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Case Study

The Price of Commercial Success
Minnesota Public Radio: social purpose capitalism

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the Price of Commercial Success

Minnesota Public Radio: social purpose capitalism

What factors contribute to a nonprofit's ability to build for-profit ventures?
How can a nonprofit best use earned income to advance its social mission?
What are the challenges and dilemmas of social entrepreneurship?

In 1981, Garrison Keillor, the popular host of Minnesota Public Radio's satirical "A Prairie Home Companion," offered listeners a free poster of his mythical sponsor's "Powdermilk Biscuits." To everyone's surprise, more than 50,000 requests poured in; the station faced a $60,000 printing bill. To avert "financial disaster," as MPR president William Kling later recalled, the station used the back of the poster to advertise products for sale, such as a Powdermilk Biscuits T-shirt. The idea worked. "I think we netted off that poster, which was really our first catalog, $15,000 or $20,000," Kling said. "It instantly became clear that there were things like that you could do."[1]

Thus began MPR's ventures into what Kling referred to as "social purpose capitalism … the application of the traditional principles of capitalism … to a nonprofit organization [to] benefit the public sector."[2] To tap the popularity of Prairie Home Companion, MPR created the Rivertown Trading Company, a mail-order catalog business that sold mugs, T-shirts, novelties, and eventually jewelry and clothing. Rivertown grew quickly, becoming so large and complex that it was spun off as a separate for-profit entity in 1986. By 1998, Rivertown published five catalogs, generating sales of close to $200 million. On average, the business had contributed $4 million a year in royalties and dividends to support MPR's operations.

In addition, the skills and confidence engendered by the success of Rivertown spawned a host of smaller revenue-generating businesses. MPR became one of the nation's biggest and richest public radio stations, known for award-winning documentaries and innovative programming. By 2000, its for-profit ventures had generated $175 million in earned income for the nonprofit, including a $90 million injection to its endowment.

MPR should have been the poster child for social enterprise and nonprofit sustainability. Instead, its entrepreneurial success made MPR a target for criticism by politicians and the media. MPR and its president were accused of secrecy, conflict of interest, anticompetitive behavior, and inappropriate use of public funds. In 1996, the complex organizational relationships between MPR and its for-profit

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PHOTOGRAPH BY J. A. KRAULIS/MASTERFILE

spin-offs triggered an inquiry by the Minnesota attorney general. Although eventually cleared of any wrongdoing, MPR spent years trying to move beyond negative publicity created by the original allegations.

The irony of MPR's triumphs and tribulations was not lost on astute observers. Jon Pratt, executive director of the Minnesota Council of Nonprofits, commented: "This is the plight of the nonprofit sector today. It is both told to be more businesslike, and then attacked for being too businesslike."[3]

Birth of a Broadcasting Empire

The MPR story began at St. John's Abbey and University in Collegeville, Minn., in 1967, when a 26-year-old student named William Kling founded a small radio station at the urging of the university president. KSJR thrived, but by 1969, the cost of running the station led the university to spin it off into a separate nonprofit. "The university had two choices," Kling explained. "It could have cut KSJR back to being a mediocre station, but one they could afford, or they could give it away, which they did, to a nonprofit corporation."[4]

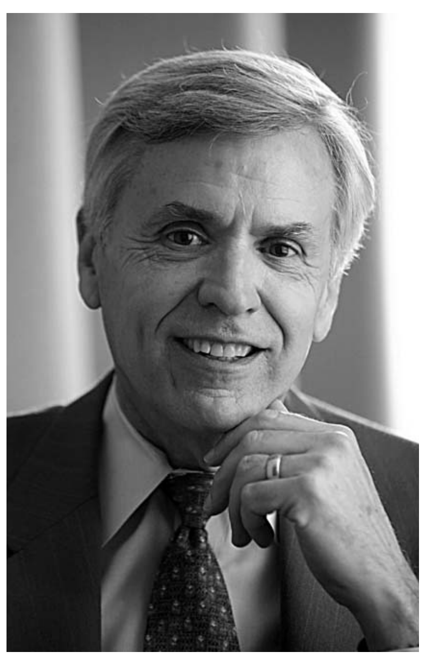
This new organization became Minnesota Public Radio. Over the 1970s and '80s, it expanded into a multistation network and a producer of original programming, most notably Keillor's Prairie Home Companion. It also became a major distributor of programming through Public Radio International (originally called American Public Radio), which grew to compete with National Public Radio (NPR) itself.

