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# A Critical Analysis of the Potential for Private Pay Options to Expand and Strengthen the Provision of Older Americans Act Services

A Report by the Area Agency on Aging 1-B  
Private Pay Ad Hoc Study Committee

A call for:

- Aging Network Action
- Education
- Technical Assistance



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## *Preface*

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Public funding and support for community-based services for older adults in Michigan has been stagnant in the new millennium. Maintenance-level annual funding, combined with a rapidly growing population and rising inflation, has eroded the purchasing power of state and federal funding, resulting in significant reductions in the number of individuals served and units of services delivered. Since 2002, the number of meals served through the congregate and home delivered meals senior nutrition programs has decreased by more than 1 million meals, and the number of Medicaid long term care consumers served through the MI Choice program has been cut almost in half. With increasing needs due to older adult population growth, and little or no growth in public funding for Older Americans Act-supported aging services on the horizon, the Area Agency on Aging 1-B (AAA 1-B) Advisory Council became interested in the potential for private sources of funding to support service provision.

The AAA 1-B Advisory Council created an Ad Hoc Study Committee to investigate the potential for aging network organizations to establish private pay components of their agency operations as a mechanism for expanding service provision, generating additional sources of revenue, enhancing product quality, and being a widely recognized and trusted focal point for the delivery of the specific service in their service area. The Committee examined applicable state and federal laws and regulations, conferred with experienced professionals from the nonprofit sector, and examined the practices of many nonprofit organizations that initiated private pay arrangements.

The Committee's work plan included:

- Identify regulatory and market forces that present incentives or barriers to the development of private pay service components
- Verify that aging network organizations can successfully establish private pay service components
- Identify service categories where there are opportunities for the development of successful private pay models
- Identify principles and considerations that should guide the development of private pay models
- Identify strategies to encourage the development of private pay models among Region 1-B service providers
- Develop recommendations to guide the development of private pay models in Region 1-B

This report represents the findings and conclusions of the first phase of the Committee's work, and is intended to serve as a guide for aging network nonprofit organizations to use in assessing whether they offer services that might better serve their consumers and the community through the establishment of a private pay option. Every nonprofit executive is encouraged to carefully consider whether there exists a viable opportunity to establish a private pay component of their services.

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## *Ad Hoc Committee on Private Pay Report*

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Appendix C: SCORE, Counselors to America's Businesses

Appendix D: DESC, Detroit Executive Service Corp

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## *Acknowledgements*

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The AAA 1-B Private Pay Ad Hoc Study Committee would like to thank the following individuals for contributing considerable time and expertise to its investigation, which led to the development of this report. Their presentations and discussion provided extremely valuable insight into the many potential benefits and pitfalls related to establishing private pay arrangements to enhance support for older adult services in Michigan.

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## *Introduction*

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The Area Agency on Aging 1-B (AAA 1-B) was established in 1974 under a federal mandate of the Older Americans Act and the state Older Michiganians Act to serve the needs of over 500,000 older adults who reside in the southeast Michigan counties of Livingston, Macomb, Monroe, Oakland, St. Clair, and Washtenaw. The AAA 1-B is dedicated to: 1) educating and advocating on issues of concern to older persons; 2) allocating federal and state funding for social and nutritional services; 3) developing new older adult services; 4) coordinating activities with other public and private organizations; and 5) assessing the needs of vulnerable older persons and linking them with community-based long term care services. The AAA 1-B depends upon a strong network of direct service providers to achieve its mission of preserving the independence, dignity, and quality of life of older adults, family caregivers, and adults with disabilities.

The AAA 1-B Advisory Council helps achieve the agency mission by identifying needs and concerns of Region 1-B residents, and planning and developing appropriate actions that assure older persons have access to high quality, efficient and effective services. Each summer, the AAA 1-B establishes an ad hoc study committee to explore selected issues of concern to older adults. For 2008, the Advisory Council chose to investigate the potential for private payments from individual consumers to expand the provision of Older Americans Act supported services by nonprofit organizations. To assist in its search, the Committee called on a wide range of experts from across the region that included representatives from organizations that consult with and train nonprofit executives, and nonprofit organizations with experience in developing private pay service components. This report is an outcome of that investigation and contains significant findings as well as recommendations to guide future activities of AAA 1-B and aging network nonprofit organizations in this.

