# Radical Revenue

## A new business model challenges conventional industry thinking

by Bruce Coppock

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On June 23 at the League's National Conference, Bruce Coppock and Larry Tamburri led the general session entitled A "Radical New Revenue Model for Orchestras"; in photo from left: Tamburri, presenter Douglas W. Kinzey, and Coppock at the session.

The thirst in our field for new thinking about orchestra finances was powerfully evident at the League's National Conference last June, when approximately 350 people attended a joint presentation by the Pittsburgh Symphony Orchestra and the Saint Paul Chamber Orchestra (SPCO) with business-strategy guru Paul Boulian. For three and a half hours, people engaged deeply in the subject of the session, deliberately and provocatively entitled "A Radical New Revenue Model for Orchestras." Although this article expands that material and puts it expressly through the unique lens of the SPCO, I would like at the outset to acknowledge the contributions my colleagues PSO President and CEO Larry Tamburri and Paul Boulian both made in stimulating our thinking in St. Paul. We are grateful to them both.

It was my good fortune to be engaged in 1999 as president and managing director of the SPCO, and to be challenged by its board of directors to "take it to the highest level." In response, we have vigorously strived for innovation and creativity on and off stage. A new artistic leadership model instituted in 2004-05; an aggressive decentralization of concerts into eight neighborhood venues; powerful roles for SPCO musicians in the artistic life of the orchestra; a labor contract driven by the SPCO's artistic and financial imperatives; and a tremendous investment in defining the SPCO's artistic profile all combined to generate a true revitalization of the orchestra. We have broken with industry traditions in governance and management by enlisting musicians, the full board, and senior staff in every major policy initiative, from strategic planning to community engagement, and by blurring the lines of demarcation among board, musicians, and management. Led by former Chair Lowell J. Noteboom, the Board of Directors has stood conventional wisdom on its head by eliminating term limits, insisting that committee-chairmanship tenures—and the board chairmanship—extend at least three to five years, instituting a rigorous annual trustee evaluation process (including the chairman), and transferring the executive committee's authority and accountability to the full board. None of these changes has been made for its own sake; all are intentional choices collectively seen as the best strategies to achieve the vision set forth in the SPCO's strategic plan.

The most vexing problem we have wrestled with is a fundamental one: defining the SPCO's business model. To attack this question, we assembled a Business Model Task Force (BMTF) comprising trustees with deep business experience; we engaged Paul Boulian as project consultant; and we charged the group to "develop a business model that will guide actions and behaviors over time in order to fund fulfillment of the SPCO vision in a sustainable manner." There are many key words in this charge to the BMTF, but none is more important than "sustainable." As is true of every SPCO committee or task force, SPCO musicians and senior staff were vigorous participants in the discussions. In particular, Beth Villaume, the SPCO vice president for finance, and Jon Limbacher, our chief operating officer and vice president for external affairs, provided stellar research and inventive thinking.

For eighteen months beginning in September 2004, the BMTF met regularly to seek answers to business-model issues that germinated from one simple question: "How can the SPCO sustain itself over the long term if its earned income ratio remains where it is at less than 30 percent?"

Indeed, the urge for the BMTF emanated from concern over the SPCO's low earned-income ratio. For many years an earned-income ratio of 50 percent or better has been a positive industry marker for financial health. But our detailed examination of this issue led us to a very different conclusion: Earned income as a percentage of total revenue is a meaningless indicator of overall financial health.

The term "earned income" conflates many kinds of income: concert tickets, concessions or hall rentals, touring, recording and broadcast fees, fees for opera and ballet performances, and some government grants. Indeed, earned income is a misnomer for "sales and fee income." It represents such a potpourri of activities that it provides no insight into our financial health or how to operate our organizations. An orchestra that sells nearly all of its tickets might have a high earned-income ratio, yet run a deficit because it has a small annual fund and virtually no endowment. If it then grows its annual fund and endowment to balance the budget, what will happen to the earned-income ratio? It will go down. So the key is to identify what revenues one can combine to balance the budget.

While trying to get past the "Earned-Income Barrier," we discovered very interesting ratios derived from the League's Orchestra Statistical Reports, an analysis updated for this article to comprise FY00 through FY06. We were unable to establish that a high earned-income ratio correlated convincingly to other factors that we believe more critical to long-term financial health: consistently balanced budget, very low accumulated deficit, a strong ratio of endowment to operating budget, and, most importantly, size of audience.

