JOURNAL OF SMALL BUSINESS STRATEGY

NEW COMPETITORS FOR SMALL BUSINESS: THE FOR-PROFIT MENTALITY OF NONPROFIT ORGANIZATIONS

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ABSTRACT

This paper seeks to raise awareness of the increasing competition small business firms are experiencing due to commercialization of the nonprofit sector. The traditional notion of the nonprofit organization is one supported by donations, grants, and government funds. However, commercial revenue has grown from 25 percent of total sector income in 1980 to 39 percent by 1996. These statistics suggest the folly of ignoring the for-profit strategies and commercial activities of nonprofit organizations.

Characteristics of small business firms and nonprofit organizations are described to highlight their competitive similarities. An empirical exploration of the emerging for-profit mentality of nonprofit organizations suggests that nonprofits are becoming more capable rivals in the competitive marketplace. The paper concludes by considering the implications of this new competition for small business firms.

INTRODUCTION

Small businesses have always faced formidable obstacles as they strive for viability and success in a competitive marketplace. Limited capital and accompanying cash flow strains, weak control systems (Ebert & Griffin, 1998), insufficient business management expertise, easy entry of competitors (Siropolis, 1994), inadequate facilities or amenities to attract employees, and personal agendas that may distract from profitability (Wall Street Journal, 1997) are problems frequently associated with small business firms. In addition, the approaching millennium promises further complexities and new challenges for entrepreneurs. The business context is becoming increasingly competitive, with crowded urban markets, continued expansion of mega-firms such as Wal-Mart into smaller markets, and added global competition (Baril, Marshall, & Sartelle, 1997). Expensive and rapidly changing computer technology carries hardship as well as opportunity (Efendioglu, 1997; Lederer and Maupin, 1997; Prescott & Miree, 1998), and proliferating government regulation complicates daily business activities (Wall Street Journal, 1997). A less visible but equally potent challenge emerging in the small business environment is the growing use of for-profit strategies by nonprofit organizations (Weisbrod, 1998).

The traditional notion of the nonprofit organization is one supported primarily by private contributions, including individual donations and corporate and foundation grants, supplemented with funding from various government sources. A combination of factors within the nonprofit sector is causing a change in this scenario. First, reduced income tax incentives and tighter institutional giving practices make it difficult for contributions to keep up with growth in the sector (Hodgkinson &Weitzman, 1988, 1997). Second, the federal government has been restrained by pressure to halt spending growth, leading to two major waves of funding cutbacks for nonprofit organizations since the early 1980s (Hodgkinson & Weitzman, 1997; Weisbrod, 1988). Third, the effects of strained contribution and government support are compounded by rapid growth in the number of nonprofit organizations -- from about 300,000 in the mid-1960s (Weisbrod, 1988) to over 1 million today (Hodgkinson & Weitzman, 1997). The overall result is intensified competition for the traditional sources of nonprofit revenue. In response, many nonprofits are turning to for-profit strategies as they engage in a variety of commercial activities to supplement traditional revenue streams.

Tracking the proportion of revenue attributed to each major source of funds illustrates the increasing importance of for-profit strategies and commercial activity for nonprofit organizations. Private contributions have generally been declining as a percentage of total revenue in the sector -- from 30 percent in 1980 (Hodgkinson & Weitzman, 1986), to 27 percent in 1986 (Hodgkinson & Weitzman, 1988), and 19 percent in 1996 (Boris, 1998). Funding from government sources has varied over time with changes in political leadership and public policy initiatives, going from 34 percent of sector funding in 1980 (Hodgkinson & Weitzman, 1986) to 27 percent in 1986 (Hodgkinson & Weitzman, 1988), and rebounding to 32 percent in 1996 (Boris, 1998). Much of the recent increase can be attributed to the growth of Medicare and Medicaid spending (Hodgkinson & Weitzman, 1997); thus, for many types of nonprofit organizations outside of the healthcare field, the percentage of total revenue provided by government sources is still declining (Boris, 1998). Hodgkinson and Weitzman have tracked the growth of commercial revenues from 25 percent of total sector income in 1980 (1986) to 38% in 1986 (1988), with continued growth to 39 percent -- the sector's largest single source of revenue -- by 1996 (Boris, 1998).