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## *Findings*

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# A Critical Analysis of the Potential for Private Pay Options to Expand and Strengthen the Provision of Older Americans Act Services

The Committee found many reasons why nonprofits should consider venturing into private pay arrangements, and many equally compelling reasons why they should not. While there is significant potential for nonprofits and their consumers to benefit from private pay services, and the growth of the senior population makes these benefits more probable, there are also considerable risk and potential harm to an organization if the private pay venture is unsuccessful. However, all things considered, the Committee concluded that there is enough known about how to determine whether a venture can be successful, and how to identify signs of possible failure, to encourage all nonprofits funded under the Older Americans Act to evaluate whether they should establish a private pay component to their services.

For the purposes of this study, the Committee created a very specific definition of private pay, and limited its investigation to services provided by nonprofits that receive funding under a contract for Older Americans Act funding. The working definition was:

Private pay is the purchase of AAA 1-B supported services from contracted service providers by private individuals (older adults, family caregivers), who purchase services at the full cost of providing the service at a competitive market rate.

It should be noted that this definition does not extend to private pay efforts that target third party payers such as corporations or insurers, including Medicare Advantage Plans.

### Private Pay vs. Fundraising

It is also necessary to understand the distinction between private pay and fundraising, because these two approaches can look very similar in practice.

## Fundraising

Fundraising is the act of soliciting donations, contributions and/or in-kind support for a charitable organization generally from individuals and corporations not receiving benefit from the charitable works of the organization.

Fundraisers tend to take the form of one-time only events or events that are cyclical in nature. Fundraisers rarely generate on-going cash flow for an organization although one fundraising event, if successful, may support an organization's services and operating expenses. This is a rare exception, usually organizations supported primarily through fundraising look to events throughout the year to support their mission.

For organizations that rely on federal and state funding, including the AAA 1-B, the cost of fundraising may not be borne from federal or state funds. The cost of fundraising, including staff time, event costs and or the cost of goods sold, must be entirely recouped by the event itself or other resources.

## Nonprofit Entrepreneurship

Many organizations are turning to entrepreneurial endeavors to create new funding streams. Entrepreneurial activities, often referred to as private pay initiatives, set themselves apart from fundraising activities by charging a customer for a service that is already provided by the organization for a charitable purpose.

The intention of the private pay option is to offer the same or a similar set of services to individuals who would have not received service based on their ability to pay, waitlist issues or other circumstances, even though the demand for the service exists. The private pay option meets two needs at once: the organization's cash flow and the individual's need for service.

Nonprofit 501 (c)(3) organizations are allowed to participate in this free market activity with some rules: 1) the private pay activity must be within the mission of the agency. For example the AAA 1-B could not begin manufacturing a consumable such as a T-shirt and sell them to roll the profits back into the agency. It can however, sell Care Management services.

2) Organizations should take care that profits do not exceed 15% of agency revenue in a given year. The funds received from a private pay initiative should be rolled back into services for non-paying consumers or other legal structures must be investigated to protect the non-profit status of the agency.

Starting a small business is always risky, and the chance of success is slim. According to the U.S. Small Business Administration, roughly 50% of small businesses fail within the first five years.

## REASONS FOR AND AGAINST PRIVATE PAY

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There are many compelling reasons why an organization should or should not undertake a private pay effort. It is incumbent that when evaluating a private pay opportunity, an organization must fully consider and understand the advantages and risks to such an endeavor. The following are key advantages and disadvantages of private pay ventures:

### Advantages

- Generates additional revenue, the profits from which can be used to provide additional subsidized service for those who cannot pay.
- Diversification of the organization's revenue sources, which is a principle of sound fiscal health and can help sustain the organization.
- Service quality is more likely when that service is provided in a competitive marketplace.
- Provides a mechanism to serve consumers who might otherwise be un-served due to waitlists or who might otherwise be ineligible.
- Provides a method of meeting increasing service demand without depending in increased public revenue.

### Disadvantages

- Being entrepreneurial entails taking financial, social, and political risks.
- The success rate for business ventures is very low.
- Most nonprofits do not have staff with business or entrepreneurial experience.
- It is very costly to initiate a business venture in terms of time, effort, and start-up capital.
- Record keeping of expenses and revenues for the private pay service must be kept separate from the nonprofit business.
- From a return on investment perspective, it may be more cost effective to engage in fundraising.
- Ethical concerns about competing with the private sector may risk relationships with funders, regulators, consumers and supporters.

"Every nonprofit must ask themselves the question: Can I get a new funding source with what I already know?"

*-Lawrence Wells*

*Michigan League  
for Human  
Services*



## NONPROFIT SOCIAL ENTERPRISE

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The notion of securing private pay from consumers for nonprofit services is a recognized aspect of nonprofit administration and practice that is typically referred to as social enterprise. While social enterprise has not historically been emphasized among aging network nonprofit organizations, it is a prominent issue in the nonprofit sector.

