Not for profit: what is it?

Daniele Giusti, ES UCMB
Presentation at the workshop
"Developing competencies in Lacor Hospital"
Gulu 22.5.2004

Preamble

The use of the term "not-for-profit - NFP" is fairly recent in the semantics that accompanies the description of the health system and its elements in Uganda. It was first introduced by the Bureau in 1996 as a better adjective to be used in the definition of the sizeable component of the health system represented by the – until then – more vaguely defined as "mission" or "voluntary" hospitals and health units. When this term was introduced it was accompanied by an additional adjective: "private not-for-profit - PNFP".

For a long time the scenario of health care in Uganda had been characterized by the presence of two main actors:

- the publicly owned health sector, financed with public funds and, to a much lesser extent, by patients' fees. This sector operated assumedly without commercial purpose: a "NFP" by definition.
- the privately-church owned health sector, financed mainly by patients fees and to a sizeable but progressively dwindling extent by charities. This sector, although heavily dependent on user fees, could break even only thanks to additional inputs from abroad: an implicit "NFP" sector.

Matters, and perceptions, became confused with the appearance and development of a third actor: the privately – individual – owned sector operating for commercial purpose. From that moment on the charging of fees started being equated with a commercial purpose. Ironically – as we shall see later – fees charged in the public sector were distributed, to a large extent, to the managers and staff employed by government, but this never led to the questioning of the implicit NFP aim. In any case matters were solved few years later by the complete scrapping of "legal" fees in the public sector.

The reason why the Bureau preferred the PNFP definition to the others in use or emerging at the time (I.e. Non governmental organizations – NGO), was that it better captured the fact that these elements of the system, although charging fees for service provided, did not operate for the purpose of making profit. In other words the introduction of the term "PNFP" tried to raise the awareness that there existed a health sector that, although privately owned, did not operate for commercial purpose but for broader and selfless social goals.

Experience shows that mind- frames are quite often fixed on paradigms that change slowly and imperfectly: even the notion of not-for-profit is not well understood. Hence the need to devote some time to bring clarity on its exact meaning. We shall take a long route, starting from some basic concept requiring clarity, and zooming later to the NFP issue.

Organizational sustainability

Nobody establishes an organization entailing sizeable capital investments and efforts (e.g. a hospital) for the purpose of having it dismantled later. Organizations are established in

order to pursue a specific aim and, almost invariably, to outlive the people who established them. In other words, organizations are established to sustain their operations over and beyond the actors that started them. Sustainability, or organizational sustainability, can be defined in several different ways. A possible definition is the following:
The capacity of an organization to operate in the long term pursuing its own declared aims/objectives and maintaining its own culture while servicing its own endowment.
Two key elements emerge in this definition:

- Pursuing declared aims/objectives, maintaining own culture: in other words this means operating in faithfulness to the original intent/mission
- Servicing the own endowment: in other words this means that the sum of assets (of various nature) constituting the organization, must be serviced, least the organizations starts shrinking and eventually dies.

For a PNFP hospital or a health unit the first element means treating patients, promoting health, training people, etc…. moved by social aims, and the second element means maintaining and/or developing the premises, the equipment and the human capital.
These two "must" for organizational sustainability are very simple to understand. Unfortunately reconciling them, finding the balance between these two "must" is far from easy.

Cost, price and economy
Our task is made a little easier by introducing concepts and terms "borrowed" from the economic field. It is always a bit risky for a NFP organization to use words drawn from the economic world, because this latter is quite often reduced to financial aspects. We prefer to understand the word "economy" in its semantic root: economy is the science studying the "rule/norm dictated by the environment"*[οίχοσ νόμοσ – the rule of the house in Greek]*. Economic science tries to understand the norms dictated by the environment we live in. In doing so it enhances our knowledge. Sometimes, like in all sciences, our limited understanding forces us to oversimplify these norms, and quite often, as in the history of all sciences, things can go wrong or astray. We shall try therefore to tread our way carefully.
There are two concepts that require a clear understanding: cost and price. We shall give our own definitions here, without claim that these definitions are perfect. As long as we stick to the meaning given at the outset, things should go smoothly. But first we need to stop a while for a short consideration.