These statistics suggest the folly of ignoring the for-profit strategies and commercial activities of nonprofit organizations. With such a large proportion of total revenue at stake, nonprofit organizations become serious competitors, intent on generating commercial revenues to supplant the increasingly scarce contributed and government dollars. The commercial earnings are typically used to cross-subsidize under-funded charitable programs, adding to the importance of successful for-profit endeavors (Adams & Perlmutter, 1991; Weisbrod, 1998; Young, 1998). Further, nonprofits have come to value the greater control over such revenues, compared to the contribution volatility and spending restrictions associated with traditional sources of funds (Gronbjerg, 1993; Young, 1998). The overall result is substantial and growing competition emanating from the nonprofit sector. Realizing that the vast majority of nonprofits are small organizations, and typically engaged in local or regional enterprise within the service sector (Hodgkinson, Weitzman, Noga & Gorski, 1993), these new competitors can directly and disproportionately affect small business firms.

The purpose of this paper is to raise awareness of the increasing competition small business firms are experiencing from the growing commercialization of the nonprofit sector. Similarities between small business firms and nonprofit organizations will be described, followed by discussion of a study that explores an emerging for-profit mentality of nonprofit organizations. The paper concludes by considering the implications of this new competition for small business firms.

PARALLELS BETWEEN SMALL BUSINESS FIRMS AND NONPROFIT COMPETITORS

Nonprofit organizations provide a wide variety of services to the public. Excluding religious organizations, the largest number of nonprofits are involved in human service areas including job training, youth development, and sports and recreation. Other major categories include health services (hospitals, clinics, nursing homes) and counseling centers, education, and the arts and humanities (Hodgkinson et al., 1993). Most nonprofits are very small; in fact, only about 25 percent of the organizations have annual incomes of $25,000, the minimum for required annual Internal Revenue Service (IRS) reporting (Hodgkinson & Weitzman, 1988). Of those filing with the IRS, about one-third report annual revenue between $25,000 and $100,000; another third list income between $100,000 and $500,000, and about 10 percent have total revenue between $500,000 and $1 million (Internal Revenue Service, 1993).

The commercial activities of these organizations vary widely. Charging fees for program services is increasingly common. Examples include healthcare or counseling fees; tuition charges; membership fees for youth groups, sports teams or health clubs; contracts for job training services; and admission fees for museums, zoos, artistic performances, or other entertainment venues. Some nonprofits stretch beyond their primary program areas and into retail operations, as evidenced by the growing numbers of charity-operated thrift stores, gift shops, concessions, and mail order businesses. Less obvious examples of commercial activity include financial and management consulting services organized as for-profit subsidiaries of United Way organizations, or property rental and catering businesses (for weddings, corporate meetings or other gala events) operated by museums. Obviously, direct and indirect competition with for-profit businesses offering similar products and services results.

In addition to size and prominent local and service sector presence, nonprofits exhibit several striking similarities to small business firms. Limited capital and cash flow crises are endemic to organizations within the nonprofit sector (Hatten, 1982). Resource limitations extend to facilities, equipment, and employee compensation (Mirvis & Hackett, 1983; Preston, 1989). Low barriers to entry allow an influx of competing organizations (Froelich, 1997), adding to the resource strains. Another problem has been described as the "virtual absence of control systems" (Kanter & Summers, 1987:164) for monitoring both efficiency and effectiveness, associated with inadequate management experience within these organizations (Drucker, 1990). Finally, factors including idealism, professional independence, and charismatic leaders often drive the organization rather than rational organizational practice (Newman & Wallender, 1978). Overall, it appears that nonprofit organizations experience some of the same vulnerabilities in the competitive marketplace as many small business firms.

