

Understanding Fee-for-Service Models

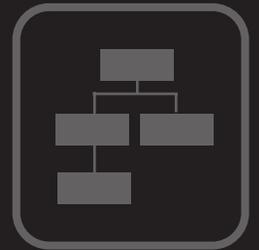


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INTRODUCTION

The Compassion Capital Fund (CCF), administered by the U.S. Department of Health and Human Services, provided capacity building grants to expand and strengthen the role of nonprofit organizations in their ability to provide social services to low-income individuals. Between 2002 and 2009, CCF awarded 1,277 grants, and the CCF National Resource Center provided training and technical assistance to all CCF grantees.

Strengthening Nonprofits: A Capacity Builder's Resource Library is born out of the expansive set of resources created by the National Resource Center during that time period, to be shared and to continue the legacy of CCF's capacity building work.

Strengthening Nonprofits: A Capacity Builder's Resource Library contains guidebooks and e-learnings on the following topics:

1. Conducting a Community Assessment
2. Delivering Training and Technical Assistance
3. Designing and Managing a Subaward Program
4. Going Virtual
5. Identifying and Promoting Effective Practices
6. Leading a Nonprofit Organization: Tips and Tools for Executive Directors and Team Leaders
7. Managing Crisis: Risk Management and Crisis Response Planning
8. Managing Public Grants
9. Measuring Outcomes
10. Partnerships: Frameworks for Working Together
11. Sustainability
12. Working with Consultants

Who is the audience for *Strengthening Nonprofits: A Capacity Builder's Resource Library*?

Anyone who is interested in expanding the capacity of nonprofit services in their community – from front line service providers to executives in large intermediary organizations – will benefit from the information contained in this resource library. The National Resource Center originally developed many of these resources for intermediary organizations, organizations that were granted funds by CCF to build the capacity of the faith-based and community-based organizations (FBCOs) they served. As such, the majority of the resources in *Strengthening Nonprofits: A Capacity Builder's Resource Library* support intermediary organizations in their capacity building efforts. However, funders of capacity building programs (Federal program offices and foundations) and the nonprofit community (including FBCOs) at large will also find these resources helpful. In addition, individuals working to build capacity within a program or an organization will be able to use these resources to support their efforts to implement change and make improvements.

The ***Understanding Fee-for-Service*** guidebook will be helpful to any organization seeking to understand, initiate, or enhance current fee-for-service activities.

Who developed the ***Understanding Fee-for-Service*** guidebook?

The guidebook was developed for the Department of Health and Human Services by the National Resource Center.

OVERVIEW

Fluctuations in the economy are a constant challenge to nonprofit sustainability. During periods of economic downturn, nonprofits experience a decrease in funding on top of an increase in demand for services. Often these financial setbacks lead to increased competition in the nonprofit sector, with many organizations vying for the same limited pool of available funding. This type of economic environment forces nonprofits to explore alternative approaches to generating income.

One viable alternative for nonprofits during times of economic instability is the introduction of mandatory, voluntary, or requested fees. This “fee-for-service” model allows nonprofit organizations to generate revenue by requesting or requiring payment for services and products.

Just as in the private sector, a thorough business plan, market analysis, and consideration of what you have to offer and who might be willing to pay for it are core elements of instituting a fee-for-service model. This toolkit includes analysis tools and planning guidance designed to help you think through whether or not to implement a fee-for-service element in your organization.

The toolkit is divided into three sections:

1. Types of Fee-for-Service Programs — reviews mandatory fees, voluntary donations and requested fees, membership programs, and hybrid approaches
2. Considerations for Implementation — explores potential conflicts with concurrent grants; segmentation; pricing; and legal and tax implications
3. Making a Decision — provides references to additional tools to help analyze the potential of employing a fee-for-service model

At the very end of this toolkit is a list of fee-for-service resources — websites and other online tools that may assist you in evaluating and implementing a fee-for-service model.