By 2004, MPR, with an operating budget of $47 million, had grown into a regional network of 38 stations, covering Minnesota, and parts of Wisconsin, the Dakotas, Michigan, Iowa, Idaho, and Canada. With 650,000 listeners per week, it had the largest audience of any regional public radio network. The organization served a regional population of more than 5 million people, had more than 83,000 members, and boasted the highest percentage of listener membership of any community-supported public radio network in the United States. MPR produced more national programming than any other station-based public radio organization in the country; its large news staff had won more than 800 journalism awards.[5]

Funding MPR: The Enterprises

Kling's ambitious goals for the breadth, quality, and geographic reach of MPR's programming were costly, providing the impetus for the creation of social enterprises. "I wanted to get top quality programming to people … and that's expensive," he explained. "We figured out early on that we had to start businesses that would create significant revenue."[6]

And indeed they did. The Rivertown catalog generated so much revenue that MPR undertook a reorganization in 1987, placing Rivertown under the umbrella of a new for-profit holding company called Greenspring. Legally separate from MPR, Greenspring was designed to avoid potential problems with the IRS about the growing magnitude of MPR's unrelated (and hence taxable) business income from Rivertown – something that could jeopardize the organization's nonprofit status. In addition, the reorganization was intended to free MPR's board and management from the "distraction" of overseeing an increasingly complex for-profit business.



Under President Bill Kling's guidance, Minnesota Public Radio became one of the nation's biggest – and richest – public radio stations.

The overarching organization was structured into a number of distinct entities. Atop the pyramid was Minnesota Communications Group (MCG), renamed American Public Media Group in 2000, a tax-exempt, nonprofit, charity-supporting organization that provided administrative, financial, and human resources services to a range of subsidiaries. These included the nonprofit flagship (MPR), the Fitzgerald Theater Company (home to Prairie Home Companion, and a range of concerts, lectures, and productions), and the for-profit holding company (Greenspring). An umbrella entity, Greenspring oversaw all of the businesses, including Rivertown Trading, Minnesota Monthly Publications (MMP), which published several magazines and ran trade shows under contract with MPR, and the KLBB Company, which ran two commercial radio stations under contract with MPR.

Despite the distinct legal and organizational status, the entities were tightly linked by the overlapping management team led by Kling, who served as president of MPR and Greenspring. The arrangement seemed to work well from a financial perspective. By 1998, the earned income from Greenspring was significant. In 1994, for instance, it amounted to $5.2 million – or about 24

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The Bottom Line

MPR Financials ('000s)

Revenue	1996	1997	1998	1999	2000	2001	2002	2003
Total Support and Revenue	$25,050	$26,831	$30,539	$31,993	$38,637	$44,415	$43,698	$48,256
Total Expenses	-$23,191	-$23,902	-$25,435	-$26,836	-$32,824	-$41,138	-$44,485	-$48,407
Endowment	$13,102	$16,050	$106,278*	$106,714	$112,875	$105,534	$94,426	$89,376

** The Oakleaf Endowment Trust for Minnesota Public Radio was created June 30, 1997, and the Earned Endowment for MPR was created in October 1998 with $85.6 million from net proceeds from the sale of Rivertown Trading Company. The values presented for 1998 and all subsequent years represent the sum of MPR's endowments.*

percent of MPR's budget – and represented a figure that was higher than the entire budgets of 99 percent of public radio stations.[7]

Fame, Fortune, and Controversy

MPR's financial success, critically acclaimed programming, aggressive expansion, and promotion of public radio propelled it to national prominence. Kling himself won a string of prestigious awards, including the 1981 Edward R. Murrow Award from the Corporation for Public Broadcasting. He also sat on a number of corporate boards, including Capital Group American Funds, Irwin Financial Corp., and Continental Cablevision. Kling was described in a *Forbes* story as "high-energy, tough-minded, extremely focused, and an extraordinarily creative … brilliant and visionary … entrepreneur."[8] NPR president Douglas Bennet called him "perhaps the ablest manager in the public radio system."