THE EMERGING FOR-PROFIT MENTALITY OF NONPROFIT ORGANIZATIONS

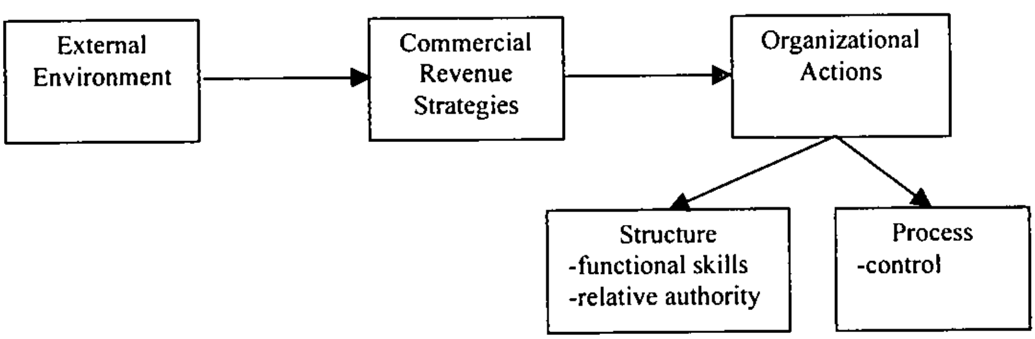
When organizations adopt new strategies, they also must install appropriate structures and processes to successfully implement the strategies (Andrews, 1980; Galbraith & Kazajian, 1986). Thus, nonprofit organizations are likely to modify their structures and processes to facilitate their increasingly important profit-seeking and commercial objectives. Such evolutionary change within nonprofit organizations is expected to create an emerging for-profit mentality (Hodgkinson & Lyman, 1989; Weisbrod, 1997) that could reduce the commonly observed vulnerabilities of nonprofit competitors. Consequently, nonprofits would become even more formidable rivals for small business firms.

Little empirical evidence exists at this time to support or refute the emergence of a for-profit mentality in nonprofit organizations. The scant research found in the literature reports that larger nonprofit organizations are more involved in commercial activities than smaller ones

(Adams & Perlmutter, 1991; Crimmins & Keil, 1983), successful for-profit strategies are related or complementary to the nonprofit's charitable mission (Adams & Perlmutter, 1991; Cain & Meritt, 1998; Young, 1998), and structural elaborations (including joint ventures and for-profit subsidiaries) to accommodate commercial activities are likely to evolve (Powell & Owen-Smith, 1998; Tuckman, 1998). In order to more specifically address competitively relevant internal adaptations, the study described below examines the effects of commercial activities on selected elements of organizational structure and process within nonprofit organizations.

The conceptual framework of the study follows basic tenets of strategic management as diagrammed below in Figure 1 (adapted from Galbraith & Kazajian, 1986). Essentially, evolving trends in the environment of nonprofit organizations have encouraged widespread adoption of commercial revenue strategies. The strategies are implemented through various organizational actions, leading to appropriate adaptations to structure and process. Many elements comprise structure and process within organizations; three fundamental components (functional skills, relative authority, and control processes) are selected here as a starting point for empirical study of factors contributing to an emerging for-profit mentality in nonprofit organizations.

Figure 1



Researchers have long observed that functional skills and relative authority within organizations adjust to reflect the critical tasks of resource acquisition strategies (Hambrick, 1981; Pfeffer & Salancik, 1977; Tolbert, 1985). Traditional resource acquisition strategies in nonprofit organizations rely on fund-raising, grant-writing, and government relations skills, enriched by experience in the particular service industry involved. In contrast, commercial revenue strategies require knowledge and skill in the functional areas of business administration (marketing, finance, accounting) in order to effectively compete for customers and efficiently manage operations for acceptable financial returns. Studies have uncovered evidence of increasing numbers of finance and marketing personnel in arts organizations (DiMaggio, 1986) and a tendency to replace traditional, social problem-focused board members with entrepreneurial, business-oriented individuals in human service organizations (Adams & Perlmutter, 1991) in response to higher levels of commercial income. Thus, it is expected that commercial revenue strategies will be associated with both a greater number and enhanced authority of staff with skills in the functional areas of business administration.

Hypothesis 1. Commercial revenue strategies are associated with an increased incidence of executive directors with functional skills in business administration.

Hypothesis 2. Commercial revenue strategies are associated with an increased incidence of middle managers with functional skills in business administration.

Hypothesis 3. Commercial revenue strategies are associated with greater relative authority in positions primarily involved with commercial functions.