TYPES OF FEE-FOR-SERVICE PROGRAMS

Mandatory Fees

In the mandatory fee model, a nonprofit charges a predetermined price or fixed fee based on a specific set of criteria. The fee must be below the “market rate” in order to adhere to legal and IRS considerations (see “Legal and Tax Implications” on p. 9 of this toolkit). Examples of nonprofit organizations that operate under this model are public universities, hospitals, nonprofit or public health clubs, and national and state parks.¹

Voluntary Donations and Requested Fees

An organization may encounter some difficulties as it begins to charge for services. One approach to help move an organization toward being in a position to charge fees is to consider voluntary donations and fees. Under this approach, an organization informs clients of any costs and requests a contribution, but it does not mandate payment.

¹ Kim Klein, ed., *Fundraising for Social Change*, 5th ed. (San Francisco: Jossey-Bass, 2006), 211-212.

Voluntary Donations

Fees for service can be made voluntary by providing a service at no cost but requesting a donation to cover some of the costs incurred. This is a good strategy for helping introduce an organization and its clients to the concept of financial support while minimizing any feeling of being coerced to pay. While this is the least invasive fee-for-service strategy, it is also the least effective, as clients tend to give only a very small amount in the form of a donation.² Some ideas for encouraging donations include:

- **Post signs or hand out flyers.** Have signs and/or flyers prominent and available whenever and wherever there is a group of people who are excited to be receiving your services. Possible messages for signs and flyers include:
 - ▶ “We thank you for your donations.”
 - ▶ “Your donations help ensure continued services.”
 - ▶ “Due to decreases in private/public funding, we are asking for your assistance in supporting our programs.”³
- **Include appeals with any survey requests.** If and when you send out service evaluations, include a statement that says, “If you rate our services highly, please consider returning a contribution along with your evaluation. We count on contributions to keep our work going and ask that you contribute whatever is appropriate for your budget to support the services we provide.” This type of voluntary donation request implies a direct connection to a service that an individual finds valuable and asks them to consider its worth.

Requested Fees

This strategy involves requesting donations with each service so that clients become more aware of the cost to the organization and the need for support. This slightly more direct approach involves publishing a menu of services and requesting, but not requiring, a fee to cover the cost of the service. This gives clients and stakeholders specific knowledge of the actual cost the organization incurs for each service rendered. Upon learning these costs, a client might choose to make a voluntary contribution to help offset some organizational expenses. This approach reinforces the client’s belief of independence and the expectation of obtaining and demanding better services or products.⁴

Here is a sample announcement of a requested fee table of services from a community service organization in Michigan:⁵

The Cost of Providing Services	
One delivery of a meal (Meals on Wheels)	\$7.00
One trip to and from a medical appointment	\$5.00
Support group counselor (per person)	\$7.00
Private counseling (per hour)	\$40.00
Lunch at the community center	\$5.00
Field trips per person per day	\$10.00
Magazine subscriptions (average)	\$15.00
Books and DVDs for the library (average)	\$12.00
Internet access (per day)	\$5.00
New games for the game room (average)	\$15.00
Any amount you can pay toward these services is gratefully accepted and will be put right to work. Thank you.	

2 Ibid., 213.

3 Ibid., 211.

4 Ibid., 210.

5 Ibid.

Membership Programs

This approach involves charging a lump sum membership, with all services and products available to members for a free or reduced cost. Organizations can be creative in thinking about how to create an awareness of the cost and value of their fees and services. Examples include:

