 \* by theme.**

MAIN THEME	COUNTRY	SAMPLE HEADLINE / QUOTE
Negative assessments	Aust	<b>THE \$70 BILLION SACRED COW</b> Are you sick of paying tax? Is your entrepreneurial drive being held back by over regulation? Would you like regular government assistance in expanding your business? Sizable corporate and private donations - no questions asked? Would you like to see your competition operate at a disadvantage? If you answer yes to any of these questions and see yourself as compassionate and charitable, send your application to the Australian Taxation Office (ATO) to start your own charity or religion. You will be joining more than 700,000 other like-minded organisations in a sector that turns over more than \$70 billion a year (almost 10% of the country's GDP) in tax-free dollars and is the last bastion of the economy that is left largely to its own devices. <i>Business Review Weekly</i> 24 March 2005.
	US	<b>CHARITY, D.C. STYLE ARE SOME NONPROFITS REALLY IN THE LOBBYING BUSINESS?</b> For some tax-exempt organizations, the question is whether their charitable works are an end in themselves--or a means to one. KORUSEC's stated goals included working for peace on the Korean peninsula and building stronger ties between U.S. and Korean leaders. But KORUSEC strengthened Kim's own ties in Washington as well. <i>Time</i> U.S. Edition, 28 March 2005.
	US	<b>CHARITIES FEAR NEW LAWS WILL BE COSTLY</b> Congress weighs tighter controls Nonprofits worry that the cost of compliance could divert money from the people they try to help. Congress is considering more stringent regulatory controls over the nonprofit sector after reported abuses by some charities, including excessive compensation for executives, inappropriate expenditures and inadequate disclosure of financial information. <i>Denver Post</i> , 25 March 2005
	UK	<b>CHARITY SHOPS THREAT TO UK BOOKSELLERS</b> British independent booksellers are facing competition from charity shops. Many UK charities have opened specialist second-hand bookshops. Oxfam has over 70 shops in the UK and claims to be the largest retailer of second-hand books in Europe. The charity shops feel that they are providing a useful service. However, traditional booksellers feel that they are providing unfair competition as they do not pay for stock, have volunteers as staff, and pay lower business taxes <i>Inside Retailing</i> 21 March 2005
	UK	<b>DO CHARITY SHOPS HAVE AN UNFAIR ADVANTAGE OVER SMALL TRADERS?</b> The Federation of Small Businesses complained last week that regulators take a soft approach to the UK's 6,500 charity shops, which get relief on business rates. Does this amount to unfair competition on the high street? <i>Third Sector</i> 20 April 2005
		<b>SAVE US FROM THE CHARITY SHOPS, SAY FIRMS NEW BREED 'TOO AGGRESSIVE'</b> CHARITY shops are

	UK	gaining an unfair advantage over small retailers and should lose their preferential tax breaks, a business pressure group said yesterday. The Forum of Private Business (FPB) claimed that its members faced heightened competition from charities, which ran their shops as professional businesses rather than volunteer-led organisations. <i>The Herald</i> 8 March 2006
Positive assessments	UK	<b>CHARITIES NEED TO STAY IN BUSINESS.</b> The past decade has seen dramatic changes in the way charities operate. Without losing their essential philanthropic purpose, working practices now closely parallel and sometimes even lead the commercial sector. <i>Daily Mail</i> , 29 March 2004.
	US	<b>"BUSINESS PLAN" COMPETITION FOR CHARITIES</b> The Pittsburgh Social Venture Accelerator... will launch a "business plan" competition in August for charities that want to augment traditional sources of funding ...with their own money-making ventures. <i>Pittsburgh Post-Gazette</i> , 10 July 2003.
	UK	<b>CHARITIES NEED TO BECOME MORE BUSINESS-LIKE</b> Major charities, including the RNID and National Trust, are now streamlining their boards to achieve better, faster decisions through business-like models, while ensuring broader representation and responsibility to service users and beneficiaries through democratic accountability. The burgeoning field of social enterprise -trading for social purposes -now aims to replicate business successes through franchising, while looking on failures as means to innovation and reinvigoration. <i>The Times</i> , 29 June 2004.
	UK	<b>RNID MOST INNOVATIVE NOT-FOR-PROFIT</b> The Royal National Institute for the Deaf was last night named most innovative charity by the top voluntary organisations, in a poll promoting the growing role of not-for profit organisations in Britain. The RNID's £125m contract to modernise hospital audiology services ... puts it at the forefront of charities delivering public services. <i>Financial Times</i> , 23 November 2004.
	Aust	<b>CHARITY BUSINESS CASES</b> Philanthropy brokers are linking donors with charities - and insisting on better accounting of where the dollars go and what they achieve. Old-style, hand-out philanthropy is dying. A new generation of donors is demanding accountability, performance measurement, analysis of social returns on their investments, formal business plans and sustainable business models. In response, many charities are becoming more business-like but some are reluctant to change their old ways. <i>Business Review Weekly</i> , 20 May 2004.