We studied the 24 largest-budget American orchestras, excluding three that did not report in each of the seven fiscal years and two others that reported their annual results in anomalous ways, leaving nineteen orchestras in the study. We then divided those nineteen orchestras into four groupings, based on reported earned-income ratios; see Fig. 1.

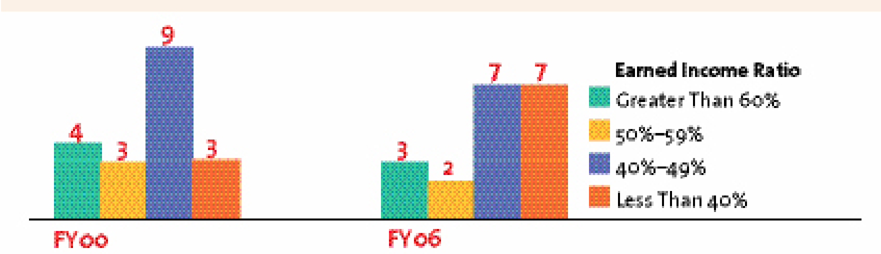
The only discernible trend during the study period is that the number of orchestras earning more than 50 percent earned income decreased, those with 40 to 49 percent earned income decreased, and the number of orchestras earning less than 40 percent earned income more than doubled. While a high level of sustainable "earned" income is clearly a good thing, the simple reality is that orchestras increasingly rely on higher levels of endowment and contributed income to remain viable.

League data from FY00 through FY06 reveals three insights about the diverse nature of orchestra business models:

- Revenue from winter classical subscription series—ostensibly the very core of these orchestras' missions—produced at the low end 6 percent of total annual revenues and at the high end 32 percent of total annual revenues.
- Winter classical subscription series revenues accounted for a low of 25 percent and a high of 94 percent of annual revenues derived from performances.
- Total orchestra performance revenues accounted for a low of 28 percent and a high of 100 percent of total annual earned income.

If our research proves anything, it's that orchestras cannot determine their own business models by simply looking at the field as a whole. Each orchestra needs to determine its business model based on its own unique situation. We believe it has been disruptive and misleading to hold up as a standard for the entire field a model that is only possible for a very few large-market orchestras with commercial summer-concert and concession businesses, which own and rent out their halls in large, culturally active cities, and which generate large revenues from pops and/or other rock and popular presentations. The circumstances that allow those few orchestras to function as multi-business entities are largely unduplicated around the country. However, if one groups orchestras not by budget size or earned-income ratio but rather by similar constellations of activities, some comparisons may be useful.

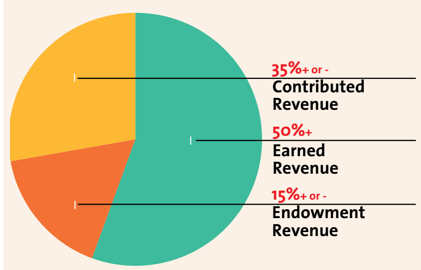
Fig. 1 **Number of Orchestras**




### Beyond the Three-Legged Stool

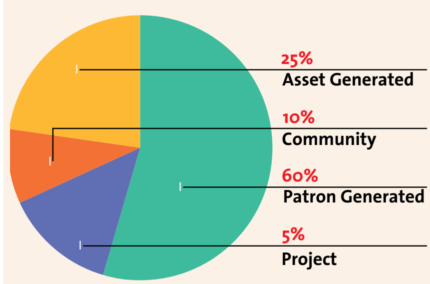
For years, there has been an immutable formula for orchestra revenues, with some variation in the percentages:

**Traditional Three-legged Revenue Model**




In St. Paul, we have proposed a different view of revenues, one that allows us to understand their varying provenances and to line them up with associated expenditures. We believe that this approach provides a stronger business-analysis tool for running the organization. Here is our model, with SPCO target percentages:

**New Revenue Categories & Nomenclature: SPCO Targets**



The categories are very different from the traditional model. The untangling of earned revenues and the allocation of revenues previously considered contributed provides us with a greater understanding of the underlying nature of relationships of revenues and expenses.

