The Roberts Enterprise Development Fund: A Case Study on Venture Philanthropy

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Introduction

In recent years, the traditional approach to foundation practice has undergone significant changes. The response of the philanthropic community to "Virtuous Capital: What Foundations Can Learn from Venture Capitalists," a *Harvard Business Review* article published in early 1997, reflects the extent of these changes. The article contrasts venture capital investment practice with that of mainstream foundations, many of which refer to themselves as "the venture capitalists" of the nonprofit sector. In the foundation community, there has been a growing interest in applying some of the venture capital approaches described in the article to the field of philanthropy. And indeed, the term "venture philanthropy" is increasingly used to describe the work of various foundations across the country.

In 1998, based on the evolution of its work since 1990, The Roberts Enterprise Development Fund (REDF), a philanthropic venture of The Roberts Foundation, released a case study through the Stanford Graduate School of Business. The case, "*The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy*," details the foundation's experience of applying venture capital practices in its philanthropic support of a portfolio of nonprofit organizations running social purpose enterprises in the San Francisco Bay Area. In this case, the authors Emerson and Tuan described the changing nonprofit and philanthropic marketplaces, the evolution and application of a social venture capital approach to philanthropy at REDF, and the limitations, challenges, and general applicability of social venture capital practice in the field of philanthropy.[1]

While many aspects of implementing a social venture capital approach to philanthropy remain relevant since the case was published, REDF's approach to venture philanthropy and understanding of the challenges and lessons learned have continued to expand and evolve. REDF is committed to an ongoing process of evaluating and assessing its approach and to sharing these learnings with the broader community. This document details these further reflections and references recent REDF papers that discuss, in a more comprehensive manner, aspects of REDF's lessons learned.[2]

Background on The Roberts Foundation

The Roberts Foundation is a private family foundation located in San Francisco, CA. George Roberts, a founding partner of the leveraged buyout firm Kohlberg Kravis Roberts & Company, established the foundation in 1986. The Roberts Foundation pursued its initial philanthropic strategy from 1990 to 1996 through its first grantmaking vehicle—The Homeless Economic Development Fund (HEDF). The HEDF's goal was to support a variety of efforts by nonprofit organizations to expand economic opportunity for homeless individuals. The strategy funded programs in three areas: increased accessibility of traditional job training programs for homeless people, self-employment for homeless women, and the practice of nonprofit-run enterprise. Foundation staff and trustees, after evaluating the HEDF's experience in these areas, decided the greatest program impacts were in the area of social purpose enterprise. Over the years, the Foundation increasingly focused on the strategy of social purpose enterprise while it decreased and eventually eliminated its funding of other approaches to homeless economic development.

By the time the HEDF was dissolved at the close of 1996, the Foundation had made grants in excess of $6 million to over 40 nonprofit organizations in the greater San Francisco Bay Area. In September of 1996, the Foundation published a report on its work entitled *New Social Entrepreneurs: The Success, Challenge and Lessons of Non-profit Enterprise Creation*, a 400-page document which presented an open, comprehensive discussion of the Foundation's work and an assessment of its outcomes.[3]

The Creation of The Roberts Enterprise Development Fund: Rationale and Strategy

The first major finding of the HEDF initiative was that, contrary to mainstream opinion,nonprofit organizations could successfully plan, launch and manage profitable, market-based enterprises while simultaneously providing employment and training opportunities for formerly unemployed individuals. This was an important finding in light of the history of failure experienced by many practitioners in the field of job creation and business development over the past 30 years. While there have been individual success stories of nonprofit-run enterprises across the country (Pioneer Human Services in Seattle, New Community Corporation in Newark, NJ among several), there has been little evidence that a group of nonprofits in a single geographic area can achieve success. The Roberts Foundation is committed to building the capacity of not one but a portfolio of nonprofits within a limited geographic region with the goal of producing successfully run social purpose enterprises.

The second major learning from HEDF was that the success of these social purpose enterprises rested largely on the provision of extensive support in addition to financial assistance in order to pursue both financial profitability and a social mission.[4] Foundations have traditionally shied away from funding the organizational capacity of nonprofit organizations and have operated at arm's length from the nonprofits. In contrast, The Roberts Foundation is committed to providing a portfolio of nonprofits with the necessary resources and building their capabilities to successfully execute social purpose enterprise business strategies.

Based on these two significant learnings from HEDF, The Roberts Enterprise Development Fund was launched in January 1997 as a social venture capital fund with a small portfolio of nonprofit organizations, each of which was running businesses to employ individuals who exist at the margin of society. A detailed description of The Roberts Foundation's evolution from a more traditional approach to philanthropy, in the early years of HEDF from 1990–1993, to HEDF from 1994-1996, to REDF in 1997 and beyond can be found in REDF's "The Challenge of Change" paper released in February 1999 and also included in this book.[5]

Whereas HEDF's mission was more narrowly defined to assisting social purpose enterprises, the mission of REDF is to:

> ***Raise the standards of excellence and integrity in the nonprofit and philanthropic community nationwide through the development and dissemination of innovative approaches to address critical social issues.***

The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy

The REDF approach to a social venture capital practice involves investments in a portfolio of seven San Francisco Bay Area nonprofit organizations. These "investee" organizations benefit from a number of core financial investments by REDF in human capital as well as a number of additional components. These components include:

- Capital grants for the business,
- Targeted business analysis and assistance,
- Involvement and partnership with REDF through Venture Committees,
- Organizational capacity-building through Farber Interns and Farber Fellows Programs for MBA students and graduates,
- Business networking through the Partners-for-Profit, and
- Access to and training in the use of technology and outcome measurement. [6]

Core Investments

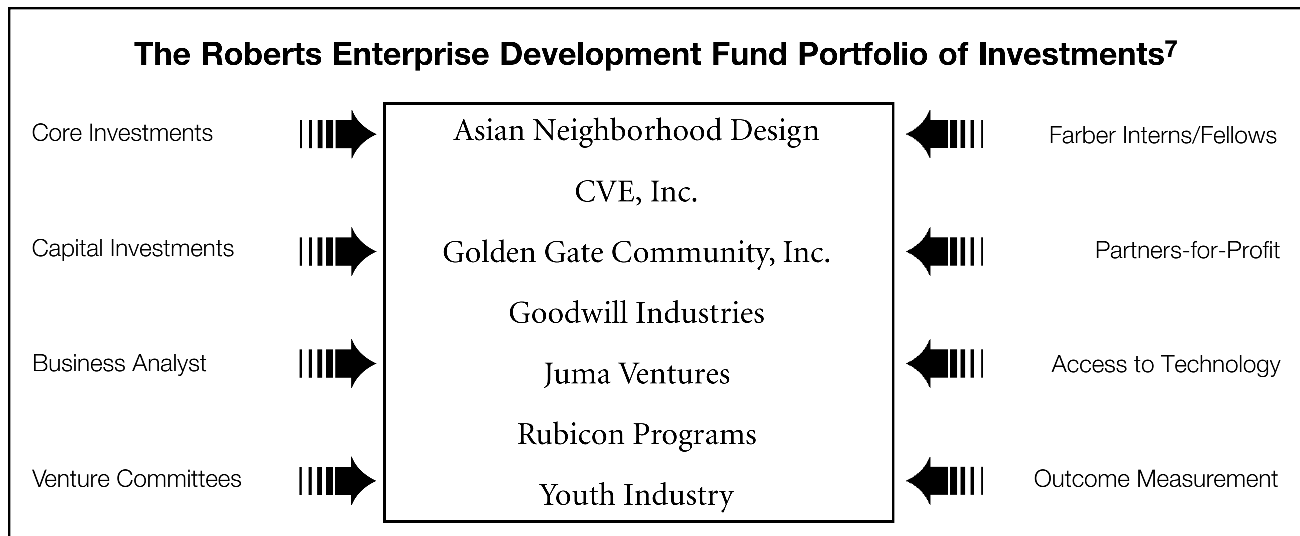
The core financial support received by each organization in the portfolio comes in the form of an annual capacity-building grant ranging between $100,000 and $125,000. This grant enables the nonprofit to hire an enterprise manager and invest in the human capital required to develop and oversee the execution of a business strategy as articulated in their 3-5 year business plan.

Capital Investments

The Fund provides additional financing as dictated by each enterprise's business plan and augments that financing with other charitable investments provided by individuals, corporations and foundations interested in supporting the enterprise development goals of the Fund. The Fund also makes available a range of other capital resources through a mix of grants, recoverable grants and networking opportunities to secure low-interest loans from both commercial and nonprofit lending institutions.

Business Analyst

REDF has partnered with Keystone Community Ventures, a local technical assistance organization specializing in nonprofit business development, to assist the manager and Venture Committee in running the



enterprise(s). Keystone Community Ventures was launched in 1993 with planning grants from The Roberts Foundation and has had a long history of collaborative work in this area. The business analyst is involved in analyzing the strategic position of the business, critiquing the venture's business plan, evaluating the business' financial statements (both actual and pro forma), and providing an objective evaluation of the business. The business analyst *directly* assists management in conducting the analysis and assists the managers in developing *their own* skill set in order to assure that knowledge transfer occurs and the future capacity of the organization to effectively manage the venture is developed.

Venture Committees

The Venture Committee consists of representatives from REDF, the nonprofit executive director, the enterprise manager, and, as appropriate, a Board member from the investee organization. This group is sometimes joined by an individual with direct expertise in the industry sector of the enterprise. Together, the committee meets monthly to review financial and operational performance, identify areas of concern, and help ensure that these concerns are addressed in accordance with the enterprise's business plan.

Farber Interns and Farber Fellows

REDF, in partnership with The Phalarope Foundation and Students for Responsible Business, established the Farber Interns and Farber Fellows programs to leverage the talent of business school students in support of investee organizations. The Farber Interns and Fellows are named to honor Michael E. Farber, who passed away in 1996. During his tenure at Rubicon Programs from 1989 to 1996, Mike helped chart out the growth and expansion of two of Rubicon's enterprises, Rubicon Buildings & Grounds and Rubicon Bakery. The presence of a summer Farber Intern or year long Farber Fellow rounds out the Fund's efforts to enhance the capacity of its portfolio organizations in the effective management of their ventures.

Partners-for-Profit

Partners-for-Profit (PFP) was created to address the enterprises' need for direct market access. The initiative is a *focused* working group of Bay Area business leaders representing a variety of industries. PFP provides REDF investees with one more level of analysis and assistance. In addition to providing advice and guidance to investees, PFP members assist in connecting enterprise managers to professional networks within their industries and target markets. Finally, PFP provides opportunities for the hands-on involvement of business people interested in making a meaningful and direct contribution to the process of social purpose enterprise creation and expansion.

Access to Technology

REDF has equipped each enterprise, on a limited basis, with the basic hardware and software necessary to gain access to the web and communicate via e-mail. REDF partnered with CompuMentor, a San Francisco-based nonprofit computer consulting organization, to build a private web site for the REDF Portfolio and organizations and to train all the nonprofit managers in accessing the web and using e-mail. Additionally, REDF has contracted with Dayspring Technologies to develop custom databases for each organization to track social indicators and provide managers with training on how to use and build upon them

Outcome Measurement

Rather than implementing traditional evaluation methods, REDF, in partnership with its investees, developed and launched a web-based information system called "WebTrack" which was custom designed using standard business MIS tools. REDF contracted with BTW Consultants to work with the enterprise managers in developing indices of operational

and social outcome success against which future performance can be measured. Over time, BTW Consultants will be building each organization's capacity to conduct its own social outcome studies. "WebTrack" will enable enterprise managers and REDF to track monthly performance on both economic *and* social terms[8] for the duration of the five-year initiative. This work will result in a system through which each organization can assess and adjust its social impacts in a meaningful and timely manner. It also creates the framework for analyzing the Social Return on Investment (SROI) on each enterprise and the REDF portfolio as a whole.[9]

Each of these components of the REDF venture philanthropy practice has evolved over time—and REDF is continually seeking to improve the support it provides to its portfolio of nonprofit organizations. There are many ways in which each of these components relates to standard venture capital practice.

The chart on the following page from the Stanford case on REDF summarizes the differences between venture capital and traditional foundation approaches across seven relevant areas of practice.[10] The fourth column provides examples of how REDF is applying a venture capital approach in each of these areas.[11]

While there are clearly many similarities between venture capital practice and REDF's venture philanthropy approach, there are also significant differences that should be highlighted in several of the categories.

Risk Management

Most venture capitalists look to build a portfolio to minimize their risk and maximize their total return on investment. While venture capitalists certainly end up backing many risky investments, they are clearly not looking to fund businesses that have a high likelihood of failure. By contrast, REDF's approach is risky by design and limits financial returns. The purpose of the REDF portfolio enterprises is to employ individuals that private sector companies have already fired or would never hire. And often, businesses with jobs appropriate for people with little or problematic work experience are in industries with low profit margins. REDF expects that at any given time, 70% of the enterprises in the portfolio will be profitable (or if losing money, doing so according to plan), while 30% will be losing money at greater rates than planned. REDF is willing to tolerate more business performance risk as a necessary tradeoff of employing its target populations.

REDF's approach to social venture capital is also different in that REDF invests in nonprofit organizations with the capacity and capability to run social purpose enterprises that may be at different stages of development across a variety of industry sectors. By contrast, the typical venture capital firm invests in a portfolio of companies at similar stages of development in a single industry. For example, in 1999 the REDF portfolio consists of 23 different businesses in a range of industries from furniture manufacturing to retail to food services. These businesses are at various stages of development, ranging from start-ups to more mature businesses of 10 years plus. This necessarily increases the complexity of managing such a portfolio and requires a different skill set on the part of REDF's management.

Amount of Funding

Many venture capital firms fund start-up businesses in their entirety or have a majority stake in the investment with other, lesser investment partners. REDF does support a majority of the social purpose enterprises' financial needs for start-up and ongoing operations; however, the social purpose enterprise is usually just one program of an entire agency whose funding needs far exceed that of the enterprise. This makes for an interesting tension in REDF's work—similar to what would happen if a venture capitalist only funded one division of an existing company, to the exclusion of the other divisions. A further discussion of this can be found in the "Lessons Learned" section that follows.

Relevant Practice	Venture Capital	Foundations	REDF Approach
Risk Management			
	High degree of shared risk Funds are lost when projects fail	Low risk for foundation High risk for nonprofit organization (NPO) Funds themselves not at risk (must be spent)	High Managerial risk management through Business Analyst, Farber Interns/Fellows. Enterprise and Organizational risk management through portfolio diversification
Amount of Funding			
	Substantial commitment to provide significant capital and to help raise additional current and follow-on capital	Partial commitment – will provide small part of total needed capital. NPO management must continue fundraising independently.	Significant Core and Capital Investments Support in fundraising efforts through networking on enterprises' behalf
Duration/Length of Relationship			
	5-7 years Linked to success	1-3 years Arbitrary	Minimum five-year horizon for Initiative
Terms of Engagement			
	Joined at the hip Small portfolios Partnership	Arm's length Large portfolios Oversight	Input into management of enterprises through venture committee structure Small portfolio (7 organizations)
Organizational Capacity Building			
	Funding to build capacity to successfully execute business plan	Funding primarily for programs not personnel, infrastructure, overhead	Funding for organizational capacity: human capital, overhead, capital requirements, technology, etc.
Performance Measures			
	Clearly defined rewards and risks for all	Funder: reward is in grant-making NPO: reward is in outcome	Social Return on Investment analysis (SROI)
Exit Strategy			
	2 stars, 2 failures, 6 walking dead or wounded	"Myth" of government take-out. Burden on nonprofits.	Portfolio decreased from 10 to 7 between 1997 and 1999. Philanthropic, market, and commercial exits
Results			
	1% of capital for all start-ups but 30% of companies that reach IPO stage	Harder to know. Not quantified. Same potential to support organizations to scale?	Social Return on Investment Reports, Agency and Enterprise Specific and Portfolio-Wide (SROI)

Exit Strategies

As described in the Stanford REDF case, the investment philosophy of REDF identifies several levels at which an exit strategy may be executed. The first is within the organization itself. REDF funds may be initially applied to a planning process and later transferred to support the capitalization of a venture. This transfer represents a graduation of funds to progressing stages of business development. Second, as the venture is increasingly successful, other foundations or sources of funds may be brought into the capital structure. This effectively decreases the percentage of REDF funds present, which in turn limits REDF's exposure. Third, as the enterprise continues to establish itself in the market, REDF funds may be replaced by market-based capital in the form of commercial lending and other resources. And finally, some businesses are now able to support all of their expenses internally, through sales revenues. Each of these levels represents a different exit strategy as REDF's funds are moved to increasingly "higher" purposes and eventually out of the capital structure all together.

A key issue in assessing exit strategies is how to determine the return on investment in the social purpose enterprise. A detailed discussion of REDF's approach to quantifying a social return on investment (SROI) can be found in a companion chapter in this book.[12] However, it should be acknowledged that for the philanthropic investor, exit strategies will most likely not look like more typical "take-out" strategies in the for-profit sector. Rather, exits may occur as a result of funding by other investors or commercial lending institutions, resulting from the achievement of operational goals and social impacts.

As the nonprofit sector achieves greater capacity to document these social impacts, public and other types of funding may be put in place to reward nonprofits for their social outcomes. This shift to outcome funding may lay the foundation for creating actual revenue streams to support the work of the nonprofit sector, providing further opportunities for initial "investors" to exit their capital and apply it in other areas of interest.

Other Differences Between Typical Venture Capital Practice and REDF's Approach to Venture Philanthropy

In addition to the areas listed above, there is one other significant area in which REDF's practice differs from traditional venture capital practice. REDF staff allocate their time quite differently than the typical venture capitalist. Many venture capitalists spend much of their time looking for "deal flow" and less of their time on actual management of the businesses they are invested in. In contrast, REDF staff spends over 90% of their time managing the portfolio enterprises and virtually no time looking for new investments outside the current portfolio. REDF focuses its efforts on expanding the existing enterprises and identifying and exploring business development opportunities for the seven nonprofit agencies in the existing portfolio. The result has been that although the REDF portfolio decreased from ten to seven nonprofit agencies from 1997 to 1999, the number of social purpose enterprises in the portfolio actually grew from 22 to 23 during the same time period.

REDF's Lessons Learned as of 1999

REDF staff continues to learn from their mistakes and successes. "The Challenge of Change: Implementation of a Venture Philanthropy Strategy," a presentation of the Fund's lessons learned from 1997–1998, included the following learnings:[13]

- The central importance of a donor's commitment to supporting an honest grantmaking process grounded in integrity
- The challenge of building genuine trust in philanthropic relationships is more difficult than many would like to believe
- It takes time to create a meaningful venture philanthropy practice
- There is a fundamental power imbalance present in funding relationships. Rather than attempting to deny or gloss over that fact, it is better to simply acknowledge it up front and find ways to work more effectively together with respect for the power each player brings to the partnership
- Both investee and funder must be open to learning new lessons and understanding how they must transform themselves to maximize the benefits of evolving relationships in a new market place. This responsibility rests equally upon both parties and is not simply the responsibility of the grantmaker

Since the "Challenge of Change" paper was written, REDF has reflected on several other significant lessons and feels these are important for the philanthropic community to understand and consider applying in their own explorations of venture philanthropy. Key areas include issues such as:

Whether to Take a Seat on the Nonprofit Organization's Board of Directors

Several newer foundation initiatives have presented a venture philanthropy strategy in which the foundation officer would take a seat on the nonprofit's Board. Proponents of taking a Board seat have argued that doing so will enable them to participate directly in the organization's decision-making process and possibly exert authority over the nonprofit's activities specifically as it relates to oversight of management. REDF has intentionally decided against such a strategy for a number of reasons.

First, REDF views all its work as a form of investment in the capacity building of the nonprofit sector. REDF believes nonprofit organizations should be "owned" by the communities of which they are a part. When Foundation trustees originally began pursuing a more engaged approach to grantmaking, they discussed whether the foundation should create a development corporation to pursue its goals or, perhaps,create an operating foundation to protect its vision over the years. The conclusion was made that while those were certainly viable options,the primary intent of the Foundation was to enhance a community's own capacity to pursue its vision of social purpose enterprise creation. If the Foundation were to take a direct seat on the board of its funded nonprofits, it was feared the presence of the foundation might in some ways threaten or distort the community authority of the board of directors.

Second, while nonprofit boards play a critical role in steering the course of an organization, most boards are significantly removed from the key operational and day-to-day decision making which makes for success or failure in social purpose enterprise development. As opposed to being in a board role to receive reports from staff,REDF wanted to be directly engaged in the internal debates and discussions of practitioners. While an organization's board and staff must retain decision-making authority, REDF has found that greater input and perspective are leveraged at the operational as opposed to policy level of an organization. Accordingly, REDF has opted to play its role at that level.

Finally, while many foundations may feel their authority is best exercised at the board level,a board seat with its single vote does not really provide the venture philanthropist with the degree of control many might hope for. In the REDF experience, it is not through the

ability to vote that an investor really exerts authority, but rather through guidance and influence as options are discussed and decisions made. In sum, REDF believes partnering with the nonprofit and the managers of its social purpose enterprises can best be accomplished through developing a relationship built on mutual trust created over time. The existing power dynamic between foundations and grantees is already largely distorted by virtue of the investor/investee relationship. This power dynamic could be further distorted by taking a Board seat. Having influence over the direction of the enterprise as opposed to exerting authority is where REDF believes a more significant contribution may be made.