Values and money
To create a certain product we need resources: people, materials, buildings, equipment, money, time, skills, procedures, organizational culture, motivation etc… Each of these represents a "value". Values are "measured" in different ways and we need a tool-a yardstick that brings all of them together. Money or currency can be such a tool. It is indeed the most commonly accepted tool.
It is relatively easy to attach a monetary value to some of these resources; it is much more difficult to attach a monetary value to others. We know that they all have a value, but expressing it with the same unit of measurement (money) is far from easy. How does one

measure “motivation” or “organizational culture” or “resilience”? And why do we have to attach a monetary value to each of these?
Money, as said above, is an accepted standard of reference, easy to quantify and compare. With all its limits and without attaching to it any value-judgment, money can be used as yardstick. The fact that not all is perfect in this approach – we are very well aware of this – gives us the measure of how much we still need to understand, and how humble our attempt must be. But we have to proceed in some way: we shall simply try to maintain a certain distance from our own conclusions.

Cost and price

- Cost is the monetary value of all resources necessary to produce a certain good (product or service). In other words cost refers to the value of inputs, expressed in a uniform unit of measurement (e.g. Ugx or US$). It is clear that we are still far to attach a monetary value to some of the important “immaterial” resources. Our costs will therefore always tend to be under estimated. It is clear from here that the perspective used in this case is that of the organization that produces the service (e.g. the hospital management).
- Price is the monetary value established by the producer to allow the acquisition of a certain good (product or service) by the consumer. It can be understood better if we think as patients vis-à-vis the fee to be paid for a treatment or as consumers vis-à-vis the money to be paid to buy a kg of rice.

The relationship between cost and price

It is clear that here we have used a shortcut and some simplification, because the concepts of Cost and Price are interchangeable, depending on the point of observation. The user of a service or a consumer will tend to consider the price s/he pays as a cost, inevitably. But in our context we maintain the perspective, the point of observation, of the organization producing the good (i.e. the hospital).
Therefore, in the context delimited by this essay:
COST is the value of resources that a health unit uses to produce its services
PRICE is the fee paid by patients to acquire the health units’ services

An inescapable rule

From within the perspective of the organization providing services or producing goods, and more in general from the economic point of view, COST and PRICE have an intrinsic relationship that cannot be ignored. In theory, PRICE must always exceed COST. In everyday accounting language we would say the same thing in another way: INCOME must always exceed EXPENDITURE.
Having given this basic economic rule, what happens if the rule not respected? The organization starts losing capacity (I.e. is no longer sustainable in time). It is only matter of time and…… soon or later the cracks will show. The organization will fall sick and …..Illness will be followed by death. Organizations operating for social goals cannot and do not escape this fundamental rule.

The dilemma of pricing in the social sector

If we now take a close look at the PNFP health sector we discover that if we set the PRICE at levels equal to the cost or above, this price becomes a deterrent to consumption

of the good/service they produce. The majority of people are too poor to pay the entire cost of the service they need to acquire.
Therefore the PNFP health sector, as other social sectors, have, along time, tried to find "PRICE SUBSTITUTES" to finance their operations. These have taken the form of subsidies, grants/donations, and sometimes loans. When these "PRICE SUBSTITUTES" are either not found or are insufficient, the only alternative left to avoid abandoning social goals is the erosion of the "endowment".

A dangerous path
The erosion of the own endowment, which may appear at first glance a decision that nobody would ever consciously take if organizational sustainability has to be maintained, is exactly what the PNFP health units have done (and keep doing!!!). We know very well as we speak that all the PNFP health units are "eating the capital assets" and "eating the human capital", to a much or lesser extent. The subsidies they are receiving from Government and other charities are only delaying the inevitable result. At the moment we do not have alternatives. Assessing for how long can the erosion of the endowment/capital can be accepted before triggering irreversible processes is nor easy. It requires a much more skillful and skilled managerial capacity that we are slowly building. This exposition on the NFP concept is part of the process of capacity building that we have undertaken.