- **Request voluntary donations along with online registration.** If participants register online for any of your organization's services, include a voluntary fee along with the cost of registration. It is recommended that you include a range of preset amounts from which to choose, as well as an area for people to enter their preferred donation amount. Stress that people can still register without submitting payment by using language such as: "Though this service is free of charge, we do rely on those who can pay to contribute an amount that is appropriate and meaningful. The service for which you are registering costs between \$_____ and \$_____."
- **Make non-coercive announcements after events/programs.** This example is offered with some caution, as it requires judgment about your clients and how they might perceive such an announcement. If your organization holds an event or program that is known to be of high value to participants, consider having a leader of the organization make a brief concluding request for donations.
 - ▶ *Example:* "We would like you to know that the cost of putting on this and other events can range from \$_____ to \$_____. We are proud that we can offer these services free of charge so that anyone can attend. However, we count on people who can afford to donate to help make it possible to keep our events free and open to the public. If you value the services that we offer, like the one you attended today, and you value that the services are available to the public, we ask that you consider donating. The recommended donation to help cover our expenses is between \$_____ and \$_____; however, please donate what is appropriate for your budget and means. If you cannot donate, please know that we value your participation and welcome your being here. To donate, please place a check in the envelope provided and mail it to us, or visit our website."⁶
- It is very important to avoid any tactics that could be perceived as coercive, e.g., asking for donations on the spot in front of other people, asking for a show of hands of who is going to donate, or saying anything that would imply pressure to give or the sense of "being wrong" for not donating. It is also important to use good judgment about which audiences you choose to solicit.
- **Publish an announcement of voluntary fees.** Your organization can publish a list of the cost of services provided. This "menu" can be posted in prominent locations, be included in event programs and brochures, and serve as a basis for fundraising initiatives.

Hybrid Approaches

Depending on your organization's circumstances, instituting one of the models described above might not be an exact fit. In some instances, a blend of approaches proves the most appropriate. For example, an organization might offer free services, services a la carte, and discounted and exclusive services and products for its members.⁷

6 Ibid., 211.

7 Ibid.

CONSIDERATIONS FOR IMPLEMENTATION

The right mix of fee-for-service alternatives will be different for every nonprofit, but all models require careful consideration before and during implementation. Whatever approach you choose, the key considerations are the same — potential conflicts with concurrent grants, segmentation, and pricing, and legal and tax implications.

Potential Conflicts with Concurrent Grants

Be sure to gain a clear understanding of the laws, rules, and regulations that apply to each grant you have. Terms of Federal grants may prohibit you from profiting from any programs or services created using Federal funds, and some Federal programs require that your federally funded services be provided free of charge. State and local funders may have similar rules governing their grant making. Therefore, it is important to discuss any fee-for-service activities with your program office before implementation.

Segmentation

Segmentation is the strategy of dividing an organization's clientele into specific characteristics to optimize the use of a service or product. One of the best ways to segment an organization's market is based on your clients' income. This sliding-scale approach provides a deliberate and strategic method that enables clients to contribute based on their financial ability. Those clients that are capable of paying a higher price will help offset some of the cost from those clients who can only pay very little or not at all.

Pricing

The first step to establishing a fee structure is to identify the costs associated with the services or products you provide.

Breaking Even

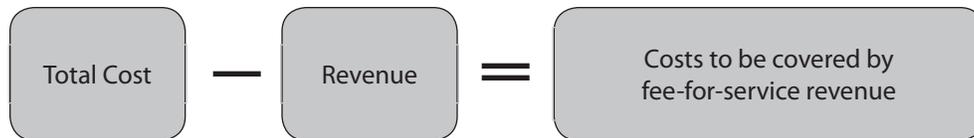
Nonprofit organizations can determine pricing based on a “break-even point.” This is defined as the level at which offering a service or product results in neither a financial gain nor a loss. It represents your organization's aim to successfully serve the right number of people at the lowest cost possible.⁸

In identifying the break-even point for your products or services, you must know the fixed and variable cost, the product or service's units of sale, and the price you will be charging for each product or service. To determine your organization's break-even point, follow the six steps below:

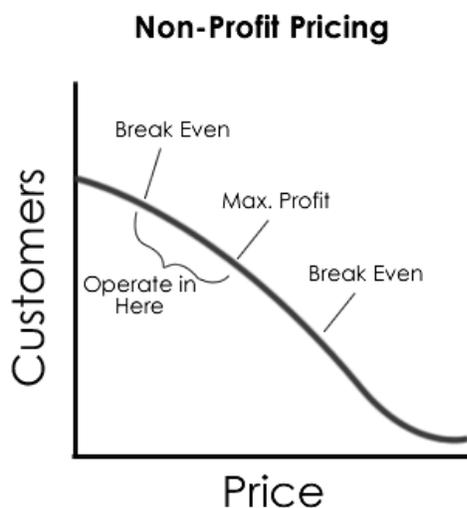
1. Determine the “units of sale” you will be offering, e.g., a single event, a series of events with one fee, etc.
2. Make a list of all the fixed costs associated with the service or product. Fixed costs are the expenses that are not related to the activities of your organization, such as salaries and rent.
3. Make a list of all the variable costs associated with the service or product. Variable costs are expenses that are directly related to the activities of the organization, such as transportation, office supplies, and program equipment.
4. Add the fixed and variable costs together. This is the total cost.