Organizational activity is disciplined by multiple types of control processes that vary according to organizational needs and traditions (see Peterson, 1984, for an overview). These include hierarchical mechanisms of behavior and output control, which are useful for monitoring efficiency, and nonhierarchical mechanisms focused on employee selection and socialization, which are concerned with value congruence and professional indoctrination of norms. The latter are instrumental when resources flow mainly from nonmarket sources; conformity to donor preferences or government mandates and demonstration of institutionally accepted intentions become keys to success. However, successful commercial strategies require an organization to face a competitive market environment where financial return targets and consumer evaluation of price and quality demand operational efficiency for success. Research specific to the nonprofit context is limited, but a study of accountability in arts organizations found more rational accountability practices and a stronger cost-benefit mentality in conjunction with affiliated commercial ventures like gift shops and restaurants (Peterson, 1986). Theory and observation thus support the expectation that commercial revenue strategies will be associated with greater use of hierarchical control processes.

Hypothesis 4. Commercial revenue strategies are associated with increased use of behavior control.

Hypothesis 5. Commercial revenue strategies are associated with increased use of output control.

THE STUDY

Sample and Data Collection

A listing of charities was obtained from the Office of the Attorney General for a state located in the Midwest. All organizations in the three largest industry categories (arts, culture, and humanities; mental health and crisis counseling; human services) were selected for study; however, organizations with no employees as well as very large organizations (annual salaries greater than $10 million) were excluded as the issues examined would be either irrelevant or too complex to assess with the methods used here.

A survey instrument was developed and administered following the Total Design Method advocated by Dillman (1978), including several rounds of expert review, modification, and field testing. (A copy of the questionnaire can be obtained by contacting the author.) *Functional skill in business administration* was assessed by asking how many employees in particular job categories had college degrees or past professional experience in specific business administration fields. To quantify *relative authority*, respondents were asked to divide 100 points among several categories of organizational actors (including the board of directors, executive director, program directors and business managers) to indicate their relative decision-making responsibility in three vital areas: resource allocation, program choices, and goal selection at the mission level. The average decision-making responsibility across the three areas (Cronbach's coefficient alpha = .74) was calculated for use in the analysis. *Behavior control* was assessed by an equally weighted composite of two questions adapted from Ouchi and Maguire (1975) and Jones (1987). The 5-point scales indicate frequency of monitoring work hours and work activity of a typical professional employee (1 = once a month or less; 5 = at least once a day). Similarly, two questions from Ouchi's (1977) *output control* measures were adapted; 5-point scales assess the importance of numerical measures of output in both employee evaluation and program evaluation (1 = not at all important; 5 = extremely important).

Financial measures were obtained directly from each organization's financial statements, accessed through the cooperating Office of the Attorney General. *Commercial revenue* was measured by the proportion of total revenue generated from program fees and sales of goods and services. *Total revenue*, an indicator of size, was also obtained from the financial statements.

The questionnaire was mailed to executive directors of the 702 nonprofits comprising the selected population. Data collection procedures resulted in 426 usable returns, for a response rate of 62% after adjustments for postal returns, dissolutions and mergers. No statistically significant differences were found when comparing industry, size, or age of respondents and nonrespondents, or among those responding to the various mailing waves.

Data Analysis

Multiple regression analysis was used to determine the relationship of commercial revenue strategies with each of the dependent variables. The analysis includes control variables to account for possible size or industry effects. Initially, the relationship between all variables was explored by generating a correlation matrix (Table 1) to determine the extent of their linear dependence.

Table 1: Means, Standard Deviations, and Pearson Correlation Coefficients

Variables	Mean	s.d.	1	2	3	4	5	6	7	8
1. Commercial activity	.33	.35								
2. Total revenue (in millions)	1.04	2.17	.11*							
3. Org-type: Arts	.23	.42	-.07	-.06						
4. Org-type: MH	.12	.32	.21**	-.02	-.20**					
5. Behavior control	2.19	1.04	.17**	-.07	.00	-.02				
6. Output control	2.71	.98	.01	.06	-.02**	.02	.12*			
7. Functional expertise: ex. dir.	.20	.40	-.03	.06	-.01	-.03	.05	.10*		
8. Functional expertise: mgrs.	.11	.15	-.24**	-.21**	.11	.01	.06	.08	.18*	
9. Authority: business mgrs.	5.99	8.23	.16**	.41**	-.10*	.07	.08	.07	.02	-.13*

Although some statistically significant correlations among variables are shown, they are of insufficient magnitude to cause concern about regression estimates. The absence of multicolinearity problems among the dependent variables made it feasible to use individual regression models for hypothesis testing. Running separate regression models for each dependent variable offers advantages over multivariate models which exclude observations due to missing values on individual variables, and can result in a considerably reduced sample size when run as a simultaneous model.