- **Social enterprise<sup>1</sup>** is the generic term used to describe any venture that applies business practices and models to the nonprofit sector to create alternative revenue streams and to ensure sustainability for the future. The concept is a hybrid of the organization's philanthropic mission and commercial service delivery model.

### Models of Social Enterprise:

Implementing social enterprise can be essential to driving and supporting the mission of the organization. Social enterprise can be used to strengthen the social impact of the agency's mission and to create additional revenue streams. There are two primary social enterprise models that are applicable to this private pay investigation.

- **Service Subsidization model:** The service subsidization model of social enterprise is primarily a funding mechanism for the organization to support the organization's mission. In this model, the business and the social missions are separate, however, the business and social program(s) overlap through resource sharing of assets such as costs, operations, income and program attributes. The separate business and social missions allow the organization to offer services to those that are not in its target population. For example, a local non profit organization owns delivery vans to provide home delivered meals. Through its social enterprise, the nonprofit contracts with outside businesses and organizations to use the agency's vans to provide food delivery services or transportation services. The revenues from contractual services are used to support the home delivery nutrition program.
- **Fee-for-service model:** In the fee for service model, the program is the business and the target population and the market overlap. This model is mission driven; the organization is able to expand their services to fill a need within their target population. For example, a home delivered meal program has a wait list of older adults. The model allows the organization to expand services to meet demand by offering meals to those on the wait list for the full cost of the meal. The organization defines the cost of the services for both the philanthropic and commercial sides of the business. All revenues and proceeds are used to further the mission and to support the philanthropic program.

<sup>1</sup> S. Kim Alter. Social Enterprise Typology. Virtue Ventures LLC. [www.virtueventures.com](http://www.virtueventures.com)

## Best Practices:

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There are common practices that the literature and networking sites suggest when undertaking social enterprise projects.

- ✓ ***Define mission of the social enterprise<sup>1</sup>:***
  - A clearly defined mission will unify everyone around a common goal and provide guidance in decision making.
  - The mission can also be used as an organizational tool to define performance measures for individuals and leadership.
  
- ✓ ***Conduct a feasibility study:***
  - The study is an opportunity for the organization to gain understanding of the market and target population, determine if the nonprofit service has any competitive market advantage, influence the pricing strategy, and assess profit potential.
  - The study will also allow the organization to determine possible conflicts of interest between the IRS and the organization's 501(c)(3) standing.
  
- ✓ ***Create a business plan<sup>2</sup>:***
  - The business plan is a planning tool that incorporates the mission and the findings from the feasibility study.
  - The business plan will also link the mission with goals, objectives, action steps, budget, and evaluation methods for the social enterprise to ensure that all activities are in line with the mission.
  
- ✓ ***Determine organizational structure of the enterprise:***
  - The Service Subsidization and Fee for Service are operational models which incorporate the social enterprise into the existing organizational structure as either a separate department or program. However, a separate private company or subsidiary can be established by the non profit to carry out the social enterprise function of the organization.

<sup>1</sup> J. Gregory Dees. *Enterprising Nonprofits: A Toolkit for Social Entrepreneurs*. John Wiley and Sons. 2002

<sup>2</sup> Ibid. J. Gregory Dees.

The Committee believes that engaging in these activities are essential steps for any nonprofit organization to take when considering a private pay venture. Each step should be considered a defining decision point, where an analysis of the results of each step should cause a re-evaluation of the advisability of proceeding with a private pay venture, and either suspending plans, or proceeding with a renewed commitment to making the private pay venture profitable.

Several successful private pay service models and programs were reviewed by the Committee, and these examples can be instructive to aging network organizations considering private pay ventures. The programs studied are included in the table below:

Organization	Private Pay Program	Description
Monroe County Opportunity Program (MCOP) Monroe, Michigan	Home Care	Home care aids provide in-home personal care, homemaking and respite for disabled adults. The service is coordinated with the MCOP OAA funded home care program, and serves higher income individuals who do not qualify for the OAA program. Consumers are billed for service monthly, and pay by check.
Mather Lifeways Café Plus Chicago, Illinois	Senior Center/Congregate Nutrition Site	Model is a combination of a private café and senior center, with a meal menu and limited programs available through senior centers, such as information and referral, and classes for fitness and enrichment. The facility looks and feels more like a café than a senior center, and consumers pay for all services except information and referral.
Evergreen Commons Holland, Michigan	Grant-funded programs (home delivered meals, homemaker, personal care, respite, adult day care, case management and medication set-up)	Services are made available to those who are not in the Older Americans Act-funded program. Fees are set at the break-even point, with no goal to make a profit.
Evergreen Commons Holland, Michigan	Health Club/Family* Fitness Center	Fitness center building purchased with assistance from \$1 million start-up grant.
Evergreen Commons Holland, Michigan	AmRamp*	Center purchased American Ramp Systems franchise with start-up investment of \$150,000.

