

USC Price School of Social Policy Presentation:
Rick Aubry, Ph.D.
Tulane University
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Challenges to scaling Impact in Social Enterprise:

An overarching theme of the USC Price conference is to identify ways that social innovation and social impact can be “scaled” so that local innovations which show promising results can increase their impact on the underlying social problem they were created to address. This challenge of scale is relevant to initiatives labeled social entrepreneurship which are often started locally as an alternative to the standard system of social equilibrium in need of change.

The term social entrepreneurship encompasses many activities that don’t necessarily involve the creation of social businesses. This paper will focus on the challenges of scaling the specific form of social entrepreneurship associated with the creation of a business venture whose primary purpose is to create a social good. However, it is initially important to define and identify the larger domain of social entrepreneurship to contextualize such efforts and to not limit the academic understanding of the field to just social ventures.

Social Entrepreneurship writ large can be understood from its linguistic derivation from the general economic term entrepreneurship based on the classical academic definition of Joseph Schumpeter. While colloquially the word entrepreneur is ascribed to anyone who chooses to open a business the more precise, and our working definition of a “true” entrepreneur, and by extension the social entrepreneur, is someone fundamentally engaged in the process of creative destruction of the existing way of doing business. As Greg Dees the seminal writer on social entrepreneurship reminds us in his framing paper for the field, harkening back to Schumpeter,

“He (Schumpeter) described entrepreneurs as the innovators who drive the “creative-destructive” process of capitalism. In his words, “the function of entrepreneurs is to reform or revolutionize the pattern of production.” They can do this in many ways: “by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on.” Schumpeter’s entrepreneurs are the change agents in the economy. By serving new markets or creating new ways of doing things, they move the economy forward.”

” (J. Gregory Dees, the meaning of social entrepreneurship 2001).

In the realm of social entrepreneurship, the goal is to create social value rather than economic value. Thus the social entrepreneur is creating increased social value by applying resources in a new way to increase the social impact. An example of a social entrepreneurial effort which has no social venture at its core that has achieved a measure of scaled success is teach for America. The founder, Wendy Kopp, saw the problem of education inequity as a huge market failure challenge. Her hypothesis was not that there was money to be made selling a new kind of textbook or opening new schools, but rather that a highly valuable asset in the Country could be better applied towards the education challenge. Talented recent graduates of the best Universities whose abilities and careers were oriented towards banking and consulting could be redirected towards the education challenge if an innovation could be put in place. As an entrepreneur she saw that by applying this valuable resource (smart young recent college grads) in a dramatically different way towards the education inequity challenge she could help create a disruptive innovation to the problem. To achieve this, she had to change the market place for this asset by making a teach for America job of greater value than working on wall street or for a consulting firm. By utilizing the attributes of an entrepreneur of gathering the necessary resources, taking huge but calculated risks, and inspiring others to work with her she created the fastest growing US nonprofit of the last 20 years. The core success of teach for America is not that a 2-year recent college graduate teacher core is better than experienced teachers, but rather that by engaging and leveraging future leadership talent and engaging these future leaders in helping solve the US education inequity challenge greater awareness, resources and national priorities will be effected. The valid criticisms of teach for America tend to focus on the two year teaching terms: what is overlooked in academic evaluations of the effectiveness of TFA is the huge impact the “alumni” of the teaching core has had on making education improvement a national priority.

With this example as a context for how social entrepreneurship is much broader than social venture creation, we return to the particular conference panel focus on social enterprise, particularly within the context of nonprofit organizations using a venture to scale their impact. The goal of this paper is to focus an analysis of the “on the ground” challenge of scaling a social venture within a nonprofit organization. Based on evidence to date, it may be the case that while an effective intervention for improving local impact, social ventures face operational contingencies that call into question the “scalability” opportunities of this strategy for.

Nevertheless, this paper is meant primarily to offer concrete advice and caution to organizations considering a social venture as the means to scale their impact. No

comprehensive analysis of social ventures in the aggregate is proffered so the conclusions beyond the individual case analysis is for a future study.