The descriptive statistics displayed in Table 2 provide a portrait of the organizations comprising the sample. The human service subgroup is large, reflecting the prevalence of this category in the nonprofit sector as a whole. Human service organizations are larger in size, as indicated by number of employees and total revenue. In general, the sample organizations have about $1 million in annual revenue and 45 total employees, half of which are full-time. The mean proportion of revenue attributed to each major funding source shows the continued reliance on contributions for a substantial percentage of total income. Consistent with the previously discussed strains on government funding, government provides a lower percentage of revenue for sample organizations compared to the other revenue streams. The importance of commercial revenue is clearly shown by the high proportion of revenue -- one-third of total revenue for organizations in the sample as a whole, and over half of total revenue for the mental health group -- attributed to this source. There may be some upward distortion in the latter however, resulting from government contract funds being reported as fee income. It should also be noted that the percentages for the three major revenue streams do not total 100 percent due to an array of relatively minor income sources including dues, interest, dividends and other investments.

A common myth is that nonprofit organizations are legally prohibited from earning profits. Actually, nonprofits are merely unable to distribute profits to individuals or groups for private gain; profits are to be retained and used for continued pursuit of the charitable mission which justifies the nonprofit designation. Like most organizations, nonprofits seek an excess of revenue over expenses (typically referred to as "surplus" rather than "profit") to facilitate stability and long-term viability. This is clearly shown in Table 2 with the average surplus exceeding $48,000. Surplus divided by total revenue produces a figure analogous to net profit margin, and averages 4 percent in this sample overall. Human service organizations report both a lower surplus and margin, likely attributable to ever-increasing demands for social services and greater competition for funds in this subgroup.

The results of separate ordinary least squares multiple regression analyses to test each hypothesis are reported in Table 3. Hypothesis 1 is not supported; none of the independent variables are significantly related to whether or not the executive director has a business administration background. The analysis also fails to support Hypothesis 2, although significant results are found. Commercial revenue strategies exhibit a negative rather than a positive relationship with business expertise in middle management positions, even after controlling for the significant effects of size. Hypothesis 3 is supported; commercial strategies are associated with significantly greater authority in business manager positions. The predicted relationship in Hypothesis 4 is also supported; commercial strategies are shown to be positively related to behavior control. In other words, as commercial revenue increases, so does the extent of employee monitoring. Significant results are also produced for Hypothesis 5, but are attributed to industry type and not commercial strategies. Thus, commercial strategies are not associated with greater output control, and Hypothesis 5 is not supported.

Table 2: Descriptive Statistics[a]

Organizational Characteristics	Total Sample N = 426	Arts & Culture N = 96	Mental Health N = 50	Human Services N = 280
Full-time employees	22.3	9.8	21.3	26.6
Total employees	45.3	18.8	31.4	56.4
Total revenue[b]	1036.3	813.9	890.3	1139.8
% Revenue from contributions	.35	.38	.23	.36
% Revenue from government	.23	.20	.20	.24
% Revenue from commercial activity	.33	.29	.54	.32
Surplus at year-end[b]	48.78	69.52	67.26	37.25
Surplus/total revenue	.04	.07	.07	.02

[a]*Means* [b]*In thousands*

Table 3: Results of Regression Analyses

Independent Variables[a]	Exec Dir (H1)	Middle Mgmt (H2)	Busn Mgr Authority (H3)	Behavior Control (H4)	Output Control (H5)	Exec Dir. Author.	Pgm Dir Author.	Board Authority
Commercial Revenue	-.032 (-.549)	-.090 (-3.481)***	2.276 (2.065)*	.556 (3.418)***	-.026 (-.182)	1.484 (.530)	5.117 (2.414)*	-9.263 (-3.159)***
Total Revenue	-1.028E-8 (-1.128)	-1.052E-8 (-3.020)**	1.501E-6 (8.678)***	-3.524E-8 (-1.376)	2.499E-8 (1.124)	-.106E-5 (-2.413)	.125E-5 (3.758)***	-.175E-5 (-3.809)**
Industry: Arts	-.007 (-.142)	.034 (1.448)	-1.175 (-1.262)	-.049 (-.345)	-.525 (-4.919)***	1.838 (.778)	-1.157 (-.646)	2.616 (1.057)
Industry: Mental Health	-.046 (-.717)	.015 (.538)	1.618 (1.333)	-.254 (-1.365)	-.031 (-.189)	-.764 (-.248)	-.621 (-.266)	-1.100 (-.341)
N	408	254	394	338	371	394	297	394
F	.555	6.704	23.024	3.277	4.845	1.678	5.871	7.791
Prob>F	.695	.000	.000	.012	.001	.154	.000	.000
R-Square	.006	.097	.191	.038	.050	.017	.057	.074

