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**COMPETITION BETWEEN NONPROFIT AND  
FOR-PROFIT ORGANISATIONS IN THE  
MARKETPLACE: A CASE STUDY OF  
THE MAILING INDUSTRY**

**WORKING PAPER NO. PONC21  
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The three sectors of our economy are not unrelated enclaves. The state, nonprofit and for-profit sectors are constantly competing for power and resources. One only has to scratch the surface of state-church relations to reveal the naked struggle for political power over many centuries between that once all powerful nonprofit entity and the state. The struggle between for-profit interests and the state for power and resources is a popular point of reference for many scholars of the left. This struggle can be perceived in the nationalisation of whole industry and service sectors, as well as recent privatisations. This has also included many nonprofit enterprises.

There has been a discernible trend in the United States of a recent struggle between for profit interests and nonprofit interests concerning competition for resources. The charge made by representatives of the for-profit lobby is that nonprofits are competing unfairly with for-profit in the same market place (US Small Business Administration [1988]). The root of the competitive advantage of the nonprofit sector is favoured treatment by the state. This treatment takes the form of comparatively lighter tax imposts and direct subsidies.

The American academy has responded to this populist debate by generating substantial literature, often from a multi-disciplinary perspective, about the competition between the two sectors and the legitimacy of the favoured state treatment of the nonprofit sector. The popularist arguments have been subjected to rigorous academic scrutiny and several economic models have been developed to assess the impact of the competition. There has been little interest by the Australian academy, but the Australian state is showing indications of wishing to re-evaluate the role and position of the nonprofit sector in Australian society.

The evidence for this is at present scant and anecdotal, being found in the perceived changing relationship of the state provision of direct welfare services and welfare organisations and the reluctance of government to extend or even maintain nonprofit fiscal privileges. The foreshadowed investigation of "charitable organisations" by the Industry Commission<sup>2</sup> may mark a watershed as the beginning of the serious public and academic debate in Australia as to the appropriateness of the favoured fiscal status of some of the nonprofit sector. A previous Commission investigation which touched on local government subsidies to the nonprofit sector and the present incomplete investigation into public housing provision indicate that a very serious attempt may be made to scrutinise the nonprofit sector's tax privileges and government subsidies.

If the academy is to play a role in this process as the American academy has, then there is a large agenda in front of it. This paper is an initial offering to begin debate concerning these issues, it is the first in a series of case studies on nonprofit / for-profit competition.<sup>3</sup> This paper examines the competition between nonprofit and for-profit entities in a small competitive market in south-east Queensland. The industry is mail production and packaging, commonly known as mail houses. The paper first identifies some of the major thrusts of American scholarship about the role of nonprofit entities in a commercial market. It then identifies some of the fiscal privileges enjoyed by sections of the Australian nonprofit sector. The paper then presents the case study of the mail house industry drawn from the perceptions of the participants. This material is then analysed and direction for further investigation are proposed.

## **The American Debate**

Current literature in the United States documents a growing trend of nonprofit organisations engaging in commercial activities (Hansmann [1987]). Reduction in the availability of government subsidies has been suggested as a reason for this trend which has caused nonprofit organisations to turn to

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<sup>2</sup> The Industry Commission is a federal government statutory body which investigates and reports on the efficiency of industries selected by the government. On 20 September, 1992, it was announced by the Federal Treasurer that 'charitable organisations' were to be placed on the commissions 1994 work plan.

<sup>3</sup> Other industries presently under consideration are child care and retirement villages.

commercial activities in an attempt to cross subsidise their non-profit activities (Salamon, Musselwhite and Devita [1986], US Small Business Administration [1984], Schiff and Weisbrod [1991]). The resultant clouding of the distinction between for-profit and nonprofit organisations (Lifset [1988]) has raised a number of issues that potentially have significance for policy makers. The role of nonprofit organisations in the community and the benefits to the public arising from nonprofit organisations undertaking commercial activities have been questioned. Such questions appear related to fears that in competing for grants and revenues and relying less on donations nonprofits will lose sight of their main objective and invalidate their authenticity (Ferris and Grady [1989]). Other questions concerning the extent, fairness and efficiency of competition have also been raised due to the entry of tax exempt nonprofit organisations into industries where for-profit organisations compete (US Small Business Administration [1988], Weisbrod [1989]). More fundamentally, some authors question the legitimacy of extending the benefits made available to donative nonprofit organisations so as to capture their commercial activities<sup>4</sup> (Schiff and Weisbrod [1991], Hansmann [1987]).

