



# Alert

The Journal for Nonprofit Managers

California Association of Nonprofits

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*CAN Deputy Director **Kathy Crabb** sat down recently with **Dave McDonough**, President of the Social Enterprise Institute, to discuss the growing trend of earned income ventures in the nonprofit sector. Following are excerpts of their conversation.*

**CAN:** Let's start with definitions. What exactly is social enterprise?

**Dave McDonough:** The Social Enterprise Alliance (SEA) has defined the term as an organization or venture that advances its mission through entrepreneurial earned income strategies. A central component of social enterprise is earned income—that is, sales, fees or some kind of strategic alliance that generates income for the organization.

Many people think of social enterprise or social venture as a separate business meant to generate profits to fund a nonprofit. That is some of the activity taking place. However, we also see it as a nonprofit generating earned income to recover all or part of the costs of a mission-based program. This is where much more of the success is found. Profit is not the main mindset. If a nonprofit has a mission-based program that's able to recover 20, 40, 70 percent of its costs, we think that's a successful social enterprise. In a for-profit business, you wouldn't last too long on that kind of model. But in the nonprofit world, you now have that much less money to raise through traditional charitable channels.

We even look at government contracts as earned income if it's a *quid pro quo* fee for service. For example, the County gives an organization \$50,000 to continue its mission—that's a grant—versus a contract of, say, \$1,200 per child for such and such services. That's earned income.

**CAN:** Why is that distinction important?

**DM:** Because fee-for-service is essentially a business activity, and it has to be evaluated in that way in terms of pricing, unit costs, business growth and so forth. Looking at a government contract from a social enterprise perspective, you'll think of ways to grow and expand it, make it more beneficial to the organization. The social enterprise viewpoint helps the organization determine if the

contract is a good one—one that's worth pursuing and signing onto year after year. Or, maybe, it's time to renegotiate.

Too often, nonprofits broadly say government funds don't cover program costs. It's really important to get a handle on those costs, to know exactly the costs and benefits of taking on a contract versus deploying the resources in another way. It creates a better structure for evaluating government contracts. So we coach nonprofits to think in terms of the value they're providing and how that compares to how they're being compensated for the services provided. They can be realistic up front about whether that contract makes sense for them.

**CAN:** Who is engaging in social enterprise? Who's not but should be?

**DM:** The more we know about nonprofits, the more we find there are more organizations doing social enterprise, or generating earned income, than we'd thought. They're selling greeting cards, leasing out computer lab space, charging fees to the people they serve—lots of different activities are generating earned income for nonprofits. And if you're generating

## Growth Strategy

Using Social Enterprise to Advance Your Mission and Sustain Your Organization



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earned income, you're conducting social enterprise. Once you know that about your organization, you can bring focus and business planning to see if there's an opportunity to grow the earned income, to offer your product or service to new markets or to expand in some other way. We have many examples of nonprofit leaders that, once they started to evaluate their programs from the "double bottom line" mindset of social enterprise, began to really focus in on the possibilities.

Many nonprofits that are not doing social enterprise now have thought about ways to leverage what they already do. That's a good place to start—with what you're already doing and what you're already good at. We encourage organizations to take stock of what's already there. For example, a hot meal delivery program with a commercial-sized kitchen has lots of potential opportunities for earned income: What other activities could be done to leverage that asset without adding overhead?

In Atlanta, one such program, which has historically delivered meals just to low-income seniors, is now also delivering meals to people who have the ability to pay. They leveraged existing assets, skill sets, infrastructure, but now they're recovering the cost of serving low-income people by providing the exact same service to people who can cover the full cost—and then some. Universities work on that same model by subsidizing low-income students while everyone gets the same quality education.

Of course, you need to balance the mix to ensure your mission is still front and center—but also plan for how you're going to generate the income necessary to keep your mission going long term.