[a] *Unstandardized regression coefficients are reported; t-statistics are in parentheses.*
**p <.05 **p<.01 ***p<.001*

The strength of the relationship between commercial strategies and business manager authority ($p < .001$; R-square = .19) led to further investigation of authority relationships using additional questionnaire data. The results, also displayed in Table 3, produce significant findings for both program director authority and board authority. Specifically, commercial revenue is shown to be positively related to the authority of program directors, and negatively related to the authority of the board of directors. The analysis does not find any relationship between commercial strategies and executive director authority.

DISCUSSION

Results of the regression analyses reveal several relationships between commercial revenue strategies and organizational structure and process. The findings offer some empirical evidence indicating an emerging for-profit mentality in nonprofit organizations.

The primary discovery is the altered authority relationships linked to use of commercial revenue strategies. As predicted by strategic management precepts, increased reliance on commercial revenue is associated with business manager positions becoming more instrumental to strategy success and ultimate organizational viability, which leads to expanded authority in these roles. Similarly, program directors are vital to successful revenue strategies when program fees are employed to generate income, and greater authority is observed in these positions. The relative authority shifts appear to be at the expense of the board of directors. Nonprofit board members have traditionally been selected based on ability to mobilize a network of contacts and generate contributions to support program services; as the proportion of contributed revenue declines, the critical nature of this function and thus the relative authority of the board diminishes.

Commercial revenue strategies were not found to be significantly related to the executive director position in terms of functional expertise or relative authority. This key position carries responsibility for a wide range of roles in addition to revenue acquisition; greater dependence on commercially generated income is apparently not singularly important enough to organizational outcomes to be reflected in the attributes or authority of executive directors. A more puzzling matter is why middle managers with functional skills in business administration comprise a lower rather than higher proportion of total employees as commercial revenue increases. A possible explanation lies in the greater importance of service production and efficiency when relying on fee income. Both of these motives would decrease the number of middle management personnel, regardless of functional background, in favor of direct service staff to enable expanded service production, higher fee income, and lower overhead costs.

The process-related findings support the prediction that commercial revenue strategies are associated with increased use of behavior control. Behavior control, including monitoring of work hours and work activity, helps achieve the efficiency necessary for successful participation in competitive markets. These process adaptations are consistent with the expanded authority of business managers and program managers discussed above. Greater monitoring of employees and increased manager authority both represent a departure from traditional nonprofit management practice, and suggest a growing for-profit mentality within these organizations.

The difficulty finding workable output measures or even agreeing on an appropriate definition of "output" in nonprofit organizations may explain the lack of a relationship between commercial revenue and output control. For example, what is an appropriate output measure in the performing arts: number of tickets sold, or artistic quality? Although output measures may provide useful guideposts to facilitate efficient and effective efforts as required by competitive markets, the mere existence of commercial activity will not erase problems of consensus about the nature of successful outcomes, or confounding measurement complexities.

CONCLUSIONS AND IMPLICATIONS FOR SMALL BUSINESS FIRMS

The deployment of for-profit strategies by nonprofit organizations provides a clear illustration of classic strategic management principles. Essentially, an evolving resource environment with increasingly scarce contribution and government funding stimulates commercial revenue-generating activities, which in turn require adjustments to internal structure and process for successful implementation of these new strategies. Structural adaptations leading to expanded authority for business managers and program directors, paired with increasing behavioral control processes, provide initial empirical support for the popular notion of an emerging for-profit mentality in nonprofit organizations. A growing for-profit mentality is likely to reduce many competitive disadvantages traditionally associated with nonprofit organizations, creating a rather insidious but ever expanding threat for small business firms.