## **THE ROLE OF NONPROFIT ORGANISATIONS IN COMMERCIAL ACTIVITIES**

Hansmann [1987] has suggested that an understanding of both the role and behaviour of nonprofit organisations is important in attempting to answer the issues surrounding their commercial activities. The general understanding of a nonprofit organisation is that it is an organisation which in conducting socially desirable functions is allowed to earn a surplus but is constrained in the distribution of those earnings. Residual earnings of a nonprofit organisation must be used only for its objects, this may include funding future ventures or be distributed to noncontrolling entities<sup>5</sup> (Hansmann [1987]).

A crucial difference between competing nonprofit organisations and for-profit organisations is their objective. The objective of a for-profit organisation is profit maximisation whereas nonprofit organisations have been accredited with producing goods or services which either fulfil their main objective or cross subsidise it. The characteristic features of a nonprofit have been described as an economic constraint and an ideology (Hansmann [1989], Ferris and Grady [1989]).

There are many economic theories that consider the role of the nonprofit organisation. Of these there are a number of demand-based models that explain the existence of nonprofit organisations in commercial markets. The public goods theory proposed by Weisbrod [1988] originates from the concept that the government supplies public goods<sup>6</sup> at a level that meets the demand of the median voter. Nonprofit organisations are viewed as arising to meet the excess demand for those public goods. Hansmann [1987] noted that although there was mild support for this model it failed to explain the production of private goods by commercial nonprofit organisations or why nonprofit organisations rather than for-profit organisations rose to meet this excess demand. Atkinson [1990] suggested that supply of public goods by nonprofits is preferred because patrons trust them to supply the product paid for. James [1987] argues that nonprofit organisations produce quasi-public goods and as such are in competition with the government on a production level. However on a financial level nonprofit organisations and the government are complementary in that the government subsidises the nonprofit organisations to enter the market to provide services in a less costly way than the government could in

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<sup>4</sup> In the US there is a unrelated business income tax which supposedly catches the commercial income of nonprofit organisations. However, Schiff and Weisbrod [1991] argue that application of this tax is difficult to enforce due the wide interpretation of related business income.

<sup>5</sup> Residual earnings must only be used to further the objects of the association. These objects cannot be illegal or result in a pecuniary gain for the members or controllers of the organisation.

<sup>6</sup> A public good is a good which is able to be enjoyed by a number of people without limiting the ability of others to enjoy that good. The problem that arises with the provision of a public good is that once supplied it is available to everyone, whether they have paid for the good or not. This results in a free rider problem where individuals are unwilling to pay for the full value these goods and services. Hall and Colombo [1991] suggest that under classical economic theory, public goods are best supplied by the government as they are able to compel everyone to pay for the good through taxation. Where the government fails to meet the demand for the public good this is achieved through collective action, that is nonprofits form.

meeting heterogeneous and excess demands. This may explain why nonprofit organisations would be successful over for-profit organisations in the production of quasi-public goods. The antithesis to this theory is the voluntary failure theory which suggests that nonprofit organisations arise in markets where for profit firms have failed to meet consumer demand (Salamon [1987]).

An alternative theory, the contract failure theory suggests that nonprofit organisations enter markets as a policing mechanism which allows consumers to better measure the quality and quantity of the service provided. The reasoning is that, nonprofit organisations, due to their non-distribution constraint, are less likely to take advantage of patrons than are for-profit organisations who, because of their profit maximising objective, have the incentive to produce less for more (Hansmann [1987]). However, this theory has a number of weaknesses as it ignores the market for corporate control which, under agency theory, ensures that management of for-profit organisations will not act opportunistically and relies on the assumption that nonprofit organisations will provide better quality and quantity of service (Hansmann[1987]). Hansmann believed that these weaknesses could be overcome through the promulgation of organisational nonprofit law which would impose strict fiduciary standards on nonprofits. Ellman [1982] criticised Hansmann's interpretation of contract failure theory on the basis that Hansmann had failed to differentiate between the donative patron and the customer. He held that in doing so Hansmann had failed to discriminate between marginal impact monitoring<sup>7</sup> which was the sole problem of the donative patron and the quality monitoring problem<sup>8</sup> which affected both the customer and the donative patron. Ellman [1982] believed that a more precise approach was necessary in the proposal of nonprofit legislature.

Other demand theories are the subsidy theory and the consumer control theory. The subsidy theory suggests that competition between nonprofit organisations and for-profit organisations is the result of subsidies offered to the nonprofit organisations<sup>9</sup>. The consumer control theory explains the existence of certain types of nonprofit organisations where patrons are attempting to prevent monopolistic exploitation.

