

# Five Challenges *Five Challenges* in Social *in Social* Purpose *Purpose* Enterprise *Enterprise* Development *Development*

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## Introduction

**T**he nonprofit sector is currently in a period of both significant challenge and profound change. The sector, as it has evolved over the past 30 years, must now address fundamental shifts in the political, economic and social marketplace in which it operates. There is clearly an immediate and ongoing need for a healthy and vital nonprof-

it sector to complement both the public and for-profit sectors. It is also clear that in the face of decreased public funding and growing public discontent with the perceived inefficiencies of many traditional nonprofit organizations, the sector as a whole must transform itself if it is to become a catalyst for positive individual, community and social change in the years to come.

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Numerous writers have discussed the broader aspects of this transformed and transforming nonprofit sector.<sup>1</sup> Our own work has focused upon the emergence of New Social Entrepreneurs (individuals involved in the community application of business practice).<sup>2</sup> Specifically, we have addressed ourselves to

- A) the creation of a venture philanthropy approach to supporting Social Entrepreneurs and the organizations which house them, and
- B) the development of social purpose enterprises that are market-based, revenue-generating ventures employing individuals on the margins of society's mainstream.

From that perspective, we have become aware of significant challenges confronting nonprofit managers attempting to engage in a process of change, both within their own organizations and the nonprofit sector as a whole. This paper outlines five elements that are critical to the process of "re-inventing" nonprofit organizations attempting to plan, launch and manage revenue-generating ventures. These elements fall into five categories:

- ◆ Organizational
- ◆ Managerial

- ◆ Marketplace
- ◆ Financial
- ◆ Investor-Related

Each of these elements has particular relevance to social purpose enterprises and this analysis is presented with reference to that specific practice. However, the importance of these elements is not limited to those engaged in the creation of social purpose enterprise. All nonprofits, whether engaged in enterprise creation or not, need to be cognizant of how these factors play out in their own environment. The fundamental issue confronting the nonprofit sector as a whole is how to build organizational capacity to pursue its social mission into the next century. The following discussion addresses the five elements that are central to any capacity-building initiative—regardless of whether the organization is involved in enterprise development or is simply attempting to manage its activities more effectively in a changed political and social environment. These elements are not definitive or exclusive of other factors that impact the work of the nonprofit sector. They are, however, critical points for consideration of the needs and future prospects of nonprofits involved in the pursuit of their social mission.

## The Five Elements

### Organizational

The battle for the creation of a healthy nonprofit sector begins and ends in the organizations in which social entrepreneurs and other practitioners are doing their work. At the end of the day, the organization is the vehicle through which individuals act to fulfill a social mission. An organization's ability to successfully manage social purpose enterprises depends significantly on the strength of its board and staff, its ability to manage potential

mission dissonance, the manner in which its enterprise activities are linked to its social or other programs and the effectiveness of its MIS/operating systems.

Much attention has been focused on the presence and role of social entrepreneurs as the driving force for change in the nonprofit community. While the presence of an "enterprise champion" is crucial, that individual must herself be supported by board and staff members if the venture is to succeed. If the

board and staff do not understand and embrace both the vision for the enterprise activity and the rationale for its pursuit, the social entrepreneur will be continually hamstrung in her efforts to create a sustainable social purpose enterprise.

Social purpose enterprises, however, do not operate in a vacuum. Those who attempt to separate the enterprise into its own department or subsidiary, hoping it will not affect the operations of the rest of the organization, are mistaken in their efforts. The enterprise *will* have an impact on the balance of the organization's structure, culture and operations. Therefore, as part of engaging the board and staff, adequate time must be spent assessing what potential mission dissonance may occur as a result of the creation or expansion of a social purpose enterprise. Specifically, the organization's stakeholders must be engaged in a process of re-examining the mission of the organization in light of the enterprise development effort.

While addressing the human element of the organization is important, it is equally important to assess the MIS/operating systems that function as the "skeleton" of any organization. Many traditional, nonprofit accounting systems simply do not generate data adequate to the needs of enterprise managers. Yet without that information, the social purpose enterprise is doomed to mediocrity and possibly failure. The challenge of developing an accounting and information management system tailored to the needs of the business, without undermining the integrity of the parent organization's system, is a critical challenge to the successful establishment of organizational capacity.<sup>3</sup> In addition to being able to accurately track financial data, enterprise managers must be provided with an appropriate level of discretionary authority regarding the enterprise finances. They must be empowered to make immediate decisions to expend capital and other resources necessary to pursue and achieve the goals of the enterprise.