The not-for-profit concept
The tools of financial accounting
By introducing the concept of PROFIT we enter the realm of financial accounting. The basic tools of Financial Accounting are

- The Chart of accounts: the tool we use to keep track of the flows and allocations of resources within a given time. The chart of accounts translates the fundamental economic rule into a quantifiable result. The balance between Income and Expenditure must be positive. In other words, there must always be a PROFIT: even a perfect balance is questionable, while a loss is hardly acceptable, otherwise the organization is heading for a disaster.
- The Balance Sheet: the tool we use to take a snapshot of the value (net worth) of the organisation at a certain point in time, including the value of its measurable endowments (or assets). The balance sheet takes a more comprehensive view of the organization at a point in time (usually at the end of a financial year). It tells us whether the organization grows or shrinks, if is becoming healthier or is ailing. Unfortunately Balance sheets are hardly ever used (or taken seriously) in not-for-profit organizations. The Auditors duly draw the balance sheet but they hardly ever help the managers to understand it. We are trying to correct this serious omission.

Both these tools are necessary: the first without the second does not give us the entire picture and does not certainly allow any assessment as to whether the organisation is healthy or ailing.

Not-for-profit: truth or lie?
If the fundamental economic rule says that INCOME must exceed EXPENDITURE and if this rule is not respected, the Balance sheet will show a net loss of worth of the

organization, thus announcing that it is sick. At this juncture it would be necessary to be sincere and say that PROFIT is a necessity of life. Does this mean therefore that NFP Organizations have been established are doomed at the outset? And does it mean that, if they are not dying, they are lying about their accounts?
Here lies the crux of the matter, requiring our going beyond stereotyped and wrong understandings.

The truth of not-for-profit concept: the "distribution constraint
The not-for-profit concept refers to:

- the aim of the organization (I.e.: the organization does not exist, primarily, to obtain a profit - I.e. profit making is not "the engine" of the organization)
- the use of the necessary profit (I.e.: the PROFIT realized cannot be distributed to owners, managers etc…; dividends cannot be paid out by need to remain within the organization. cannot receive dividends

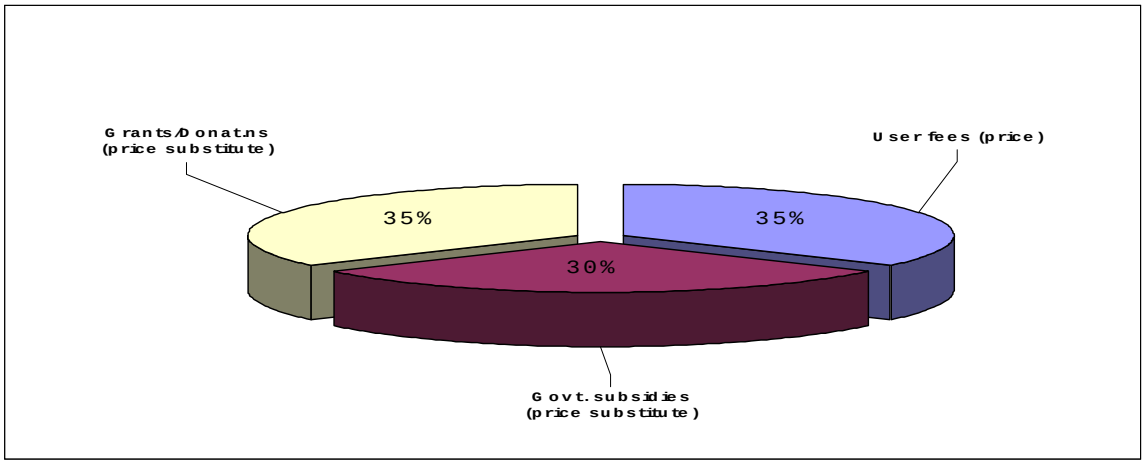
This latter is called the "NON DISTRIBUTION" constraint.
Said in other simple words: a NFP Organization must make profits, but cannot distribute these profits.

Having said this, it is anyway true that many not-for-profit organisations in Uganda incur in net losses on the chart of accounts more often than not, and even when they do not, they certainly lose value on the balance sheet. Alas, Balance sheets, even when prepared, are hardly looked at!

Basic facts about the PNFP health services
Now some basic facts about the 44 PNFP hospitals in Uganda.

Income-expenditure
Last year they spent to produce their services about 24.88 M US$, and they raised about 25.08 M US$. This means a net profit of about 200,000 US$ (+0.8%) – or 4,000 US$ (8 M Ugx) per hospital on average. Just enough to start the new year, treading on a very thin edge.