**CAN:** *About that balance: How do you respond to concerns that a social enterprise may become more about money than mission? Especially when financial sustainability is at stake?*

**DM:** Yes, those concerns are real and legitimate. There is a lot of anxiety over sustainability for a number of reasons—a big one being that funders are saying to grantees, "We want you to be sustainable." Donors are looking for sustainable models because they're concerned that their contributions are the sole source of income and don't want to hold programs up in the long-term. Building sustainability starts with a game plan about how to sustain mission activities over time. It doesn't mean it can't include donations and grants, but the long view is very important. I would like to see nonprofits break free from of the annual cycle of starting

at zero to fund successful programs. This type of existence makes organizations very vulnerable. That vulnerability can, in turn, result in poor decision-making about accepting funding because of a "crisis of the moment" mentality. Mission drift is a real possibility with social enterprise—but the same pressures exist in traditional fundraising.

There is a tendency to look for the silver bullet, and people have to know that social enterprise is not that. You have to be very cautious, very clear about what's possible. Sometimes there are opportunities to break even—or better—but very often it's about cost recovery. It's about encouraging a healthy mix of revenue.

To some, social enterprise can appear to be more expensive than other means of generating income—but I recommend that nonprofits compare the start-up costs of social enterprise versus the cost of fundraising. Compare the projected return on investment. Take stock of what the various investments are for different income strategies and see where the most return can be maximized.

[Los Angeles-based nonprofit] Chrysalis is a good example of an organization that has a mix of revenue sources. About 60 percent of its income comes from social enterprises, which provide jobs to economically disadvantaged and homeless people. They determined that one of their greatest assets was their labor pool and that employers would pay for screened and trained employees. And their social enterprises are very successful today, both in terms of mission impact and contribution to the organization's financial sustainability.

**CAN:** *Why would someone want to do social enterprise? A lot of nonprofit leaders don't necessarily think of themselves as entrepreneurs.*

**DM:** They probably aren't giving themselves full credit, which is often typical of nonprofit leaders!

Think of how much social impact nonprofit leaders have generated from, oftentimes, very few resources. Think of the innovation, creativity, persistence many have demonstrated to get where they are today. That's entrepreneurship.

But the desire and need for sustainability is a very compelling reason to pursue earned income. There are simply not enough dollars in the donor world to have the social impact we really need to have.

Also, by approaching social missions with a new mindset, new and creative ideas arise.

It's worth pursuing social enterprise in order to generate new ideas, new ways of doing things.

For example, a low-income housing organization the Social Enterprise Institute works with was very good at developing affordable housing units. But they knew that the key to success of their residents was not just bricks and mortar but also wraparound services like case management, health care and after-school activities.

The organization developed and implemented its own slate of wraparound services but quickly realized that it was an entirely different business. So they developed a separate entity to provide outsourced social services to low-income housing developments—including their own! They provide their services to non-profit and for-profit landlords with the value proposition of creating a more stable resident pool, decreasing crime in their buildings, building community, increasing access to resources and so forth. At five years old, this organization is now 85 percent funded by earned income.

At the Institute we convene social entrepreneurs in a monthly leadership forum and are continually amazed at the wealth of experiences, best practices and networks they have. And when you bring these entrepreneurs together, they start seeing all kinds of new opportunities to further their missions in a sustainable way.

**CAN:** *What are the measures of success for a social enterprise?*

**DM:** Success is measured by what we call the double bottom line: First, how does this enterprise further our social mission? And second, how will we do it in a way that we can sustain over the long haul? A good social enterprise seeks to match the organization's core competencies with marketplace opportunities in order to simultaneously grow earned income and expand social impact. Of course, we now are also incorporating the triple bottom line, which refers to environmental sustainability as well. This should be a goal for nonprofits as much as it should be for the business sector.

Goodwill is a great example. Most people think of them only as thrift stores, but many Goodwills actually operate several different earned income businesses. Their baseline for determining whether or not to launch a social enterprise is, "Will we employ the people we serve? Will the social enterprise activity advance our mission?"

So now in Orange County, Goodwill is running at least six different enterprises—custodial services, landscaping and document

destruction, to name a few. They're choosing ventures that maximize their existing assets—space, vehicles, labor pool—and finding opportunities in the marketplace where they can leverage those assets. They are having an impact on the environment by recovering and recycling goods that would otherwise end up in landfills. And in the process, Goodwill is employing the people they serve. They're advancing their social mission. This is a great example of a triple bottom line organization.