Supply based theories generally supplement demand based theories (Winkle [1990]) providing supposedly better explanations for why nonprofit organisations succeed and coexist with for-profit organisations in commercial markets. James [1987] developed a supply based theory to explain why nonprofit organisations develop and may succeed over for-profit organisations. It is reasoned that as it is difficult for nonprofit organisations to raise capital they generally enter labour intensive industries. Access to donations and lower labour costs allow them to provide goods and services at lower prices than for-profit organisations.

Winkle [1990] devised a supply based model which took into consideration the relative power of various classes of actors in the market. This model held that besides having access to capital and entrepreneurship, classes of actors within an industry must have the power to mobilise the nonprofit sector. Government bodies and for profit firms must also have this power to be successful in an industry. Winkle [1990] questioned the validity of the government failure theory by suggesting that it was unlikely that one group would be able to succeed in an industry where another had failed.

## UNFAIR COMPETITION

It would appear from the theories on the role of commercial nonprofit organisations that nonprofit organisations have some kind of advantage over for-profit organisations operating in the same industry. Each theory suggests some advantage nonprofit organisations have; customer trust, access to

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<sup>7</sup> Marginal impact monitoring involves being able to measure the added benefit arising from each dollar a patron donates.

<sup>8</sup> Quality monitoring is being able to measure the added quality provided by the nonprofit organisation in comparison to that provided by a for profit or governmental organisation.

<sup>9</sup> Hansmann [1985] (cited in Hansmann [1987]) provided some evidence that tax exemptions had a significant effect on the market share of non profit organisations as compared to for profit organisations.

subsidies or lower production costs. Based on these theories it would seem reasonable to presume that nonprofit organisations have some competitive edge on for-profit organisations. In the US there are many arguments along this line, with small business resenting the advantage offered to their nonprofit competition (Weisbrod [1988], US Small Business Administration [1984]).

However, this is not the view taken by many of the theorists on competition between for-profit organisation and nonprofit organisations. Rose-Ackermann [1988] holds that for-profit organisations and nonprofit organisations can coexist through the production of non-homogeneous goods and services for which each has a competitive advantage. That is, through the identification and adherence to their particular market niche. Based on the different objectives they assign to nonprofit organisations<sup>10</sup> and for-profit organisations, Schiff and Weisbrod [1991] provide these alternative explanations for this coexistence: that the industry is not in long term equilibrium<sup>11</sup>; that the nonprofit organisations are earning just enough to make it worth their while and the for-profit organisations earn approximately zero economic profits; or that in at least some of the industries for-profit organisations and nonprofit organisations are producing different products.

Schiff and Weisbrod [1991] also argue that, the provision of tax exemptions to commercial nonprofit organisations does not result in unfair competition, but rather inefficiencies. They suggested that inefficiencies involving commercial activities and nonprofit activities could result from the tax advantages given to nonprofit organisations. Tax exemption on commercial activity could result in the government subsidising nonprofit organisations commercial activity with no external benefit. By allowing nonprofit organisations to have lower levels of production at lower prices, there is an opportunity for for-profit organisations to meet the excess demand at a higher price.

The nonprofit activity inefficiency arises due to suboptimal allocation of subsidies to the exempt activities of the nonprofit organisation. The nonprofit organisation would benefit more from the tax exemptions the greater their involvement in commercial activity. Given the assumption of cross subsidisation, it is possible that the tax advantages are allocated to activities for which there may be no public benefit, rather than to the nonprofit activities the main purpose for which the organisation exists. Schiff and Weisbrod [1991] conclude that a more efficient allocation would result from the government subsidising the charitable output directly rather than subsidising the commercial activities through tax advantages.

Weisbrod [1988], did however, hold the view that certain activities merit subsidisation<sup>12</sup> through nonprofit organisations and as such competition between subsidised nonprofit organisations and nonsubsidised for-profit organisation was efficient. Hansmann [1987] though, questioned the legitimacy of the provision of tax advantages to the commercial activities of nonprofit organisations arguing that it is difficult to rationalise the tax exemptions for nonprofit organisations on the basis that they provide a service worthy of subsidisation in general. Such an argument suggests that for-profit organisations providing the same service should also be subsidised. Hansmann [1987] states that arguments that the nondistribution constraint ensures that any advantage is passed on to the customer can be refuted by allusion to the fact that the existence of competition among firms generally would also ensure that any benefits provided to for-profit organisations would also be distributed to consumers.

