

Pricing in the Nonprofit Ventures
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As nonprofit organizations move into commercial ventures and as they seek, within their traditional operations, to replace philanthropic and public funding with earned income, it has become more important for nonprofit managers to understand pricing. When is it appropriate for nonprofits to collect fees for services rendered? How should fees be set? In setting fees, to what extent should nonprofits discriminate among clients, charging higher rates to some than to others? What rules can nonprofits use in structuring fees among a variety of different programs? In answering these questions, nonprofits must grapple with both the economic realities of their markets and the broader value issues of their organizations. Thus, while for-profits are principally concerned with setting prices so as to raise as much revenue as possible, nonprofits will also typically care about how the revenues are raised, both in terms of which clients pay and which programs they pay for.

The first reality of price setting is one too often overlooked by nonprofits: increasing prices typically reduces the number of clients interested in a service. As many of the New Economy internet firms have recently discovered, this demand effect is often quite large as one begins to charge for a service historically offered free. There are at least three important implications of the demand effect. First, revenue raised for imposing fees may well be quite a bit less than the

nonprofit originally forecasts, as the client base shrinks. Second, with the shrinkage of the client base, typically comes a change in the composition of the client base. Third, the client base shrinkage may affect the nonprofit's ability to raise philanthropic and/or public revenues. We can think about each of these three effects in turn.

The extent to which demand goes down as prices increase is referred to by economists as demand elasticity. As a general matter, elasticity is high— that is, more clients desert as prices go up— when there are lots of substitutes or alternative available to those clients. In other words, when your clients really desperately need your services, that's the time you can charge them a high price without losing their patronage! One can already see that for a socially sensitive nonprofit, price setting is a tricky matter. When we add the cost side, the picture gets even more complicated. For a number of nonprofits, serving an additional customer has very low incremental costs, at least within some range. For example, for the Guggenheim museum to open its doors to one more art lover likely costs it nothing. Under these circumstances losing clients as a result of raising prices is especially troublesome. In other situations, like health care or education, it is expensive to serve an added client and here reducing demand by charging a positive price may actually be an advantage because it limits the extent to which expensive services are provided to people who do not value them very highly.

When a nonprofit decides to charge prices for its services, it potentially affects not only the number of clients it serves, but which clients it serves. In many cases, this sorting is very useful. When we make a client pay something for a service, people who don't value the service very much often drop out. Especially in cases in which it is expensive to provide the service, this sorting is very desirable. As an added bonus, in making people pay at least some of the service costs, we may be

giving them more of a stake in the enterprise and encouraging them to take it more seriously. On both of these grounds, for example, most private schools make parents pay some tuition, regardless of how poor they may be. Similarly, Habitat for Humanity requires a contribution from the new homeowners it serves, both financial and in sweat equity. There are clearly many other circumstances in which we do not wish to have certain clients “sorted out” by a price system and here is where some form of sliding fees come in. Almost all nonprofits that use prices charge different prices to different categories of customers. Often, the price structure is based on income levels, but other client characteristics may also play a role. In some cases, nonprofits use prices for some programs and not others largely because of the characteristics of the clients who use the particular programs. A settlement house might have highly subsidized fees for its after school program serving at-risk youth, while charging full fees to the evening adult recreational program. One of the key differences between a nonprofit and a for-profit is that the nonprofit cares not only about how many customers it has, but also who its customers are. One consequence of this feature is that when nonprofits do use pricing, they tend to have more complicated pricing structures than comparably sized for-profits.

For the typical nonprofit, about one-third of revenues is raised through fees. Whatever the nonprofit does in the fees arena must be carefully weighed against what is going on for the rest of its revenue stream. When raising prices reduces the client base or changes its composition, there may be an adverse effect on the organization’s ability to raise either public funds or charitable contributions. When commercial activity becomes highly visible, potential donors may be less likely to contribute to the organization. If the American Red Cross began charging disaster victims for the relief it provides, one can be sure that the negative effect of this policy on volunteer efforts and charitable contributions would far

outweigh any revenue raised. It is clear that in some areas, charging for a service would be unacceptable to either donors or staff, regardless of how much such charges would contribute to the efficiency of the operation. As a society, our sense of what is best kept out of the market system has changed over time, but clearly there are such categories of goods and services, and nonprofits must be especially careful not to violate these social and organizational norms.

A final consideration in deciding whether or not to begin charging a price for a service is a practical one. My favorite example here is of a swing set in a public park. When my children were young, I often stood waiting for a free swing at the local park. As an economist, I spent my time in line musing on the inefficiency of the current system: Clearly the child who was on the swing would have relinquished the swing to my own child much sooner had he or she had to pay a swinging charge. Indeed, such a charge would have disciplined the “all-day swingers” and made room for the rest of the clamoring children. (Perhaps only economists have these thoughts as they stand in line). But, of course, charging at the park would be, in another sense, quite inefficient: most of the time there is no queue of children and hiring someone to collect the fees and time the children would cost more than the revenue raised! For services in which access is easy and capacity adequate, charging prices is often neither practical nor wise.

As competition for donations and public resources intensifies, more nonprofits are likely to turn to activities that have the potential to generate earned income. Setting prices for these services can involve an intricate balance of economics, ideology and common sense.

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