



Increasing Revenues while Minimizing Risk – Growing without Betting the Farm

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I have made the case elsewhere that nonprofits should concentrate on growing revenue with the same vigor that we have taken to cutting costs. One reason this is difficult advice is the nature of risk. We can confidently estimate the immediate financial results of freezing salaries or laying off staff. Increasing revenues usually involves an up front investment. Even if we can predict the investment, it is difficult to forecast the revenues. Revenue growth, whether it is an investment in a fundraising initiative, or even scarier, a program expansion, involves more uncertainties and therefore more risk than cutting costs.

Nonprofits usually do not dwell on risk except in the context of insurance. Financial risk is ever present, and even more so when we contemplate change. Being risk adverse and settling for the status quo creates its own set of risks. Organizations that do not seek to change – to improve performance and/or to grow - risk of stagnation and eventual irrelevance. You simply cannot avoid risk, so our task is to understand and minimize it.

In this article I will address risk in the context of a program expansion. I will share some of what I have learned as an entrepreneur and a nonprofit consultant. So let's plunge forward. We have wrung all of the costs out of our organization. We have done whatever we can to market our existing products or services to our existing base. It is time to expand revenues.

What Causes Risk?

Risk is produced by change. It can be external. Examples are a deteriorating economy, new technology trends, change in government policy, or the emergence of new competitors. We can introduce internal risk – by trying something new - something we have never done. This may be in response to an external risk, a perceived opportunity, or a desire to avoid stagnation.

The more new things we try, the riskier. In the business world, companies routinely launch successful new products. In contrast, the percentage of start-ups that survive is thought to be 20%, and most of those are only marginally successful. With start-ups there are simply more new moving parts – more new things to make work together - than in a product launch. Not only does the entrepreneur have to create a valuable new product, they have to learn how to sell and deliver it, while doing a credible job of building out a supporting infrastructure.



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Venture Capitalists love to fund serial entrepreneurs. They know serial entrepreneurs have done it before, have fewer new things to learn, and are more likely to avoid the pitfalls of turning a new concept into a viable business.

How Do We Minimize Risk?

The first step is to look close to home. What we know best is our existing client base and our existing services. We can consider offering more services to our existing base or we can consider expanding our existing services to a similar client base in another region.

In most cases a geographic expansion is the lower risk. The success of franchises such as McDonalds is just one example of developing a good concept and rolling it out to other locations (on a scale that is unimaginable to most of us.) Sometimes a geographic expansion results in a duplication of services – something not well received by funders or government officials.

This suggests expanding services to address additional needs of our existing base. By working with our target population, it is easier and cheaper to learn about their needs. It is possible to test offerings on a “captive” friendly audience.

Lower the Investment

Lowering the financial investment is an important part of lowering the risk. From the movies, we learned the concept of “Other People’s Money”. We have our own version of that. Many funders are willing to underwrite a part or all of the cost of launching promising new programs, particularly if the sponsor has a good track record.

Other ways of minimize risk are piloting the project on a very small scale. This is a powerful way of shaking down the program, before a full roll out. We had a client who intended to start an innovative high school for kids with a history of substance abuse. After considering the risks of a significant commitment to purchase or lease classroom space, the client elected to test the concept with a handful of students that could easily be accommodated in its existing facility.

Avoid long term commitments to the extent possible. Outsource as much as possible. Share staff and resources with other programs. Use temporary help.

Consider collaboration – does someone else have access to a target population, where you can deliver a service? Do you have a population base where you can outsource additional services? We know a nonprofit that successfully serves a very needy cohort of new emigrants from Africa. They deliver core services, but contract to others for much of what they provide.



Finally, if this is a service with reimbursements, will the funder accelerate payments to lower the working capital required?

Revenue Risks

Especially with new products, market research can be very helpful. In most cases this requires the professional help of a marketing research consultant. If you intend to offer a new service to your existing base, take advantage of your access to learn as much as you can about their needs.