THE SOCIAL VENTURE IN A NONPROFIT HOST ORGANIZATION:

A “social enterprise” or “social venture” is an entity that generates revenues—and hopefully profits—while advancing a social mission. Hence, this term applies to all nonprofit earned income strategies, but can be also more widely, including describing mission-led for-profit companies.

There are two basic forms of earned income strategies. One entails earning revenues not directly related to a nonprofits mission or core activities. For example, a restaurant located in an art museum, or the sale of candy bars, holiday cards, or other third party items. While these may generate income, the activity does not directly advance the mission or purpose of the organization.

The second form of earned income is a revenue generating activity that inherently furthers the mission. Think of a homeless shelter that creates jobs for clients by starting a business, or a group that has developed a new system to help at-risk students graduate that creates and sells software based on that method in an effort to scale its efforts and generate funding. The point of view of this presentation is that most nonprofits have limited resources, most critically the time of the leadership and that since nonprofits often have to make resource constraint decisions, when an earned income strategy does not directly advance the mission, it’s often a distraction and should not be pursued

Because a Social enterprise is usually a departure from business as usual in a nonprofit, it has been observed by this author in numerous cases that the pre conditions for success of the enterprise are highly correlated with the likelihood of long term success. The “champion” for the enterprise must devote significant upfront time to do whatever it takes to get buy-in and support from several key actors within the organization before getting started. A deeply supportive environment within the organization is essential for the venture to succeed. Part of this is clarifying, in advance, that running a successful social enterprise is more complicated than operating a traditional nonprofit or business, (because of the dual motivations) and that it may not succeed. It’s also about securing the full commitment of senior management and board, ensuring they see this venture as a core asset of the organization. Most nonprofits are resource constrained with numerous competing needs for limited resources. Further they exist

to advance a social mission, not run a business. During the inevitable downturns and headaches, the venture will require resources to succeed, and during the first few years, it will require a lot more investment than it returns.

Part of what's required to ensure this success initially and moving forward is a focus on asking, and answering, what success looks like; social ventures require a robust set of metrics to evaluate both social impact and financial success, often referred to as a "double bottom line." These key performance indicators (KPIs) are especially important for earned income strategies, since you'll need to benchmark the impact against traditional approaches to assess success. For example, if the goal is creating jobs for those with barriers to employment and the social venture invests \$500,000 annually and only creates three jobs, the nonprofit is likely better off expanding its nonprofit programs or pursuing other approaches.

Another critical lesson learned from studying the success and failure of numerous social ventures is that the parent nonprofit has to have a realistic assessment of the risks involved. As with any new business, success with a startup is extremely difficult. Most studies indicate over 60% of small businesses fail within the first four years. If the goal is simply to increase income for the organization, most nonprofits are best served focusing on traditional fundraising or investing the resources in more traditional and safer investment vehicles. Funding, launching, and managing a social enterprise requires lots of work, and many don't make it. That said, if you decide the potential mission and revenue benefits are worth the risk, here are suggested tips and strategies to maximize the probability for success.

The plan for the best and prepare for the worst homily applies for social ventures. The champion within the organization must work with the governing board about a "realistic time horizon" for the venture to reach breakeven, and clarify the exact limits to the organization's patience and support in advance—in terms of both money and time—should things take longer to get there and require more resources, as they inevitably do. Putting the programs at risk for a venture that might not succeed will prove unacceptable to the board at some point, and it's best you identify this risk tolerance ahead of time versus in the moments of crisis. When preparing for "plan B," take into consideration that tight times in a business environment are different than those at a nonprofit. If a grant is cut, you can reduce staff or programs to stay on budget, but if it costs more to make a biscuit than the budget projected, you can't just eliminate the ingredients. In planning for a social business it will take time to learn about business-focused cost accounting, production management, and sales forecasting which are usually not part of the nonprofit accounting skillset.