The Importance of Nurturing the Communication Process By Creating Different Levels of Communication Between the Investor and Investee

REDF's management team is made up of REDF's Executive Director, Associate Director, the Business Analyst, Social Outcomes Consultant, Technology Consultant and SROI Analyst. The diversity of the personalities, communication styles, and expertise of each individual represents opportunities for communicating with portfolio members with even greater diversity. In REDF's monthly management team meetings,sensitive issues regarding relationships with portfolio members and individual enterprise managers or nonprofit executive directors are discussed. A diverse management team allows REDF to communicate with and engage investees in a coordinated yet individualized manner.

Over time, REDF has learned that certain members of the management team are more effective at communicating certain types of decisions, asking tough questions, or providing the necessary verbal support and encouragement to the many different individuals responsible for the evolving success of the portfolio's social enterprises. Time and again, REDF has observed that nurturing relationships through constant and consistent communication is key to the success of the Initiative. Managing REDF's overall communication with investees has been and continues to be both more difficult and more important than REDF staff had initially appreciated.

The Value of Creating Flexible Funding Instruments

REDF has increasingly found that flexible funding instruments are necessary to engage in this type of venture philanthropy. Over time, the needs of the social purpose enterprises in the portfolio have pushed REDF to engage in different types of funding and use various financial instruments to provide the necessary support for the enterprises. While The Roberts Foundation began its funding with traditional program grants, REDF now provides an array of financial support,including enterprise grants, capital grants, recoverable grants, credit lines and loan guarantees. REDF continues to investigate other means of providing financial backing for portfolio enterprises. A description of this progression toward more varied financial instruments is discussed in "The Challenge of Change" mentioned earlier.

The Incredible Complexity of True Venture Philanthropy Implementation

When The Roberts Foundation first launched its Fund, staff and trustees were both aware that the Foundation was embarking on a new, largely untried path. Existing relations between "classical" foundations and their grantees have evolved over decades; on the whole, most of the players understand and fulfill their various roles. To a greater or lesser degree, the traditional "system" works. At the beginning, neither the foundation staff nor the investees fully anticipated the complexity involved in pursuing a venture philanthropy practice. An overarching learning has been that this is complicated, difficult work.

Like the proverbial "pulling a thread on a sweater," the REDF experience has shown that venture philanthropy is not to be undertaken lightly. This new approach cannot be based on the old, traditional relationships and assumptions. Venture philanthropy rapidly moves the foundation from simply funding the work of others to being a participant observer, advisor, advocate and investor. As

the REDF experience has evolved, staff has become involved in

- recruiting candidates and helping retain individuals for positions within the portfolio,
- negotiating conflicts and relationships between agency and enterprise staff,
- brokering relations between portfolio organizations and interested others,
- engaging in discussions about and complete re-design of organizations' accounting systems,
- developing management information systems with portfolio organizations in order to more effectively track social and financial information,
- managing relations with other funders interested in participating in investees' work,
- and countless other areas of support.

This has required REDF staff to develop new skills, shift roles from meeting to meeting (depending upon the needs of a particular organization), and continually be open to a process of change not commonly experienced by those involved in classical foundation practice. While this growth of skills and flexibility is a value-added outcome of a venture philanthropy practice, it has also placed significant demands upon the Foundation and its staff.

Are Smaller/Younger Nonprofit Organizations in Better Positions to Benefit from a Venture Philanthropy Partnership than Larger/ Older Organizations?

From the beginning, REDF's focus has been on the creation and support of viable, market-based social purpose enterprises. Over the years, however, it has become clear that beyond assisting in specific venture development, REDF has also come to be involved in areas of core organizational development with the nonprofits in its portfolio. The nature of REDF's working relationship differs depending upon the size and age of any given nonprofit organization.

An area of future exploration for the Fund will be the question of whether smaller, perhaps earlier stage organizations gain greater benefit from a venture philanthropy approach than those organizations that enter the venture relationship with a more established (or perhaps entrenched) culture, organizational structure and history. The younger organizations' flexibility and openness to experimentation may hold the key to a successful relationship, while the established nonprofit may find greater benefit from a philanthropic approach more like that of an investment banker than a venture capitalist.

Conclusion

Like any good relationship, the relationship between REDF and its investee organizations has evolved. The venture philanthropy approach has made it possible for the organizations in the portfolio to receive support and investments not previously available in the nonprofit sector. And the patience of REDF investees has allowed the Foundation to grow in its understanding of how best to support the work of the practitioner community. We have learned a great deal from this process and look forward to expanding upon our learnings over coming years.

Footnotes

1 A comprehensive description and analysis of REDF can be found in the Stanford Graduate School of Business case study entitled "The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy," October, 1998. This case is available through the REDF office or by contacting the Stanford Graduate School of Business.

2 A complete listing of REDF publications may be found on the publications page of REDF's website at www.redf.org.

3 Copies of the book can be downloaded from our website and hard copies may be ordered from the REDF office. Please visit our web site at www.redf.org or email book@redf.org.

4 See the Stanford Graduate School of Business case study entitled "The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy," October, 1998, pages 6 - 7 for a more in-depth discussion of the lessons learned from HEDF.

5 "The Challenge of Change: Implementation of a Venture Philanthropy Strategy," can be found in Chapter 2 of this book and is also available at www.redf.org.

6 Please see the Stanford Graduate School of Business case study entitled "The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy," October, 1998.

7 REDF began in January 1997 with a portfolio of ten nonprofit organizations. As of Fall 1999, three organizations had been excused from the portfolio. See "Enterprises Gone But Not Forgotten," Chapter 3 of this book for a more detailed account of the lessons learned with these organizations.

8 See "WebTrack and Beyond: Documenting the Impact of Social Purpose Enterprises" in Chapter 6 of this book.

9 For a more detailed discussion of SROI,please see "Social Return on Investment: Exploring Aspects of Value Creation in the Nonprofit Sector" in Chapter 8 of this book.

10 Chart adapted from Stanford Graduate School of Business case "The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy," October, 1998, p. 5.

11 Please see the Stanford Graduate School of Business case on REDF, pages 11 - 19 for a more detailed discussion of REDF's venture capital approach in each of these practice areas.

12 Please see "Social Return on Investment: Exploring Aspects of Value Creation in the Nonprofit Sector" in Chapter 8 in this book.

13 Please see "The Challenge of Change: Implementation of a Venture Philanthropy Strategy," in Chapter 2 of this book.

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Chapter 2

The Challenge of Change: Implementation of a Venture Philanthropy Strategy

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The Roberts Enterprise Development Fund and BTW Consultants—informing change

Introduction

The Roberts Enterprise Development Fund (REDF) is a venture philanthropy approach to supporting social purpose enterprise development. REDF maintains a portfolio of seven nonprofit organizations, which collectively operate 23 revenue-generating enterprises. The goal of social purpose enterprises is to provide transitional and permanent employment opportunities to those deemed "unemployable" by the mainstream labor market.

REDF is all about innovation and change:

- REDF funds new strategies for job creation and the development of community assets.

- REDF provides an array of ancillary support to nonprofit organizations through the innovative application of techniques borrowed from the for-profit, venture capital field.

- REDF assists nonprofits in being as effective in the pursuit of their business mission as they seek to be in their social mission.

- REDF seeks to overcome the limitations of traditional, classical approaches to philanthropy through the creation of a meaningful, significantly more engaged partnership between funder and investee.

However, change is challenging—even for those who seek it out and understand its value. This chapter presents a discussion of the challenges REDF experienced during the initial months of launching its initiative and the steps taken to date to respond to these challenges.

The following pages begin with a presentation of a basic framework for understanding organizational change. This is followed by a brief description of the transformation The Roberts Foundation has undergone over the past decade. During that period, the Foundation moved from implementation of a classical foundation strategy to the creation of the Homeless Economic Development Fund (1990), which then led to The Roberts Enterprise Development Fund (1997). Now REDF, in 1999 and beyond, pursues a continuation of its venture philanthropy strategy which has been greatly informed by the feedback received over the first 18 months of its operation.

After this background discussion, the document presents the findings of a process appraisal conducted in 1998 to assess how this transformation from classical to venture philanthropy was experienced by the Foundation and its investee[1] organizations. The process appraisal findings are followed by a discussion of the steps taken by Foundation staff to address the issues raised in the appraisal.

Presently the concept of venture philanthropy is receiving a great deal of attention. This interest in a new approach to funding has very real implications for the traditional relationship between grantee and grantor. Therefore, this chapter concludes with a discussion of lessons learned from The Roberts Foundation's experience that may be of interest to foundations and nonprofit organizations in the early stages of formation, as well as those considering a transformation of existing funding strategies and relationships.

Before presenting the outcomes from this process appraisal, it is first helpful to have some understanding of how change is experienced within organizations and what factors may influence the change process.

Navigating the Stages of Change: A Theoretical Framework

There are a variety of ways to understand, describe and analyze a process of organizational change, particularly as reflected in such a creative and complex collaboration as The Roberts Enterprise Development Fund (REDF). There are other frameworks that are more specific to nonprofit organizations, such as Drucker's seven stages of effective and sustainable innovation.[2] And there are frameworks that are psychologically based, such as Lewin's well known three-phase approach to change—unfreezing, changing and refreezing—or change cycles that reflect more of the emotional aspects of organizational change.[3]

We chose a framework presented by Michael Heifetz because it seemed the most relevant and useful model for understanding the stages of change experienced in The Roberts Foundation's initiatives, which in many ways are a hybrid of for-profit and nonprofit philosophies. Regardless of which theoretical framework one chooses, the most important point is that the REDF initiative, and The Roberts Foundation generally, engage in processes grounded in a commitment to ongoing organizational reflection and learning. REDF is creating innovative systems for supporting social purpose enterprise development, reflecting on those systems, refining its approach based on evidence gathered both informally and formally, and disseminating its learnings in order to inform

a growing field of interest in venture philanthropic practice.

Peter Drucker has observed that in order to be a successful innovator it is first essential to learn from the process of change. This means having the courage to critically examine what needs to change and then managing that change in a manner that reflects where one wants to go. In commissioning its process appraisal, REDF took an essential and courageous step in asking questions of its nonprofit partners and itself as a foundation program initiative. As it has been said, "You cannot get to where you want to be by remaining where you are."

Michael Heifetz, a specialist in organizational development, has presented a seven-stage process for effectively creating change in organizations. His framework for change and the seven stages he enunciates are derived from extensive research and experience in analyzing organizational development in both business and government. Heifetz's seven stages include:

Stage One: Choosing the Target

Stage Two: Setting Goals

Stage Three: Initiating Action

Stage Four: Making Connections

Stage Five: Re-Balancing to Accommodate the Change

Stage Six: Consolidating the Learning

Stage Seven: Moving to the Next Cycle

Associated with each stage is a desired set of outcomes, actions initiated to accomplish those outcomes, and common issues or barriers to overcome. The Roberts Foundation experienced each of these seven stages of change during HEDF; when it reached Stage Seven—Moving to the Next Cycle—HEDF transitioned to REDF. In 1997, The Roberts Foundation chose its next target (Stage One)—REDF—by focusing on social purpose enterprise development specifically and by choosing to deliberately implement a venture philanthropy approach to its funding.

In establishing its investee portfolio, REDF set explicit goals for itself and worked with each group to set its own business-specific goals (Stage Two). During the first year of REDF implementation, action was initiated (Stage Three). This action reflected many of the major components of a venture capital practice—i.e., core financial investments were made in each organization, regular venture committee meetings were held, business assistance was provided, additional capital and business networking opportunities were made available, and a management information system was established.

The REDF process appraisal was undertaken during the fourth stage of Heifetz's seven-stage process, "Making Connections." According to Heifetz, the fourth stage is when "people wrestle with change as it plays out in their daily work." For the REDF portfolio this was the time when conflicts over control and direction emerged between organizations and The Roberts Foundation and within the organizations themselves. The terrain was shifting and the players were trying to establish firm footing to manage both their organizations and the new funding relationship.

Examples of actions that are typically part of the fourth stage of change include ensuring everyone understands how the new approach affects them and scrutinizing the results of the initial change process to determine if the benefits of the change are real. The REDF process appraisal, conducted 14 months into the REDF initiative, was such an action. It was intended to provide formal feedback to all REDF stakeholders regarding the effectiveness of a venture philanthropy approach and offer possible guidance to make refinements in any and all components of the initiative. The process appraisal was also intended to and, in fact, did lead to Heifetz's Stages Five and Six, "Re-Balancing to Accommodate Change" and "Consolidating the Learning," which are happening currently.

1990 through 1996: Evolving From a Classical to Venture Philanthropy Strategy

The Roberts Foundation was founded in 1986 as the family foundation of George and Leanne Roberts. Located in the San Francisco Bay Area, from 1986 to 1989 the Foundation funded a variety of youth, education, animal welfare and arts organizations through a classical approach which included:

- publication of an annual report with giving guidelines,
- submission of grant proposals by prospective grantees,
- review of those proposals by staff[4] and
- presentation of those proposals to The Foundation's board of directors in the form of "dockets" consisting of a summary of the proposal and recommended giving levels.

In 1989, the Roberts decided they were interested in funding a "strategic effort which would not normally receive support were it not without the assistance of The Roberts Foundation."[5] Furthermore, George Roberts began conversations with the Foundation's executive director regarding strategies by which The Foundation could identify and fund a "free enterprise approach to homelessness." To that end, a staff person was hired to investigate the potential of such an approach and create a strategy The Foundation could pursue.

In January of 1990, The Roberts Foundation launched the Homeless Economic Development Fund (HEDF).[6] The goal of the Fund was to support efforts to expand economic opportunity for homeless individuals through three strategies:

- expanding the accessibility of the mainstream job training and placement system;
- creating a self-employment program tailored to meeting the needs of homeless women; and
- assisting nonprofit organizations in the planning, launch and management of nonprofit, social purpose enterprises.

The HEDF's experience in the first two areas and the lessons learned regarding the third are described at length in other documents. The reader is encouraged to review that material for a full discussion of The Foundation's experience in social purpose enterprise development.[7] The focus of this paper, however, is less upon what was being funded between 1990 and 1998, and more upon how that funding was provided.

The following chart illustrates how The Foundation's approach to investing in nonprofit organizations evolved from a classical to a venture philanthropy strategy. Accordingly, the fundamental elements of the Foundation's work shifted over time in the following areas:

- Amount of Initiative Budget and Average Grant Size
- Type/Form of Investment
- Number of Investees Supported by the Foundation
- Number of Social Purpose Enterprises Operated by Investees
- Fundamentals of the Investment Relationship
- Target Population
- Range of Supports Provided to Investee Organizations
- Professional Development of HEDF/REDF staff
- Form of Primary Donor Involvement

The specifics of this shift are presented in the accompanying chart and other documents provide detailed information concerning The Foundation's strategy. By the end of 1996 it became clear that The Foundation's goals could be best achieved through shifting from its prior structure to a new, focused initiative that could take the lessons of the past and apply them to future efforts. To that end, at

the close of 1996, HEDF was dissolved and The Roberts Enterprise Development Fund launched.

The reader should keep in mind that the following chart, while reflecting the general stages The Foundation moved through over time, should itself be viewed as an evolving continuum. Within each stage lessons were learned and internalized, while across the decade described, the process moved forward in a somewhat fluid motion not easily reflected in linear charts and diagrams.

Evolution of A Philanthropic Strategy

Category	1990-1993	1994-1996	1997-
Annual Budget			
	$1 million per year	$1.5 million per year	$3.5 million per year
Average Grant			
	(average: $25,000)	(average: $60,000)	(average: $125,000)
Type/Form of Investment			
	Grants	Grants Cash Guarantees Cash Flow Advances	Grants Cash Guarantees Cash Flow Advances Recoverable Grants Leveraging other resources around investment
# of Funded Organizations			
	40-50	20	10 (7 as of 1999)
# of Social Purpose Enterprises			
	8	12	25+
Investment Relationship			
	High funder discretionary authority Some multi-year grants Engaged funder Shared learnings Commitment to honesty in relationship	High funder discretionary authority Some multi-year grants Engaged funder Shared learnings Commitment to honesty in relationship and general steps to achievement	High funder discretionary authority All multi-year grants Engaged funder Shared learnings Commitment to honesty in relationship and specific steps to achieving and maintaining same
Targeted Population Served			
	Homeless individuals (both youth and adults)	Homeless individuals (both youth and adults)	Individuals in recovery from homelessness, drug and alcohol addiction Very low-income Disabled physically and psychiatrically

Continued...

Evolution of A Philanthropic Strategy *Continued...*

Category	1990-1993	1994-1996	1997-
Range of Support			
	Program grants Isolated/individual grants Process/qualitative evaluation Evaluation by outside consultant Ad hoc business assistance provided by individual outside consultants	Program grants Individual grants/group meetings Greater outcome-focused evaluation Collaborative evaluation Targeted business assistance	Program grants, capital grants, based on business plans Portfolio approach Social Return on Investment Analysis[8] Shift from evaluation to MIS with emphasis on capacity-building for portfolio organizations to manage internal MIS and evaluation Focused business assistance by REDF team: Venture Committees, Partners-for-Profit, Farber Interns/ Fellows, Computer/other Technology Assistance
Professional Development of Foundation Staff			
	Individual Executive Director with MSW	Individual ED with MSW and MBA earned while working on HEDF	Management Team Approach: ◆ Executive Director with MSW and MBA ◆ Associate Director with MBA ◆ Business Analyst with MBA ◆ MIS, "Evaluation" and Computer Technology Consultants
Form of Primary Donor Involvement			
	Traditional reporting relationship Met 2 times per year for briefings Periodic meetings and input	Interactive relationship Met 6 times per year Regular meetings and communication	Fully engaged relationship Met minimum of 12 times per year Ongoing communication and shared decision-making

1997: The Roberts Enterprise Development Fund

The strategy created by the Foundation to support the work of its investees is part venture capital, part organizational development and part small business development. To this end, REDF has the following components:

Core Investments

The core financial support received by each organization in the portfolio comes in the form of an annual capacity-building grant ranging between $100,000 and $125,000. Among other things, this grant enables the nonprofit to hire an enterprise manager and invest in the human capital required to develop and oversee the execution of a business strategy as articulated in their 3-5 year business plan.

Capital Investments

In order to build upon REDF's Core Investments, the Fund provides additional financing as dictated by each enterprise's business plan and augments that financing with efforts to solicit other charitable investments from individuals, corporations and foundations interested in supporting the enterprise development goals of the Fund and its investees. The Fund also provides additional access to capital resources through a mix of grants, recoverable grants and networking opportunities to secure low-interest loans from both commercial and nonprofit lending institutions.

Business Analyst

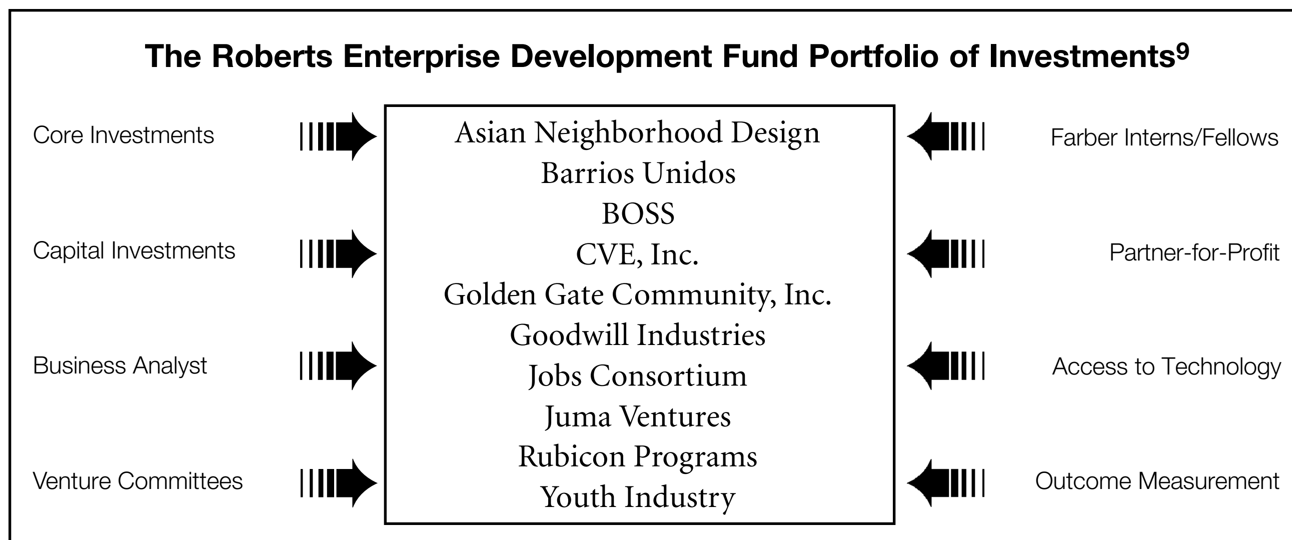
REDF partners with Keystone Community Ventures, a local technical assistance organization specializing in nonprofit business development, providing a business analyst to assist the manager and Venture Committee in analyzing the strategic position of the business, critique the venture's business plan, evaluate the business's financial statements (both actual and pro forma), and provide an objective evaluation of the business. The business analyst directly assists management in conducting the analysis and assists the managers in developing their own skill sets in order to assure that knowledge transfer occurs and the future capacity of the organization to effectively manage the venture is developed.

Venture Committees

The Venture Committee consists of representatives from REDF, the nonprofit executive director, the enterprise manager, and as appropriate, a Board member from the nonprofit organization and an individual with direct expertise in the industry sector of the enterprise. Together, the committee meets monthly to review financial and operational performance, identify areas of concern, and help ensure these concerns are addressed in accordance with the enterprise's business plan.