**Getting Past the Earned-Income Barrier**

Through analysis we established that the SPCO's low ticket-revenue percent was in large measure a result of our structure. Unlike most orchestras, the SPCO produces a single musical activity: winter classical subscription concerts. By virtue of artistic mission, size, and geographic circumstance, the SPCO is a boutique shop, and can only increase the percentage of revenue derived from tickets to a maximum of 30 to 35 percent—if every ticket is sold at full price. In previous years, we tried to increase ticket revenue by maintaining or increasing prices, but given the inverse ratio between ticket price and attendance, this only resulted in smaller audiences. Catch-22. Convinced that there had to be a sustainable business model that would support the SPCO's vision, we examined our assets for potential revenue. The orchestra? The board? The staff? The endowment? A new commercial venture, like a parking garage? Perhaps, but none was capable of generating the 15 to 20 percent more in sustainable annual revenue required to eliminate the gap between long-term, sustainable revenues and the expenses necessary to fulfill our strategic plan.

Then came the epiphany! The largest asset of the SPCO—and the most untapped—is our audience. Why? We know enough about the demographics of our audience to make some assumptions about its financial capacity. Although the industry has never accounted for revenue in this manner, the fact is that the audience is the primary source of revenue for orchestras—least of all through ticket purchases, but more significantly through annual fund contributions, special-project funding, endowment funding, and bequests. Most interesting of all, the audience keeps on giving after it stops attending: 50 percent of our individual donors are former subscribers. And the size of the audience matters enormously in influencing foundation, government, and corporate giving, persuading subscribers to renew, and building the pool of potential contributors.

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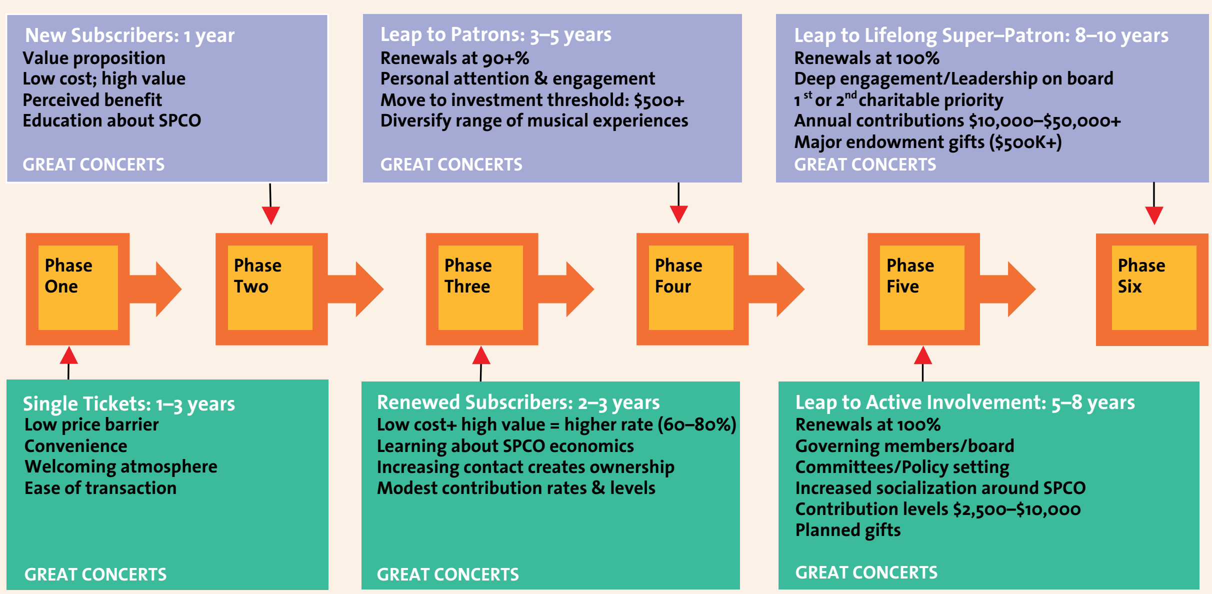
The audience is therefore the key to all financial growth. But orchestras are primarily organized to promote, produce, and perform concerts in a commercial manner, not to convert consumers into passionate believers and donors on the large scale necessary for sustainable revenue.