But along with the kudos came criticism – often based on the same aggressive qualities that won him praise. Bennet qualified his comments about Kling, continuing, "But he has tended to mistakenly view our relationship as a competitive zero-sum game in which one party's gain is another's loss."[9]

Critics claimed that MPR was all about the money. "If there's a nickel to be made, Bill Kling will find it," said Frank Mankiewicz, former NPR president.[10] Others were even less tactful in their attacks. New Times media critic Ron Russell dubbed Kling "Darth Vader."[11] One article about MPR's reputation in the field reported that among nonaffiliate stations, MPR was called "The Klingdom" or "The Klingon Empire" after the belligerent superpower of TV's "Star Trek." "They live up to the name," said Everett Forte, station manager of Minneapolis' noncommercial KFAI-FM. "Not the staff people. Every staffer I've talked to has been friendly and helpful. But when you reach up to the executive level, you're afraid to sit down with them without a lawyer because they might steal your pants."[12]

While Kling and MPR appeared to shrug off the "sticks and stones" for years, real trouble began in December 1995 in the form of a controversy that would plague the organization and its leader for almost four years. During the busy holiday season, Rivertown encountered difficulties with its new state-of-the-art distribution system and was unable to fulfill an unexpectedly large volume of orders. Greenspring executives, who also were MPR executives, asked employees at the nonprofit to volunteer at their for-profit sibling's distribution center to help Rivertown get orders out the door.

{ By 2004, MPR had an operating budget of $47 million, and had grown into a regional network of 38 stations with more than 650,000 listeners per week. }

Rivertown promised to donate the equivalent of the volunteers' hourly pay to their favorite charities. Ultimately, nine MPR and two MCG employees responded to the call for help, collectively working 49 hours.[13]

Minnesota State Rep. Matt Entenza demanded an inquiry by the state attorney general, arguing public funds contributed to a nonprofit could not be used for the benefit of a profit-making entity. Entenza, a former prosecutor with the Minnesota Attorney General's Office, said: "If United Way employees were working at Cargill on donated money, we'd all know that was illegal. … It's also illegal for MPR employees to be working at a Christmas-package distribution center when that's a for-profit operation."[14]

MPR and Greenspring senior executive Thomas Kigin defended the volunteer effort. "It's not the same thing," he argued. "Rivertown was paying the value of those employees while they were working for them, either in direct compensation to the employees or in charitable contributions to charities of their choice."[15]

Ultimately, the attorney general agreed with Kigin, noting further that the amount involved ($343 for 49 hours at $7 hour) was insignificant. However, the inquiry broadened into an official examination of the relationships between Greenspring and MPR. In particular, concerns focused on Kling's and Kigin's dual roles as executives of both nonprofit and for-profit entities. Questions were raised about potential or actual conflicts of interest, inappropriate transfers between the nonprofit MPR and for-profit Greenspring/Rivertown, and executive compensation.

Another issue related to the use of public money. Critics stressed that MPR received funding from federal, state, and local government. In 1994, support from the Corporation for Public Broadcasting amounted to $2.6 million. The city of St. Paul had helped finance the renovation of MPR's headquarters, the refurbishing of the Fitzgerald Theater, and MPR's $12 million purchase of classical station WLOL-FM. The city's Port Authority had loaned funds to upgrade the heating system at MPR headquarters, and aided Greenspring with a "land-cost buy-down" at the Westgate office park where Rivertown Trading had its 120,000-square-foot headquarters.