## **Australian Taxation Benefits and Subsidies**

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<sup>10</sup>Schiff and Weisbrod [1991] assume that nonprofit organisations undertake commercial activities to cross subsidise their non-profit activities. As such, the utility of the managers of nonprofit organisations is increased by the production of nonprofit activities and reduced by the production of commercial outputs. Thus there is little incentive for nonprofit organisations to meet consumer demand.

<sup>11</sup>If an industry was in equilibrium, Schiff and Weisbrod [1988] argue that it would either be dominated by tax exempt nonprofit organisations or by for profit organisations.

<sup>12</sup>An example, given by Weisbrod, was markets where there may be a barrier to entry.

The three tiers of Australian government being the Federal government, the states and territories and local governments all levy financial imposts on the community. The Federal government is the largest tax gatherer imposing income tax, sales tax and capital gains tax on the Australian public.<sup>13</sup> States impose a range of subsidiary taxes such as land tax, payroll tax, stamp duty and licence fees. Local government taxes are usually confined to rates and service charges. All three levels of government also provide various subsidies to nonprofit organisations.

As each taxation or subsidy statute has a unique definition of nonprofit entities that are exempted from the particular impost, it is beyond the scope of this work to even begin to attempt a classification of which bodies exemptions and subsidies apply to. The Federal legislation contains 72 different definitions of the word "charitable" when referring to exemptions and this is exponentially cloned in differing state legislation. It would appear to be one of the important tasks of the academy to chart and classify all of the different definitions of nonprofit entities that are exempted from various pieces of legislation.

One of the most important taxation benefits available to a large number of "charity" nonprofits is Section 23 of the Income Tax Assessment Act. This section relieves organisations from paying income tax on any income however derived. There is no equivalent of the American Unrelated Business Tax and it is far wider than the English taxation exemptions. There are many nonprofit organisations in Australia that operate purely commercial divisions that have very little to do with their objects apart from financially cross subsidising them. These include chains of book shops, cereal manufacturers, hot bread kitchens, record shops and even large wheat farms.

Compared to the scrutiny given to the American 990 Internal Revenue Service forms the administrative regulation of the taxation exemption is very minimal. Many Australian nonprofit organisation who do not appear to have taxation exemption still do not even lodge a taxation return and there are little practical consequences of this breach of the law.

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<sup>13</sup> Depending on the outcome of a Federal election in March, 1993, this tax mix could alter with the introduction of a broad based goods and services tax.

**TABLE 1**  
**Major Benefits available to Australian nonprofit organisations**

<b>Benefit</b>	<b>Description</b>
Income Tax	Charitable institutions exempt under s23 of Income Tax Assessment Act (ITAA). Special rates for non-exempt nonprofit organisations. Section 78 allows donors to claim donations of over \$2.00 to specified organisations as taxable deductions against their assessable income.
Tax File Numbers	Exempt charities not required to quote a Tax File Number to ensure exemption.
Deductibility of Donations	Donations made to public benevolent institutions may be deductible to the donor under s78 of the ITAA.
Training Guarantee Levy	Public benevolent institutions are excepted from spending 1.5% of their annual national payroll on training.
Sales Tax	Goods for use by public benevolent bodies and other nonprofit organisations are exempt from sales tax.
Bank Accounts Debits Tax	Exempt
Payroll Tax	Schools up to and including secondary level and institutions which relieve poverty, care for the sick, aged, infirm or incorrigible persons are exempt. Payroll Tax only applies to annual wages in excess of \$600,000.
Stamp Duty	Exemptions for qualifying institutions.
Fringe Benefits Tax	Exemptions for employment of employees in public benevolent institutions.
Local Council Rates	Exemptions for land used for the purposes of public charities.
Land Tax	Exempts land owned by nonprofit charitable institutions carried on solely for charitable purposes.
Corporate Affairs Lodging Fees	Reduction in annual return fees for charity companies.
Other	There are other exemptions and reductions in fees etc, that are provided to nonprofit organisations but these tend to be specific to the industry the nonprofit organisation is operating in, for example there are certain industries in which only nonprofits are allowed to operate such as art unions, large scale poker machine operations.



## **RESEARCH METHOD**

The research undertaken in this paper is exploratory in nature. Interviews conducted were designed to obtain participants differing perceptions of the industry<sup>1</sup>. A number of reasons led to the selection of the mailing industry for a case study. There was little government participation in the industry, a clear delineation between nonprofit and for-profit firms existed, and a small population.