Farber Interns and Farber Fellows

REDF, in partnership with The Phalarope Foundation and Students for Responsible



Business, established the Farber Interns and Farber Fellows program to leverage the talent of business school students in support of investee organizations. The Farber Interns and Fellows are named to honor Michael E. Farber, who passed away in 1996. During his tenure at Rubicon Programs from 1989 to 1996, Mike helped guide the expansion of two of Rubicon's enterprises, Rubicon Buildings & Grounds and Rubicon Bakery. The presence of a summer Farber Intern or year-long Farber Fellow rounds out the Fund's efforts to enhance the capacity of its portfolio organizations in the effective management the venture.

Partners-for-Profit

Partners-for-Profit (PFP) was created to address the enterprises' need for direct market access. The initiative is a focused working group of Bay Area business leaders representing a variety of industries. PFP provides REDF investees with one more level of analysis and assistance. In addition to providing advice and guidance to investees, PFP members assist in connecting enterprise managers to professional networks within their industries and areas of interest. Finally, PFP provides opportunities for the hands-on involvement of business people interested in making a more meaningful and direct contribution to the process of social purpose enterprise creation and expansion.

Access to Technology

REDF has, on a limited basis, equipped each enterprise with the basic hardware and software necessary to gain access to the web and communicate via e-mail. REDF partnered with CompuMentor, a San Francisco-based nonprofit computer consulting organization, to build a private web site for the REDF portfolio and organizations and to train all the nonprofit managers in accessing the web and using e-mail. Additionally, REDF has contracted with Dayspring Technologies to develop custom databases for each organization to track social indicators and to provide training to managers on how to use and build upon them. This management information system is described at length in a companion chapter, "WebTrack and Beyond: Documenting the Impact of Social Purpose Enterprises."

Outcome Measurement

Rather than implementing traditional evaluation methods, REDF, in partnership with its investees, developed and launched a web-based information system called WebTrack which was custom-designed through the use of standard business MIS tools. REDF contracted with BTW Consultants to work with the enterprise managers on developing indices of operational and social outcome success against which future performance can be measured. Over time, BTW Consultants will be building each organization's capacity to conduct its own social outcome studies. WebTrack will enable enterprise managers and REDF to track monthly performance on both economic and social terms for the duration of the five-year initiative. This will allow each organization to assess and modify its program in order to maximize its social impacts in a meaningful and timely manner. In this way, evaluation is re-invented to provide meaningful data to managers, allowing them to continually improve practice instead of awaiting an external assessment of the effectiveness of their programs. Such a management information system also allows each enterprise and the portfolio as a whole to analyze Social Return on Investment (SROI).[10]

Year-End 1997: Assessment of First Year's Experience—Beginning to Articulate the Successes and Challenges of the REDF Approach

Over the course of its first year of operation, the REDF approach appeared to be largely successful. Investments (in the form of grants) were made by REDF in a portfolio of 10 nonprofit organizations. Groups were formalizing and refining their strategies. Venture Committee meetings were held; operating decisions were made in partnership with investee organizations. Increasing numbers of formerly homeless and very low-income individuals were being provided access to the transitional employment opportunities necessary for them to gain stability and long-term independence. On the surface, it appeared that the transition was going smoothly and operating as planned.

However, over a period of months, REDF's staff became aware that several REDF investees were dissatisfied with some aspects of the strategy and its management. The executive and associate directors began receiving, in bits and pieces, feedback that several of the executive directors and business managers were frustrated with the process. This feedback came in a variety of forms:

- The outside consultant hired by REDF to manage the design and implementation of the social outcome indicators system (by which the impact of the programs and businesses would be measured), began hearing comments from various managers that the process was "top down" and did not allow for enough input by participants.

- The business analyst, working closely with business managers examining the operations of the social purpose enterprises, also detected dissatisfaction with how the transition from HEDF to REDF was being executed. Questions were raised regarding whether her contributions were in support of the nonprofits or as a "monitor" on behalf of REDF—a critical concern in light of REDF's commitment to partner with the organizations in the development of their ventures.

- REDF's executive and associate directors, in individual meetings with investee executive directors and business managers, were also receiving feedback that while parts of the REDF approach were going smoothly, other components were viewed as intrusive, overly demanding or (of perhaps the greatest horror to REDF staff) not contributing to the ability of the nonprofit to manage its venture more effectively.

At the same time that some REDF investees began voicing concern regarding the process, the REDF staff itself was also not fully satisfied with how the initiative was evolving. REDF staff discussed the situation with the evaluation consultant and considered the option of bringing in an independent third party to interview the players and assess opportunities for improvement. While REDF staff immediately endorsed this option as a logical possible next step, the REDF executive director wanted first to discuss the issues with the executive directors of the funded organizations. These were all individuals with whom the REDF executive director had long, multi-year professional and, in some cases, personal relationships. The initial, perhaps naive, belief was that with a few well-managed conversations, REDF would be able to solicit input, modify its approach as needed, and move ahead into the new year.

With this thought in mind, a meeting was held with the executive directors and REDF staff to discuss the experience of 1997 and assess how to improve the process and continue moving forward. The meeting began with a review of how the strategy had been developed and an overview of the basic components of the REDF approach, with REDF's executive director presenting areas of concern. These "concerns" were framed in terms of REDF expectations that funded organizations would:

- Be fully committed to managing their ventures and organizations effectively

- Include REDF in all relevant decision-making

- Honestly assess their own strengths and weaknesses
- Make full use of the resources REDF offered
- Provide accurate information in both their reporting and meeting contributions
- Build strong businesses and organizations
- Provide the businesses with the necessary resources required for growth

The document presented to the executive directors included a basic review of the evolution of REDF, as well as an outline of issues the REDF executive director felt were important for both REDF and the participating organizations. These included such challenges as:

- How do we make this process work more effectively for us all?
- How do we not have this be simply one more foundation funding opportunity? (Or is it?)
- Are REDF expectations realistic?
- What is the actual and perceived value added by REDF's participation in your business development process?
- How do we deal with the tension between training/supported employment goals and the need for permanent employment to maintain business viability?
- Once REDF funds are invested, without "real" equity position,how is REDF role to be defined?
- How do we balance executive director, business manager and REDF perspectives on the status of the business venture?
- How do we address the attitude of "we managed this as a small business, we can manage this as a large business"?
- How do we manage the tension of REDF allegiance to business versus the executive director's larger commitment to the organization?
- How do we address the "spin" factor (e.g., the tendency on the part of executive directors and staff to attempt to always put the nonprofit in the "best" light possible when interacting with funders)?

As the REDF executive director was presenting the section on REDF's Expectations, many of the other executive directors had begun flipping through the next pages of the presentation and could see where the discussion was heading. Having presented the basic issues as viewed from the REDF perspective, the executive director then paused halfway through his presentation to ask for comments and opened the discussion for each organization's director to respond and raise his or her own questions or concerns.A, shall we say, lively conversation ensued...

The executive directors raised a number of their own questions regarding the transition process, the interaction between REDF and each organization, and the degree to which the organizations felt allowed to provide input regarding the process itself. The conversation, and subsequent process appraisal, were highly complicated by the fact that some executive directors, while having suggestions for improving the process, were largely satisfied with how REDF had been designed and implemented. These directors expressed frustration about spending their limited time addressing process issues they did not view as significant or of central importance to the overall effectiveness of the REDF process. Others took the meeting as an opportunity to share a variety of concerns and firmly voiced an interest in having a significantly greater role in doing so.

At the next REDF executive directors meeting, there was a follow-up discussion about these issues. The REDF executive director also invited REDF's outside evaluation consultant to this meeting and together the group discussed options for identifying and addressing concerns about the process. The REDF executive director offered and the group agreed that in the interest of all individuals having a full and fair exchange of ideas, the evaluation consultant should bring in outside interviewers to conduct confidential interviews with each executive director and a representative

number of business managers. This came to be known as the process appraisal and would be used to frame a four-month reassessment of how REDF was pursuing its goals and how participating organizations could be more effectively supported in their efforts, while maintaining the integrity of the REDF vision and strategy.

1998: The REDF Process Appraisal

I. Methodology

The REDF process appraisal relied on key informant interviews with 10 executive directors and 12 business managers participating in the REDF initiative. As part of the appraisal, interviews were also conducted with REDF staff and the business analyst.

The methodology reflects two overriding goals:

1. to gather REDF participants' detailed assessments on the initiative's strengths, challenges, and opportunities to improve; and

2. to support the creation of an operating environment that encourages frank feedback.

REDF engaged a consultant, Fay Twersky of BTW Consultants, with evaluation expertise to conduct the process appraisal. This consultant has a longstanding history with The Roberts Foundation, as well as significant expertise in providing evaluation and management information assistance to both nonprofits and the foundations that support their work. The consultant had oversight of the entire process; however, in order to assure open discussion, she contracted with two independent interviewers with no prior contact with either The Roberts Foundation or its funded organizations. All interviews were conducted in person and kept strictly confidential, lasting between 60 and 90 minutes.

The protocols used in the key interviews contained several questions focused on organizational issues and participants' interest in and support of the REDF approach. Others focused on the key components of REDF support. For each component, interviewees were asked to comment on:

- the concept (is this type of assistance useful?);

- the process (is the way the support is made available useful to the businesses?); and

- the interpersonal dynamics (do the businesses work well with the people providing the support?).

The protocol was designed to be open-ended in order to elicit detailed responses from REDF participants. Copies of the protocols are included as an appendix to this chapter.

II. Assessing the Key Components of the REDF Approach to Venture Philanthropy

After conducting key informant interviews, the consulting team consolidated common responses with regard to perceived benefits and challenges associated with participating in REDF. The responses, summarized by each of the major initiative components, fall into two categories: What's Working and Areas to Address.

At the outset, it should be underscored that the overall sentiment of those participating in the REDF initiative was positive. By and large, the businesses felt privileged to be included in the initiative and, in virtually all cases, felt the benefits outweighed any difficulties or frustrations. The participants expressed appreciation for the process appraisal itself and the opportunity it provided to comment on how things were going from their perspective. The following is a

summary of the feedback given in each of REDF's strategy areas.

III. Core Financial Investments

The intention of providing an annual grant to the nonprofit enterprises is to enable the businesses to hire an enterprise manager and to support general overhead expenses. These funds—paid in quarterly installments throughout the year—are intended to be flexible and accommodate the range of needs identified by each organization.

What's Working

The organizations were extremely positive about the core financial investments. These core investments were seen as invaluable in terms of the level of support, the length of the financial commitment, and the flexibility of the funds. Both the executive directors and business managers of the organizations saw the overall flexibility of the core financial investments as distinguishing REDF from traditional grant making where grants tend to be more restrictive both in terms of the size, length of commitment and the possible use of funds.

Areas to Address

Organizations expressed concern regarding several elements of the core investment practice. First and foremost, executive directors and business managers said they were unclear about the terms of the multi-year commitment,and what would render them either eligible or ineligible for continued funding. The possibility that the core investment could be taken away if performance did not meet expectations added a level of stress and ambiguity to some relationships with REDF and the business analyst from Keystone Community Ventures. The businesses indicated the need for a more clearly defined set of conditions under which the investment would not be renewed. The businesses also requested the establishment of a "warning system" that would enable them to restructure, seek alternative (replacement) funding, or prepare for the loss of financial support in some other manner.

REDF staff members agreed that greater clarity was needed—for example, better defining what it means to be "under plan"—but the REDF staff emphasized that the business plan and pro forma financials had been and continued to be the benchmark for business performance.

As this issue was discussed, it became clear that there were inherent trade-offs in setting policies: while they add clarity and structure,they can diminish flexibility. This is especially important since the Fund is itself pursuing an evolving form of grant making, venture philanthropy, and is still creating the process by which it will relate to its investee organizations. This issue became especially important later as REDF began responding to the findings of the process appraisal and refining its own approach.

Several executive directors and business managers indicated that because of the relatively large size of the investment in the businesses, REDF sometimes adopted a proprietary relationship with the businesses. This manifested itself in several ways. First, sometimes businesses perceived REDF's "advice" as more directive than consultative. Second, some businesses resented the level of credit assumed by REDF for the evolution and growth of the businesses in its portfolio. Finally, REDF positioned itself as "senior equity partner" because of the size and longevity of its investment, a position seen by some investees as helpful in attracting new investors, but by others as harmful to their efforts to bring in new funders.

These comments reflect a difference in perspective between REDF and some of the businesses. In REDF's view, since many of the ventures were not initially meeting their stated targets it was essential to provide advice and critical feedback. In many ways, that was the central intention of the initiative. If the businesses were performing well enough to simply receive funding and no additional assistance, they would not have been asked, nor would they have agreed, to participate in the initiative from the outset. Furthermore, due to the size of its grants, REDF believed it had a philanthropic investment to protect; and with three MBAs on staff or consultancy and a number of years of experience to offer, REDF felt it had something significant to contribute. More importantly, REDF had clearly articulated the role it intended to play in the initial commitment letter that was accepted

and signed by all the organizations. From REDF's perspective, it was simply doing what it had said it would do in the context of the new relationship.

The value of the process appraisal lay in the opportunity to make these varying perspectives conscious, to validate the different expectations held by each player and reach some new and common understanding that would allow change to occur.

IV. Capital Investments

In addition to the Core Financial Investments made available through the REDF initiative, each enterprise has access to additional funds for capital improvements or other needs as dictated by the business plans. Businesses may augment these funds by soliciting other charitable investments from individuals, corporations and foundations. The access to additional capital from REDF is analyzed on a "deal-driven" model, with individual enterprise needs recognized and assessed on a case-by-case basis.

What's Working

REDF has provided several businesses with additional funding to support their expansion plans, purchase needed equipment or meet other enterprise needs. This access to additional funding is a significant benefit to participating businesses. In general, the businesses see REDF as highly flexible and responsive to requests for additional funding. One business noted that funding for a new piece of "cutting-edge" equipment has helped compensate for the additional labor expenses associated with employing an at-risk population with costly training needs. The relative advantage afforded by this equipment helps the group achieve its social goals while attempting to break even.

Many of the organizations noted that their participation in REDF makes it easier to solicit funds from other sources. By participating in the REDF effort, the credibility of the business can be enhanced, both by virtue of their selection by REDF, and because of the extent of long-term support committed to those enterprises. They also benefit from REDF's ongoing efforts to raise the visibility of the initiative and inform a growing field of interest in this area nationally.

Areas to Address

Nonprofit organizations seek out and rely on multiple sources of funding to support their enterprise development efforts. As mentioned earlier, REDF's position as "senior equity partner" was problematic for several organizations. These organizations feared other funders might be reluctant to support their efforts because they would not want their support to be overshadowed by REDF.

The consulting team identified that a key challenge for REDF is to work with the investees to develop a process that enables the enterprises to bring in other funders without compromising one of REDF's primary objectives: putting the venture philanthropy strategy into practice. The process appraisal suggested that at this point in its development, REDF would benefit from clarifying the specific nature of The Roberts Foundation's partnership with the social purpose enterprises and working with its investees to more effectively communicate that partnership to other potential investors/funders.

As a result of this discussion, REDF also decided to drop the use of the term "senior equity partner" to describe its relationship to investee organizations and adopted the term "senior funding partner." This was due to the fact that some program officers voiced discomfort with what they felt was the proprietary role of The Foundation in its work with portfolio organizations.

V. Business Analyst/Targeted Business Assistance (Keystone Community Ventures)

The business assistance offered as part of the REDF initiative provides businesses with ongoing technical support for assessing the strategic position of the businesses, critiquing the business plans, evaluating the financial statements and accounting systems, and other general assistance in evaluating the health of the businesses. The purpose of the support is to help the businesses operate more effectively and profitably. Keystone Community Ventures was hired to oversee this technical support, either by providing the assistance directly or bringing in the needed expertise. This support is further augmented by the active participation of the REDF associate director and executive director in monthly Venture Committee meetings.

What's Working
All the groups embrace the concept of being provided with some form of business consulting services aimed at increasing their general business savvy and at growing the business to scale. For many organizations, the technical assistance provided by Keystone Community Ventures is extremely valuable. Those with "under-developed" in-house financial expertise are particularly appreciative of the direction provided so they can proceed with preparing business plans and establishing business-oriented financial and accounting systems.

Areas to Address
Investees most in need of general business support indicated that they would like increased access and time with the business analyst. Because she provides consulting to all of the businesses,her time with any one group is perceived as limited. A subset of businesses would prefer having the business analyst available to work collaboratively at their offices for a few hours every week,particularly until their improved financial and accounting systems are in place.

The process appraisal surfaced confusion and concern about the role of the business analyst. The nonprofit organizations were not clear as to whom the business analyst viewed as the client—the social purpose enterprise itself or The Roberts Foundation. She was supposed to be helping the organizations, yet—at the same time—alerting REDF if individual businesses were not meeting targets. This consultant was also in the position of monitoring the timely submission of financial reports and requesting those reports if and when they did not arrive when expected. This placed her in a difficult position between the investees and the funder.

Identifying this concern was enormously helpful to REDF in its response to the process appraisal findings. REDF staff was able to address much of this confusion by better defining roles and responsibilities for all staff and consultants working with The Foundation.

VI. Venture Committees
The Venture Committees were established as a capacity-building forum for enhancing the ability of the businesses to successfully execute their business plans. As originally conceived, the Venture Committee representatives were to consist of REDF staff and business analyst, the nonprofit executive director, the business manager, and, as appropriate, a board member. The committee was to meet monthly to review financial and operational performance and identify strategies for addressing concerns.

What's Working
The majority of the organizations found it helpful to have monthly meetings to review and discuss financial and operational business performance issues. Some of the business managers appreciated the opportunity to go over business issues with both REDF staff and the executive directors so that everyone was "on the same page" regarding the status of the business and its direction. (In some cases,the monthly meetings provide the business manager with an ally—REDF—when he or she needs to convince the executive director and nonprofit parent to take a particular action.)

Areas to Address
The process appraisal found that the composition and dynamics within the Venture Committee meetings sometimes resulted in tensions regarding who sets the direction for the business. In some cases, in particular when board members were present, the executive directors and other nonprofit staff did not feel free to be completely candid in the meetings. In other cases, executive directors were concerned about the extent of REDF involvement in internal organizational issues such as the performance, hiring and firing of employees, or the relationship between the businesses and nonprofit parent organizations.

These dynamics were compounded by the fact that the Venture Committees were bringing together a whole new set of players with no prior history of working together. These individuals required time to sort out role relationships as well as basic personal operating styles in order to function effectively as a group charged with overseeing the activities of the venture.

Furthermore, at some Venture Committee meetings, selected groups felt there was an insufficient recognition for the

hard work undertaken over the previous month(s) as compared with the businesses' shortcomings. While the businesses recognized the need to identify and resolve problems, they felt that feedback from REDF often created an urgency or pressure to focus on "problem areas" and get on with it—to move faster, get all systems in place, and grow to scale more rapidly.

From REDF's perspective, the Venture Committees were not designed to be comfortable meetings. Rather, they are structured to bring all the key decision-makers around the table and tackle tough questions. In this view, tensions are inevitable, particularly since the meetings can highlight internal strains and differing opinions among the nonprofit's business manager, executive director and board. Good news is valued, but not emphasized, REDF staff members say, because there is limited time and the group needs to focus its attention on the trouble spots. Just as the executive directors must oversee all elements of their nonprofits, REDF staff members say, REDF too, has a responsibility and right to aggressively manage its portfolio of social purpose enterprises—even when issues arise relating to the nonprofit parent. REDF staff feels this does not mean REDF and the nonprofits cannot work as partners. In fact, staff members stress and regularly act upon their commitment to working in partnership with other players. But it does, according to REDF, mean there needs to be recognition that, in any partnership, each partner has different roles, authority and influence.

The differences in perspective that emerged from the process appraisal led the consulting team to suggest specific policies to clarify who attends Venture Committee meetings, how they are run and what substantive areas are within and outside the purview of each partner. Further, as in most dynamic work environments, there is often pressure to perform and the ideal is to control the pressure level so it remains constructive rather than destructive. Regardless, the process appraisal suggested that the pressure level within the initiative might need to be readjusted.

VII. The Farber Interns/Fellows Program

The Farber Intern or year-long Farber Fellow provides the social purpose enterprises with targeted management and/or business support. The intern/fellow's specific responsibilities are tailored to the needs of the individual group and have ranged from undertaking industry market research projects, to assisting in the preparation of the business plan, to carrying out other projects designed by the business manager. This flexibility regarding the use of interns is intended to help the business managers develop or expand their business acumen and capacity, thus increasing the venture's potential for long-term success.

What's Working

A majority of the businesses have used a Farber Intern. By providing the businesses with assistance tied to overall operations—from putting together a business plan to tackling day-to-day operational issues—the interns are key allies in helping the businesses expand overall capacity. Perhaps the greatest value of the interns is their ability to pitch in on a daily basis for a period of months. The presence of another person with technical business expertise has been a great resource to the nonprofit staffs, most of whom work long hours. Some of the interns have been so successful that the businesses now use them for other consulting assignments, or are seeking ways of using them again in the future.

Areas to Address

The value of the interns varies somewhat, based on the knowledge of the intern and ability level of the individual working with the business, as well as the overall fit of the intern with the venture and nonprofit culture. While a few of the businesses are not pleased with the outcome of the Farber Intern program—an almost inevitable result, given the vagaries of hiring—most generally indicate an interest in hiring another intern in the future. The consulting team suggested that perhaps the screening and placement process could be refined to increase the likelihood of a good fit between an intern and a business.