While small businesses and nonprofits are similarly afflicted by a lack of management experience and/or distracting personal agendas of key players, as well as inadequate internal control mechanisms, the internal shifts identified in the study above demonstrate progress on the part of nonprofit organizations to address these limitations. Greater importance of and attention to success in commercial revenue-generating activities enhances a rational business perspective that is likely to improve the competitive performance of nonprofit organizations.

In addition, nonprofit organizations possess numerous advantages over their for-profit rivals. Although both nonprofits and small firms often suffer from resource shortages, the former have access to alternative revenue streams from contributions and government funds which can supplement profit shortfalls and provide a safety net for commercial failures. Further, nonprofits do not pay income tax on revenues from activities related to their charitable mission. Since most fee income flows from related programming, few organizations are subject to what is called the Unrelated Business Income Tax (UBIT). Nonprofits also enjoy property tax exemptions and reduced postal rates. Finally, the historical presence of these organizations in many service industries (including healthcare, counseling, daycare, job training, and physical fitness -- which offer expanding commercial opportunities today) bestow first mover advantages as well as the reputational and credibility benefits associated with being "not-for-profit".

Small businesses need to be responsive to the growing competition from nonprofit organizations. The first step is awareness. Educators, business associations, consultants and small business managers must look beyond traditional competitors and recognize expanding commercialism in the nonprofit sector. These increasingly formidable rivals present a new set of challenges that require understanding and heightened vigilance. The parallel attributes of nonprofits and small businesses will frequently create direct competition based on similar strengths. Reputation, service and customer relationships that convey advantages in battles with large firms will not necessarily provide differentiation here. Still, the small business must continue to rely on strengths built over time through attentive satisfaction of their particular customer needs. The new competition brings renewed urgency to the familiar advice of relentless attention to all possible opportunities for improved products, operations and relationships.

Opportunities -- whether new products or target markets, joint venture arrangements, or geographical expansion -- can be seized upon swiftly by independent firms. By contrast, nonprofits are constrained by multiple constituencies pursuing various social ideals through a charitable mission. Careful and often contentious debate about the appropriateness of new commercial initiatives slows response to the marketplace. Stipulations accompanying grant funds or government contracts also reduce agility. Thus, autonomy and flexibility are powerful weapons small businesses should mobilize when confronted with nonprofit rivals. Price competition, on the other hand, should be avoided. The supplemental revenue streams available to nonprofits enable low prices and continued operation through unprofitable periods. And since profit is not a primary goal of these organizations, merely a contribution to cost coverage can be viewed as an adequate return. Pricing decisions are further distorted by imprecise cost accounting; organizational overhead is often ignored, resulting in low perceived operating expense. The low-income markets frequently targeted by nonprofits also contribute to a low price mindset. Thus, careful selection and cultivation of higher-end target markets can be another effective tactic for competing with nonprofit organizations.

On a broader scale, small business groups need to monitor the appropriateness of nonprofit ventures. Commercial activities disguised as charitable efforts create unfair competitive advantages. Activities that are unrelated to the charitable mission are not eligible for tax-exempt benefits. A high proportion of commercial relative to charitable activity can result in loss of the nonprofit designation. A collaborative effort to accumulate such knowledge about general legal requirements compared to specific competitive practices can help maintain a fair context for competition, while continued public pressure through appropriate media and government channels can curtail bold competitive initiatives.

Additional research on the dynamics of competition between small business firms and nonprofit organizations is sorely needed. Descriptive studies identifying for-profit and non-profit market shares in particular industries would be useful, as well as market share growth rates for each type of player. Information about how the strategies and tactics of nonprofits might differ from more familiar competitors, along with studies of successful small business responses, would be valuable. And prescriptions for dealing with the unique (and maybe unfair) advantages of the nonprofit competitor need to be discovered and disseminated.

So although many unknowns remain, it is important that small business firms recognize the growing competitive stance and for-profit mentality of previously benign nonprofit organizations. These organizations can no longer be considered merely bystanders on the local business scene, or awkward participants in leftover markets. Increasingly, nonprofit organizations are becoming an effective competitive force and a compelling concern for small business firms.

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