The focus of the research was the private nonprofit sector. Within this group the research has centred on organisations which compete in the mailing industry. A purposive sample was used in conducting this research. The sample selected is listed below:

Security Mailing	QM Industries
Hermes Precisa Australia	Nitefold
Endeavour Foundation	Unicare
Red Cross	

The advantage in using such a sample is that it was possible to choose the major participants in the market.

Black and Champion (1976, p.306-307) believe judgemental samples are most useful where errors in selecting elements will not seriously effect the research objectives. As the research is attempting to develop directions for future research, a judgemental sample is less likely to effect the research objective.

### **Limitations of this research**

A limitation of this study was the use of interviewee's perceptions and the possibility of bias in the researcher's interpretation. However our understanding of the structure and operations of the mailing industry in Brisbane was examined by one of the large for-profit firms and found to be accurate, in their opinion.

This research was conducted in an Australian capital city, Brisbane, thus any findings are limited to this geographic location. It is possible that in different locations, for example smaller country towns, such findings may be different because of the size of the market, and the strength of the participants.

As competitive forces are dynamic over time the findings of this study, which illustrate current competition in the mailing industry, may be unable to be used to predict future developments in the industry.

## **HISTORY OF THE MAIL HOUSE INDUSTRY**

A mailing house is a firm that processes mailing articles and outputs them in a form which gains the greatest discount from Australia Post. The organisations interviewed performed many operations mainly based around creating value-added service to their mailing division.

The original mailing house in Brisbane was The Endeavour Foundation (nonprofit organisation). With the growth in direct marketing, in particular direct mail, the industry grew rapidly with new entrants coming from both the nonprofit and the for-profit sector. The original participant's profit came not from profit-margins on service provided but rather from retaining a portion of the bulk mailing discount obtained from Australia Post. As competition increased, due to new entrants, firms could not justify retaining the mailing discount and were compelled to pass on all discounts to the customer. Because of good market information about processing costs, firms found it difficult to increase profit

margins on their services. Thus the market for mailing services was firstly based on price competition, and only then on quality and timeliness.

Such competition forced for-profit operators to gain more efficiency out of their mailing operations by investing in new technology (capital equipment) that lowered the cost per unit, and thus increased their profit per unit. This profit advantage was only short lived for as soon as one for-profit gained a competitive advantage, the other for-profit competitors immediately adopted the new technology. Having no control over suppliers of the new technologies also allowed large customers (for example the Brisbane City Council) to develop their own in-house mailing services. It is possible that these once mail house customers will become part-time competitors attempting to use their surplus capacity, again increasing rivalry in the mailing industry.

The for-profit firms were forced to develop value-added services (laser printing services, database marketing) in an attempt to differentiate their product between themselves, and obtain a premium price. Again such advancements by one firm were easily copied by their competitors and eventually the market returned to price based competition. These new services were based on adopting new technology, which required capital investment, employment of specialised staff and training of existing staff, and a change in work practices.

The motivation of being able to obtain a premium price has not been evident in the non-profit sector. This combined with their altruistic objectives has seen nonprofit firms in the mailing industry virtually remain the same, even though the market has become more price competitive and customers have become more powerful.

At present the mailing industry in Brisbane appears to be in a stable state. The nonprofit firms concentrate mainly on small 'hand-line work'<sup>14</sup> which the for-profit firms find a 'nuisance'<sup>15</sup>. Their limitations in capital and labour causes any large hand-line work to go to the for-profit operators. While the nonprofit organisations do some mechanical inserting, any large jobs are done by the for-profit organisations. This is well illustrated by the Endeavour Foundation contracting out their Art Union mailing rather than doing it inhouse<sup>16</sup>. Both nonprofits and for-profits are satisfied with the industry structure with neither believing they compete with each other. Both parties fulfil the differing needs of the community while also meeting their own objectives.

In 1992 the Federal government introduced changes to the Disability Services Act 1986. The amendments are aimed at making nonprofit service providers, such as nonprofit mail houses, more 'business-like' by adopting a factory model, that is productivity-based wages, normal working conditions, and a high community profile. The effects of these amendments are yet to be seen in the mailing industry.

## **THE ROLE OF NONPROFIT ORGANISATIONS IN THE MAILING INDUSTRY**

The literature has presented economic theories which are used to describe nonprofit organisations conducting for-profit operations. However such economic analysis to define the role and function of the nonprofit sector ignores the traditional mission of the nonprofit sector. Such theories propose that:

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<sup>14</sup>Hand-line work relies on hand insertion of materials into envelopes or packages.