Asking questions like “How likely would you be to use this service? At what price would you pay? What are the barriers to signing up?”

Focus groups and surveys – when well done by a professional – can provide powerful insights.

For a geographic expansion you need to know: “Is the area underserved? Does it need another provider? How many potential clients are there? Do the clients in the new location have the same needs? How many would sign up?”

In all of this, you need to keep the essential question: “What is your competitive advantage? Why is your summer camp better than the one down the street? Why is your after school program best and for who? If we introduce this concert series – how many people would like to come – how can we let them know?”

Market research should give you give you an insight to the competition. What are the alternatives to your product or service? If you are in the arts, it may be everything else a consumer could do with their leisure time. Is your concept compelling enough that consumers will choose it?

Finally, if you are successful – what are the barriers to new competition? Will your success attract either for profit or nonprofit competition.

Planning – Running the Numbers

With the benefit of market research, you should begin to have a clear enough outline of the program costs and potential revenues to make a financial model.

You need to be able to prove that the concept is financially viable with a business plan. We prefer flexible, spread sheet models which can test for varying assumptions. We have created financial models for clients with up to 50 variables, but it can be much simpler than that.

We like to see a worst case, an expected case, and a best case model. Focus your energy on the worst case and the best case scenarios. One of our clients launched a



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new service which paralleled the best case – until the recession hit – where it dropped to the worst case. At least they were prepared.

The model should be based on cash flow. A bottom line surplus or profit using accrual accounting is an important goal, but getting to cash flow break even is more important than profit for a new initiative. We have seen promising projects that were canceled because the client was not willing to risk the up front investment to fund facilities, training, marketing, and accounts receivable, before the cash flow started.

We like to see three additional steps. The first is an analysis of the Critical Success Factors. What is a concise list of what has to go right for this to work? “Is it success with referral sources? Does the roll out need to be perfect? Is an outside vendor critical?” Make this list and stay focused on it as the new initiative is rolled out.

What keeps you up at night, what is your biggest concern? This is often the part of the expansion that you have the least experience with. Take the time to think this through. What is the downside if your worst fears come to pass? How do you minimize this? If things go wrong, how do you cut your losses?

Finally, you should give some consideration to what constitutes failure. When do you give up, and what is the exit strategy.

Execution

Several things can help with execution. One of our clients was intending to roll out a novel preschool. They gave a sigh of relief when they were able to hire an experienced head teacher who had managed a preschool. Experience counts – think of the serial entrepreneur.

If you cannot hire experience, you can still benefit by sharing experience with someone who has done this elsewhere. In one case we had to go to Texas to find a model, but there is usually one out there somewhere. Best practices from others are always worth considering.

This is a time when project management skills become important. Make a time line. Monitor the progress.

Be flexible. Be committed to learning and adapting, as the project progresses. Returning to the venture capitalists for the last time, they usually bet on the management, not the product. More often than not, the product or service needs to be modified, sometimes substantially as it comes to market.

In most cases your new services will not be so novel as to require a makeover in progress, but be prepared to monitor acceptance, or lack thereof, and make continuous tweaks to the product, the marketing, or the execution as necessary.



Economic Environment

Be aware of the economic environment. Are you facing headwinds or tail winds from the economy? The early stage of an economic expansion has many advantages. It is possible to hire good workers and the suppliers, funders and potential clients are likely to be receptive.

Be aware of demographic trends – is demand growing? Some services such as job counseling, hunger, mental health, and education tend to be countercyclical. For those it may be better to get started near the peak of an economic cycle.

What about costs. Are you going to be able to hire the workers you need at the cost that is acceptable? What do rising costs, such as medical inflation do to your model?

Whatever you do, it needs to work over a complete economic cycle. We have seen promising programs that were not successful because the sponsor lost the will for a final push in the face of a deteriorating economic climate.

Commitment

A clear vision of what success is and a commitment to getting there are critical. Very few new programs go smoothly. Successful expansions never succeed without a committed sponsor in the organization.

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