VIII. Partners-For-Profit (PFP)

Partners-for-Profit is a working group comprised of business leaders in the Bay

Area business community. PFP was established to provide business contacts to those REDF investees that have developed the expertise and maturity to go to scale. The stature and scale associated with potential PFP contacts can have a significant impact on the opportunities available to the businesses.

What's Working

The businesses appreciated the significant role the PFP can potentially play in launching their operations into a much larger milieu. Several businesses have had preliminary discussions with the PFP and were impressed by the potential contacts and business opportunities they may afford. Several of the businesses indicated the PFP is potentially the most valuable asset provided by the REDF initiative in that one successful phone contact has the potential to lead to a major contract or increase in business.

Areas to Address

Executive directors and business managers were hopeful that the PFP would materialize as a source of future business opportunities. There is an interest in gaining increased understanding of the prerequisites and timing of possible meetings with the PFP. Two of the groups indicated some frustration by the lack of direct access to the PFP or PFP contacts, indicating that it would be helpful if they could pursue the relationship more directly themselves,instead of using REDF as an intermediary. This suggestion may prove difficult to implement, however, as PFP members specifically asked that REDF—in this case,the associate director—act as liaison, managing the contacts and workflow between PFP members and REDF investees.

IX. CROSSCUTTING THEMES EMERGING FROM THE PROCESS APPRAISAL

Strengths

The process appraisal highlighted widespread support for the REDF initiative. For the most part, REDF participants demonstrated a strong understanding and appreciation for REDF's evolving approach. As one participant says:"I'm passionate about it. It's a great vehicle for making change in lives." The executive directors and business managers saw significant advantages from their association with and participation in REDF.

REDF's specific strengths include:

- **Supporting investees' efforts to pursue a double bottom-line strategy.** REDF's funding, approach and philosophy enable the nonprofits to pursue their dual goals of operating a successful business and helping hard-to-employ individuals gain skills, work experience and access to the general market place of employment.

- **Developing support systems and programs that strengthen an organization's viability in the marketplace.** REDF's wide-ranging support—from targeted business assistance to Farber Interns and Partners-for-Profit—layers in expertise, advice and connections that increase the businesses' ability to be profitable. By and large, business managers and executive directors believe REDF has pieced together a package of truly beneficial support.

- **Raising the nonprofits' visibility and credibility among businesses, funders and others.** REDF's approach and connections heighten the businesses' profile and credibility, increasing their exposure in business and funding circles.

- **Providing the nonprofits access to other funders and hard-to-attain resources.** By and large, the investees say their connections with REDF open doors to potential business deals, business advisors and funders.

Most of those interviewed also praised the expertise and enthusiasm, as well as the mix of resources, advice and perspectives available through REDF staff and consultants. Many were aware of and appreciated REDF's increasing willingness to reshape program components to meet individual nonprofits' needs and characteristics.

Challenges

The process appraisal also demonstrated that the REDF initiative, though widely supported

by the investees, faces several important challenges that potentially undermine its overall effectiveness.

- **Ambiguity.** Many of the concerns identified are rooted in ambiguity. Though REDF staff has repeatedly attempted to define the initiative in meetings and correspondence with participants, from the perspective of participating organizations some components still appear to suffer from a lack of clarity. Specific examples include: the conditions and process for not renewing core investment; the requirements needed to appear before the Partners-for-Profit;and the role played by the business analyst. This lack of clarity has contributed to uneasiness among the managers and was beginning to undermine REDF efforts to build a collaborative spirit among portfolio organizations.

- **Power Dynamic.** REDF has been striving to break the power dynamic found in traditional funder-grantee relationships. REDF staff do believe, however, that they have the right and the responsibility as social venture capitalists to ensure that both the investees and the REDF approach itself are as successful as possible. While the investees generally appreciate and value this involvement, REDF's hands-on approach can also be perceived as undermining the enterprises' autonomy and authority. For example, suggestions from REDF staff can be perceived as ultimatums by the businesses. Core investments, though designed to be annual and part of a long-term relationship, are seen by at least a few participants as a "potential stick" to be wielded by REDF in order to keep the nonprofits in line. And REDF staff comments at Venture Committee meetings can be perceived as challenging, though REDF sees them as an important way to help maintain accountability for outcomes to which the investee has committed.

- **Pressure.** The businesses felt they were operating under immense pressure. While REDF had attributed this tension to the pressures inherent in running any small start-up business, many business managers and executive directors said REDF adds another layer of stress:from the push to grow to scale, to REDF's reporting expectations. While most said they understand and agree with REDF's aims and approaches, a number of executive directors and business managers felt the pressure was unproductive. Moreover, they said the emphasis on business operations has resulted in a pressure to demonstrate financial results that undermines their ability to achieve a balanced double bottom-line, with the push for business performance taking a toll on the investees' social agendas.

- **One-Size-Fits-All.** Though a number of executive directors and business managers noted REDF's increasing willingness to tailor programs to meet each organization's particular needs—for example, recent changes in the composition and timing of some businesses' Venture Committee meetings—a number of the weaknesses identified seem to stem from a one-size-fits-all approach. Examples include:

  A business analyst who is not able to provide all the expertise needed to all businesses;

  Executive director meetings where time is spent on issues that are not always relevant to all organizations; and

  Partners-for-Profit being dominated by individuals from larger corporations who have little to offer some of the smaller investees partnering with REDF.

REDF Process Appraisal Conclusion

At the time of the process appraisal, REDF was already aware of and concerned about many of these challenges. However, solutions had been difficult to craft. For example, it was not easy to balance flexibility with clarity. Flexibility can be perceived as vague, but it allows for important and timely adjustments in process and support. On the other hand, clarity can be perceived as controlling and inflexible, but it can also provide some comfort to investees unsure of all of the rules and expectations of the new social venture capital approach. There is often a trade-off between the two. REDF wants to be seen as a helping hand, a well-con-

nected and well-intentioned partner that is just a phone call away. While many of the businesses welcomed the offer and benefited from the additional partnering, others saw REDF as meddling and were reluctant to talk openly with REDF staff about their challenges. The differences between the two relationships—one that spirals up into an increasingly collaborative approach, one that spirals down into decreasing contact and mistrust—are embedded in a complex web of personality, relationship and communication challenges.

At the time of the appraisal, the REDF initiative faced obstacles in its present and future. The process appraisal demonstrated, however, that as REDF moves forward, it does so with a group of nonprofit organizations that supports its overall effort, shares a common understanding of the obstacles ahead, brings suggestions for addressing key issues and appreciates the opportunity to work together to strengthen the initiative.

Does REDF have the potential to be a great initiative? Yes. But whether it can manifest that greatness in part depends on how it meets the challenges that will continue to present themselves along this path of innovation. REDF is currently facing—and will probably continue to face—the challenge of change. That is inherent in its nature as a dynamic collaboration assuming the risk of innovation and doing things differently—in both philanthropy and the development of social purpose enterprises.

Recommendations Emerging from the Process Appraisal

A number of specific recommendations emerged out of the process appraisal regarding ways to improve various aspects of the initiative, and as described in the following section, REDF responded directly to most of those recommendations. It is important to note several guiding principles that cut across the recommendations. These guiding principles were designed to help REDF staff and participants build a more productive relationship. They were:

- **Clarity.** REDF staff and participating investees need to ensure they have a shared understanding of the initiative's aims and approach. Nonprofit and REDF staff should work together to better define areas that are unclear, with a particular emphasis placed on clarifying specific program components, the definition of successful collaboration, and the expected roles and responsibilities of nonprofits, enterprises, REDF staff and consultants to the REDF initiative.

- **Communication.** Both the investees and REDF staff must redouble efforts to communicate clearly and frequently. REDF staff will need to be particularly attuned to actions and comments that negatively feed the historic funder-grantee power dynamic. The investees—or at least some of them—will also have to affirm their commitment to honesty about the challenges facing their enterprises and not attempt to "spin" REDF in the traditional way funders are treated by grantees.

- **Collaboration.** The REDF initiative is built on partnering. Investees and REDF staff must work collaboratively to identify and address challenges within both individual businesses and the overall initiative. This places a burden on both participants and REDF staff to invest the time necessary to ensure they are forging true partnerships.

1998/1999: Responding to Opportunities for Change

In June 1998 a final report on the process appraisal was presented to REDF staff. At that point, the Foundation had a choice: it could simply receive the report and not share it with participants in the Fund, or it could use the report as an organizing tool to move the work of the Fund to a new level of effectiveness. In retrospect, the correct decision was obvious and it may seem overly self-congratulatory to now applaud that decision.

However, it must be acknowledged that the decision was not an easy one. In general, the foundation community is not known for its bold steps to engage grantees in critiquing or modifying foundation operating practices. More specifically, in this particular case REDF's executive director leans toward perfectionism. It was not easy to accept that the initiative he had conceived and led might need to be refined or that REDF's overall management approach developed over the prior 10 years might benefit from different operating procedures.

At this point, it is important to acknowledge the critical role played by George Roberts in affirming a process whereby change could be pursued not only in the traditional foundation approach, but also in how REDF staff sought to execute the strategy he had provided resources to underwrite. Instead of creating an environment where any outcome that departed from plan was viewed as a mistake, he encouraged REDF staff to understand that the initial process and actual achievements of the Fund would evolve over time. Just as the investees were learning how to successfully operate a social purpose enterprise, REDF had to learn how to manage support of their efforts. Indeed, as REDF staff moved through the process of releasing the report to the portfolio's executive directors, Roberts continually reassured REDF staff that "healthy criticism was positive" and that it should be accepted in the spirit offered.

To that end, REDF staff began a three-month process of regular meetings with portfolio executive directors that included:

- reviewing the report with portfolio executive directors,
- responding to each of the issues raised in the report,
- exploring with the executive directors what areas were negotiable and which were not, and
- integrating those changes into the overall operation of the Fund.

In addition to this process and the steps presented below, this chapter, "The Challenge of Change," was itself reviewed and commented upon by members of the REDF Investee Portfolio prior to its release. The purpose of this unique step was to help assure that the various stakeholders in the REDF initiative would have an opportunity to read the report and provide input to the final public document.

In response to the general issues raised by the report with regard to clarity, communication and collaboration, the following steps were taken by REDF in concert with investee organizations:

- Individual letters were provided to each organization re-stating REDF's expectations of funded organizations and providing each executive director with specific feedback concerning performance in five areas: commitment to the goal of market-based sustainability, commitment to achieving an appropriate level of scale, commitment to the creation of venture committees, financial accountability, and commitment to business and program accountability. Organizations were provided with both positive feedback and areas for improvement.
- REDF staff met individually with each executive director to review these letters. Executive directors were specifically informed as to whether REDF felt their organization was: 1) in good shape,2) had some areas of concern that if addressed wouldn't be a problem, and 3) had significant/serious areas of concern which, if not addressed in dramatic ways, could mean the organization would be "excused"from the portfolio in 1999.
- Staff from REDF and the organizations then jointly agreed upon and set specific

performance targets to be pursued over the next six-month period.

- Discussions were held within the REDF Information Management Team regarding the role of the business analyst. It was decided that the analyst's role would be strictly that of support and facilitation,and would not include any reporting. Those reporting responsibilities were transferred to REDF's associate director.

- The executive directors agreed to meet on a monthly basis with REDF staff to discuss crosscutting issues of concern to the groups.

- The REDF executive director committed to meet with each organization's executive director on a regular basis to discuss specific issues of mutual concern and track overall interactions between REDF and investee organizations.

- REDF established a portfolio-wide list-serve (an Internet-based e-mail system with the ability to track "threads" of conversations between list-serve members) as a tool for engaging REDF, executive directors and business managers in general discussions regarding any aspect of their work.

- Overall, through this process REDF became much more aware of the need to reflect on its communication with organizations and individuals in its portfolio and which member of the REDF team is most appropriate to pursue issues of concern.

- Collectively, the executive directors and REDF staff agreed that a new document, tentatively titled "Practitioner Perspectives," would be developed to provide REDF practitioners the opportunity to reflect upon and write articles regarding the challenges of their work. The papers comprising this document would also serve as a platform to promote the efforts of individual organizations and professionals involved in the REDF initiative.

In addition to REDF's responses to these general areas of concern, REDF and its portfolio organizations also took the following steps, a number of which were already underway at the time of the process appraisal:

Core Investments:

- REDF modified its disbursement schedule to better accommodate the cash flow needs of individual organizations by coordinating specific amounts of grants with the projected cash flow requirements presented in business plans of each organization. Prior to embracing this as an operating policy, this had been done on a case-by-case basis.

- REDF dropped the language "senior equity partner" in favor of "senior funding partner" to better reflect both its history of investing in portfolio organizations and interest in working with other possible investors/funders.

Business Analyst:

- Reporting responsibilities of the business analyst were transferred to REDF's associate director. This shift also eliminated previous time constraints of the business analyst, freeing up more time for direct work with investees.

- The REDF associate director and business analyst are working together to identify industry/field-specific consultants for those organizations in need of more specialized consulting.

- REDF clarified the expectation that as issues arise in the course of providing business assistance or other support from REDF, portfolio organizations must take responsibility for informing REDF's staff of the need for change. The REDF executive director articulated the Fund's commitment to providing the most meaningful and constructive support to investee organizations.

Venture Committee Structure:

- REDF staff affirmed for the portfolio that the decision to include an organi-

zation's board members in Venture Committee meetings was the responsibility of the investee organization. REDF's concern was simply that the board be fully involved and aware of issues affecting the social purpose enterprise.

- REDF clarified that the primary contact with Venture Committees would be through both the associate director and business analyst, with REDF's executive director attending at regular intervals, as deemed appropriate by the investee and REDF jointly.
- REDF affirmed ongoing assessment with each investee regarding whether the Venture Committee process was effective and how to make it more so.
- REDF committed to regularly affirming the good work and efforts of portfolio organizations before focusing on areas needing improvement.

Farber Interns/Fellows Program:

- REDF's associate director will work more closely with enterprise managers to assist in screening and interviewing potential candidates.
- Both REDF and organizations affirmed the challenge of bringing in new staff and recognize there is no way to guarantee a "good fit" between any individual and an organization—but that all involved would work to identify any problems early on and address them promptly.

Partners-for-Profit:

- REDF committed to work with PFP to clarify their expectations of investees interested in presenting to the larger group.
- REDF committed to communicating these expectations more effectively to portfolio organizations and working with them to help them meet those expectations.
- REDF will aggressively recruit individual business mentors for those organizations requesting such support.
- REDF will work to recruit additional PFP members who reflect the diversity of industries represented in the portfolio.

Lessons for the Field of Philanthropy: Transitioning Through the Change Process

At the close of 1998, REDF was well positioned to continue building both strong partnerships and viable social purpose enterprises. The experience of opening itself up to criticism by its investees was in some ways a difficult one. However, the power unleashed by the opportunity for key players in the initiative to re-connect with their basic vision for both individual organizations and REDF as a whole has been an unmitigated success, creating new potential for building even more significant partnerships in the future. The following lessons from this experience are applicable to other funders attempting to become more responsive to the needs of their grantees:

It is critically important that a donor be fully committed to supporting an honest grantmaking process grounded in integrity.

Beginning with the creation of the HEDF in 1990, George Roberts continually expressed to his staff the importance of being open to understanding the true learnings of both the grantees and staff efforts. The 1996 report produced by the Foundation, *New Social Entrepreneurs*, is distinct from many foundation reports in that it went well beyond the traditional documentation of "grants awarded, programs launched" to describe the specific experiences of those involved in the initiative and the challenges they confronted. As

the REDF experience evolved over its first year, George Roberts continually supported staff efforts to "get to the core" of the issues and attempt to engage investee organizations in breaking through old roles and assumptions regarding the appropriate relationship between funder and grantee.

This backing allowed REDF staff to execute the four-month long process of self-assessment and discussion with its investee organizations.REDF staff, led by an executive director already known for his personal directness and desire to build an organization with true integrity, was in essence "given permission" to push the envelope. The process engaged REDF investees in an open debate regarding the Foundation's approach not often seen in the field of philanthropy. While many foundations fund evaluations of grantees,seldom do they ask their grantees to evaluate the quality of the foundation's efforts and even more seldom do they publish their experience in the form of a document such as this one.

While the staff of REDF is fully committed to a process of honesty and integrity, it is only with the backing and support of the donor that they can act on that commitment. Foundation boards should understand that if they seek to fund innovation and experimentation in the nonprofit sector, they must not simply voice openness to the variety of outcomes such innovation might bring, but must continually affirm staff efforts to honestly reflect on their work and engage grantees in that process. Otherwise, a drive to "succeed" may undermine the full possibility of learning from that potential evolving success.

In many ways, the Foundation has learned more from what it has not executed effectively than it has from those efforts which have been viewed by all as a success.

The challenge of building genuine trust in philanthropic relationships is more difficult than many would like to believe.

The Roberts Foundation has a funding relationship with many of its investees that has spanned many years. In some cases, the relationship has been built over the full nine years of the Foundation's experience in this area of grant making. REDF's executive director came to the Foundation with significant experience in the management of nonprofit organizations. The associate director of REDF also had experience in the nonprofit sector and both directors felt they had made meaningful efforts to engage in a true "partnership" with its investee organizations.

Even with this background, developing truly honest, open relationships between REDF and the organizations' management has been extremely challenging. While some may find the thought offensive, the fact of the matter is the funding relationship is in many ways founded upon deceit. The need of nonprofits to secure the funding for the programs they wish to operate continually forces them to re-design, re-position and re-present their core programs in response to an often shifting and difficult to negotiate funding marketplace. In this marketplace, the successful nonprofit leader, in addition to being an effective manager of programs targeting society's most challenging problems, must also be able to "spin" the funder. Executive directors and program managers alike must be able to play the game effectively if they hope to secure the funding they need to keep their doors open. Whether government, foundation or individual donor support, they must have the skills of a politician—continually stroking, affirming and cultivating the funding relationship. Grants and grant decisions are often predicated with greater reference to politics, persuasion and perception than to any objective assessment of the value that they create in our communities.

This spin effect is supported to some degree by the realities of the power imbalance present in the funding relationship. While foundations need good nonprofit organizations to which they can give their support, those with the capital tend to set the terms of the relationship. As such, foundations need to be especially aware of how the realities of this power dynamic effect their communications with grantee organizations. It may seem self-evident, but communication takes place on many different levels and through a variety of media, as well as personal avenues. And understanding how foundations and the organizations they fund communicate is a much more challenging task to understand than might first appear. Executive directors, business managers and program directors all have different perspectives and communicate with foundation staff in various ways. Furthermore, the "Greenspan Effect" (whereby a foundation

staff's word may carry far more weight than intended) can also distort the effort to communicate openly. Staff must use spoken words, e-mail and letters appropriately and be consistent in their communications.

These elements,along with a host of others, work to keep funders and grantees in separate camps, each circling the other at appointed times of the year, when grant reports come due and new funding initiatives are launched. Working to break through such camps is a major challenge for professionals on both sides of the checkbook. Whether funder or grantee, investor or investee,simply because you have a "good working relationship" doesn't mean you will tell each other the truth. And just because you ask someone to give you feedback on your work, doesn't mean he will tell you what's truly on his mind.

Finally, developing a funding relationship based on trust and open communication takes more work and time than most players may want to invest. While there can be great rewards in doing so, the challenge cannot be underestimated. Simply because one foundation announces a commitment to changing the rules of the game doesn't mean that the rules themselves have actually changed—only that there is perhaps an opportunity to move in a different direction. If other foundations continue in a classical approach while one funder shifts to a venture approach, the potential tensions between both approaches must be managed in some way by all involved. One should never underestimate the energy required to create the type of changed relationships described in this document.

It takes time to create a meaningful venture philanthropy practice.

Effective venture philanthropy grantmaking is not like buying a share of stock or even funding an effective program—it is like building an organization and challenging an effective program to have even greater impact. This effort takes a great amount of time in order to work through a process of organizational, cultural and individual transformation.

A commitment to such an investment horizon is not for everyone. There is a place for "one-shot" grants targeting short-term needs of both nonprofit organizations and society. If one is going to talk about long-term venture philanthropy, it must first be understood that both foundation staff and investees must have enough time to work through this process appropriately. It cannot be rushed or it will run the risk of simply repeating the mistakes of the past, without benefiting from the many worthy and important lessons to be gathered in the process.

If you can't take the time to do it right, you probably shouldn't do it at all.

There is a fundamental power imbalance present in funding relationships. Rather than attempting to deny that fact, it is better to acknowledge it and find ways to work more effectively together with respect for the power each player brings to the partnership.

Perhaps one of the most important things to come out of the REDF process appraisal was an honest discussion with the executive directors and business managers regarding the power dynamics of the funding relationship. Talking about power imbalances is hard. We all like to have a pretense of equality and are committed to the idea that all people, regardless of any number of social status factors, are equal.

Certainly, nonprofit managers have a degree of power. After all, foundations and government players need them in order to realize their own objectives. However, those with access to financial resources realistically do have greater power than those without. If a foundation doesn't like how a certain program is being managed, it can withdraw its support at the next funding cycle. If a foundation really doesn't like how a certain issue is being addressed, it can simply create a new initiative or, in some cases,convert to an operating foundation and engage in the work directly itself. Most nonprofit organizations don't have those options.

The most powerful aspect of the REDF experience has been the degree to which we have been able to address the issue of power directly and move ahead. This conversation is in various stages of process with each of the investee organizations and continues to be a dynamic topic within the REDF management team as well. For the most part the organizations participating in the REDF initiative are approaching the partnership from a position of confidence and strength while allowing

REDF to also maximize the strength it brings to the relationship.