{ Critics claimed that Minnesota Public Radio was all about money. "If there's a nickel to be made, Bill Kling will find it." }

"I admire Bill Kling for his successes, but he reached his successes through the taxpayers by getting monies from the city, state, and federal governments, and he used that money to build his nonprofit company and then spin off for-profit companies," said Wayne Eddy, past president of the Minnesota Broadcasters Association and owner of competitor station KYMN in Northfield, Minn. "And so, what he did is use the seed money from taxpayers to become a wealthy entrepreneur."[16]

Henry Goldstein, head of a philanthropy consulting firm and former president of the National Society of Fundraising Executives, criticized MPR for "building up the for-profit side of its operation through the subsidy provided by tax exemption and tax deductibility. Substantial personal gain has resulted, but the people involved took none of the normal business risk. That was left to taxpayers in general, and Minnesota Public Radio's donors, in particular."[17]

MPR's continued fundraising was also criticized. "We don't think it is fair to keep going to the general public if you are sitting on huge funds, claiming to need more when you've got bank accounts that are overflowing," said Matthew Landy, vice president for finance and administration at the National Charities Information Bureau.[18]

Responding to Goldstein, Steven M. Rothschild, chairman of the MPR board, said the "supposition that 'the organization built up the for-profit side of its operation through the subsidy provided by tax exemption and tax deductibility' is just plain wrong. Since its inception, the for-profit business has been a tax-paying corporation operating like any other commercial business. … [Also] the structure of the companies appropriately insulated the nonprofit. No nonprofit assets were ever put at risk in the for-profit business."[19]

NPR executive vice president Peter Jablow also defended MPR, asserting, "There is a great need for public broadcasters to look for alternative streams of revenue, especially in light of shrinking public dollars and the huge technological costs we are facing, and endowment is one significant piece of the puzzle."[20]

Showing the Money

The most emotional point of contention proved to be executive compensation.

As an officer of a nonprofit, Kling's MPR salary was a matter of public record. In 1995, it was $67,000. However, since Greenspring had been set up as a subsidiary of the parent organization, Minnesota Communications Group, rather than of MPR, it was a private for-profit company and was under no obligation based on IRS rules or Minnesota law to disclose executive pay.

Former St. Paul mayor George Latimer praised Kling's job performance, but criticized the secrecy. "The guy has done a masterful job, but the fact is that all of the operations are imbued with a public purpose and they support each other," Latimer said. "It is very difficult to think of the information relative to payroll as being private information."[21]

The issue tapped into strongly held beliefs about secrecy vs. privacy, and expectations of self-sacrifice and benevolence in the nonprofit world vs. a culture of generous rewards for entrepreneurial zeal in the business world. Entenza, who had sparked the inquiry with his complaint, led the fight for a bill that would require for-profits related to nonprofits, like Greenspring, to disclose the salaries of top employees. For their part, MPR and Greenspring fought the public release of executive salaries and bonuses, arguing that it would put the for-profit operations at a disadvantage relative to competitors. Despite the explanation, the resistance was characterized as stonewalling; to many, it looked like MPR had something to hide.

In 1996, the Minnesota Legislature passed Entenza's bill requiring nonprofits to report executives' income from related for-profits. Greenspring was forced to disclose Kling's income, which totaled $291,752 in 1995. When combined with the MPR salary of $67,000, this brought his total compensation to $358,752. Though significantly higher than his MPR compensation alone, newspaper reports of the salary disclosure noted that the total made Kling only the 15th highest paid nonprofit executive in the state.[22] Kigin earned $160,742 from Greenspring.

An on-air promotion by Garrison Keillor, host of the popular "Prairie Home Companion," led to the creation of MPR's lucrative mail-order catalog business.