<sup>15</sup>If a job is described as a nuisance by a for-profit firm then they simply mean that such a job is unprofitable.

<sup>16</sup>Nonprofit organisations contribute considerably to the work of the for-profit mailing houses, the largest mailer in Queensland being the Boystown Art Union. This may be another reason why the nonprofit mailing houses are so well received in this commercial activity.

*The individual nonprofit exists only to the extent that there are market forces sufficient to generate a corresponding organizational response designed to fill what is a market generated need. Altruism, compassion, charity, and philanthropy, to the extent they exist, are viewed as secondary elements in the generation of third sector institutions and organisations. Bush [1992, p.398]*

The mission of nonprofit mailing divisions in this research was to provide **training for people who were intellectually disadvantaged so that they are able to gain employment in the private or public sector**. Secondary to this mission was the need for the division to break-even. If the demand theories already presented are to hold any sway then it could be expected that as the market changed, nonprofit organisations would have also changed its product, price, distribution, and promotion in an attempt to maintain market share. This has not been the case in the mailing industry.

This research does give limited support to a supply based economic theory on why nonprofit organisations coexist with for-profit organisations in commercial markets. The nonprofit organisations in the mailing industry entered the market because it was labour intensive. However the reason was not because they had difficulty raising capital but rather because being labour intensive, and relatively simple repetitive work, helped the nonprofit organisation meet its objectives.<sup>17</sup> And it would appear that while the nonprofit organisation is meeting its primary objective it will remain in the industry. This supports Hansmann [1989, p.92] in his belief that nonprofit firms operate *with considerable efficiency when faced with financial stringency and hence cannot easily be driven out of business simply through competition from for-profit firms*.

## **PERCEIVED ADVANTAGES BY NONPROFIT OPERATORS**

While it may be possible for nonprofit organisations to receive considerable tax benefits, the nonprofit mailing houses take little advantage of these concessions due to their very nature. Exemption from federal tax on income is of little benefit as in all cases expenses were matched to income. If it appeared that the division would make a surplus in any period, more staff were employed. Any surplus was small and in most years the mail house divisions broke even or were cross subsidised by other divisions within then organisation. Payroll tax exemption only effects those nonprofits with payroll over \$600,000, sales tax exemption would be advantageous if these nonprofit organisations were buying capital equipment, and the notion that customers give work to nonprofits because of their altruistic objectives belongs with the myth that computer technology will reduce bureaucratic expansion. There are minor financial advantages available to nonprofit organisations in the areas of car registration, superannuation, and obtaining government buying prices (state store prices); however it would appear that these are heavily outweighed by the disadvantages of being a nonprofit organisation. Being restrained by their organisational rules restricts them in raising capital, being unable to extend work shifts (operating 24 hours), lack of responsibility by workers, and lack of business drive threaten the survival of some nonprofit mailing houses.

## **UNFAIR COMPETITION IN THE MAILING INDUSTRY**

At present, competition in the mailing industry is based on price. While some operators maintain that they provide superior service or quicker delivery time, there is clear evidence to show that it is mere wishful thinking by management that customers see this as more than secondary to price. Any competitive advantage gained in the area of customer service is short lived and is quickly adopted by competitors.

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<sup>17</sup>If the supply based theory was held then it would be expected that as the mailing industry became more capital intensive then nonprofit organisations would have moved to a more labour intensive industry.

Competition occurs within two major niches; large and small jobs (either mechanical insertion or hand line work). Coincidentally the for-profits base themselves around the large jobs and the nonprofits around the small jobs<sup>18</sup>. While there is fierce competition within the two groups there is little competition between the groups. Interestingly price in both niches is not set by costs plus a margin, but rather at what the market is prepared to pay. Thus an organisation may lose on certain jobs because it has to pay overtime rates and casual labor to complete a job on time. This illustrates the strength of the customer<sup>19</sup>, and the misguided belief that customer loyalty is prevalent. In price competition the customer is very loyal to the price of the product.

Nonprofit firms interviewed maintained that they merely broke-even each year. If any profit was made then more people with disabilities would be employed or if a loss was forecasted then some workers would be laid-off. There was no cross-subsidisation by the mailing house division to other divisions, in fact in some nonprofits the mailing house division was often cross-subsidised by other divisions.