As Table 1 shows, a number of recent media reports adopt the same position as much of the social enterprise literature, with five articles advocating that remedies for current nonprofit management deficiencies can be found in the market. For example, one report described how:

The burgeoning field of social enterprise -trading for social purposes - now aims to replicate business successes through franchising, while looking on failures as means to innovation and reinvigoration (*The Times*, 29 June 2004).

Some of the articles, however, appear less enthusiastic about nonprofits' burgeoning corporate orientation. In particular, business activity that does not appear to be directly tied to the realisation of a nonprofit's mission - that is activities that do not employ the disadvantaged or sell mission-driven products and services - have been the subject of criticism in the business media. For example, a recent article published by Australia's *Business Review Weekly* was critical of nonprofit ventures in areas such as poker machines, pizza chains and producing a horse racing newspaper. The journalist Adele Ferguson writes:

Without adequate supervision or transparency, the not-for-profit sector is a ticking time bomb. It would take just two or three scandals to harm all the good that the other charities are doing (*Business Review Weekly*, 2005).

Another article in the UK newspaper, *The Times* warned that:

Voluntary organisations must work harder to distinguish themselves if they want to retain public support. Charities are going to have to be clearer about what they are

doing because the boundaries between the sectors are blurring ... How will the public tell the difference? (*The Times*, 21 October 2003)

In an article titled “The \$70 billion sacred cow” the tone is clear:

Are you sick of paying tax? Is your entrepreneurial drive being held back by over regulation? Would you like regular government assistance in expanding your business? Sizable corporate and private donations - no questions asked? Would you like to see your competition operate at a disadvantage? If you answer yes to any of these questions and see yourself as compassionate and charitable, send your application to the ATO to start your own charity or religion. You will be joining more than 700,000 other like-minded organisations in a sector that turns over more than \$70 billion a year (almost 10% of the country's GDP) in tax-free dollars and is the last bastion of the economy that is left largely to its own devices (*Business Review Weekly* 24 March 2005).

These reports may inflate negative sentiment toward nonprofits that engage in business activity and can increase pressure on policy-makers to revisit tax arrangements that are favourable to nonprofits. It is therefore important that nonprofits develop strategies to effectively respond (and refute) such negative press.

### **Defending nonprofit business venturing in the light of current research**

While there has been widespread promotion of and engagement in commercial activities in nonprofit circles these reports from the business media suggest that nonprofits should

be prepared to answer criticisms regarding this strategy. What has been nonprofits response so far?

It is possible to examine some of the tactics employed by nonprofits to defend business venturing by looking at the responses made by nonprofit sector representatives to accusations that charity shops are a source of unfair competition. Defending charity shops place in the UK market one commentator in the *Independent On Sunday* (12 March 2006) took the sarcastic approach saying “Bad Oxfam - trying to end world poverty is one thing but, please, not at the expense of small retailers.” Other arguments made in defence of charity shops during this debate include highlighting the social benefit charities and charity shops provide, the relatively few subsidies extended to charities and that they generate custom for nearby businesses. According to a CEO of a nonprofit that runs charity shops:

Business rates relief for charity shops such as those run by Cancer Research UK represents less than 2 per cent of the costs of running our retail chain. We pay the standard market rates for all of our other property costs. For many years we have helped to keep traditional high streets alive as many commercial retailers moved to out-of-town retail centres.<sup>11</sup>

However, another strategy available to commercially oriented nonprofits is to promote the findings of the significant body of research that has found that nonprofit market participation does not inevitably create an unlevel playing field.