Both investee and funder must be open to learning new lessons and understanding how they must transform themselves to maximize the benefits of evolving relationships in a new market place. This responsibility rests equally upon both parties and is not simply the responsibility of the grantmaker.

The true challenge of engaging in a process of honest self-assessment and change should not be underestimated. The venture philanthropy process requires openness to admitting shortcomings in oneself, one's own organization and those of others. It necessitates a commitment to working through those issues and a belief that the overall goal is worth the time and effort necessary to achieve it. Organizations and individuals tend to succumb to the inertia of the status quo.

That said,the potential benefits of pursuing improvement, increased effectiveness and enhanced quality are well worth the effort. With the first phase of REDF's implementation of a venture philanthropy approach behind us (for one must continually embrace the challenge of change) we are well positioned to take on new challenges and document future achievements. The responsibility for pursuing this positive change rests equally upon both parties. With partners willing to openly assess our mutual areas for growth, as we move through future learnings we can continue to build valuable community assets and sustainable avenues out of poverty for those on the margins of society.

Conclusion

This chapter began with a presentation of Michael Heifetz's seven stages of organizational change. And we have now seen how The Roberts Foundation progressively moved through each level in its process of executing a venture philanthropy approach to its grantmaking:

Stage One: Choosing the Target

Our first step was choosing the target of supporting the creation of social purpose enterprises that would provide transitional and permanent employment to those on the margins.

Stage Two: Setting Goals

We set the goal of designing and applying a venture philanthropy approach to our grantmaking and created a conceptual framework/grantmaking strategy to guide our efforts.

Stage Three: Initiating Action

We took the step of organizing a portfolio of nonprofit organizations committed to pursuing that goal and making significant investments in their work.

Stage Four: Making Connections

As we began to execute our strategy and take action, we found a need to connect more deeply with those involved—seeking out their input and together building greater ownership of our process.

Stage Five: Re-Balancing to Accommodate the Change

Stage Six: Consolidating the Learning

As a result of the feedback received through the process appraisal, we re-adjusted our relationships and communicated a renewed vision for our efforts, before evolving into

Stage Seven: Moving to the Next Cycle

As we prepare for the next phase of our work, we have re-confirmed our targets and the strategy in which we are engaged to attain our goals. Challenges remain to be addressed and success is not guaranteed by any means. Regardless, we faced a crossroads of sorts: we could have maintained the

defense of a foundation process that "worked" but was not achieving its full potential or we could open up the process itself to examination and transformation. Having done so we are all stronger, more effective members of our partnership and are re-committed to moving forward to engage the future that awaits us all.

The staff of The Roberts Enterprise Development Fund and BTW Consultants-informing change jointly authored this paper, with significant input from the REDF Portfolio. If the reader is interested in discussing any aspect of our experience at greater length, the individuals contributing to this report may be reached through the REDF Web Site at www.redf.org.

Footnotes

1 While The Roberts Foundation is a private foundation that makes grants to nonprofit community-based organizations, it views all its financial support of those organizations as a form of investment. Therefore, "grantees" are referred to throughout this document as "investees."

2 The stages identified by Drucker are similar to Heifetz's and include: Stage 1: Exploring the Environment; Stage 2: Synthesizing the Learning; Stage 3: Integrating the Learning; Stage 4: Internalizing the Learning and Creating Ownership; Stage 5: Applying the New Learning; Stage 6: Reflecting and Checking; Stage 7: Disseminating.

3 An example of this is the Change Cycle developed by Interchange International which includes Stage 1: Loss; Stage 2: Doubt; Stage 3: Discomfort; Stage 4: Discovery; Stage 5: Understanding;and Stage 6: Integration.

4 From 1986 through 1997 the staffing for The Roberts Foundation was provided under contract by Pacific Foundation Services, a management firm with expertise in philanthropy. It was not until 1998 that The Roberts Foundation itself employed staff to manage The Roberts Enterprise Development Fund.

5 George R. Roberts, public comments, Stanford University, Graduate School of Business, November 1997.

6 While the creation of the HEDF represented a major commitment on the part of the Foundation, it is important to note that the Foundation continued to be active in funding a variety of organizations involved in areas of historic interest to the board of directors. While the Foundation increased its annual support for the HEDF/REDF initiatives,it continues to fund other areas of interest based upon a classical philanthropy framework.

7 Please see *New Social Entrepreneurs: The Success, Challenge and Lessons of Non-profit Enterprise Creation*, and other documents available through the REDF web site:www.redf.org.

8 For a more detailed discussion of SROI, please see Chapter 8.

9 The ten organizations listed here were the original process appraisal participants;however this list does not reflect the current REDF portfolio of organizations.

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Appendix A
Process Appraisal Protocols

REDF Process Appraisal
Business Manager Protocol

Background:

1. Please tell me a little about your professional background. What is your current position and responsibilities? When did you start working with [enterprise name]? What was your background prior to joining [enterprise name]?

2. What do you see as [enterprise name] overall strengths/weaknesses? What are your goals for [enterprise name] over the next year?

REDF:

3. What first comes to mind when you think about REDF? [Probe: strengths, challenges, successes, frustrations]

4. Was [enterprise name] involved in the Roberts Foundation's earlier work on the Homeless Economic Development Fund? If so, what are your impressions of the transition from the Homeless Economic Development Fund to REDF? [Probe: your level of involvement in decision-making, strengths/weaknesses of change, value to your organization]

5. REDF is committed to the Social Venture Capital approach. What is your understanding of the Social Venture Capital model? What is your opinion of this approach? What is your definition of a New Social Entrepreneur? Do you consider yourself a New Social Entrepreneur? Why/why not?

6. As you know, REDF offers six major forms of support to nonprofit enterprises—

   core investments (the $xxx grant you receive from REDF)

   access to other capital

   targeted business assistance

   the venture committee

   the Farber Interns/Fellows program

   Partners-for-Profit; and

It also includes an information management component. We'd like to look a bit more closely at each of these elements. In each case, we'd like to explore three areas: ***the concept*** (is this type of assistance useful to your enterprise); ***the process*** (is the way the support is made available useful to your enterprise); and ***the interpersonal dynamics*** (do you work well with the people providing the support).

First let's look at the core investments. [Probe: What works well/poorly? Level of contact with/support from REDF staff? Who? Opportunity to offer feedback? Relevance/value to your enterprise? Limits to value? REDF staff responsiveness to your needs?] *Follow with questions on targeted business assistance, the Farber Interns/Fellows, access to other capital, Partners-for-Profit, information management, and the venture committee.*

Organizational Issues:

7. Let's now look at some organizational issues. What are relations like between the three main participants in this effort: the social purpose enterprise, REDF and the nonprofit organization? [Probe: Do the three entities share common goals and priorities? Are there tensions?]

8. Who do you turn to for guidance/assistance when making business decisions

about the social purpose enterprise? REDF or your nonprofit organization's executive director or other? Why? Is this a source of tension for you?

9. Are there any other organizational issues/concerns you'd like to raise? [Probe: Value of meetings, reports, REDF as source of future funding, other REDF requirements (WebTrack, e-mail, web site usage, social cost accounting, special event?)]

Recommendations:

10. Do you have any overall recommendations for strengthening the REDF's work with your organization? Any additional comments/concerns you'd like to make?

REDF Process Appraisal Executive Director Protocol

Background:

1. Please tell me a little about your professional background. What is your current position and responsibilities? When did you start working with [nonprofit organization name]? What was your background prior to joining [nonprofit organization name]?

2. What do you see as [nonprofit enterprise's] overall strengths/weaknesses? What are your goals for [nonprofit enterprise] over the next year?

REDF:

3. What first comes to mind when you think about REDF? [Probe: strengths, challenges, successes, frustrations]

4. Was [enterprise name] involved in the Roberts Foundation's earlier work on the Homeless Economic Development Fund? If so, what are your impressions of the transition from the Homeless Economic Development Fund to REDF? [Probe: your level of involvement in decision-making, strengths/weaknesses of change, value to your organization]

5. REDF is committed to the Social Venture Capital approach. What is your understanding of the Social Venture Capital model? What is your opinion of this approach? What is your definition of a New Social Entrepreneur? Do you consider your business manager to be a New Social Entrepreneur? Why/why not?

6. As you know, REDF offers six major forms of support to nonprofit enterprises—

   core investments (the $xxx grant you receive from REDF)

   access to other capital

   targeted business assistance

   the venture committee

   the Farber Interns/Fellows program

   Partners-for-Profit; and

It also includes an information management component. We'd like to look a bit more closely at each of these elements. In each case, we'd like to explore three areas: ***the concept*** (is this type of assistance useful to your enterprise); ***the process*** (is the way the support is made available useful to your enterprise); and ***the interpersonal dynamics*** (do you work well with the people providing the support).

First let's look at the core investments. [Probe: What works well/poorly? Level of contact with/support from REDF staff? Who? Opportunity to offer feedback? Relevance/value to your enterprise? Limits to value? REDF staff responsiveness to your needs?] Follow with questions on targeted business assistance, the Farber Fellows, access to other capital, Partners for Profit, information management, and the venture committee.

Organizational Issues:

7. Let's now look at some organizational issues. What are relations like between the three main participants in this effort: the social purpose enterprise, REDF and the nonprofit organization? [Probe: Do the three entities share common goals and priorities? Are there tensions?]

8. Who does your business manager look to for advice? You? REDF staff? Others? Is this a source of tension?

9. Are there any other organizational issues/concerns you'd like to raise? [Probe: Value of meetings, reports, REDF as source of future funding, other REDF requirements (WebTrack, e-mail, web site usage, social cost accounting, special event?)]

Recommendations:

10. Do you have any overall recommendations for strengthening the REDF's work with your organization? Any additional comments/concerns you'd like to make?

Appendix A
The Roberts Enterprise Development Fund Organizations 1997-1998 [11]

1) Asian Neighborhood Design, Inc. San Francisco/Oakland, CA

Asian Neighborhood Design is a nonprofit community development organization providing low-income communities with housing and employment services. A.N.D.'s mission is to advance community development programs and policies that empower, transform, and improve the lives of low-income and disenfranchised individuals and communities.

(415) 593-0423 **www.andnet.org**

Programs: Housing and community development, architecture and planning, family and youth resources, employment training, business development

Business: Specialty Mill Products furniture and cabinet manufacturing

2) Barrios Unidos Santa Cruz, CA

Barrios Unidos is a nonprofit community based organization located in downtown Santa Cruz. The strategy of Barrios Unidos is to reduce violence among Latino youth by providing them with alternatives to violence. Barrios Unidos has been working in violence prevention for 17 years and has a solid reputation for providing youth with support and alternatives from the "madness."

(831) 457-8208

Programs: General youth programs, computer lab

Business: BU Productions screen printing

3) Building Opportunities for Self-Sufficiency (BOSS) Berkeley, CA

For over a quarter of a century, Building Opportunities for Self Sufficiency (BOSS, Inc., formerly known as Berkeley Oakland Support Services) has worked to elevate people out of poverty and homelessness. BOSS is one of the largest players, innovators, and collaborators in the field of homelessness and poverty in the state.

(510) 649-1931

Programs: A comprehensive array of housing services and approaches, unique employment programs and opportunities

Business: BOSS Enterprises Property Improvement

4) CVE, Inc. San Francisco, CA

CVE, Inc. (Community Vocational Enterprises), since 1986, has been the main employer in San Francisco of people with psychiatric disabilities. CVE combines vocational rehabilitation with its

role as an employer in a model program that emphasizes getting people back to work and helping them stay there.

(415) 544-0424 **www.cve.org**

Programs: Assessment, vocational planning, extensive training, and job placement

Businesses: Industrial Maintenance Engineers (Janitorial), CVE Cafes, Clerical Services, Driver/Messenger

5) Golden Gate Community, Inc. — San Francisco, CA

Golden Gate Community, Inc. (GGCI) was founded in 1981 by a group of individuals, churches, and organizations that were concerned about the growing homeless population in the Haight-Ashbury/Golden Gate Park area of San Francisco. During the past 15 years the agency has grown to provide services across San Francisco addressing the needs of the poor and the sick of the city.

(415) 552-1700 **www.ggci.org**

Programs: The Bridge for Kids and Camp Bridge (in-home respite child care and summer day camp for children in families affected by HIV/AIDS), community service projects, Oak Street House transitional residence for women and children

Businesses: Ashbury Images screen printing, San Francisco City Stores – Pier 39 and Beach Chalet

6) Goodwill Industries — San Francisco/Greater East Bay, CA

Goodwill's mission is to help people with disabilities of disadvantaging conditions become more employable by providing work, skill training, and job placement in the community.

(415) 575-2100

Programs: Retail stores, vocational school, job training, job placement

Business: Goodwill Staffing Services

7) Jobs Consortium — Oakland, CA

The Jobs for the Homeless Consortium is a nonprofit organization providing employment services to the homeless and low income populations.

(510) 251-6241

Programs: Vocational counseling, addiction and recovery counseling, disability peer counseling, job preparation workshop, Homeless Learning Center, job development system

Business: RelyAble Choices Employment Services

8) Juma Ventures — San Francisco, CA

Juma Ventures is a nonprofit organization that owns and operates small businesses employing at-

risk youth. The core work of their organization focuses on economic development,job creation and training, geared specifically toward high-risk youth from low-income Bay Area communities. Juma Ventures' goal is to use business as a vehicle for social change and to help young people from marginalized backgrounds develop the skills, both practical and emotional, to take hold of their lives and succeed.

(415) 247-6580 **www.jumaventures.org**

Programs: Business/work skill development training, emotional intelligence/life skills

Businesses: Ben & Jerry's Ice Cream on Wheels (ICOW), Ben & Jerry's Ice Cream Concession at 3Com Park, Ben & Jerry's Scoop Shops on Castro and Chestnut

9) Rubicon Programs Richmond, CA

Rubicon Programs mission is to provide a comprehensive and integrated continuum of social and rehabilitative services for people who have barriers preventing them from functioning independently and fully participating in the economic and social life of our community.

(510) 235-1516 **www.rubiconpgms.org**

Programs: Independent living program, vocational program, mental health services, housing development

Businesses: Rubicon Buildings & Grounds, Rubicon Bakery, Rubicon HomeCare Consortium

10) Youth Industry San Francisco, CA

Youth Industry is a nonprofit organization providing vocational training and job placement for San Francisco homeless, transitional, and at-risk youth, ages 15-22. Youth Industry was founded in 1993 and operates out of three warehouses in the Mission District, furnishing a safe and supportive environment, teaching youth marketable skills through the creation, development and operation of small businesses.

(415) 206-9945 **www.youthindustry.org**

Programs: Life skills classes, Artists Mentorship Program in ceramics, multi-media, music, photography, and furniture painting

Businesses: YI Recycled Merchandise, Nu2u thrift store, Pedal Revolution bicycle repair shop, Einstein's Cafe

Chapter 3

Enterprises Gone But Not Forgotten: Lessons Learned from Three Organizations and REDF

Enterprises Gone But Not Forgotten: Lessons Learned from Three Organizations and REDF

By Fay Twersky

and

Laura Lanzerotti

BTW Consultants-informing change

Acknowledgements

Many people reviewed and offered constructive comments to this chapter. The preparation of these case studies required a sensitive process and the honest reflection of all involved. The authors would like to acknowledge the contributions of all the reviewers:

boona cheema
Executive Director
Building Opportunities for Self-Sufficiency (BOSS)

Executive Director
"Agency A"

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The Roberts Enterprise Development Fund

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Overview

In order to keep up with emerging community needs as well as changes in philanthropy and the nonprofit capital marketplace in general, nonprofits of all sizes and types are seeking innovative strategies to achieve greater self-sufficiency. Motivated to broaden their funding base as well as find new ways to pursue their social mission,nonprofits are increasingly aiming to apply market-based principles of accountability and revenue generation to support programs and services. Various market-oriented strategies have emerged as part of this shifting landscape, strategies that have been designed to benefit nonprofit organizations and the people they serve. Terminology in this field has not yet been codified, but some of the strategies often referred to include: corporate partnership, cause-related marketing, income generation and social purpose enterprise. It can be a challenging and complex undertaking for a nonprofit organization to sift through these and other options and select the best approach to suit its organizational culture and capacity.

This chapter tells the story of three organizations that elected to pursue a particular strategy – social purpose enterprise – in order to employ low-skilled and/or formerly homeless individuals and generate a profit. After several years,it became clear, both to the organizations and the investor, that they were not ideally suited or ready to operate businesses that were compatible with the investor's expectations.

These are three organizations that in January of 1997 were invited to be part of The Roberts Enterprise Development Fund's (REDF) portfolio of 10 nonprofit organizations collectively operating 23 social purpose enterprises. The enterprises run by these three organizations respectively include:

- "Agency A" - a silk screen printing business employing young people at risk for gang involvement;

- "BOSS- Building Opportunities for Self-Sufficiency" - BOSS Enterprises, a property maintenance services business employing and training homeless and/or formerly homeless people in the basic skills of the construction trade; and

- "Agency C" - a temporary staffing business employing formerly homeless people in temporary staffing positions.

After two years, Agency A and Agency C were excused from the REDF portfolio. Both organizations have requested that their identities be anonymous for purposes of this publication. During its third year, BOSS's Executive Director felt it was in the best interests of both BOSS and REDF to close down BOSS Enterprises and asked to be excused from the REDF portfolio. BOSS explicitly did not want its case study to be "blinded," as the organization felt it was essential to be as open and honest as possible about the experience in order to learn from what happened and to share that learning with others. This chapter attempts to do just that – document that learning in order to share it with others.

The chapter presents case studies for Agency A's Silkscreening Enterprise and BOSS Enterprises, detailing their experiences in the REDF portfolio and in operating their respective enterprises. It concludes with crosscutting lessons learned. These are lessons that have applicability both to nonprofits seeking to pursue social purpose enterprise or other market-oriented approaches, as well as to philanthropic investors wanting to effectively support these types of ventures.

Agency C requested that the case prepared regarding its temporary services enterprise not be published despite being "blinded" to preserve anonymity. Agency C reviewed the case numerous times, offering input and suggestions, many of which were incorporated in the case. But Agency C was still not satisfied with the multiple perspectives reflected in the final version and declined REDF's invitation to prepare a companion piece that solely reflected that agency's point of view. Out of respect for the agency's wishes, the case is not being published as part of this paper, but the lessons learned from Agency C's experience are integrated into the paper's final section on cross-cutting lessons learned.

It is important that the reader understand that this chapter and the case studies herein do not provide an assessment of the two organizations in general or the services they provide. These organizations are both highly respected in their communities and are

known to be effective nonprofit service providers. They are making important contributions to the communities they serve. They have leaders who are committed to making a difference and who have spent most of their adult lives in pursuit of social justice. This chapter should therefore in no way be interpreted as an evaluation of the organizations, their capacity or their overall performance.

The case studies are specifically focused on these two groups' efforts and experiences in operating a social purpose enterprise while part of the REDF portfolio. It includes detailed descriptions of the organizations' experiences in this regard as well as the experiences of REDF, the investor.

As is often the case in science and in life, the more useful learnings are gleaned from circumstances that did not work out as expected. When experimenting with new and different models of social purpose enterprise operation, it is important that unexpected results are examined not as failures but as learning opportunities. This chapter attempts to present the case studies and lessons learned in that spirit – telling the stories with honesty and due respect for all involved. It is from this sort of recounting that others may learn from those who have gone before them and make choices that are more informed as a result.

The Roberts Enterprise Development Fund would like to publicly thank both organizations for allowing their story to be shared with others in the field who are exploring social purpose enterprise creation and seeking to understand the complexities involved in such work.

Background on The Roberts Enterprise Development Fund

In January of 1997, The Roberts Enterprise Development Fund (REDF) invited ten northern California nonprofit organizations to become part of its social purpose enterprise portfolio. By REDF's definition, social purpose enterprises are those ventures that are managed against a double bottom line: a social mission to employ low-skilled and/or formerly homeless individuals and a business mission to operate on a profitable basis.

REDF is recognized as one of the pioneers of an approach to charitable giving known as "venture philanthropy." This practice involves the application of fundamental for-profit venture capital principles to philanthropy. As such, REDF makes a variety of investments in each of the organizations in the portfolio. The organizations receive core financial investments from REDF in addition to a full complement of other support, including:

- capital grants for the business,
- targeted business analysis and assistance,
- involvement and partnership with REDF through Venture Committees,
- enterprise capacity-building through the Farber Interns and Farber Fellows Program,
- business networking through the Partners-for-Profit, and
- access to and training in the use of technology and outcome measurement.

Central to REDF's approach is the notion of a partnership with the enterprises in the portfolio. It sees itself as both investor and business partner/advisor. This way of working with nonprofit organizations represents a paradigm shift in the traditional funding relationship between philanthropy and nonprofits. Through its venture philanthropy practice, REDF is trying to transform the traditional grantor-grantee relationship with an eye toward both sectors becoming more effective. The expectation in this shift is that funders will become more effective investors in social programs and that nonprofits will be better positioned to draw on philanthropic resources to become more effective practitioners.

Thus, the lessons learned from these case studies do not just concern nonprofit organizational decisions and enterprise operation. The lessons also apply to a philanthropic investor, particularly to this new type of venture philanthropy that is trying to establish a different relationship with the organizations and programs they seek to support.

In preparing the cases, five critical themes emerged across all of the groups' experiences. These are expanded upon in the final section: Cross-Cutting Lessons Learned, but it may be helpful for the reader to note five issue areas illustrated in great detail in the case studies themselves. They are:

1. Organizational commitment to the enterprise's business mission;
2. Adequate financial accounting systems;
3. Role distinction between the nonprofit, the enterprise,and the investor as it relates to authority and decision making;
4. Capacity to produce or deliver on business product or service at the level needed; and
5. Consistency and clarity in the investor's approach to the partnership.