⁸ Chas Grundy, “How to Charge for Service and Not Lose Customers,” Non-Profit Chas, 7 August 2008, <http://nonprofitchas.com/2008/08/07/how-to-charge-for-service-and-not-lose-customers>.

- Determine what sources of revenue you have to cover the costs, and identify any additional revenue needed to cover the costs.
- The additional revenue needed is the price per unit you will charge to be able to cover your costs. This is reaching your break-even point.



The graph below illustrates the relationship of price to customers. The break-even point will decrease due to an increase in revenue from a third party. This subsidy will allow an organization to charge a lower price for the product or service to fewer clients to break even.⁹



For a community service organization, the break-even point is a milestone, not necessarily the goal. The aim that your organization might want to achieve is to successfully serve the most people while supporting your organization’s mission, vision, and values.¹⁰

You might also consider using a “break-even calculator” to assist in your calculations. Please refer to the fee-for-service resources on p. 15 of this toolkit or simply search for “break-even calculator” on any online search engine.

Will Clients Pay the Price?

An additional factor in determining pricing involves comparing what you hope to be able to charge with the going market rate. It’s important to conduct some research to

determine the going rate for similar products or services provided by other nonprofit organizations.

If your price is higher than that of other nonprofits and there are similar products and services offered in your geographic area, you should first consider whether your price is appropriate; if you believe it is, you will need to think carefully about how to market your products or services in a way that differentiates them and justifies the cost. If you determine that your desired price is unreasonable, you should look into ways to raise additional funds to help supplement the cost.

Legal and Tax Implications

When charging fees for rendered services or products, an organization should remain aware of several important considerations. First, your fee must be less than what a for-profit business would charge for a similar service.¹¹ Also, if the product or service for which you are charging a fee is not associated with your organization’s mission, it could be subject to unrelated business income tax (UBIT).¹²

⁹ Ibid.

¹⁰ Ibid.

¹¹ Joanne Fritz, “Can a Nonprofit Charge Fees for Its Services?” About.com: Nonprofit Charitable Orgs, <http://nonprofit.about.com/od/financialconcerns/f/feesforservices.htm>.

¹² Ibid.

According to the IRS, “unrelated business income” is any money earned from a trade or business that is regularly carried on by an exempt organization and is not substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from the activity. If an exempt community organization engages in a great deal of unrelated business activities, its tax-exempt status could become jeopardized.¹³ For more information regarding unrelated business income or activities, consult IRS Publication 598, “[Tax on Unrelated Business Income of Exempt Organizations](#).”

Another key consideration to keep in mind when charging fees is that these fees are strictly voluntary; individuals must not be coerced into paying them. A coercive action is one that makes the organization or person feel that the product or service is not really free and that the donation is involuntary.¹⁴ If a community service organization chooses this approach, it must make sure that its relevant policies and procedures are planned and implemented appropriately so that not even the impression of coercion is made.

MAKING A DECISION

As nonprofit organizations experience an increased demand for their services and products, accompanied by a diminished supply of revenue sources, the need to explore alternative options for generating income becomes increasingly salient. A fee-for-service strategy may help an organization offset its expenses and increase revenue while minimizing its capital or human investments.

To further increase your knowledge base and to help implement a fee-for-service model, consider using the following tools, templates, and resources:

- **Fee-for-Service Models** — an at-a-glance reference guide of the various fee-for-service models described in greater detail on pp. 5–7 of this toolkit
- **Can Fee-for-Service Work for Your Organization?** — a table to help determine if the fee-for-service model is appropriate for your organization
- **Fee-for-Service Plan** — a list of ten essential elements to consider in the implementation of a fee-for-service plan

¹³ IRS, Publication 598, 3.