This research supports Rose-Ackermann [1988] and Schiff and Weisbrod [1991] in their view that unfair competition often does not arise because each sector adheres to their particular niche where they have a competitive advantage. When this occurs the community is not only receiving the economic benefits of an efficient industry but also the social welfare benefits of the nonprofit organisations meeting their objectives. The notion of nonprofit mailing houses being inefficient because of tax advantages and government subsidies is secondary to the fact that these organisations desire to be inefficient to achieve their organisational objective. By out-placing their most efficient employees they are willfully being inefficient in their commercial activities. An organisational objective, supported by the community, which forces the nonprofit to be inefficient has not been widely addressed by current literature. The economic arguments of American academics have been based on models where the nonprofit organisation has an objective of profit making, when a nonprofit business lacks this objective the models become invalid and meaningless.

## **FUTURE COMPETITION IN THE MAILING INDUSTRY**

The 'large job' mail market, dominated by for-profit organisations, is threatened by large buyers developing their own in-house services. Since there is no restrictions on suppliers selling their equipment, any mailing house customer can immediately acquire the latest technology.<sup>20</sup> The buyers participating in such activity are mainly from the public sector, which while being nonprofit, they are outside the scope of this report. Another threat to this market is the entrance of Australia Post<sup>21</sup>. The government authority is targeting large national mailers, such as the Commonwealth Bank, offering lower costs.<sup>22</sup> The for-profit sector do not perceive Australia Post as a threat because they believe Australia Post can not compete with their customer service.

The new Disability Services Act may have a profound impact on the nonprofit mail houses. It is perceived by the nonprofit organisations interviewed that because of productivity-based wages, including a minimum wage, that breaking-even financially will become increasingly difficult. There is expected to be a significant increase in the cost of production in the nonprofit sector. There are five

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<sup>18</sup> While there are some for-profit operators in the small jobs market they exist on the fringe and are mainly geographically based and compete on this. The question is whether the mere fact that nonprofit organisation maintain a strong position in the 'small jobs' market discourages other organisations from entering the market.

<sup>19</sup> The reason for strong buyer power is because of low switching costs, high buyer information, and the product is increasingly being regarded as a commodity. See Porter [1985] and Day [1990] for strategies to combat these competitive forces.

<sup>20</sup> Suppliers of mailing house capital equipment are trying to expand their own market by targeting large customers of mailing houses.

<sup>21</sup> Australia Post is a Federal Government statutory body which has the sole right to distribute mail within Australia. Such a monopoly is at present under attack, because of government rationalisations.

<sup>22</sup> The lower costs are possible through the transfer of information via computer networks and the printing of that information at the closest capital city to the postal address.

possible solutions:

1. change organisation structure (increase efficiency through economies of scale);
2. increase productivity to lower cost per unit output (increase efficiency with a given scale);
3. increase prices to maintain break-even point;
4. move into another industry;
5. or subsidise the mail house division.

The first possibility is very real to many nonprofit service providers. The National Technical Assistance Unit (NTAU)<sup>23</sup> expressed that many nonprofit service providers will have difficulty surviving expected changes in the industry without altering their organisational structure. It was implied that in many cases that cooperation between presently competing nonprofits was the key to their survival.<sup>24</sup>

Increasing productivity seems an obvious alternative. This could be done by capital investment in more modern technology or increased use of more skilled labour. Both propositions leads the nonprofit further from its objective and closer to competing against the for-profit organisations. The objective of the increased efficiency is not being to lower costs but rather to maintain them at the current level.

The third solution, nonprofit organisations (as a group) increase their prices to maintain break-even, is not a valid answer. At a higher price the for-profit firms may not consider the 'small job' market so unattractive. It is also likely that the nonprofit firms themselves would be tempted into price-cutting tactics to maintain their previous production levels and continue to meet the divisions disadvantaged employment level objectives<sup>25</sup>. Such a solution assumes that the nonprofit mail houses are the only suppliers to the market<sup>26</sup> and revenue will increase as a result of the price increase. Such assumptions are invalid.

Moving to another industry which provided better returns is unlikely. While financial resources may become scarcer and threaten the survival of many nonprofit mailing houses, we agree with Hansmann [1989] that difficulty in transferring capital to another industry, and management's stake in retaining the nonprofit in the mailing industry, will see the survival of the nonprofit mail houses.

The final solution of providing or increasing subsidisation to the mailing division is a difficult proposition which will be faced by some nonprofit boards. If one assumes that prior to these increased demands from the mailing house division the nonprofit organisation distributed their funds efficiently, then by increasing subsidisation to the mailing division is the organisation less efficient in meeting its objectives?