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<sup>11</sup> Opinion: Hot issue - Do charity shops have an unfair advantage over small traders? *The Third Sector* 20 April 2005 [www.haymarketgroup.com](http://www.haymarketgroup.com)

The question as to whether nonprofit competition creates an unfair advantage exists which distorts the market has been the subject of various studies (eg Rose-Ackerman 1990; Schiff and Weisbrod 1993). Most of this research has been conducted by economists and argues that there are flaws in the argument that tax exemption in some way gives nonprofits an unfair advantage when they venture into money-making activities.

According to analysis by Weisbrod, a nonprofit organization is likely to underprice its for-profit competitor (the “unfair” part of the competition), just as it would not accept a lower return on an (untaxed) passive investment (Weisbrod 1988). Thus nonprofit-run businesses are price takers not price makers. In response to the challenges launched by Kelloggs mentioned above, Australia’s Industry Commission report supported this finding saying:

The income tax exemption does not compromise competitive neutrality between organisations. All organisations..., regardless of their taxation status, aim to maximise their surplus (profit) are unaffected in their business decisions by their tax or tax-exempt status (Industry Commission, 1995: K5).

By examining duopoly price competition, Lui and Weinberg (2003) show that critics of nonprofit business venturing exaggerate the benefit of tax exemption and other nonprofit subsidies. They find that damage to the for-profit caused financial advantages conferred by public policy is marginal at best. In a similar argument Steuerle (1988) points out that

an income-tax exemption is not an input subsidy and is thus no more “unfair” to a taxed competitor than are the progressive income-tax rates on individuals who conduct business activities in a sole proprietorship or through a partnership or limited liability company.

Some scholars maintain that unrelated business taxes can be the real culprit, in terms of leading to anti-competitive situations. Scott (2003) argues that the imposition of a UBIT or similar taxes is likely to be a source of market distortion because the UBIT has the effect of channelling investments into particular types of commercial activities. This may have the effect of imposing more competitive pressure on for-profit firms.<sup>12</sup>

Several studies by economists have found that a nonprofit presence in a market has at best a marginal effect on the competitiveness of for-profit organisations in the same industry. It would therefore make sense for nonprofits to meet criticism from business head on and cite this evidence regularly and publicly.

## **Conclusion**

Nonprofit business venturing has created new opportunities and new challenges for the nonprofit sector. Business venturing has the potential to bring innovation to nonprofit management and operations and to provide an opportunity for nonprofits to augment scarce resources. This latter benefit is particularly attractive at a time when demand for nonprofit services far outstrips sector resources.

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<sup>12</sup> Also as noted above, from the experiences of the US and UK, it would appear that the introduction of a tax on commercial activity carried on by nonprofits may not generate enough extra revenue to justify the administration and compliance costs involved (Scott 2003).

It is important, however, that nonprofits understand the meanings and contestation surrounding business venturing, and social enterprise more broadly, if they are to apply it critically and reflectively in practice and participate in contemporary debates about its place in nonprofit management. For example, nonprofits need to be aware of the risks of being seen as more of a business than a social agency and a threat to private operations competing in the same markets.

To explore the new possibilities of commercialisation and to avoid its perils, nonprofits need to craft their strategies carefully. In considering business ventures nonprofits should pay attention to the organisation's mission, its capability, the financial impact, legal and taxation aspects, implications for community relations, and professional and ethical considerations. A strategy will also be required to defend forays into the market as a justifiable and logical response to new challenges facing contemporary nonprofits. In order to avoid for-profit competitors attempts to remove a source of competition a strategic response should be informed by current research findings that question the degree to which nonprofits distort the market.

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