¹⁴ Klein, Fundraising, 213.

Fee-for-Service Models¹⁵

MODEL	DESCRIPTION	CONSIDERATIONS	PROS	CONS
MANDATORY FEES	Request a fixed payment amount that is based on a set of criteria	<ul style="list-style-type: none"> Ensure that fees are below the market rate offered by for-profit organizations Conduct some preliminary market research Treat it like a for-profit business Ensure that the fee is consistent and aligned with the mission, vision, goals and objectives, and clientele 	<ul style="list-style-type: none"> Since fees are below market rate, some people who would not have otherwise used the services might use them Creates a new revenue stream Paying clients often gain feelings of self-reliance and independence 	<ul style="list-style-type: none"> Requiring fees might deter some current clients from using your services Using this model could prove to be restrictive in some grants for which you have applied
VOLUNTARY DONATIONS	The organization provides the services for free but requests a donation	<ul style="list-style-type: none"> Consider your clients and their ability to provide payment Visual requests for payment (posters, etc.) must be in a central, visible location 	<ul style="list-style-type: none"> It is the least intrusive for both clients and staff Tax and legal liability are reduced 	<ul style="list-style-type: none"> This is the least responsive method and it yields the least amount of money
REQUESTED FEES	Clients pay an amount of their choosing	<ul style="list-style-type: none"> Make sure your organization has non-coercive systems, policies, and procedures in place when collecting voluntary fees The fees must be perceived as voluntary by your clients Consider your clients and their capacity to provide payment The fee must be below the market of what a for-profit would charge for the service or good being acquired A range of costs for the product or service is established and posted Clients can donate toward a specific service that they received 	<ul style="list-style-type: none"> This method of fee-for-service offers clients a flexible range of payments while enhancing the agency's ability to generate revenue Some clients feel empowered by paying for services or products 	<ul style="list-style-type: none"> There might be tax and legal ramifications if implemented improperly Using this model might create some restrictions in applying for grants
HYBRID APPROACHES	Combine requested fees for some services and voluntary donations for others	<ul style="list-style-type: none"> Discern which services will be free and which will require a fee Make sure that this structure defines and communicates to staff, volunteers, and clients which services or products are free and which have fees 	<ul style="list-style-type: none"> This model allows for generation of revenue It can provide flexibility to the organization 	<ul style="list-style-type: none"> Implementation of this model might be the most challenging of all options

Can Fee-for-Service Work for Your Organization?

A solid analysis and good business planning is central to identifying which of your organization's services and products can be used to generate fees. The following is designed to assist you in the evaluation process.

CORE SERVICES AND PRODUCTS

- Identify your organization's distinctive areas of expertise.
- Identify unique products and services that "stand out" and meet an important need.

CLIENTS

- Identify who currently benefits from your organization's expertise, products, and/or services.
- Identify what specific need(s) is/are met by offering a particular product to each type of client.

CLIENT RESPONSE TO FEES

- Describe each client identified in the previous row. Consider how fees (mandatory or voluntary) might affect them (both positively and negatively).
- Then answer the question, "Are fees for these products/services a viable alternative for the current population that receives them?"

POTENTIAL MARKET RESEARCH

- Explore who else might benefit from this expertise, product, or service. How do you know?
- Who else is offering similar products?
- What is your competitive advantage?

FEE-FOR-SERVICE MODEL

- Consider which fee-for-service model, if any, would best suit the current clients.
- Could you possibly use a different fee-for-service model for a different set of clients?
- How would the implementation affect your organization?

IMPLEMENTATION STRATEGY

- Brainstorm what steps and elements you would need to take to put each model into practice.