All these key elements, along with conservative financial projections, a market survey to support those estimates, a list of strong leaders, including executives and advisors, a detailed strategy and timeline, a detailed competitive analysis, and a strong but concise executive summary must find their way into a compelling business plan, approved by the board.

Before an organization can think further about diving into earned income, it's critical that a zealous, empowered entrepreneur that is committed to the venture as an all-encompassing job for at least the first several years is on board. Savvy startup investors will tell you that the credibility and dedication of the management team is even more important than the business model, and having a champion to spearhead the efforts—ideally with ample, relevant industry experience—will be one of the biggest factors determining the success.

To find the right leader, a nonprofit must look for what social enterprise pioneer Jed Emerson calls, “the mutant manager.” (Emerson, the new social entrepreneur 1996) Look first and foremost for a deep experience base in the specific business or industry chosen, a clear commitment to the social mission of the organization, and the ability to work well with the leadership team of both the nonprofit and the business.

Under almost all circumstances observed by this author, it has not been wise to promote the best nonprofit manager at the organization to run a venture if they lack relevant business experience. The requirements for success in a business environment are fundamentally different. Instead, finding leaders from the industry who are ready to devote the next phase of their professional life to advancing the social mission through the business has been observed to be the most successful strategy. Often, mid-career executives are eager to apply their skills and industry knowledge to a business that offers both purpose and profit, and this is the typical profile of the successful social venture CEO.

To recruit someone like this, while an organization may be able to secure a small discount off corporate salary potential, but usually not a significant one and not something that should be the key expectation. Developing an operating budget for a competitive compensation package that's in line with salaries at comparable for-profit businesses is a more prudent approach. Another observation has been that an organization needs to allocate time and resources into successfully integrating someone from the for-profit sector into a nonprofit environment, with its unique culture, focus, and pace. Rob Waldron, a successful for-profit CEO who became CEO of the nonprofit

Jumpstart, reported “I feel like I have moved from being a general in the army to a member of the Senate. In for-profits I gave a direction and people jumped to it. In the nonprofit I have stakeholders, various interest groups, a whole different culture and I have to lead through persuasion rather than through authority.”

For the social enterprise to succeed, an organization must find and take advantage of the whatever unique and inherent competitive advantage exists in the particular nonprofit. What are the abilities and competencies that make organization best positioned to solve the social problem the organization was created to address? Does the nonprofit have a strong relationship with the community served compared to traditional businesses in the space, and how can these benefit the venture? Do they have a way of providing services more effectively or efficiently? Can they leverage the physical locations in some unique way? Have they developed a unique way of addressing a problem that would be hard for others to copy without significant time and resources? Do they have team members with talents or expertise others don't? Would the nonprofit's reputation translate well into a social venture? An organizational analysis of the existing and the unique advantages, with particular time spent in asking clients and potential customers how they perceive the organization will help identify these competitive advantages.

This process may bring to light advantages so significant, they provide one of the few exceptions to the rule that you should only pursue social enterprises that directly advance the mission. For example, a museum with a great location can realistically generate significant revenue from a restaurant. If the nonprofit is lucky enough to have a unique geographic advantage, there may be an earned income strategy worth undertaking.

Ultimately, the competitive advantage will translate into the actual delivery of products and services. That's when it's crucial to remember that simply offering “a worthy cause” in the marketplace is not necessarily a competitive advantage. Typically, customers don't primarily buy to support a cause, but to get the best value. In study after study of customer behavior, any social benefits associated with a product or service are a tertiary consideration, after quality, and then value and dependability. All other things being equal, many will choose the conscious option, but, as Carrie Portis, a former general manager of Rubicon Bakery reported to the author, “Our Rubicon Cakes have to be the best cake in the dessert case, not the best nonprofit cake.” There are some rare circumstances where the social purpose of the venture will prove instrumental, such as government “set aside” contracts. For example, the Javits Wagner O'Day law carved out US federal contracts for organizations that hire disabled workers. Keep an

eye out for such opportunities, and if appropriate, lobby to advance policies that create additional ones.