Methodology

The case studies were prepared based on in-depth key informant interviews with all of those who were centrally involved in the management of the two businesses as well as a review of written background materials. Twenty individuals were interviewed for the two case studies.[1] The list of key informants was developed and agreed to by both REDF and the organizations. Each face-to-face interview took approximately one to two hours.

Individuals Interviewed for Case Studies

AgencyA/Silkscreen Printing Enterprise	BOSS/ BOSS Enterprises	REDF staff and consultant
Executive Director	Executive Director	Executive Director
Assistant Director	Economic Development Director	Associate Director
Financial Manager	Fiscal Manager and Fiscal Assistant	Business Analyst
First Business Manager	Board Member	
Second Business Manager	Organizational Development Consultant	
Current General Manager	First General Manager	
	Second General Manager	
	Training Supervisor	
	Office Manager	
	Enterprise Employee (BOSS Participant)	

All interviews were conducted with an interview guide that was designed to gather key informants' perspectives on a uniform set of issues related to the business operation. The interview protocol included questions related to

- organizational background and history,
- the decision to launch a social purpose enterprise,
- the enterprise's management with regard to finances, personnel and other operations, and
- communications and relationship between and among the nonprofit, the enterprise and REDF staff and consultants.

REDF engaged BTW Consultants to oversee the case study process. Staff at BTW Consultants have a long history of working with The Roberts Foundation and in providing management information assistance to REDF and the groups it supports. BTW's familiarity with REDF provided important contextual information for the case studies. In order to assure objectivity and open discussion for the first two cases – Agency A and Agency C – BTW contracted with an independent contractor who had no prior contact with either The Roberts Foundation or its funded organizations. This contractor was responsible for conducting all interviews for those cases, including all additional fact-checking and follow-up conversations. For the BOSS Enterprises case study, BOSS welcomed BTW staff to conduct the interviews as well as prepare the written case. No independent contractors were used.

Agency A: Silkscreen Printing Enterprise Summary of Social Accomplishments

- Utilized community artists to produce cultural art with violence prevention messages.
- Provided the vehicle for cultural art to become a viable commercial product to advance the cause of ending barrio warfare. These are not Nike or Fila shirts so commonly seen on youth today, but peace warrior shirts with a cultural message.
- Built community capacity to advocate for community causes utilizing a commercial vehicle.
- Built the business capacity within the larger nonprofit, including strengthening systems, improving skills and efficiency, and expanding economic development strategies beyond the T-shirt business.
- Positively influenced people and communities: 100% of all permanent staff transitioned from Welfare to work. Provided training and/or employment opportunities to youth who were on probation, in group homes or out of school.
- Conducted trainings and workshops on the business model and the associated successes and challenges with community groups, schools and other community based organizations from state,national and international regions.
- Purchased local land, facility and business. The agency leveraged and purchased a 2 acre site which includes a 6,500 sq ft. production facility which will permanently house the Silkscreen Printing Enterprise. This is expected to eliminate enterprise overhead costs by over $400,000.
- Shared information with other chapters nationally and other community organizations about a "Long-Term Sustainability Concept." The concept includes using land acquisition and the creation of small businesses to begin the process of job creation and business ownership through their own ingenuity and resources.
- Leveraged collective experiences, challenges and successes to continue to build a larger economic development strategy for the agency and the Silkscreen Printing Enterprise. As a community-based organization focusing on youth development, the organization is creating community assets through economic development. The enterprise is completing a consolidation process and is taking a major step towards a stable path both financially and programmatically.

(The above information is provided by the staff of Agency A)

Agency A: Silkscreen Printing Enterprise

Background

Agency A is an organization passionately committed to supporting peace and nonviolence in a Chicano community torn apart by crime and drugs. The visionary and charismatic man who runs Agency A has personally overcome obstacles in his own life. He lost two of his brothers to violence and counts 25 relatives in prison.

Now he spends his days visiting prisons to talk about peace, hugging young gang members whom society has given up on, and shepherding a six-year-old nonprofit into ever new stages of development. Agency A provides a variety of violence prevention programs and services in the community and has spawned many other chapters nationwide. As Agency A's Assistant Director says: "We started out to build an organization and wound up building a movement." It was not always that way. For years, the organization was comprised of an informal group of friends and relatives who attended anti-violence conventions, trying to have their voices heard there and in their own community.

To finance their work, the group decided to sell t-shirts they made themselves. In the beginning, they silk-screened t-shirts the hard way. They worked in a living room,laying the shirts out on planks, inking them, and drying them with hair dryers. Then the man who would later become Agency A's Executive Director would pile the shirts in his car and drive off to conventions to sell them. Agency A's leaders say their movement was born in the trunk of that car. Selling t-shirts was a portable activity that allowed them access to and visibility in these convention sites.

While this small group of activists began organizing and spreading the message of peace in the early 70's, they did not actually incorporate as a nonprofit until 1993. During all those years, the group never stopped making t-shirts. In 1994, one year after the organization itself incorporated, Agency A's Executive Director thought it was time for the t-shirt operation to grow along with the nonprofit. He decided a silkscreen printing business would work well with the organization's mission in three distinct ways:

1) Inspirational t-shirts and other silkscreen products could carry Agency A's message of nonviolence;

2) The money earned could finance nonprofit programs and services; and

3) The business could employ young people and adults trying to change their lives for the better.

They soon set about looking for someone to run the silkscreen printing enterprise. They knew it might be difficult to find the right person for the job, because, as the Assistant Director explains,"There's a conflict between business and social values, and the challenge is getting someone to create a balance." The person they hired for the Business Manager position was a woman from outside the Chicano community who had worked in a private sector, for-profit company that did screen-printing and had achieved significant growth to become a major player in the industry. The Assistant Director says he knew within 15 minutes that she was right for the job because she "shared the consciousness of the people."

Agency A's Silkscreen Printing Enterprise Joins the REDF Portfolio

In 1996, the Agency A Business Manager heard about what seemed to be a perfect opportunity for the fledgling company. The Roberts Foundation, building upon six years of funding in this issue area, was embarking on an exciting experiment – The Roberts Enterprise Development Fund (REDF) – investing in nonprofits' efforts to run social purpose enterprises. Agency A would have to adopt some formal business practices in exchange for the investment. The manager met with REDF's Executive Director and then applied for inclusion in the portfolio.

In late 1996, REDF selected Agency A as one of 10 portfolio members and agreed to provide a $100,000 enterprise grant in 1997 to support Agency A's Silkscreen Printing Enterprise. The funds were to be expended according to the needs and priorities of the business. In addition, REDF also gave the enterprise a $15,250 capital grant.

Even at the time of the initial investment, REDF had some concern based on its experience with another silkscreen business about what appeared to be inflated financial projec-

tions for Agency A's Silkscreen Printing Enterprise. However, REDF's Executive Director was led to believe that the enterprise had significant commitments for purchases from many of their national chapters. REDF was also interested in portfolio businesses going to scale quickly, so the Executive Director was willing to take a chance that Agency A – with a Business Manager he respected – could accomplish their ambitious goals.

The Business Manager in charge of Agency A's Silkscreen Printing Enterprise had strong sales experience and skills but did not possess business finance or accounting skills. At the same time, Agency A's Executive Director did not fully appreciate the implications of REDF's expectation that the silkscreening operation would have to achieve business outcomes while attending to its social mission. They did not realize, for example, that they might ultimately have to fire staff from their target population if they could not perform their jobs well.

Early Successes

Over the first six months of its participation in the REDF portfolio, Agency A's Silkscreen Printing Enterprise blossomed in many ways. The Business Manager had won loyalty from her workers, and they bonded as a team. She says she could always count on her staff to do whatever was necessary to complete an order, including working long hours. Her strong marketing skills paid off for the company: she brought in work, partly because of her background in marketing and partly because the mission "sells well." People wanted to help a nonprofit that was doing good work.

Things were going so well, in fact, that the progress began to reveal other organizational challenges. Agency A's Silkscreen Printing Enterprise was getting so many contracts that the demand exceeded its capacity and the Business Manager had to subcontract some of the work out to other businesses. It became clear that the business would not be able to handle big jobs until it upgraded its equipment and moved from a slow manual press to an automated one.

From the nonprofit's perspective, Agency A's Silkscreen Printing Enterprise was already a success with respect to its social mission. The business employed several people who had been on welfare before they were hired. Their full-time employment with the enterprise enabled them to achieve self-sufficiency by getting off welfare. The enterprise also employed many young people, especially in the summer. Most of these young people were former gang members – and at risk of ending up in the juvenile justice system if they had not been there already. These jobs not only put money in their pockets, but also kept them off the street and out of trouble.

Early Warning Signs

After a few months,REDF began to have concerns that the Silkscreen Printing Enterprise was in trouble; it did not appear to be generating enough revenue to cover its cost of operation. REDF's staff and business analyst doubted the enterprise was generating as much revenue as it needed to cover the fixed costs of the operation. The problem was they could not tell for sure because Agency A was not able to produce the financial reports necessary for assessing the health of the Silkscreen Printing Enterprise.

Two essential elements REDF built into its venture philanthropy initiative were not working effectively with Agency A's Silkscreen Printing Enterprise: 1) monthly venture committee meetings and 2) the preparation of financial reports.

The Venture Committee meetings were established as a capacity-building forum for enhancing the ability of the businesses to successfully execute their business plans. As originally conceived, the Venture Committee representatives were to consist of REDF staff and business analyst, the nonprofit Executive Director, the Business Manager, and, as appropriate, a Board Member. The Committee was to meet monthly to review financial and operational performance and identify strategies for addressing concerns.

The REDF business analyst was having one-to-one monthly meetings with Agency A's Business Manager to review the enterprise's progress and help get the enterprise's accounting system on line. During the first six months of Agency A's involvement in the portfolio, however, no formal Venture Committee meetings were held. There were multiple factors contributing to this: REDF staff and Agency A had busy and often conflicting schedules, there was significant travel time required between their two office locations, and perhaps most importantly, communications between the two groups were bad. REDF staff said they would leave tele-

phone and e-mail messages and never hear back. Messages were left with the receptionist because no one at Agency A had voice mail or an individual e-mail account. For REDF, e-mail was a primary mode of communication with groups in its portfolio. It was so important, that early on, REDF provided financial and technical support to all of the enterprises in the portfolio to "come online." Over the course of their relationship, not having personal e-mail accounts would be a tremendous obstacle to communication between the two organizations.

In preparation for Venture Committee discussions, Agency A's Silkscreen Printing Enterprise was supposed to prepare and send income statements and balance sheets monthly so REDF and the business management team could assess the enterprise's health and make necessary adjustments. However, no income statements or balance sheets were sent to REDF during the first six months that Agency A was in the REDF portfolio. Agency A could and did produce reports for the agency as a whole, but not for the enterprise specifically. Agency A's first Business Manager says a big part of the problem was that she had no background in financial management and did not know how to compile the reports. She hoped sales were covering expenses, but had no way of knowing because no one was calculating cost-of-sales.

The Business Manager did recognize the need for the data and purchased a software program to make compiling financial reports relatively easy. The REDF business analyst worked with her to select a consultant who would set up the software program. But installing the program and training staff on it took time, and that time lapse proved critical. Because the Business Manager did not know how much money Agency A's Silkscreen Printing Enterprise was losing, she mistakenly thought she had the luxury to manage gently.

She says she recognized there were periods when she had more workers than there was work to be done. She was marketing the enterprise's products but as is common in the industry, sales levels fluctuated. The commitments from Agency A's other chapters did not materialize at the volume expected. She also realized that the enterprise's workers were often performing their jobs inefficiently. In general, they did not take the initiative to find work if there were no t-shirts to be screened and at least some were late to work on a regular basis. The Business Manager says she was preparing herself to get tougher with her workers soon – as soon as she could see her cost-of-sales figures. But she left before she could make the change.

Management Transitions

In May, just five months after Agency A joined the REDF portfolio, the Business Manager gave notice. Although she retains fond memories of her days with Agency A – she still carries around a photo of the group's leaders – she says she decided to leave because of an organizational culture clash, in this case between the for-profit and nonprofit.

For one thing, the business manager had taken a substantial pay cut when she left the private sector and was interested in earning a higher salary. Agency A paid her according to existing organizational standards given her job responsibilities within the agency. As a nonprofit, Agency A could not afford high salaries for its workers, and the Executive Director felt the enterprise staff should not make substantially more than the nonprofit staff. Still,at the time the organization was in the process of increasing the pay for that position, but the manager left before that occurred. The next manager did receive the new level of compensation.

This issue of compensation has come up in many of the REDF portfolio organizations. It has become clear that in order to attract and retain qualified managers with sound business skills, it is often necessary to offer higher salaries than is typical in a nonprofit agency. Agency A wanted to retain its Business Manager, but was not willing to compromise equity in the organization's pay scale to do so. This may have been the first time that it became clear to REDF that Agency A's leaders had not committed to a market mentality.

Beyond that, the Business Manager says some decisions were being made above her that accomplished Agency A's social mission, but hurt the business. As an example, Agency A's Executive Director sometimes gave away t-shirts to promote the organization's social mission, leaving the business to absorb the production costs. For the Executive Director, this is easily defensible because there is a line item in the organization's budget for promotional items. However, that line item in the organization's

budget was not accounted for in the enterprise's business plan.

However, most troubling for the Business Manager, was the difficulty accessing earmarked REDF money and enterprise financial information from the agency. Agency A's Business Manager tried to solve the dilemma by suggesting that Agency A allow her to control the business's cash. REDF's business analyst strongly agreed with this approach. For a few months, Agency A went along with this plan. When the Agency A Financial Manager was also not able to get the financial information she needed from the Silkscreen Printing Enterprise, however, the nonprofit resumed its control over the business' finances.

The Business Manager's decision to leave Agency A Silkscreen Printing Enterprise disturbed REDF's Executive Director. He already sensed that Agency A was having trouble balancing its business and social missions. He felt the nonprofit hired some managers and essential personnel for Agency A's Silkscreen Printing Enterprise more for their need than for the need of the enterprise. For example, the production supervisor and bookkeeper were from Agency A's target population but neither had backgrounds in business. REDF's Executive Director was concerned that Agency A would hire another such person as its next Business Manager; he was afraid that such a decision would seriously undermine the business.

REDF's Executive Director sent a frank letter to Agency A's Executive Director stating that the Silkscreen Printing Enterprise needed a high caliber Business Manager to ensure its success and to secure continued REDF funding.

Such warnings are not unusual in the business world; venture capitalists fund people as much as ideas and they often stop investing if an important person leaves a start-up business. However, Agency A's Executive Director did not receive the letter in that spirit. He began to feel that these modern capitalists were not wholly unlike the patrones who mistreated his migrant-worker parents.

"I read that letter and it was kind of like, 'I've got the purse and you're going to dance,'" he said. "It doesn't work that way here. It's again THE MAN telling us, 'You've got to dance for me.'" The letter also began to convince him that he and REDF spoke very different languages. In a sense, the Business Manager had served as a translator between the nonprofit and for-profit cultures. After she left, communications between REDF and Agency A steadily eroded.

The Second Business Manager

Agency A chose a new Business Manager in July 1997 and REDF's Executive and Associate Directors were relieved. The new manager was from outside Agency A's close-knit staff. His business background seemed right – he had screen-printing and management experience. His personal background also suggested he might be more successful in persuading the organization to make changes than his predecessor. He was a Chicano man who grew up in a rough California neighborhood.

REDF's hopefulness did not last long. The weaknesses of the Silkscreen Printing Enterprise continued to manifest. Agency A's leaders blame the second Business Manager for many of the problems – he was considered an especially bad team leader.

But he could not have joined the company at a worse time. The summer is peak season for t-shirt sales. Agency A's Silkscreen Printing Enterprise should have been in a major sales push, but the new manager had to learn the business before he could market it.

Worse yet, the new Business Manager no longer had the luxury of ignoring personnel problems; it became clear several months into his tenure that the enterprise was losing money. Making workplace changes is hard enough, but competing with a popular ghost makes it even more difficult. His workers questioned his stricter approach partly because their first manager never made such demands on them.

Still, it might have been possible to institute change if the new Business Manager had more effectively garnered support for his plans. Instead, workers say he treated them disrespectfully and ordered them to do things differently without always explaining why. They allege he made many personal telephone calls at work. He alienated the Production Supervisor almost immediately, which soured his relations with the shop's youth, who were fiercely loyal to the Production Supervisor.

At one point, the Business Manager tried to have a time clock installed because,he says, his workers were consistently late. Agency A's leaders were adamantly opposed to the suggested change. As a businessman,the manager saw the clock as a standard tool. As com-

passionate people who side with the oppressed, Agency A's leaders worried the clock would rob workers of their dignity. Once again, it was clear that Agency A's leaders did not share the management mentality of the business people they hired to run Agency A's Silkscreen Printing Enterprise.

At another point, the Business Manager tried to discourage visits by small children, the relatives of workers. He said he took the action after the Production Supervisor brought in a box of toys so young visitors would have something to play with. The Business Manager felt that children are not only distractions in the workplace, but also could be endangered by the shop's heavy equipment if they wandered into the back room. He says the leaders of Agency A were shocked. They pointed out that their mission is about helping youth and building strong families. They were speaking of their social mission, not their business one.

At the same time he was struggling with his workers and superiors, the Business Manager was also having trouble with financial accounting. Like his predecessor, the REDF business analyst says, the Business Manager lacked financial accounting skills. The accounting software program ordered by the first manager had been installed and should have made reporting easier, but the second Business Manager did not understand how to use it and, the REDF business analyst says, he did not seem to want to learn it from her.

It was at this point that Agency A resumed responsibility for the enterprise's finances and the Agency A Financial Manager began preparing the enterprise's financial statements. The Financial Manager took over the financial reporting and attended her first venture committee meeting in October 1997, ten months after joining the REDF portfolio. At the next venture committee meeting, Agency A's Silkscreen Printing Enterprise presented its first standard financial statement, for November. That should have been the 11th monthly statement.

According to the REDF business analyst, however, it soon became clear that it was impossible to have confidence in any of the company's past data presented at that point. The information presented showed that by the end of 1997, sales were mounting. Much later it became clear that sales for the calendar year were approximately 40% less than what Agency A had estimated, and the business posted a loss of approximately $100,000. Despite that, REDF fulfilled its commitment to help groups through their "learning curve" and awarded a second $100,000 for the venture. As part of a venture philanthropy approach, portfolio members were to receive more than just one year of funding, and REDF staff still hoped the second manager could turn the enterprise around once he was more established in the business. They were at least encouraged that the accounting problems appeared to be solved.

The Corporate Incident

By March 1998, the new Business Manager was unable to move the Silkscreen Printing Enterprise anywhere close to its original projections. That was the month when the business's production problems became acute. This production low-point is significant enough that everyone involved still refers to it with a slight sense of horror as "The Corporate Incident."

A large Silicon Valley corporation – just the type of customer Agency A's enterprise wanted to attract – ordered nearly 1,000 shirts that winter. Agency A's Business Manager was ecstatic. The Business Manager says he asked his staff if they could do the job, and they said they could. He did not realize that orders of this magnitude had been contracted out under his predecessor.

It was only as the t-shirts started rolling off the press that the Business Manager realized just how ill-equipped his staff was to handle a large job. The shirts looked awful. Eventually he figured out the workers had used the wrong type of ink.

The manager, a true believer in pleasing the customer, tried to give the Corporation a discount on the job in the hopes of retaining a relationship. Agency A refused to let him, saying they needed all the money they could get to run their programs. The Corporation never took his calls again, the manager says.

The production failure convinced the Business Manager he needed to make major changes – the most important of which was the removal of the Production Supervisor. REDF, who also heard about "The Corporate Incident," agreed that staffing changes were necessary, and began questioning Agency A's

leaders about whether they were satisfied with the Production Supervisor's work.

Agency A's Executive and Assistant Directors both resisted firing the Production Supervisor or even transferring him to the nonprofit. The man in question is loyal to their cause and had been with them for several years. They felt that even transferring him into a position within the parent agency would be a betrayal of sorts. First, they suggested moving him to sales and marketing, although he had no previous sales experience. REDF staff countered that perhaps he could work for the nonprofit. The business, after all, was not doing well enough that it could afford to have a salesperson that was not up to the job.

Agency A leadership resisted making any change and the Production Supervisor remained in his position for several more months. Problems with production grew, weakening other parts of the business. Perhaps the greatest effect it had was to tie up the Business Manager's time. After the Corporate incident,the Business Manager felt he needed to oversee production for every job. But that consumed hours he should have been spending on sales and marketing. Eventually, the Production Supervisor was reassigned out of the enterprise, and according to Agency A leaders, has achieved success in another position within the nonprofit.

Trying To Achieve Balance in the Venture Partner Relationship

Throughout this period, REDF was trying to find the right balance in working with the organization. REDF wanted to create a new type of relationship between philanthropic investor and investee; one built more on partnership and trust than "fear-of-the-funder." The foundation was initially unwilling, for instance, to withhold new investment until Agency A produced financial reports because they were repeatedly told that such reports would be forthcoming. REDF believed in Agency A's potential and wanted to provide the opportunity to realize that potential.

In other ways, REDF became more aggressive, trying to safeguard its investment in this high-risk start-up venture. At one point, for instance, so few contracts were coming in that the REDF business analyst began acting as a kind of daily coach. She would call the Business Manager several days in a row, first to remind him of his plans to make sales calls, then to prod him to actually leave the office to make those calls when he said he would.