Not reflected in the compensation figures were "value participation units" (VPUs), an incentive plan intended to reward Greenspring's top executives if the company were sold. These VPUs were used in lieu of stock options or other forms of equity. Susan Boren, then chair of MPR's board, said that the units were "a piece of the long-term incentive compensation packages." According to compensation consultants hired by the board, the packages "reflect typical executive compensation, which encourages short- and long-term performance" within similar-sized private companies, said Boren.[23]

Vindication

In 1998, after 18 months of investigation, the attorney general's office concluded there was no evidence of illegality in the relations between MPR and Greenspring. It did, however, raise "questions about the appropriateness of a lucrative [VPU bonus plan]." The plan, which applied to Kling, Kigin, and Rivertown president Donna Avery, was potentially worth $7.9 million to the trio. As a specific remedy, the report asked MCG to secure independent assessments of the valuation of Greenspring and to conduct a comparative salary analysis to justify the compensation plan provided to MPR/Greenspring executives.

MCG board members considered the report a vindication. Chairman Thomas McBurney cited a review by a Chicago consulting firm that char-

The Rivertown Trading Company, Minnesota Public Radio's initial foray into what Kling referred to as "social purpose capitalism," proved so profitable that the station was forced to spin it off as a separate for-profit entity to avoid jeopardizing its nonprofit status. Rivertown's assortment of mugs and T-shirts earned MPR an average of $4 million a year.

acterized Kling's, Kigin's, and Avery's compensation as "reasonable relative to public companies of similar size and business complexity." He also said that the attorney general's report "affirms the success of our unique nonprofit/for-profit model in public broadcasting," and declared the controversy over.[24]

The Rivertown Windfall: Controversy Redux

Less than two months later, in March 1998, MPR announced it would sell Rivertown Trading, Greenspring's major business, to the Dayton Hudson Corporation, owners of department stores Target and Marshall Field's. The price: $120 million. MPR retained its Prairie Home Companion catalog and Public Radio MusicSource catalog, which sold recordings of music played on MPR and other noncommercial stations. Kling explained the rationale for the sale by noting that it had merely converted Rivertown from an "operating asset" to an "endowment asset," thereby reducing the risk associated with the possibility of poor financial performance at the for-profit – as had happened in 1996, when Rivertown suffered losses – thus depriving MPR of anticipated dividend and royalty payments.[25] MPR received $90 million for its endowment fund, giving it by far the largest endowment in public radio at $109 million. The benefits for MPR's long-term security were obvious. But critics focused on the payment of $7.3 million in bonuses to Greenspring/Rivertown executives. Kling received $2.6 million, Kigin, $1.4 million. Avery's payout was undisclosed, but some estimated the amount to be $2.6 million.[26]

The executive compensation controversy revived. As a divestiture bonus, the payments were "on the high side," said Carol Bowey, research director of Executive Compensation Advisory Services, in the *Business Journal of Min-*

neapolis/St. Paul.[27] The media highlighted the apparent conflict of interest inherent in the sale of Rivertown: Kling, Kigin, and others' decision to sell the business could have been influenced by the knowledge that they personally would make millions of dollars.

Entenza then introduced a new bill to prevent nonprofit executives from making "inappropriate gains" from deals they recommended to their boards. "My understanding is that Minnesota Public Radio has a fairly detailed conflict-of-interest standard, and they followed it," he said. "But the standard in our state and most states is lax."[28] Entenza wanted to create new regulations that would "require profit/nonprofit hybrids such as MCG to disclose executives' future compensation possibilities. It also would make it a conflict of interest for a board member of such an organization to vote on the sale of a related business that might enrich them."[29]

Others praised the MPR leader. "Kling probably has secured Minnesota Public Radio for decades to come," said Jim Russell, head of Marketplace Productions. "Everyone talks a good game about endowments. He's actually done it. I can't imagine anyone in public radio or TV who has accomplished that kind of security."[30]

Even Entenza expressed admiration for Kling's accomplishments: "He has been a brilliant businessperson. … MPR is ahead of most foundations in the Twin Cities. … [The sale of Rivertown] will "create an excellent large endowment and tremendous opportunity [for MPR]."[31]

Reflections and Implications for Social Enterprises

Among the many issues raised by the controversy surrounding Minnesota Public Radio's entrepreneurial activities, three have important implications for the nonprofit sector.