It is likely that there will be a combination of the propositions of increased efficiency and cross-subsidisation with the outcome being the 'small job' market will see little change in its structure<sup>27</sup>. That is competition between nonprofit and for-profit organisations will continue to be negligible in the mailing house industry. However to maintain this market structure the nonprofit mail

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<sup>23</sup>The NTAU was set up by the Federal Government in 1992. The aim of the unit is to provide high-quality technical assistance, advice, support and training to sheltered workshops such that consumers will achieve measurable positive outcomes.

<sup>24</sup>Program on Nonprofit Corporations Seminar Series, Queensland University of Technology, November, 1992.

<sup>25</sup>Price cutting is already practiced by certain nonprofits, it is fair to assume that such a practice would increase as commercial pressure escalates. Of course this will cause a escalating effect which should be avoided at all costs, however without some collusion it appears inevitable.

<sup>26</sup>Although there is little competition between nonprofit and for-profit firms there would be considerable competition between nonprofit firms and potential clients who choose to perform the work inhouse.

<sup>27</sup>The authors do believe that individual nonprofits in the market will experience an unstable environment and that some nonprofit divisions may face extinction, however the 'small job' market as a whole will remain stable.

houses will have to lower their divisional goals, and the quest of becoming more 'business-like' may endanger the traditional spirit of the organisation.

*As business practices and interest in efficiency come to dominate nonprofit thinking and action, more people may slip through the cracks of the so-called social safety net. [Bush, 1992, p.393]*

## CONCLUSION

This research has shown that providing tax benefits and subsidies to the nonprofit sector does not necessarily create an environment which encourages unfair competition, it may however discourage competition by increasing the barriers to entry for other organisations. Where there appears to be direct competition between the for-profit sector and the nonprofit sector then there must at least be an attempt to measure the trade-off between the economic rational model and other outcomes for society such as the training of intellectually disabled people. The community should be aware of organisational objectives apart from producing the least cost product.

In attempting to explain the mail house environment this paper first examined economic models. No one specific model explains the business activity in the nonprofit mail houses. This is not a criticism of the academic literature, but rather an example of the perplexing nonprofit environment. Lohmann [1989] attacks existing economic and financial theories of nonprofit organisations for assuming that all nonprofit activity is somehow a deviant form of commercial enterprise. However this research has shown that participants in the nonprofit mail house industry have pursued a strategy that has led them to developing their own niche, away from the for-profit operators.<sup>28</sup> Perhaps this is indicative of a need for nonprofit organisations to choose between various aspects of the for-profit marketing model in order to meet their objectives. For example, for a nonprofit organisation to run a successful cross subsidising division, it may be necessary to adopt for-profit marketing techniques. This permits them to concentrate on the 'bottom line' and compete successfully with for-profit and nonprofit competitors. If the nonprofit organisation has mixed objectives, then it may be necessary to alter the model to serve its objects which are only partly for-profit and partly for other objectives. The challenge that faces nonprofit managers is to define or redefine the present strategies and processes. When applying economic models to a nonprofit industry it is not only the environment which governs their aptness but also the objectives of each individual organisation.

The findings of this research suggest that modelling the nonprofit sector is cumbersome. Thus for appropriate policy decisions to be made, considerably more research is required by the Australian academy into competition between for-profit and nonprofit organisations. The difficulty faced by researchers is the lack of base data compared to that available to American researchers through the Internal Revenue Service.

It is presently impossible to replicate the intricate American economic models (for example, Schiff & Weisbrod [1991]) in Australia, as they use aggregated data from sources such as the Internal Revenue Service. In Australia the taxation authorities can not, by law, release such information and it is suspected that they do not have the appropriate information in any case. There is no other source at present of such aggregated data across the spectrum of nonprofit organisations in Australia, nor is there likely to be in the near future. It is even difficult obtaining accurate specific industry data in Australia of for-profit organisations which are reluctant to release sensitive commercial information. Nonprofit divisions often have very basic accounting procedures which are not refined enough to provide an accurate picture of their financial status.

Given these constraints it appears that Australian research into the area of competition between

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<sup>28</sup>That the strategy required them to remain the same is not important. And having to take this strategy to fulfil their objectives is very similar to a for-profit firm adopting strategies to meet their objectives.

for-profit and nonprofit organisations may well be confined for a period to case studies. It may be possible by examining industries that have particular attributes to gradually build a broader picture of the interaction of nonprofit, for-profit and state competition for resources in commercial markets and the role of state taxation exemptions and subsidies. Public policy made without firm research into the actual state of competition between the sector is likely at best to be an educated guess.

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Before the questionnaire was designed initial interviews were conducted with Automail, The Brisbane City Council, and the Spastic Welfare Centre.