The more we thought about it, the more we came to believe that if we think of ourselves as being in the concert production business, with ticket revenue as our core revenue, we severely limit potential income. However, if we think of ourselves as being in the patron-development business and think of producing concerts as our mission, new horizons appear.

The descriptions and Fig. 2 imply very different resource allocations, use of the orchestra, program design and distribution, mindset, and strategies from traditional orchestra operations.

- **A Large Audience:** Consistently filling the hall is the *sine qua non,* even at the expense of ticket revenue.
- **Concerts Are a Loss Leader:** Lower

Fig. 2 **Ten-Year Patron Development Cycle**



prices stimulate attendance and early subscription and renewal rates. Low prices combined with great concerts create a strong value proposition. Transactional costs go down as price goes down, and in our case we are spending less on marketing, garnering a larger audience, and securing higher net revenue from ticket sales.

- **A Strong Value Proposition Is Essential**: A great concert at a low price gives attendees the sense that they have been given a gift, rather than extracting the last possible dollar from the ticket sale. This fosters the willingness of audience members to contribute.
- **Educating the Audience about Orchestra Finances:** Without being informed about the economics of orchestras, audiences will act like buyers in a commercial transaction. Patron development begins with teaching the audience that our concerts are only made possible by audience contributions—and always giving them great musical experiences.
- **Encouraging Small Contributions Builds Ownership:** Even at a modest level, contributing begins the process of building engagement and ownership of the organization.
- **Continually Develop Patrons to the Next Level:** Allocating institutional resources—musical, financial, staff, and volunteers—in tiered levels of benefits will encourage donors to move up "the patron ladder" over time. The graphic on page 23 demonstrates the concept.

### Two Essential Matrices Concerning Orchestra Revenues

**1. The Alchemy of Patron-Revenue Growth.** Three variables influence patron revenue: number of households in the audience, percent of audience households that contribute to the orchestra, and the average size of the contribution. Moving each variable requires different sets of intentional behaviors on the part of the entire organization.

The potentially powerful interaction of these variables can be demonstrated in Fig. 3.

Each orchestra will need to calibrate this chart to its own circumstances, and will have to determine what to focus on in order to increase the size of the variables. Play with the chart below to see which variable will impact your patron revenue line more quickly.

**2. All orchestra revenues are not created equal.** Understanding the differences among types of revenue is critical in developing a plan for what kind of revenue to pursue most intensively. We decided upon three key factors to determine which kinds of revenue to focus on:

**Sustainability.** Orchestras need revenue that is sustainable over time. Corporate, foundation, and government revenues are generally volatile and depend upon external factors beyond our control. This led to our view that such revenues (which we bundle together and call "Community Revenue") are not highly sustainable. By contrast, endowment revenues—provided the organization *never* raids the principal, does not draw at a rate higher than 5 percent, and smoothes the draw over at least 36 months—have a high level of sustainability even through difficult business cycles. In the SPCO experience, the most sustainable revenue is annual individual giving by orchestra patrons. In the aggregate, even in down business cycles, individual giving remains steady, and in up cycles can grow at rates significantly higher than the rate of inflation.

**Net Revenue.** Understanding the net revenue derived from any transaction is essential. An operating dollar generated from funds already in your endowment

Fig. 3 **The Power of Three Variables**

| | | | | |
|---|---|---|---|---|
| Audience Households | 3,000 | 6,000 | 10,000 | 15,000 |
| Percent Who Contribute | 25% | 35% | 50% | 65% |
| Average Contribution | $150 | $300 | $750 | $1,000 |
| Patron Revenue Derived | $112,000 | $630,000 | $3,750,000 | $9,750,000 |

returns an extremely high percentage of the cost to generate it, probably well in excess of $.95 after allowing for fees and the possibility of a market adjustment; at the SPCO a dollar raised in the annual fund generates $.86 after out-of-pocket and staff expenses. A dollar of single-ticket income may generate as little as $.30 after marketing expenses, and at the margins may cost more than a dollar to generate. A dollar of European touring revenue may require a subsidy of $3 to $1. Matching corporate or foundation contributions to organizational dollars 1:1 to participate in a three-year non-renewable project clearly has negative net revenue. The intrinsic programmatic value of a project may indeed justify negative net revenue, but it is important to have one's eyes wide open to whether net revenue is negative or positive, whether it can be turned into sustainable revenue, and whether net negative financial impact gets larger each year.