### Management

Much of any enterprise's success, whether for-profit or nonprofit, is tied to the talent, skill and acumen of the managers charged with overseeing the execution of the organization's business and related strategies. There was a

time in nonprofit history when virtually all managers of community-based organizations were social workers who had been promoted into administrative positions or trained in social work administration. For the most part, the presence of nonprofit managers with formal business training and skills was an extreme rarity. While traditional skills in nonprofit administration were relevant to securing government funding or managing community programs, those skills are less relevant in ensuring the success of the nonprofit of the future. The challenge of evolving skilled and committed managers able to address the double bottom-line of both social and financial outcomes remains a central issue for the field of social purpose enterprise.

In recent years, a new pool of nonprofit managers has emerged from three sources:

- ◆ "Evolved" social workers (individuals with a nonprofit background who have worked toward business degrees or have developed relevant business skills in the course of managing their enterprises)
- ◆ Second careerists (individuals who, with five or more years of experience in the for-profit sector, have chosen to accept a position in a nonprofit organization)
- ◆ "Social-purpose" MBAs (individuals who are pursuing graduate degrees with the specific intent of engaging in the community application of business skills and practice).

The combined presence of these individuals in the nonprofit sector creates new standards for professionalism, compensation and expected outcomes and performance.

These individuals are not, however, successful on their own. They require other support in order to successfully guide their social enterprise to achieve its goals. Increasingly, project interns, business analysts and mentors from the business community complement the basic skills these new "mutant managers" bring to the table. With the combined input of both the managers and these outside supports, the overall managerial skill set of the organization is greatly enhanced, expanded and leveraged. Providing networking opportunities for this new breed of social purpose business managers is an important contribu-

tion to be made by those involved in supporting such efforts.

### Marketplace

The issue of market definition and penetration has two core aspects. First, the line between nonprofit and for-profit markets is increasingly blurred. With such major corporations as Lockheed and EDS competing for welfare-to-work contracts and for-profit HMOs taking over formerly nonprofit hospitals, nonprofit managers are confronted with a significantly transformed market environment. This new marketplace entails a new form of competition and necessitates new types of resources if existing nonprofits are to succeed. A full discussion of the issues raised by this transformation of the nonprofit marketplace is beyond the scope of this chapter, yet it must be acknowledged as having a significant impact on the nonprofit organizations active in the sector.

Second, in light of this changed marketplace, there are new challenges for nonprofit organizations. Historically, the cultural worlds of business and nonprofit organizations have been miles apart. Many of those in the nonprofit sector have viewed business people with suspicion. And many of those from the business community believe nonprofit managers have no understanding of the true value of a dollar. While there may be a degree of truth in each community's perception of the other, the success of social purpose enterprises hinges upon the ability of the nonprofit to create meaningful networks into and within the business community. Through the creation of these networks, nonprofit organizations may at least have a chance to be "at the table" when market demand and customer needs are discussed and deals made. Therefore, successfully gaining credibility within the business community is key to the sustainability of social purpose enterprises.

When a social purpose enterprise and its management team are viewed as credible players by those with leverage in the for-profit community, they are able to gain increasing access to the deal stream. Initially this access takes the form of individual sales contracts or other opportunities to provide services or product offerings to for-profit customers. These individual sales lay the foundation for

relationship-building and position the social purpose enterprise to begin developing long-term partnerships with its for-profit corporate counterparts. The goal is to move a nonprofit from the position of being viewed with some degree of distrust ("A business run by a nonprofit could never really be a business") to that of collaborator ("I wonder if that nonprofit can help me deal with..."). While it may seem far-fetched to imagine a nonprofit operating as meaningful corporate partner, the accomplishments of organizations such as Pioneer Human Services (WA), Foodlink (CA) and Minnesota Diversified Industries (MN) serve as role models to managers of emerging social purpose enterprises. These and other organizations are increasingly successful at developing meaningful corporate partnerships and establishing themselves as peers with their for-profit colleagues.

### Capital<sup>4</sup>

Assuming one has a solid nonprofit organization, staffed by competent managers with specific market opportunities, one must then have access to adequate capital to capture those opportunities. The existing nonprofit capital market is driven primarily by foundation and public funding support, and only secondarily by access to mainstream sources of capital such as commercial loans or various forms of equity and equity equivalents. While the public funding stream has changed rapidly over recent years, the private foundation funding stream remains largely unaltered. It is increasingly clear that the nonprofit capital market must alter its approach if it is to be relevant to the evolving work of nonprofit organizations.

In the specific area of social purpose enterprise, many enterprises are significantly under-capitalized. They are often funded with one-time grants, self-financed by the nonprofit or supported by high-cost debt. To have even a modest hope of success, the nonprofit must be able to access additional financial support to adequately cover costs related to growing the enterprise and supporting what are often significant cash flow requirements.

