

5.5: Profits and Purpose

Learning Objectives

- Explain the purpose of for-profit businesses
- Explain the purpose of nonprofit businesses/organizations
- Distinguish between for-profit and nonprofit businesses

A **nonprofit** or **not-for-profit business** is one that provides goods or services to consumers, but its primary goal is not to return profit to the owners of the business (as is the case with a for-profit business). Instead, it uses those profits to provide a public service, advance a cause, or assist others. The American Red Cross, the local SPCA, and the American Cancer Society are all examples of nonprofit businesses. They use any revenue generated from operations to support the continued mission of the organization. In addition, most nonprofits also rely on donations from individuals and businesses, grants, and government funding to help fund their work, since the revenue they raise rarely covers all their operating costs.

Much of what differentiates a for-profit business from a nonprofit business goes on behind the scenes and isn't very visible to the customer. For example, a nonprofit organization is subject to government regulation and oversight in ways that differ significantly from a for-profit business: Nonprofits do not pay taxes on their revenue, but how their funds are disbursed and their operations are managed is tightly regulated.

Profit and Non-Profit Lemonade Stands

Despite their differences, nonprofits and for-profits have some fundamental business principles and practices in common. Let's explore these shared aspects by comparing two businesses—one for-profit and one nonprofit.



Figure 5.5.1: Molly's For-Profit Lemonade Stand

Molly opens a lemonade stand in front of a local museum and intends to use her profits to purchase a new bike at the end of the summer. There are expenses associated with Molly's business such as lemons, sugar, cups, and ice. She also spends money on advertising when she prints up flyers and makes directional signs to alert customers to her location. She hires Jamie to help her on busy weekends and pays her a percentage of the stand's revenue on the days she works. She has T-shirts printed at a local shop with her slogan on the back: "When life gives you lemons, Molly makes lemonade." She sells the shirts at her stand for \$10 each. A local bakery owner sees that Molly's business is thriving and asks if she can sell her cookies at the lemonade stand. Molly arranges to sell the cookies for the bakery and keep 25 percent of the revenue generated from cookie sales.

Molly is running a for-profit business and generates revenue from several sources (lemonade, T-shirts, and cookies). Every day, after packing up her stand, she goes home and calculates her profit by subtracting her expenses (wages to Jamie, advertising, T-shirts, and supplies) from her revenue. She takes the profit and deposits it in the bank account her father helped her open.

At the end of the summer, Molly can withdraw the money from the bank account and buy the bike she wants. If she has profits left after she buys the bike, she can do whatever she wants with that money. As a for-profit business owner, she owns all the profits.



Figure 5.5.2: Emma's Nonprofit Lemonade Stand

Emma opens a lemonade stand in front of a local museum and intends to donate her profits to the local Humane Society to support their Feline Hope program. Besides that difference of purpose, Emma's business is nearly identical to Molly's: There are expenses associated with Emma's business such as lemons, sugar, cups, and ice. Emma spends money on advertising when she prints up flyers and makes directional signs to alert customers to her location. She hires Linda to help her on busy weekends and pays her a percentage of the stand's revenue on the days she works. She has T-shirts printed at a local shop with her slogan on the back: "When life gives you lemons, Emma makes lemonade." She sells the shirts at her stand for \$10 each. A local bakery owner sees that Emma's business is thriving and asks if she can sell her cookies at the lemonade stand. Emma arranges to sell the cookies for the bakery and keep 25 percent of the revenue generated from cookie sales.

Emma is running a not-for-profit business and generates revenue from several sources (lemonade, T-shirts, and cookies). Like Molly, after packing up her stand, she goes home and calculates her profit by subtracting her expenses (wages to Linda, advertising, T-shirts, and supplies) from her revenue. She takes the profit and deposits it in the bank account her father helped her open.

At the end of the summer, Emma can withdraw the money from the bank account and deliver a check to the Humane Society. If the business has profits in excess of what she promised to donate to the Humane Society, Emma can pay herself a *small* wage for running the business all summer, but the majority of the profits will either need to stay in the bank account to fund future causes or be used to expand the business to support charitable or social causes later on. Emma isn't really a business "owner," because she doesn't own the profit generated by the business. We'd expect to hear Emma say that she's *running* a not-for-profit (or nonprofit) *organization*—in contrast to Molly, who would probably say that she owns a business.

Although these may be very simple examples, they show that, from a customer's perspective, there is virtually no difference in the way the two businesses operate. Emma might decide to advertise that her proceeds support an important cause (the Humane Society's Feline Hope program) as a way of attracting customers. If not, the two lemonade stands would seem nearly identical from the outside.

? Practice Questions

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It's not until you look behind the scenes that you will see the differences between a for-profit and nonprofit business. The following table compares the attributes of for-profit and not-for-profit businesses and highlights some of the "hidden" differences.

For-Profit vs. Not-for-Profit/Nonprofit

For-Profit

- Incurs expenses for operations
- Provides goods and services to customers
- Generates revenues from sales
- **Owned by individuals, partners, or shareholders**
- Profit is used to pay owners, partners, or shareholders
- Pays salaries to employees and managers
- **Profits are subject to taxation by local, state, and federal authorities**

Not-for-Profit/Nonprofit

- Incurs expenses for operations
- Provides goods and services to customers
- Generates revenues from sales **and/or contributions**
- **Operated by board of directors, trustees, or managers**
- Profit is used to further the mission of the organization
- Pays salaries to employees and managers
- **Profits are NOT subject to taxation by local, state, and federal authorities**

? Practice Question

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