Even with the right leadership, business idea and plan, and internal support in place, finding and securing sufficient capital is both critical and difficult. Social ventures often suffer from undercapitalizing the business at the beginning. No matter how conservative the business plan, more financial and other resources will be needed than you originally anticipate.

Typically, it will take more than twice as long to achieve the most conservative revenue goals projected in the financial model, so plan for that when setting the fundraising goal, or ensure the ability to deficit spend if needed. Expenses also almost always run high, so budgeting for unexpected “miscellaneous” costs of 25% in the budget is prudent.

When it comes to identifying investors for the social enterprise, there’s good news, and bad news. The good news is that although traditional sources of startup capital will likely be unavailable, there’s a movement around “impact investing,” where people and institutions are actively looking to support social ventures. The bad news is it’s still relatively small, so time and costs will need to be allocated for securing funds from this community.

“Social capital market” is a term widely used to describe grants, loans, program or mission related investments, equity, and other financing tools to support nonprofit and for-profit social ventures. Here, funds are made available by foundations, government agencies, corporations, and individuals, known as “impact investors” or “social investors” seeking both financial returns and social impact, typically with a focus on the latter. This so called market, however, is not well coordinated, but it generally describes the universe of capital sources for nonprofit social business since typically an organization cannot issue equity or ownership in the nonprofit’s business. To start a social enterprise an inordinate amount of time raising money is required compared to a small business startup. By many estimates, traditional businesses invest 3-5% of leadership time raising funds for the venture, with the rest devoted to making the business work. The nonprofit should expect to spend 20-50% of its leadership time raising money, a significant distraction from the actual work of the organization.

After spending decades analyzing the formula of success for the most prosperous social enterprises, most of them had an “angel” customer or investor that made all the difference and got them off the ground. Emblematic of this “angel” relationship with a

social business is Greyston Bakery in New York which has a crucial partnership with Ben Cohen of Ben & Jerry's Ice Cream. Ben and Jerry's agreed to use their brownies and other products as an ongoing and core part of their sourcing. As you can imagine, for a small startup this was transformative, yielding a huge, steady customer in the early years that even made a long-term commitment to purchase from Greyston at sustainable prices. Although it's a long shot for the scrappy startup to score this kind of partnership, it is a common indicator of success amongst the handful of "successful" social ventures.

More common than the magical appearance of an angel the pitfall the startup social enterprise needs to avoid: the investor or board member that pushes you too far, too fast. A 20-year-old, successful social venture nearly went bankrupt when the overly ambitious growth plan it developed in partnership with a foundation led it to the brink of financial collapse. They lost over \$2 million dollars of foundation funding and bank debt trying to implement a business plan that wasn't adequately tested, and when the business crashed and burned, the parent nonprofit shrunk overnight from a budget of \$8 million and 150 employees (mostly hard-to-employ workers) to a budget of \$2 million and 30 staff. Remember to know the limits since businesses come and go, and in the for-profit world, it's primarily the capital that's lost. In the nonprofit world, if you're not careful the entire social benefit organization is at stake.

CONCLUSION

Many nonprofits look for additional revenue sources to supplement their income. A social enterprise that accomplishes this looks enticing, but it's something that must only be undertaken with the proper consideration and commitment. That includes a realistic analysis of the risks, rewards, true costs, impact on the parent nonprofit's culture, and core competitive advantage. It's hard to make any blanket statements in the world of business, but one thing is for certain: go into it with eyes open. On the plus side, a successful social enterprise not only supports work financially, it can also advance the mission and creates a "halo" effect with funders and the broader community. Balancing the mission with the business goals is the critical element in any social business success.

While this paper primarily evaluates the operational challenges of creating a social venture in a nonprofit environment, it suggests that further research evaluating on an aggregated basis the overall "scalability" of social ventures writ large. Because of the burgeoning number of such ventures, and the interest on the part of funders and organizations to evaluate effectiveness, future research is suggested.