While highly fragmented, the nonprofit capital market consists of a continuum of capital instruments. These instruments include grants, recoverable grants (which

function as no-interest loans), program-related investments (below market-rate loans), various forms of commercial debt (these would include lines of credit and fixed-rate loans) and equity equivalents.

This last area of equity equivalents represents the cutting edge in the field of nonprofit capital development. In the for-profit sector, corporations access capital required for growth through the injection of outside equity investments. Without a nonprofit equity equivalent, and with the public policy trend toward removal of major public support, the social purpose enterprise will be unable to finance the growth of its ventures and programs. Equity equivalents may best be considered as capital investments made available to the nonprofit sector in exchange for both market and non-market returns. Market returns may be gauged with existing financial measurements for return on equity; however, non-financial investment returns require the creation of new social measurements able to calculate a social return on investment. Other chapters of this book address this challenge more specifically.

### Investor Relationships

Success in positioning the nonprofit sector to effectively pursue its social mission will not come through the provision of one-time grants between practitioners and funders. Success will come over time as individuals and organizations develop long-term, multi-year relationships. This long-term relationship will require a shift in the funder's perspective. All resources brought to the nonprofit must not be viewed as charity. Rather, philanthropic and other resources should be viewed as various forms of investment in individuals, organizations and the broader social agenda of the nonprofit sector. The funder must become an investor, and therefore the question of investor practice represents an evolving issue of concern for the field.

In other publications, REDF has described at length various elements of this

investor relationship and will not repeat that discussion here.<sup>5</sup> However, at a minimum, investors should be cognizant of the following aspects of their activities:

- ◆ Risk management
- ◆ Amount of funding
- ◆ Duration/length of relationship
- ◆ Terms of engagement
- ◆ Organizational capacity-building
- ◆ Performance measures
- ◆ Exit strategies and results

Each of these elements has its own complexities and is applicable in varying degrees to all forms of "investment" in the work of the nonprofit sector.

As theories of philanthropic investing continue to evolve, the field is also demonstrating a variety of initiatives that actively engage in this practice. The REDF focuses its efforts in the area of social purpose enterprise creation and support. The Robin Hood Foundation, based in New York City, uses a social venture capital approach to its work with nonprofits pursuing an array of community program and service activities. Social Venture Partners, based in the Puget Sound area of Washington, represents yet a third approach to investing in the work of the nonprofit sector. And The Andy Warhol Foundation, in partnership with other foundations across the country, has recently launched the Creative Capital Fund in an effort to apply such techniques to its support of cultural arts organizations and individual artists. Each of these efforts and others not mentioned represent new approaches to providing resources for nonprofit work that is grounded not simply in traditional notions of philanthropy and charity, but also in investment and stewardship of resources.

## Conclusion

Presently, a variety of debates are taking place within both the philanthropic and nonprofit communities concerning whether the historic approaches to philanthropy should be carried into the future. The point, however, may be less one of whether or not past approaches work in today's environment. Rather the question at hand is what aspects of traditional philanthropic practice are truly relevant to the present market conditions and how the field of philanthropy may best develop other approaches to sustain investments made in past years. It is clear that while philanthropic efforts of the past were not "wrong," other approaches must be created to respond to changed circumstance and new demands. The most challenging question for the sector is whether or not the nonprofit community and its supporters have the ability and willingness to question the

fundamentals of and core approaches to the execution of its work.

This change process will not happen in the course of a single initiative, organizational retreat or revised mission statement, but it will evolve over time as various players respond to both their changed environment and their evolving vision for the future. Regardless of whether an organization chooses to operate a social purpose enterprise, the successful nonprofit of the future will need to effectively balance the tension between external demands for change and internal pressures for both change and stasis.

This chapter has presented five challenges confronting the nonprofit sector as it moves through the process of reassessment and revision. Time will tell how effectively the community will respond to this demand for thoughtful reflection and meaningful transformation.

**Footnotes**

- 1 While there are numerous works on this topic, of particular note are: “Enterprising Nonprofits,” Gregory Dees, Harvard Business Review, January/February, 1998; “The 21st Century Nonprofit: Remaking the Organization in the Post-Government Era,” Paul Firstenberg, The Foundation Center, 1996; “The Organization of the Future,” and “The Community of the Future,” Jossey-Bass Publishers, 1998.
- 2 New Social Entrepreneurs: The Success, Challenge and Lessons of Non-Profit Enterprise Creation, 1996, and “The REDF: Implementing a Social Venture Capital Approach to Philanthropy” (a case study published by the Graduate School of Business at Stanford University).
- 3 The process and challenges of developing appropriate MIS/operating systems are discussed in further detail in Chapters 4 and 6.
- 4 “The Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and Funding Instruments,” an analysis of the nonprofit capital market, is found elsewhere in this book.
- 5 Please see Chapter 1 “The REDF: A Case Study on Venture Philanthropy.”