You have to recognize that the effort is not about money as much as it is about furthering mission. You may have an exciting idea, but you need to evaluate whether it's going to impact your mission significantly. The commitment of resources, time and energy required by social enterprise demands a big-bang payoff. That's the test. If it's not a big idea with a big social impact, it's probably not worth the effort and investment.

**CAN:** *But an enterprise designed to generate a large amount of income often requires outside financing. Is that kind of support available to nonprofit organizations?*

**DM:** Many organizations are trying to figure out how to fund and scale up good ideas. There are many such projects in the environmental movement – for example hybrid cars, zero waste, super-efficient light bulbs and other products to save energy and be more environmentally friendly. Some are being developed by nonprofits that need capital to grow their businesses.

In addition to traditional nonprofit sources like grants and reserves, there are traditional business financing vehicles, like venture capital or venture philanthropy, emerging specifically for nonprofits. They understand that the financial return won't be as high as it might be if they invested in a successful for-profit. But they're looking for high social return and a potentially reasonable financial return—which is to say, a nonprofit that can pay back the investment over time.

There are other new funding models in the social enterprise/earned income arena—Good Capital ([www.goodcap.net](http://www.goodcap.net)), based in San Francisco, is one of them. It's very new territory. They're working on the traditional investment model but also looking at other methods of financing social impact, including bringing potential investors together to scale up and accelerate financing for social enterprises. [Editor's note: See the sidebar on page 6 for more resources.]

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**CAN:** *I want to shift gears for a minute and talk about a couple trends the larger nonprofit sector is experiencing and how those trends might interact with social enterprise. First, how do ongoing changes in corporate giving impact the social enterprise movement?*

**DM:** The corporate social responsibility trend is very real. What's changed is that, traditionally, corporations were making charitable contributions to support their public relations needs, their corporate image in the community and the communities they work in. Now, though—and there are studies that support this—they're finding that charitable giving and other partnerships with nonprofits actually add profit to their own bottom lines. So being environmentally aware, sensitive to community issues, etc., is actually profitable for corporations.

The public is looking to do business with companies that demonstrate social responsibility. And companies are paying dearly for mistakes and missteps in this area. There's also growing pressure from employees as well as a proliferation of socially responsible investing opportunities.

And, maybe most important, there are genuine opportunities for nonprofits to create and initiate real, productive partnerships with the business community. And we—nonprofits—ought to help them in this area, since we're most in tune with the social needs of our communities.

It's got to start with a synergy between, on one hand, the nonprofit's mission and, on the other hand, companies that are engaged in similar activities. For example, a low-income housing group could easily find ways to partner with homebuilders; a meal program could partner with the food industry; nonprofit temporary employment could partner with for-profit employment agencies. Think about how local businesses or large corporations could help your organization beyond making a purely financial contribution.

It's time to shed the idea that companies are only about profit. We've found a genuine desire in the for-profit sector to do the right thing, to be good community citizens, to have business practices that are beneficial to the community. There are so many opportunities to work together.

**CAN:** *Another trend the nonprofit sector is now facing is a major demographic turnover in its leadership. How will this shift impact the social enterprise movement?*

**DM:** The founders and others now in leadership positions are certainly very capable of engaging in social enterprise. They've been the ones to build up the large stable of entrepreneurial, earned income ventures that nonprofits now have in place. They've also been the ones to make sure the focus stays on mission rather than becoming more about money.

But the changeover in leadership is also a genuine opportunity for social enterprise. A fresh, new, nontraditional way of looking at sustainability is a unique opportunity. A fresh breed of leaders coming in is a good time to evaluate what exists now and maybe to pursue different strategies. Changeover and transition always bring fresh perspectives. This is a different time and environment—the social enterprise movement is gaining momentum. There are models nationwide to follow and innovate.

**CAN:** *How can a nonprofit get started on social enterprise?*

**DM:** Two ways: First, create awareness among your board and staff about these concepts. The social enterprise field is maturing, so there are lots of articles, reports, case studies and other resources available. Take time to do that. The Social Enterprise Institute ([www.se-institute.org](http://www.se-institute.org)) has a library of resources. The Social Enterprise Alliance ([www.se-alliance.org](http://www.se-alliance.org)) can help as well. [Editor's note: Also see the sidebar on page 6 for further resources.]