\* Ventures are formed as separate LLC companies, and all profits go to Evergreen Commons

## Lessons Learned

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The Committee recognizes that most nonprofit organizations have no experience or knowledge about undertaking ‘profit-making’ private pay ventures, and that there are many potential pitfalls that can put an agency’s legal and financial status, as well as reputation, at risk. In addition, any agency must guard against the potential for “mission creep,” whereby the objectives of the endeavor depart from and potentially supersede the agency mission. Therefore, the Committee recommends that any nonprofit organization should allow the following principles to guide any consideration or initiation of a private pay venture:

- Nonprofit organizations should strive to diversify their sources of revenue, to the extent feasible and within the confines of their mission, as a means of enhancing service to the community and strengthening their organization.
- It is incumbent upon the leadership of any nonprofit organizations to assess whether the agency’s mission can be advanced through the development of a private pay component.
- Any nonprofit that undertakes a private pay venture should do so knowing that, like most business start-ups, most private pay ventures fail, or fail to make a significant profit.
- Prior to undertaking a private pay venture it is advised that consent from a principal funding or regulatory organization be secured.
- Nonprofit organizations must clearly understand the differences between fundraising and private pay ventures, and evaluate the advantages and disadvantages of each.
- Nonprofits should only enter markets where demand exists among their consumers, and/or where there are unmet needs in the community relating to access, quality, and competency.
- Nonprofit organizations must recognize that considerable legal, financial, marketing, start-up capital, and business expertise is required for a successful private pay venture, and that professional assistance in these areas is essential. Non-profits must also understand the significant up-front costs of such guidance and be prepared for it.

- The Older Americans Act stipulates that individuals and entities purchasing services provided under the Act must do so at the fair market rate. Nonprofit ventures must not utilize publicly-financed infrastructure or resources to under-cut the market and provide a service at below market rates (Older Americans Act, Sec. 212).
- All profits earned by private pay ventures must be reinvested into providing enhanced or additional services in accordance with the nonprofit agency's mission.

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## *Recommendations*

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1. The AAA 1-B should encourage all aging network nonprofit organizations to assess whether its mission can be advanced through the development of a private pay component. However, this should not be construed as desirable or required. The AAA 1-B will not exert undue influence on an agency to do so.
2. The AAA 1-B should collaborate with interested parties to conduct a single educational workshop that will provide nonprofit leaders and executives with the information and technical resources necessary to evaluate whether they are uniquely positioned to undertake a successful private pay venture that will strengthen their services, organization and mission to the community. Such an educational workshop should include information on:
  - a. Entrepreneurship
  - b. Best practices
  - c. Legal considerations
  - d. Financial and accounting considerations
  - e. Market analysis
  - f. Business plan development
3. The ongoing role of the AAA 1-B in promoting the development of private pay programs among aging network organizations shall be limited to technical assistance and referral to the appropriate professional or programmatic resources, and shall not include business consultation.

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## *Appendix A*

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### Committee Charge and Membership

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#### PRIVATE PAY AD HOC STUDY COMMITTEE CHARGE

This Committee was created to investigate the potential for aging network organizations to establish private pay components of their agency operations as a mechanism for expanding service provision, generating additional sources of revenue, enhancing product quality, and being a widely recognized and trusted focal point for the delivery of the specific service in their service area. Aging network organizations must do well to do good, and successful operation of a private component is an important indicator of achieving this goal. The Committee will conduct its investigation during the summer months of 2008, and produce a final report or product for approval at the November meetings of the Area Agency on Aging 1-B Advisory Council and Board of Directors.

#### RESPONSIBILITIES

- Identify regulatory and market forces that present incentives or barriers to the development of private pay service components
- Verify that aging network organizations can successfully establish private pay service components
  - Identify best practice private pay models
  - Identify criteria to evaluate the effectiveness of private pay models
  - Analyze the effectiveness of identified models
- Identify service categories where there are opportunities for the development of successful private pay models
- Identify principles and considerations that should guide the development of private pay models
- Identify strategies to encourage the development of private pay models among Region 1-B service providers
- Develop recommendations to guide the development of private pay models in Region 1-B

#### DELIVERABLES

- Recognized best practice private pay models
- Guiding principles and considerations for the development of private pay models
- Report on committee findings, conclusions, and recommendations

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