First, why did MPR's for-profit ventures succeed so dramatically? Despite the lure of unrestricted earned income, it's not easy for a nonprofit to start a for-profit business, and run it profitably. "Nonprofits are learning that success, as with any startup business, is far from guaranteed," observed Jon Pratt. "Deciding how to develop additional revenue streams and whether to establish separate for-profit companies is a complex process. … What MPR has done with Greenspring is a unique example. If it was that easy, everyone would be doing it. To do it right, it takes great creativity and unique access to the market."[32]

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MPR's experience suggests that one of the keys is understanding the nature of the revenue-generating business and its industry. Moreover, it is also important to create some type of competitive advantage that provides the basis for economic viability. In this instance, MPR's began with assets in the form of the visibility and appeal of Prairie Home Companion, and a loyal, affluent audience of potential customers.

In addition, regardless of how one feels about Kling's approach, management style, or values, it is clear that his leadership was important. Even his detractors acknowledge that he is a tenacious and savvy entrepreneur.

Kling emphasized that the success of MPR and Greenspring were the product of the collective efforts of the entire management team and trustees, saying, "It is not a one-man band, it's an orchestra."[33] Arguably, while the compensation issue fueled controversy, the opportunity for members of the management team to secure financial rewards that were significant – particularly by nonprofit standards – helped in attracting and retaining them. Kling commented, "One of the things that kept me from [moving to the commercial world] was knowing that there was some chance that the compensation systems in place at the for-profit companies would provide a reasonable return."[34]

The second issue involves understanding how MPR used the resulting financial-capitalizing resources to drive the growth and social impact of the nonprofit. Here, MPR was clearly an early mover in programming innovations, as well as organizational and entrepreneurial practices, such as recognizing the advantages of scale in broadcasting. Other striking examples of innovation include the creation of its own distribution network, Public Radio International, and other for-profit businesses like MNN Radio Networks, which sold regional news reports to Minnesota commercial stations via satellite, or Public Radio MusicSource. Though some of these initiatives were undertaken in partnership with other public radio stations, Kling and MPR were leaders in bringing them to life.

The third issue relates to the controversy over MPR's entrepreneurial activities. Regardless of how one sees the debate itself, judges MPR's businesslike conduct, or feels about the amount of the compensation paid to its executives, this case study illustrates poignantly the dilemma noted by Pratt at the beginning of this story. Both the government and private funders have encouraged – and even pressured – nonprofits like MPR to become more self-reliant by pursuing earned income. But these stakeholders, as well as the general public, are ambivalent about such commercial activity when it becomes so successful that it outstrips the core social purpose activities.

Is this unfair? Undoubtedly. But the tension is inherent in the fundamental economics of the nonprofit sector. As long as nonprofit organizations rely on both contributions and earned income (especially from unrelated commercial activities), there will be divergent perceptions about the appropriate balance between those sources. One observer's crass commercialism may be another's exemplary social capitalism.

Moreover, as the industries in which nonprofits and their social enterprises operate become more competitive, there will be increased pressure on executives to maximize revenues.

With regard to whether the ambivalence about social purpose capitalism is unfair, one suspects that Bill Kling has moved beyond this question. Sitting astride a broadcasting empire with a $109 million endowment, Kling, though personally stung by the criticism, seems undeterred by it and satisfied with what MPR has accomplished: "We are proud of the model we created. … We intend to continue our support for our public broadcasting activities through for-profit enterprises undertaken within separately incorporated, responsibly governed entities. … Our model will surely continue to be debated and criticized by 'experts.' But we believe it has proven itself to be a responsible and effective adaptation to the nationally changing needs of maturing nonprofit organizations."[35] □

This article is adapted from a Stanford Graduate School of Business teaching case on Minnesota Public Radio. Both were prepared entirely based on publicly available materials.

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