Second, all organizations should take the time to evaluate whether social enterprise makes sense for them. Create a social enterprise task force within your organization. It should be small—six to ten people—and include board members (especially any with an entrepreneurial background), staff and outside entrepreneurs. Plan on only three to four meetings to get started, just to evaluate whether the idea of social enterprise makes sense for you.

The goal of the task force is to map out the organization's inventory and assets, determine whether it wants to go ahead with a new enterprise or with expanding an existing one. Look at what's possible. Start with the current ideas on your board and staff. Look at existing earned income, if you have it, and see if it can be expanded instead of starting something completely new. It's really important to consider leveraging things you're already doing as a way to build earned income.

For example, an organization we worked

with was selling greeting cards to fund cancer research. Kids with cancer designed the cards, which generated more than \$300,000 a year for the nonprofit's mission. And that was from selling only in southern California and only around the holidays! Now they're looking at expanding their sales nationally, year-round.

In doing the research, they discovered a for-profit company that was interested in adding a socially aware product line. The non-profit and the business worked out a partnership, and the cards will expand into a few new markets across the country in 2008. The non-profit realized significant savings through the for-profit partnership—and will also be reaping significant financial and mission rewards.

The point of the task force is just to determine whether social enterprise is something your organization wants to pursue and, if you do, in what particular area you could create the biggest bang for your buck—and for your mission. Social enterprise isn't for everyone, but for those organizations that want to pursue it, it's advisable to take a hard look at where they are right now with current assets, skill sets, core competencies, potential partnerships and so forth.

And if you're not ready right now, but think you will be in the future, take a look at your current revenue structure and commit to making it more sustainable in, say, five or ten years or whatever makes sense for your organization. Commitment breeds creativity.

**CAN:** *If a nonprofit does decide to move ahead with a social enterprise, what are some of the key factors of success to keep in mind?*

**DM:** First, remember to stick to the "3Cs"—core competencies, capabilities and constituencies. Understand what you do best. Start there and leverage out from that position of strength.

Second, hire a passionate champion. Often nonprofits don't dedicate enough staff resources to the enterprise. But to succeed, you need someone who is fully committed to the mission side – and who has a solid understanding of the business side. The leader is key.

Third, never lose sight of the mission or the margin. Unlike in private business, it's not necessarily disastrous if you're "losing" money. But you always want to have an understanding of the financial model you're using, what you're expecting to get

out of it in terms of cost recovery, and how you're performing against your expectations. For example, health clinics are reimbursed by Medicare, MediCal and insurance companies. They often don't get reimbursed at the full rate of what it costs to provide the care. But they need to know what's expected and how they can fill the gap.

Fourth, the social and financial returns on a social enterprise must be substantial enough to be worth the investment. It just takes too much effort, planning and ongoing resources to do it for small returns. Think big!

**CAN:** *Any final thoughts?*

**DM:** Remember that social enterprise isn't necessarily about starting a profit-making venture in the traditional sense of the phrase. Be realistic about the amount of income you can generate.

There's been some criticism about the efficacy of social enterprise because not all social enterprises succeed in the end. But it happens in the for-profit world, too. Businesses go out of business for all kinds of reasons. It doesn't only happen in nonprofits, and it doesn't always happen in nonprofits. Failure is one possible outcome of taking a risk. But so is success. Most organizations wouldn't stop writing grants because some of them get rejected.

Planning is key. And we have found in our leadership forums that working with other social entrepreneurs to tap their experiences and networks is very valuable as well.

We have found enormous creativity and innovation within nonprofit organizations. That's no surprise! Look at what they've done with limited and restricted funding over so many years. Entrepreneurship is about creativity and commitment.

So nonprofits are excellent candidates.

*Dave McDonough is President of the Social Enterprise Institute ([www.se-institute.org](http://www.se-institute.org)), a not-for-profit organization which offers philanthropic leaders a unique opportunity to develop the skills and networks needed for implementing successful social enterprises. Its mission is to organize and facilitate peer to peer learning forums that significantly improve the "triple bottom line" performance of all participants.*

▶ **Don't miss Dave's luncheon address at the Earned Income Conference on April 8.**

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