**Return on Investment.** Return on investment is related to net revenue but has a time dimension to it. If we invest $25,000 to secure a $1,000,000 endowment pledge paid in five equal installments, that pledge will generate negative net revenue in year one. But by year five, that pledge will be generating $50,000 annually—a return on investment of 100 percent. Conversely, an investment of $100,000 in staff costs to boost the annual fund by $100,000 yields zero percent return. Spending $1.40 to generate a dollar of single-ticket revenue (not uncommon) will have a negative return on investment—unless one converts that single-ticket buyer into a subscriber for $.36, and two years later into a subscribing annual fund donor for $.14, and into a subscriber-owner who contributes $2,500 in year five. Then, one has achieved a magnificent return on the initial investment. This return increases exponentially as patrons travel the Patron Life Cycle.

Fig. 4 shows how the SPCO decided to evaluate different kinds of revenue with respect to its sustainability, net return, and return on investment.

**Conclusion: Mission vs. Business Model**

Understanding of the business model must be separated from understanding of the mission. Yet the two are inextricably intertwined, thus explaining confusion about what business we are in. Confusion is partially the result of our evolution from purely concert-giving organizations with flexible cost structures supported by a few wealthy believers into multi-million-dollar, not-for-profit corporations with expensive fixed-cost structures and complex governance, fund-raising, and marketing operations.

While our business has changed over the past 40 years, the business model has not changed with it. Therein lies the disconnect between how we are organized to operate and what business we must be in to survive and thrive. To thrive, we must produce great concerts—concerts so compelling that they induce patrons to attend our orchestras instead of the myriad cultural and entertainment choices available. But we

Fig. 4 **Stratification of Revenues**

| Category | Sustainability | Net Revenue | Return on Investment (over 5 years) |
|---|---|---|---|
| Patron Revenue | High | Medium | Very High |
| Single Tickets | Low | Very Low | Potentially High |
| Subscriptions | Fairly High | Medium | High |
| Contributions | High | High | Very High |
| Asset-Generated Revenue | Very High | Extremely High | Extremely High |
| Project Revenue | Low | Potentially Negative | Potentially Negative |
| Community Support | Medium | High | High |

must also mobilize our audiences in large numbers to do something fundamentally irrational: to pay an exorbitantly high price through charitable contributions for the stimulation of hearing a great orchestra play. Many people reading this may argue that we are just making the case for stronger development departments. Nothing could be further from the truth. What this revenue model suggests is that orchestras need to reorganize themselves in basic ways to function as both producers of great concerts from the perspective of mission, and as membership and patron-development organizations from the perspective of the business model.

One of the most sweeping changes the SPCO has made on the business model was in the 2005-06 season, when we lowered prices in our neighborhood venues—from seats ranging up to $49 to all seats for either $10 or $25. This decision involved significant financial risk—and could not have been made had our organization not believed in the business model. Since the institution of this new pricing structure and subsequent aggressive expansion of neighborhood series concerts, our neighborhood series subscriber base has more than doubled, and our overall subscriber base has grown by over 35 percent. During this period, net patron revenue has increased by almost $500,000.

For years, we have operated our orchestral organizations with the musicians and music director at the center. Governance, marketing, and development functions have been tangential to the orchestra's artistic operations:

**Current Model**

Perhaps we need now to think of ourselves in this way, which is completely inside out from conventional wisdom:

**New Model**


We exist in order to serve our communities with great musical experiences. We can no longer afford to believe that if we just do what we do well, sufficient dollars and bodies will follow. Rather, we must now up the ante on the quality of the experience we provide for our community,

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and then up the ante even further by organizing ourselves to stimulate the patron development cycle on a grand scale. That will increase the size of the audience, inspire the audience to contribute, and create a much larger group of owners and investors than ever before. ∾

Bruce Coppock is in his ninth season as president and managing director of the Saint Paul Chamber Orchestra. He has previously served as a vice president of the League of American Orchestras and the first director of its Orchestra Leadership Academy; earlier posts include deputy director of Carnegie Hall and executive director of the Saint Louis Symphony.