Fee-for-Service Plan

- 1. Identify a core area of expertise, service, or product.** These should match the core areas of expertise, services, or products identified in the first row of the analysis table above. For each item identified, work through all of the essential elements on this list.
- 2. Identify an appropriate fee-for-service model.** Determine which model or models will work best in charging fees for the core expertise, service, or product. You may have already determined this using the analysis table.
- 3. Consider what policies and procedures need to be put in place.** Determine how to ensure that the selected strategy will conform to your organization's operating procedures; what the operational policies and procedures for the new venture will be; and which government regulations, laws, and other guidelines you may need to keep in mind. How will you communicate any changes to your key stakeholders? What kind of standards need to be introduced to staff, and what training will be required for this? Think through every area of potential concern and create a policy and procedure around it.
- 4. Determine roles and responsibilities.** Who do you have on board to help implement this strategy? Who will support communications and marketing? Who can look into the financial and legal implications? Who can review your business plan to make sure it is solid? If this is a major change for your organization, make sure to involve the right people in strategic and meaningful ways. Will they be board members, staff, key stakeholders (constituents, donors, or community representatives)? This will help build support and ensure that your strategy is successfully and carefully executed.
- 5. Develop your business plan.** A business plan is the blueprint of your business venture and the most important document when engaging stakeholders. It encompasses a focused and systematic approach to the planning and implementation of the business. Even though it is a labor-intensive task, it will help you avoid potentially costly pitfalls. For information on free or low-cost consultations, tutorials, and business plan templates, please refer to the fee-for-service resources listed on p. 14 of this toolkit.
- 6. Gain a clear sense of your budget.** All revenue development strategies have an initial and operational cost. Make sure that your organization has the necessary financial systems and resources in place prior to starting the initiative. It is also important to recognize that the venture will cause some financial drain before it starts to generate revenue for your organization.
- 7. Determine your resource needs.** Consider what resources you need — human or otherwise — to implement this strategy. Do the resources come from within the organization or from outside? Are you going to have strategic partners? Consider the opportunity cost associated with the venture.
- 8. Create a work breakdown structure.** Develop a work breakdown structure (WBS) or planning method to outline each component of work. See http://en.wikipedia.org/wiki/Work_breakdown_structure for more on creating a WBS.
- 9. Develop an evaluation plan.** Determine how and when you will evaluate the success of the venture. One approach to consider is the development of a logic model identifying activities, outputs, and outcomes. Make sure to determine how you will measure the achievement of the desired outcomes.
- 10. Consider and evaluate the risks.** Brainstorm, ideally with a group, the possible risks associated with this strategy. Determine the likelihood and potential impact of each risk. Put a plan in place for the risks identified, particularly those with high likelihood and high impact, as well as those with low likelihood and high impact.

APPENDIX A

Resources

Tax on Unrelated Business Income of Exempt Organizations

This IRS publication explains which organizations are subject to the unrelated business income tax. It also explains the filing requirements and which practices are unrelated. <http://www.irs.gov/pub/irs-pdf/p598.pdf>

Break-Even Analysis Calculator

Use this tool to determine your potential cost and units of sale that would cover the expense associated with your venture. <http://www.dinkytown.net/java/BreakEven.html>

U.S. Small Business Administration (SBA)

The SBA website (<http://www.sba.gov>) contains a wealth of information on small business start-ups and maintenance, including the following resources related to the fee-for-service model:

Small Business Readiness Assessment Tool

This tool is designed to help you better understand your readiness for starting a small business. <http://web.sba.gov/sbtn/sbat/index.cfm?Tool=4>

Small Business Training Network (SBTN)

This virtual campus offers online courses, publications, and other forms of technical assistance, including information on building a business plan. <http://www.sba.gov/services/training/index.html>

SCORE

A resource partner with SBA, SCORE is a nonprofit that offers small business advice for entrepreneurs. SCORE has a network of volunteer counselors that comprises working and retired business owners, executives, and corporate leaders. SCORE's website also offers free business advice, online workshops, and a monthly e-newsletter.

<http://www.score.org>

Nonprofit Risk Management Center

This organization offers many resources to help assess, plan for, manage, and mitigate risk in your organization, including free technical assistance, online tools, workshops, publications, and consulting services. <http://www.nonprofitrisk.org>

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