Income structure of PNFP Hospitals



What does this tell us? The PNFP health sector manages to break even on its chart of accounts, with a very small positive margin, but only through PRICE substitutes (more than 60% of its income is PRICE substitutes). We cannot obviously say much about Balance sheets but one thing is sure. The small profit margin is absolutely far from being close to financing even the depreciation of the most essential equipment (leave alone premises). This is a gloomy consideration vis-à-vis organisational sustainability. Is the clock ticking the inevitable death?

In summary

- We have understood that "not-for-profit" refers to the restricted use of profits (if any): no money paid out to owners or managers as dividends
- We have understood that making a profit is necessary for the continuity of an organisation
- We have understood that PNFP hospitals make a "virtual profit" on the chart of account: just enough to start the following period without interrupting services and that they do so
    - only by finding PRICE substitutes - I.e. downloading on the users only a fraction of the cost
    - at the expenses of the endowment of the organisation – I.e. this occurrence is so far invisible because balance sheets are too often ignored

The critical question

At this junction only the last decisive question remains: are these organisations sustainable?

The answer is easy: as economic theory goes…….clearly NO! These are not sustainable in the long term. And yet, some of them have reached the century, others are approaching half century life. Another question is therefore legitimate: if they are not sustainable, how comes they are so "resilient"?

The limits of our knowledge

We have to go back here at the beginning of this essay, when we spoke of the immaterial" inputs and the limited development of economic science to "capture" these inputs and attribute a value to them. Economic science and its tools, so far have been unable to "tell the whole story". It has not yet been able to keep into account some "imponderable" "immaterial" factors like the personality of the founders, the value set of the mangers and the workers, the work-culture shared and passed on from one to another and from generation to the next, the importance of role models……..

Economic and social sciences are trying hard to develop adequate tools to "read" these factors of production, but it will take years before these tools will become available, known and utilized. And besides this, there is another factor that will never be predictable, and we cannot easily shun: "miracles".

We Christians believe that God holds the ultimate control of all the factors constituting reality. Times and again He likes to surprise us by placing in front of us something we cannot explain and that fills us with wonder. We use the word "miracle" to define this "something". I personally cannot find adequate explanations to the survival of the PNFP health services through the ravages of the seventies to the end of eighties. The story told

by the PNFP health sector in Uganda, "unsustainable" organisation surviving through the most trying environment and events is perhaps the most evident miracle we have witnessed at the turn of the century. We need to recognise it to strengthen our resolve and meet the new challenges.

The new challenges

A public administration, a political program, a society that do not value and protect not-for-profit organisations for social benefit like ours, and, worse still, create un-necessary obstacles to their operations instead of taking stock of the importance of "immaterial" factors of productions they bring into the picture, have not understood how convenient it is for everybody to safe guard for future generations the heritage that has reached us through a history that, in Uganda, has already had its first hundredth anniversary. Indeed God likes to surprise us with miracles – every now and then: while we are always open to their occurrence, we are also aware of the command "Do not put your God to the test" (Dt 6,16) un-necessarily. In other words: while we remain open to the miracles God can do, we have to do all that is in our powers to create conducive conditions of operation for works like the health units we have received: if we are managers we have to manage them well, if workers we have to serve them – and the patients – well, if we are decision makers we have to protect and support them.

The PNFP health sector in Uganda survived through the ravages of the Amin's and Obote's 2 era; and is still vibrant in the harshest conditions of operation of the last 18 years in the North of the Country.

While we register that their management and their workers have responded generously to the established partnership and the support provided for some years by decision makers (to the benefit of everybody), we also register that, of late, the decision makers' commitment to partnership seems to have dramatically dwindled[1]. This fact may mark the beginning of another very stormy period for the PNFP health sector: one more reason to boost our awareness on its importance for the "common good" of the people, bank on the "immaterial/imponderable" factors of production and brace ourselves for the rough ride we are heading to.

[1] The pay rise for health workers un-explicably forgets that 40% of the health workers in Uganda are employed in the PNFP health sector. All commitment of Government has gone to civil servants, forgetting that in a system, as well as in a partnership, elements are intertwined and unilateral/unbalanced decisions may seriously damage one of the partners.