Difficulty in Producing and Using Financial Reports

More than a year into Agency A's inclusion in the portfolio, the enterprise was still struggling in its attempts to produce accurate financial reports for the Silkscreen Printing Enterprise. It was obvious to REDF that the enterprise was floundering, but without accurate financial statements,managers and REDF could not work to create solutions to solving the company's woes.

The accounting problems were different from before; now Agency A was at least producing income statements for the enterprise. But the data were often inaccurate and sometimes painted a rosier picture than REDF thought possible.

REDF's business analyst says these problems resulted from a communications breakdown between the nonprofit and its for-profit enterprise. She recalled how Agency A's Business and Financial Managers would spend their time at venture committee meetings disagreeing about whether the financial statements were accurate. That made it difficult for the group to assess the Silkscreen Printing Enterprise's performance.

In at least some cases,the consultant stated, the Business Manager was changing the Financial Manager's data before presenting it to REDF, and was masking losses. The consultant says the Business Manager later explained that he thought REDF would not want to hear the bad news, despite REDF's stated commitment to working with its organizations as they dealt with whatever problems were of concern to them. In addition, the consultant says, the Business Manager did not understand financial data well and had difficulty interpreting the reports that the Financial Manager produced. As a result, the consultant says, he would sometimes input the wrong numbers into the financial reports.

The Business Manager remembers the difficulties differently. He says he often told REDF how badly business was going, although he says Agency A's Assistant Director wanted him to present a positive picture. He also says the Financial Manager was overworked,and she would often get him data too late for him to review it adequately before

a venture committee meeting. As a result, he said, the days leading up to the meetings were "a frenzy," and disagreements over the data could not be worked out calmly.

Complicating matters,the two managers were locked in a struggle over the bookkeeper, who provided the raw data used to compile the financial reports. The bookkeeper worked at the Silkscreen Printing Enterprise and the Business Manager believed she should take his direction. But the Financial Manager wanted the bookkeeper to give her information directly in order for her to produce the most accurate financial picture of the enterprise's revenue and expenses.

Frustrated that no one was taking action to stop the enterprise's losses, the Financial Manager says she began regularly going into the Executive Director's office to show him data that proved the company was losing frightening amounts of money. She repeatedly said they needed a sales person because current sales could not support the business' expenses; later, she began advocating for the Business Manager to be fired.

The Financial Manager says she does not know why the Executive Director and the Assistant Director did not heed her warnings. She suspects they are simply more patient than she, unwilling for instance to fire someone until they were absolutely convinced problems could not be worked out.

For their part,the Executive Director and Assistant Director say, they did not really understand the import of the financial data. They also are used to succeeding in their nonprofit work,and tend to believe they can overcome even the worst of obstacles. Without that belief, they might not have created their anti-violence movement.

As a result, Agency A's leaders continued to talk to REDF staff in the same upbeat inspirational language they use in preaching their message; they talked about their mission and about being on the "mountaintop." Their words seemed to indicate they did not grasp the magnitude of the enterprise's losses, and REDF's Executive and Associate Directors began having a sinking feeling every time they attended a venture committee meeting.

Agency A's Executive Director was also increasingly anxious at the venture committee meetings, but for different reasons. In the first place, he had never intended to regularly participate in venture committee meetings and had asked his Assistant Director to assume that responsibility. The few times he did attend, he was frustrated that REDF's Executive Director was increasingly focusing on the bottom line and seemed disinterested in the good works the nonprofit was doing.

Often, the head of Agency A says, the meetings were simply surreal for him. He says he attended one the morning after a shooting in his neighborhood and he just could not put his heart into a discussion of financial data – although he never discussed this situation with REDF staff or requested to re-schedule the meeting.

The Final Months

The last months of Agency A's participation in the REDF portfolio were nothing short of tumultuous at the Silkscreen Printing Enterprise. Relations between Agency A and the Business Manager continued to sour. The Business Manager asked to reorganize his staff. He wanted to shift youth to trainee positions and hire a few more highly trained people to oversee production jobs. The organization refused.

The Business Manager and Agency A leaders were also engaged in a longstanding tug-of-war over REDF's money. In February 1998,REDF had made a $48,000 capital grant so the business could buy computers and a van. The Business Manager wanted the van to make deliveries;his idea was to use the service as a selling point. Agency A's Financial Manager did receive the money from REDF and had passed on money for computers, but refused to release the money for the van.

At that point, the Financial Manager says, the Business Manager was overspending his budget. In addition, the Silkscreen Printing Enterprise losses had grown so large that REDF's funding no longer covered them. The enterprise was drawing money out of all the nonprofit programs, and she thought the money earmarked for the van should instead be used to replenish those funds, at least temporarily.

Besides, she says, the Silkscreen Printing Enterprise was in so much trouble, a van was not going to help. She may have been right but what this situation clearly demonstrated was that Agency A, the enterprise, and REDF could not agree on a direction for the enterprise. REDF had, after all, earmarked its money for a van so presumably the investor thought buying it was a good idea.

In May 1998, REDF weighed in on the side of the Business Manager, writing a letter that said Agency A staff should not be able to overrule him, particularly on how he spent REDF's money and on staffing decisions. REDF staff wrote: "The … Manager of the Silkscreen Printing Enterprise needs to have authority to make personnel decisions that will further the growth of the business. This may include letting go certain youth trainees or staff from the target population that are not performing up to the standards of the business."

The Business Manager says Agency A promised to make some changes, but never did. In July 1998, the Business Manager was fired and the enterprise's graphic designer took over, becoming the enterprise's third Business Manager in less than two years.

At about the same time, REDF decided it needed to inform Agency A that it was in danger of being excused from the portfolio. (REDF had recently received feedback from a study it commissioned that investees wanted greater clarity about what merited inclusion or exclusion from the portfolio and so was in the process of "tightening up" its own operating procedures and work with "investee" organizations.)

In a letter dated July 30, 1998 REDF told Agency A's Executive Director that Agency A's Silkscreen Printing Enterprise would not qualify for the portfolio in 1999 unless major changes were made. REDF affirmed the positive developments; REDF specifically noted that financial reporting had improved once Agency A's Financial Manager began participating in venture committee meetings.

But REDF remained convinced that Agency A's leaders were not truly concerned with the "double bottom-line," and were pursuing social goals at the direct expense of the venture, without making adequate provisions for doing so. And they stated this clearly in their letter: "While we share your commitment to achieving both social and business objectives, if the business does not first have the opportunity to build adequate operating systems and sound practices, the effort to blend program clients and staff into the venture will have the end result of sabotaging both goals."

That letter, along with financial necessities, catalyzed a collaborative decision to reduce costs and re-organize operations. The new Business Manager was allowed to replace the Production Supervisor, who was transferred to the nonprofit. He also was allowed to lay people off, reducing the business to a skeleton staff until he could generate sales. That at least staunched the hemorrhaging of money. However, neither the enterprise nor the nonprofit had the resources necessary for hiring a salesperson and rebuilding the business.

Despite those changes, REDF still felt Agency A was unable to commit to market principles – or to REDF – fully enough. The new manager of Agency A's Silkscreen Printing Enterprise was still making financial promises the enterprise could not possibly keep. The enterprise still could not produce reliably accurate financial reports.

During the meeting to discuss Agency A's turnaround plan, the Business Manager presented data to REDF that showed the company would break even for the remainder of 1998. REDF staff felt the business plan was vague and incomplete even though the business analyst had provided the enterprise with a complete outline of what should be part of a turnaround plan. When REDF challenged the numbers,the Business Manager said the business would not, in fact, be able to cover its costs. The manager explained that he provided the break-even scenario because he did not think REDF would want to hear that losses would continue. In addition, REDF says the turnaround plan developed by Agency A's Assistant Director was vague – with little of the essential information found in a standard business plan.

REDF invested (in the form of operating grants) nearly $400,000 in Agency A's Silkscreen Printing Enterprise over two years, including capital grants, but the business was not even nearing its break-even point of $600,000 in annual sales. For the first eight months of 1998, the company posted sales of just $100,000.

Finally, in November of 1998, REDF sent a letter to Agency A saying that after a great deal of discussion,REDF felt it could not continue to keep the group in its portfolio. They extended a grant of $50,000 to support the transition.

Although it was clear by then that Agency A's Silkscreen Printing Enterprise had so far failed as a business, there was also no question that the business had made at least some social impact. During 1998, the enterprise employed 13 people from its "target population," eight of

whom were youth between the ages of 16 and 22. The company also provided training and workplace experience for an additional 25 young people from the community.

Looking back, Agency A's Executive Director takes pride in the enterprise's social accomplishments, but is saddened that the Silkscreen Printing Enterprise has not yet succeeded as a business. He assumes his share of the responsibility for the failure. He says he was not ready for the hard choices the market demands. He is unsure he will ever be ready for that.

"Capitalism has done us wrong – it has not been our greatest friend,'' he says. "We have to see how we can use it on our path." Then he pointed to a picture of the Mexican revolutionary leader Zapata and added: "We don't make money off the backs of our people."

Epilogue

As of April 1999, the Silkscreen Printing Enterprise was still ailing. The Business Manager said sales were dribbling in, and he still did not have a sales manager. He is spending his time, he says, trying to get systems in place that will allow the Silkscreen Printing Enterprise to function well as a business when it gears up again.

Among other things, the manager says he rearranged the physical shop so that work flows more efficiently. He also began locking up inventory because he said it was disappearing.

Agency A's leaders still count the enterprise as a success, and not just because of the number of people they employed during the two years in the REDF portfolio. Beyond that, they say, they learned important lessons about the marketplace. They now know that running a for-profit venture sometimes requires making painful decisions – like firing employees – that not only may hurt people, but also run counter to their social mission.

Agency A's Executive Director says he is continuing to mull over those lessons to decide how the silkscreen operation will be run in the future. He might try to keep the business running as a for-profit, but he also might decide to convert it to a funded program of the nonprofit. As a training program, the T-shirt shop can provide young people with skills development and experience without worries about overhead and breaking even.

If the Silkscreen Printing Enterprise becomes a program instead of an enterprise, the Executive Director says, it will be because he carefully considered the demands of the market and turned away from them. REDF's legacy, he says, may have been teaching him what he needed to know to make that decision.

BOSS Enterprises: Property Improvement & Light Construction Summary of Social Accomplishments

- Trained 39 homeless/low-income individuals in the construction and property maintenance trades — 24 unskilled, 2 semi-skilled, 13 skilled/journey level.
- Partnered with Rubicon Programs Inc. and Juma Ventures in HUD-funded Bay Area-wide Training and Enterprise Collaborative for the Homeless (TECH) which placed 318 individuals in jobs and trainings.
- Through TECH, conducted workshops on enterprise development attended by 36 people representing community-based organizations from Alameda, San Francisco, Contra Costa, Santa Clara, Marin and Sonoma counties; at the close of TECH (October 1998), 6 agencies were engaged in business planning for enterprise development.
- Received 2 merit awards for commercial remodel from the National Association of the Remodeling Industry — enhancing BOSS's image as not just providing food and shelter, but able to deliver quality services to the larger community.
- Increased agency focus on economic development activities during period of enterprise operation:(1) addition/refinement of Job Training Institute — paid training internships in six tracks: clerical,culinary, janitorial, community organizing, urban gardening, adult education; (2) expansion of Clean City street cleaning program; and (3) engagement in new CalWORKS job placement efforts in partnership with Alameda County.
- Attracted other enterprise or economic development funding opportunities: $64,000 from HUD, $20,000 annually from the City of Berkeley, $40,000 (2 years) from San Francisco Foundation, and $7,500 from the East Bay Community Foundation.
- Improvement of agency training approaches — addition of soft skills training and workplace culture education to better facilitate the transition from homelessness and joblessness into daily work routine.
- Educated and positively influenced members of the business community who utilized the services of BOSS Enterprises — 64 separate property improvement contracts were successfully executed by the enterprise.
- Learned from and used experience dealing with enterprise financials to initiate a comprehensive systems analysis and conversion in BOSS's fiscal office.
- Increased interaction with business and individuals in the for-profit community: Berkeley and Oakland chambers of commerce, business associations, business showcases and job fairs — this provided the opportunity to build relationships with businesses that continue to this day which have increased employment opportunities for participants.
- Increased interaction with nonprofits engaged in enterprise — this provided the opportunity to share BOSS's mission and programs and become part of ongoing long-term economic development discussions and planning in the community.
- Built capacity in business selection, operation, and analysis that is currently guiding BOSS in developing a future enterprise.

(The above information is provided by the staff of BOSS)

Building Opportunities for Self-Sufficiency: BOSS Enterprises

Background

Since 1971, Building Opportunities for Self-Sufficiency (BOSS) has provided housing and services to homeless people living in Alameda County. The organization began as a network of street counselors providing assistance to homeless mentally ill and disabled people in Berkeley. Today BOSS is a multifaceted organization that works to end poverty and homelessness using four strategies: economic development, community building, housing and support services. It serves people at 29 sites in Berkeley, Oakland, and Hayward.

BOSS's Executive Director is nationally recognized for the innovative organization she has led for over 21 years. She joined the organization in 1971, after BOSS provided her with the emergency services she needed upon arrival to the United States. She is the tireless force behind BOSS's transformation from a small, obscure organization with a budget of $268,000 to a $7 million agency, recognized as one of California's foremost organizations engaged in the fight against poverty and homelessness.

BOSS is an entrepreneurial organization that has grown according to new needs and opportunities. The seed that grew into BOSS Enterprises was planted when BOSS established a program to help BOSS participants obtain employment. The program helped participants clarify their goals, build self-esteem, prepare resumes, and search for jobs. After 1991, it also included two on-the-job training programs – Clean Streets and Graffiti Masters. Under contract to the City of Berkeley and local businesses, BOSS participants removed litter and graffiti while engaged in the six-month training program.

Over several years, the on-the-job training programs secured larger and larger contracts. While their first contract in 1991 was for less than $5,000, four years later they out-competed several other bidders to get a contract from the City of Berkeley worth nearly $200,000. Both the Executive Director and the Employment Program Coordinator saw that BOSS had the opportunity to secure more public and private contracts and create even more paid training for BOSS program participants. They began exploring additional ways to create training and employment programs that would bring more revenue to the organization.

The Planning Stage

One way to move beyond solely providing paid training opportunities for participants was to start a business that could employ BOSS participants and generate income for the organization. In 1995, BOSS sought and obtained a planning grant from the San Francisco Foundation to learn about enterprise development. A working group comprised of the organization's Executive Director, Employment Program Coordinator, and an Organizational Consultant began in-depth research to investigate other nonprofits engaged in enterprise development and to determine what BOSS needed to do to start a business.

In 1995, BOSS's Executive Director also approached the Director of The Roberts Foundation's Homeless Economic Development Fund (HEDF) to talk about BOSS's interest in launching a business. HEDF's goal was to help nonprofit organizations implement economic development projects that would enable homeless individuals become more fully involved and contributing members of society.

The Director of HEDF was interested in BOSS. BOSS had a strong reputation and credibility among homeless people. The Director recognized BOSS as an experimental, grassroots organization, committed to hiring participants as staff, and "big on client self-determination." These qualities fit with HEDF's interest in innovative nonprofit organizations that were interested in more than simply providing services to homeless people.

The Executive Director of BOSS and the Director of HEDF already had a working relationship. They had both been active on a regional level advocating for policies that met the needs of homeless people. Although they had this connection, the Director of HEDF had to be convinced that BOSS was ready to run a business. For example, he was concerned that the organization might not be comfortable with "firing people who weren't performing, holding themselves accountable for financials, making a profit." Were they ready to enter the competitive world of business? Although he had some con-

cerns, he was interested in helping BOSS determine if they were.

HEDF provided BOSS with $25,000 to begin a planning process. The conversation at BOSS shifted from "Should we attempt a business venture?" to, "If we launch a business, what type of business venture should it be?" The first goal of the planning process was to conduct a feasibility study that would narrow the possibilities for the type of business to pursue.

Under the guidance of BOSS's Executive Director and board, a Venture Team was created. The team was comprised of six members – BOSS's Board Chair, Employment Program Coordinator, and Planning and Marketing Associate, as well as an intern from UC Berkeley, Organizational Consultant, and Enterprise Development Consultant. Over the course of five months, the Venture Team met regularly, performed market research, and completed a document that presented their recommendations. From over 90 different types of business ideas considered, the feasibility study pointed to just one – Property Maintenance Services.

Property Maintenance Services seemed like a natural extension of the types of services – street cleaning and graffiti removal – that BOSS already provided. It also met the criteria against which the Venture Team was measuring each business idea:

1. Low capitalization;
2. Relatively simple equipment needs;
3. Relatively high use of labor;
4. Generates transferable skills;
5. Easy training;
6. Relatively easy entry into marketplace;
7. Relatively innocuous regulatory environment; and
8. Is profitable and expandable.

A Property Maintenance Services business seemed like the most feasible business idea.

At various points in the process and then again at the end, BOSS's Executive Director invited HEDF's Director to attend a board meeting. This was, in part, to help convince her Board of Directors that starting a business was a good idea. It was also to convince the Director of HEDF that BOSS was ready to launch a business. At that meeting, she articulated two distinct reasons for BOSS to start a business:

1. A business would generate revenue that would support BOSS in its mission of ending poverty and homelessness.
2. The business would create long-term, living wage jobs for BOSS participants.

While some board members were more interested in starting a business to generate profits for the agency, others were more attracted to the possibility of creating jobs. Within the HEDF framework these two objectives were inextricably linked and of equal importance. Therefore, BOSS's board was not forced to choose which goal the organization should pursue. After this meeting, both the board and the Director of HEDF were persuaded that BOSS's Executive Director and staff were committed to taking on this new challenge.

The next step for BOSS was to develop a business plan. Supported by money from HEDF, the Venture Team built upon the work they had begun in conducting the feasibility study. They continued their work together to research and prepare a plan for the Property Maintenance Service business. Their thoughtful planning process produced a business plan at the end of 1995.

The plan focused on three core market segments:

1. Residential cleaning (interior and exterior),
2. Commercial cleaning (interior and exterior) and
3. Vacant space preparation.

The business plan explained how the services that BOSS currently offered, specifically graffiti removal and exterior clean up, would be expanded and how a new service, the preparation of residential and commercial units for new tenants, would be added.

BOSS participants would be employed in the business from the beginning. The business plan outlined a start-up team for the business that included a "supervisor," a

"skilled worker," and a "helper." This helper would be drawn from BOSS's participant population. As part of its contract with the City of Berkeley to provide street cleaning services, BOSS was already running a six-month on-the-job training program. Enterprise workers could be drawn from this training program. Further on-the-job training would be offered in the enterprise as needed.

The business plan outlined a further goal of creating a separate subsidiary corporation to develop and manage for-profit enterprises. The Property Maintenance Services business was to be BOSS's first, but not last, leap into the for-profit arena.

BOSS's Venture Team prepared the business plan in dialogue with HEDF. The original plan showed the business breaking even after five years. HEDF wanted a more aggressive plan that could demonstrate break-even in three years. After this and other final revisions were made, the plan was completed. The Director of HEDF was interested in the business that was proposed. He suggested that additional funding might be available to BOSS in the near future.

On the eve of the organization's 25th anniversary, BOSS launched its first for-profit venture – BOSS Enterprises.

Launching the Business

It was critical that BOSS locate the right person to lead the new venture. In a document prepared by BOSS's organizational consultant, the ideal candidate was described as: someone who knows the trade, and knows the science of quick and accurate bidding, and is experienced in the details of cost control, and computerized tracking and understanding the dynamics and practice of business development, and can successfully apply the social dimension of BOSS's enterprise (training low-income people for marketable jobs).

In short, BOSS was looking for someone with a unique set of qualities and skills.

Remarkably, before even finalizing the business plan and fully securing funding, BOSS found someone who seemed to have just the right mix of experience and expertise. The candidate would be coming to BOSS from his position as General Manager of a painting and residential remodeling business that had formerly been supported by HEDF.

Reporting on the interview that she and two other members of the Venture Team had held with the candidate, BOSS's organizational consultant commented that the candidate had the "rare combination of skills" they sought. He had run a business that employed people similar to those served by BOSS – the business he was managing had employed 10 people, seven or eight of whom were unskilled workers. From his account, he had run a business that had a strong reputation and high customer satisfaction. The company had a number of repeat customers; most of the company's marketing was through referrals. The candidate was able to demonstrate his ability to bid on projects and track revenue; he showed his interviewers financial statements that demonstrated accurate bidding and high productivity.

The candidate also described challenges he faced in his previous employment. During the interviewing process, he specifically spoke about problems that surfaced as a result of the nonprofit organization's management of the business's finances. He thought it was critical that a business's finances be separated from the nonprofit's. In the consultant's assessment, the candidate's primary reason for leaving the business was that "he [was] tired of working with a non-supportive nonprofit." Despite the frustrations that had come with his work, the candidate had shown strong commitment to running a social purpose enterprise.

The candidate seemed ready to try again with a new social purpose enterprise. Furthermore, because the business he had managed was shutting down, he could bring relevant business contacts and referrals to BOSS's venture. From all angles, it seemed like he was the right person to launch BOSS Enterprises.

With hindsight, staff at BOSS now talk about the hiring process with regret. The Executive Director admits that she did not fully investigate the candidate's background. She realized later what a mistake that had been; "He was coming from a business that had been in bankruptcy. BOSS was not aware of that at the time."

The reason why the Executive Director did not check his qualifications was because, as she saw it, "he came highly recommended from HEDF." HEDF had already been involved in helping BOSS find individuals who could help them start a business. For example, HEDF had recommended the

Planning Consultant who worked with the Venture Team to develop their business plan. BOSS's Executive Director may have assumed that HEDF had more expertise in identifying appropriate candidates than she did and therefore trusted the Director's recommendations.

HEDF's Director did not intend to have such an impact when he gave BOSS's Executive Director the candidate's name. He suggested the candidate be interviewed and while he thought he would be a good candidate,did not intend his suggestion to be taken as such a strong endorsement.

These two different interpretations of the same set of events suggest an inherent difficulty in the relationship between a funder, like HEDF, and a nonprofit organization, like BOSS. HEDF's Director thought he had made it clear that he did not want to have a traditional funder-grantee relationship with portfolio organizations. He wanted to forge a strong partnership where there could be honest communication from both sides without fear of repercussion. Therefore, he was not aware that BOSS's Executive Director felt a strong power imbalance remained between them and that she felt somewhat obligated to heed his recommendations. Neither HEDF nor BOSS had the foresight to see that they had different understandings of the terms of their relationship and that this might be a barrier to honest and equal communication between the two organizations.

Start-Up Phase

BOSS Enterprises opened its doors in July 1996. As was stated in the business plan, the General Manager (GM) determined the business needed a reliable vehicle. He began to look into buying a truck. Given that funds were available to support the business, the GM wanted to purchase a new Toyota truck.

This precipitated the first conflict between BOSS Enterprises and BOSS's fiscal office. The GM remembers being surprised by this resistance. The head of the fiscal office indicated to him that the purchase would not be approved. Both the executive director and fiscal manager felt the GM was moving too fast. BOSS was concerned with keeping start-up costs low and they did not want to buy an expensive truck before getting a sense of what type of jobs were coming in. BOSS's board wanted the GM to buy a used vehicle rather than the new vehicle he wanted.

Although the GM ultimately bought the new truck, he recalls that incident as a pivotal one. He was perplexed and frustrated by how much influence the head of the fiscal office and the board had over the business. Although he had worked for another social purpose enterprise, he still thought like a sole proprietor. He felt "unprepared for working in a large organization like BOSS."

The incident could have served as a catalyst for clarifying the relationship between BOSS and BOSS Enterprises, particularly as it related to decision-making processes and lines of authority. The GM had become aware of the fact that he did not have final decision-making authority on business matters. Still, he did nothing to get explicit direction on the types of issues for which he needed input, the process for regular communication between BOSS Enterprises and BOSS about such issues, and ultimately how different types of business decisions would be made. No one, not the GM, the Executive Director, nor the Employment Program Coordinator, established the groundwork for the multiple decision-points that lay ahead.

Joining the REDF Portfolio

Within a few months after BOSS Enterprises opened its doors, The Roberts Foundation launched a new initiative, The Roberts Enterprise Development Fund (REDF). Under the direction of the former HEDF Director, the new initiative would invest in a portfolio of nonprofit organizations that were already or were planning to operate enterprises that employed very low income and formerly homeless individuals. The goal of REDF was to assist these social purpose enterprises in achieving both increased scale and full sustainability in the marketplace.

In January 1997, REDF invited BOSS to participate in its portfolio of social purpose enterprises. REDF awarded BOSS an enterprise grant of $75,000 for the first year of the business.

REDF was poised not only to provide the organization with necessary funds but also the technical assistance BOSS needed. One of REDF's explicit goals in supporting a portfolio of social purpose enterprises was to be a different kind of funder, one that was a partner in the venture. This was an opportunity for BOSS Enterprises to get the funds and support that it needed.

Operations

BOSS Enterprises was a new, small business operation, but it was already facing significant challenges. For one thing, BOSS Enterprises had tremendous overhead and expenses. Unlike other businesses of its kind that might start out of someone's garage, BOSS Enterprises had rented a warehouse. While someone working alone might fill their toolbox and purchase equipment as gradually as possible and as jobs required, the GM of BOSS Enterprises made purchases immediately. He saw that the business had money available and saw no reason not to ramp up quickly. Someone working alone might build the business slowly, working solo and only hiring day laborers as required for particular jobs. In contrast, BOSS Enterprises had a full time GM as well as a Training Manager, a carpenter, and a helper to keep busy. These people were on the payroll regardless of how many jobs the GM could bring in to the business.

Unlike its competitors, BOSS Enterprises also had expensive liability insurance and workers compensation costs. The GM understood that property owners "get unlicensed and uninsured people to do cleaning and painting." But BOSS Enterprises had to "protect the entire BOSS organization with insurance,license,and liability. [Wewere] competing with people who don't have that overhead." Insuring BOSS Enterprises was necessary, but very expensive.

BOSS Enterprises was also earning only a small profit on the jobs it was completing. The GM was finding that,in general,the profit margin in property maintenance services was miniscule. It was no wonder, therefore, that most of BOSS Enterprise's competitors were one-person, one-truck type of operations. These single operators were willing and able to work for less money than BOSS Enterprises could afford.

Furthermore, as it turned out, maintenance services was not a type of work in which the GM had particular interest or expertise. He had skills as a carpenter and project manager. He had a General Contractor's license. While these qualifications were not necessary for the types of jobs BOSS Enterprises was doing, they could be useful if the business changed its focus slightly. In particular, vacant space preparation jobs might require "light construction" work. This type of job would fit with the GM's particular expertise.

After several months of operating BOSS Enterprises, the GM shifted the focus of the business away from property maintenance. According to him, he "gravitated toward places where [BOSS Enterprises] could make money." Multiple reasons justified this shift. He thought he had enough evidence to demonstrate that it would be impossible to compete in the property maintenance services industry. Furthermore, he was receiving referrals for more profitable jobs in which he could utilize his skills more fully. The GM acknowledged that he was deviating from the business plan and brought this to the attention of the Executive Director, board members,and REDF's Business Analyst.

The board had concerns, but did not intercede except to note that BOSS would be incurring a greater risk of liability. Already, the worker's compensation and other insurance cost more than had been projected in the original plan. The board also did not formally approve or support this change of direction. Despite the fact that on other, smaller decisions such as the purchase of the truck, the board had intervened, board members did not become significantly involved in this major issue.

During these first critical months of BOSS Enterprises's operations, REDF did not play a strong advisory role. REDF was more responsive with its advice than it was proactive. As a start-up business, BOSS Enterprises required more hands-on, expert assistance. Nearly all of the other businesses were already well-established at the time that they joined the REDF portfolio, and REDF may not have had the foresight to see that start-up businesses like BOSS Enterprises needed more intensive support. On the other hand,if REDF had been more involved during this early stage, BOSS Enterprises may have felt that constant supervision from its major investor put too much pressure on a business that was still trying to find its own feet to stand on. In hindsight, however, BOSS staff feels that they would have benefited from getting more support from REDF during this early stage of development.

REDF's Business Analyst was aware that the GM was deviating from the business plan, and, to her, it made sense. He was acting like a "seat of the pants entrepreneur" – taking

advantage of contacts and his talents in the interest of making the business successful. The Business Analyst could see that the GM was being opportunistic, acknowledging that "the jobs that were coming in, were not what the business plan outlined." She appreciated the shift given that profit margins in construction were higher than in property maintenance services.

What had happened was that the GM had found a critical flaw in the original business plan. The business plan had identified the fact that, of the 285 businesses in the area offering building maintenance services, very few had more than 4 employees. Rather than seeing this as an indication that the market did not readily support larger businesses, the business plan pointed to this as an opportunity for BOSS Enterprises. By the third year of the business, the plan projected that "our capacity and revenues will be significantly larger than the high percentage of 'mom and pop' operations in the industry." Just a few months into the business, this already seemed like it would be difficult to achieve in the property maintenance services industry.

This was a critical moment for the business. The planning process that resulted in the first business plan involved a large number of people, time, and expense. After only the first few months of the business,however, the original plan was describing a different kind of business than was now evolving and being implemented. Rather than immediately revisiting the planning process and considering how the change in business focus would affect income generation and job creation, the GM moved forward without a clear plan. In reflecting back, the GM said, "in some ways [moving forward without a plan] was my fault. [Someone should have said] if this is the plan, let's follow it. And if not, let's change it."

BOSS's Executive Director strongly disagrees with the GM's sense that he was not given clear direction about this. She recalls numerous conversations in which she and the Employment Program Coordinator emphasized the importance of either following the plan or changing it. They grew more frustrated as he blatantly ignored them.

REDF's Business Analyst commented on this, "what became critical was to move on, look at what the market was telling us, rather than the old business plan's analysis." She did not think the agency's business plan, created prior to REDF's formation, accurately analyzed the market and each market segment's job skill requirements. Only a few months after REDF got involved with BOSS Enterprises, REDF's Business Analyst, as well as everyone involved in the enterprise, began encouraging the organization to revise its business plan.

Looking back, those at BOSS who were involved in the start-up of BOSS Enterprises wonder why BOSS received funds from REDF if their business plan was so inadequate. However, BOSS Enterprises was not so different from other businesses in the REDF portfolio in this respect;other businesses were also reworking the business plans they originally submitted to REDF. If they did not already have sound plans, it was important to REDF that the businesses revise them before more time passed. Particularly in the case of BOSS Enterprises, REDF's Business Analyst saw that the GM was not following a plan and needed stronger direction and oversight.

Venture Committee

The venture committee was the group that should have provided oversight to the business. As a member of the REDF portfolio, BOSS Enterprises was obliged to convene monthly meetings of this committee,as previously stated, a group composed of the REDF Executive Director, Associate Director and Business Analyst, the business's general manager, the nonprofit's Executive Director, and, initially, two board members.

As REDF staff recall, BOSS's Executive Director invited a large number of people to participate on BOSS Enterprise's venture committee. To REDF, the venture committee almost seemed to be a sub-committee of BOSS's Board of Directors. It was something that REDF's staff recall as somewhat unusual. But REDF was hesitant to challenge BOSS's Executive Director's authority with respect to who should participate since they wanted organizations in the portfolio to "own" the process.

BOSS's Executive Director thought she was just inviting the people who she had been instructed to invite by REDF. It was only later, she said,that REDF staff changed their minds and said the venture committee should be a smaller group composed only of BOSS and BOSS Enterprises staff and REDF staff and consultants. Further, she was frustrated that REDF's Executive Director, who was original-

ly supposed to attend,came to only one meeting of BOSS's venture committee.

These two recollections demonstrate one of the challenges of engaging in two development processes at once. While BOSS was starting its business, REDF was still refining its process of venture philanthropy. Perhaps if REDF had foreseen the trouble that lay ahead, REDF staff may have given different instructions on whom to involve on the venture committee. Regardless of the reasons,the fact that REDF did not help BOSS design an effective venture committee had a negative impact on the business. Rather than providing the enterprise with clear vision and direction, the venture committee itself became mired in tension and dissent.

The issue that absorbed the venture committee's focus and time was finances. REDF's staff and Business Analyst wanted the business to be able to produce basic reports on a monthly basis: profit and loss statements, balance sheets, and the actual to budgeted cost of jobs. This was more than the fiscal office could produce using their accounting system, which was tailored to meet the needs of a nonprofit,social service organization. Additionally, the president of BOSS's board was even more demanding. He thought the business should have a particular type of job cost accounting that showed "completed operations reporting."

From the very first venture committee meeting, conflict brewed between REDF staff and Business Analyst and BOSS's fiscal office and between REDF staff and Business Analyst and BOSS board members. The venture committee members could not fully agree on what they wanted or how they wanted it. According to BOSS's Executive Director, "there were as many opinions about how this should be done, as there were people involved." Because the venture committee could not agree, it could not give clear direction to the GM.

Despite the strong differences of opinion that were aired during the venture committee meetings, all committee members agreed that the enterprise would need to begin tracking its financial information in a new way and on a consistent basis.

Internal Finances

As each month passed,the venture committee members grew more frustrated with the inadequate and conflicting information BOSS and BOSS Enterprises were providing. Behind the scenes, in trying to generate this information, there was even more trouble.

According to the head of the fiscal office, in the beginning, she received no written instructions on how she would be involved in the enterprise. She therefore considered it to be no different from all of the other programs at BOSS. She received bills and timesheets; she issued the paychecks and handled the overhead expenses. The head of the fiscal office had developed a unique financial accounting system for BOSS that tracks 125 different public and private sources of funds for the $7 million operation. Although this fund accounting system provided adequate information for BOSS prior to the creation of the enterprise, this system could not provide the kind of specific information a business manager needed. While she could create reports that showed expenses and revenue, for example, she could not generate a profit and loss statement or balance sheet.

The GM also did not know how to keep track of the business's finances in the way REDF and the board wanted. Reflecting back, he recognizes that he did not have adequate experience or courage to be able to say what he should have said: "We can do this, but it will cost you money." In fact, when he explored different options for accounting software,he identified the package that would later be successfully implemented by his successor. That software cost $5,000, and, early in the process, BOSS was not willing to make the investment. As a result, he implemented the system he knew how to use – QuickBooks. According to the Employment Program Coordinator, "he [the GM] wanted to use QuickBooks, but the President of the Board did not want him to. He implemented it anyway." The GM still had trouble producing accurate reports, because he did not have a background in financial accounting.

Creating duplicate sets of books, one at the fiscal office and one at the enterprise, was an inefficient solution to the different accounting needs and requirements of the business. The fact that the two sets of books did not match produced even more problems. The head of the fiscal office was concerned. She was not getting adequate and timely information from the GM – for example, she never knew when jobs had been completed, or invoices submitted. This particularly trou-

bled her, because she doubted his financial management ability. According to the Employment Program Coordinator, "she checked and double checked everything. There wasn't any trust there." Based on the information she did receive, for example, she could see that the GM allowed receivables to remain on the books far too long and invoiced far too slowly.

What is surprising here is that the GM supposedly understood the value of financial accounting. He had previous experience working for a social purpose enterprise that did not receive adequate support from its nonprofit parent, specifically in connection to financial accounting, but he seemed to be making the same mistake again. In reflection, the GM admits to being "blatantly negligent about setting up an accounting system." His focus was elsewhere. At the time, he felt like "it wasn't that important. Trying to keep customers happy was the priority." The GM avoided tasks that he did not know how to do and focused his energy where he had the most capability. Rather than asking for help, therefore, he either tried to hide or ignore difficulties he faced in terms of managing the business's finances.

The fiscal office could see that the GM lacked skills in financial management. Even though BOSS Enterprises hired a part-time bookkeeper to help the GM track the finances, the head of the fiscal office still felt like she was not receiving information in a timely or accurate fashion. As a result, a member of the fiscal office started working part-time at the enterprise. The head of the fiscal office hoped she "would be able to get more of an idea about what was going on there." The assistant from the fiscal office reported that things were in complete disarray at the enterprise. The bookkeeper was already "on the verge of quitting." The fiscal office and enterprise had to reconcile their books at the end of the first year of the business. After a long and tedious effort, they finally did so. This was a fruitless investment of time, however, as the same problems continued through the second year of the business. According to the head of the fiscal office, "they did not even try to reconcile the books" at the end of the second year.

Ultimately, it would take until March 1999, nearly three years after the business had started operating, before a functional accounting system was established. Those who were involved in the venture committee, in the fiscal office, and in the enterprise still talk about this issue with bewilderment and a sense of defeat.

Why did it take so long to establish a standard system for tracking the enterprise's finances? There are several distinct reasons. Those at BOSS question the type and amount of assistance that REDF provided to them in this area. BOSS's staff now say that they would have appreciated more direct advice or specific help in how to set up their system. The head of the fiscal office reflected, "REDF must have had experience with others and known about software that would work, but they left it up to [the GM]. I wish they had given more guidance about this."

It also felt to BOSS staff that REDF's demands kept changing. BOSS's Executive Director remembered, "REDF was also going through a process to figure out how the financials should be done. The rules changed almost every time we met."

BOSS's Executive Director was concerned that the information that REDF's Business Analyst wanted on their financial statements was not appropriate for BOSS Enterprises. She felt like REDF was inflexible about "diverse ways of presenting financial information." They "wanted standardization. This was a burden." She wishes that she had just gone to a construction company to find out how they kept their books, and then copied them. In her mind, the problem was, she trusted REDF to be the "experts," when in reality, they had just as steep of a learning curve to go through as BOSS did, especially about the construction industry.

The REDF Business Analyst had a different recollection about this aspect of events. While it is true that REDF's Business Analyst did not have specific industry expertise, she focused her guidance in the area of overall business financial reporting, something with which she does have in-depth experience. She felt it was her goal to assist BOSS staff in pulling out the basic financial performance information that would help them make informed decisions.

She spent a lot of time at BOSS, training different staff in the general rules of financial accounting. Part of the problem she encountered was that she was not sure whom to work with at BOSS. She tried to work with the Employment Program Coordinator, since he

was the GM's supervisor. She worked with the GM. She spent time with the head of the fiscal office and then another person within the fiscal office to try to reconcile the differences between the two sets of books. What she found was that there was no one who had particular aptitude or time to manage this part of the business. It also seemed like they lacked interest. According to REDF's Business Analyst,"no one with the right information was championing the need" for a new system of financial reporting. She remembers showing BOSS and BOSS Enterprises' staff the same tracking and financial report templates numerous times. Each time she felt that she had to start from the beginning and re-instruct them on how to create the reports. She sensed resistance from BOSS staff, as if they did not understand that what REDF requested was standard information that every business manager, owner, and investor needs.

REDF's Business Analyst readily admits she made mistakes in working with BOSS on their financials. At first, she said, she tried to be flexible. When changes did not happen, she "got definitive." Throughout her relationship with BOSS Enterprises, she found it difficult to strike the right balance between being adaptable and giving direction. Her early conflict with the president of the board,about the proper way to present the business's financial information,had also made her more tentative about advising the business.

In the end, missteps by both BOSS and REDF created a financial accounting nightmare for BOSS Enterprises. First, BOSS failed to establish who was ultimately responsible and accountable for this task. On a very basic level, there was a problem with keeping the enterprise's financial accounting under the auspices of the agency's fiscal office if the fiscal office could not produce the standard information the business needed to operate effectively. Secondly, BOSS did not heed REDF's Business Analyst's recommendation that BOSS should invest in different, more appropriate software to track the business' accounting. Third, the GM did not have the necessary skills to develop and manage the enterprise's financial accounting system. Furthermore, because the fiscal office and enterprise were in different locations, this added an additional barrier to communication. Although BOSS Enterprises had the capacity to communicate via email, the technology did not facilitate communication because the GM did not make communication with BOSS's fiscal office a priority.

Further, REDF's Business Analyst did not provide BOSS Enterprises with the type of assistance they wanted and needed. While BOSS hoped for expert advice regarding the construction trade from her, REDF's Business Analyst was more capable of providing general support, identifying issues, and raising questions that would clarify BOSS Enterprises' specific needs. In addition, the style in which REDF's Business Analyst approached her work often conflicted with the work styles of BOSS staff. REDF's Business Analyst's sensed that BOSS resisted her suggestions and help, but rather than trying to find out why or confronting this issue directly, she retreated. As a result, BOSS Enterprises did not develop the internal systems it needed to track financial information that the business needed and that REDF was demanding.

Training and Employment

The GM focused on "establishing a business and getting going," which meant doing jobs, rather than focusing on refining the financial management system. It also meant he focused on doing jobs rather than training and hiring BOSS participants.

The GM's sense was that "as many participants as they could employ was great," and everyone "thought the people part would come." Although from his perspective "there was some pressure from the board to hire [participants]," at this point,he was not aware of any clear mandate about how many to employ and in what time frame.

When the GM shifted the business focus from property maintenance services wholly toward vacant space preparation and light construction, he created the need for more skilled workers. The GM recruited and retained several journey level carpenters and painters to complete the work he solicited. Not only did this mean that the business was employing a higher ratio of skilled workers to unskilled workers but also that BOSS Enterprises had to pay higher salaries to its workers than had been anticipated. Initially, the GM and the Executive Director got into a conflict over how much to pay BOSS Enterprise employees. To keep expenses down, the Executive Director initially did not

want to pay workers in the business more than $13 per hour. When it became clear that BOSS Enterprises would never be able to hire workers at that rate, she agreed to raise the wage to $20 per hour. This was still a lower rate than what most carpenters and painters could command. The GM had to find skilled workers who were willing to work for less than the market could bear in order to work for BOSS Enterprises. According to the Training Manager, "the jobs were there but [we did not have] enough journey level people to work the jobs."

One of the consistent workers in the business was the Training Manager. The Training Manager was a member of the original Venture Team that worked on the feasibility study and first business plan (at that time his position was "Planning and Marketing Associate"). Prior to working at BOSS,he had lived in Hawaii where he helped organize and train volunteers to rebuild homes after a hurricane devastated the island. Once BOSS Enterprises opened, he joined the staff as the Training Manager. He was so committed to BOSS's mission that he commuted to Berkeley from Santa Cruz, a two-hour drive in good traffic, to work for BOSS Enterprises.

His job title, Training Manager, did not accurately describe the work he was doing for BOSS Enterprises. The Training Manager worked alongside the GM on jobs while "waiting for direction on how to do the training piece." The Training Manager recalled that "we were trying to get jobs so that there would be a training program." The work of the GM and the Training Manager became increasingly interconnected. According to the Training Manager, "he and I pretty much teamed up. We needed each other…I needed the business to run the training. He needed trainees to run the business. We did things together."

BOSS Enterprises did not have a clear plan for how to conduct training. As the GM saw it, we "slid back and forth between on-the-job training and a sheltered workshop." What BOSS discovered was that it was expensive to run a sheltered workshop, and on-the-job training required finding carpenters and painters who were willing to spend a significant amount of their time working alongside and training BOSS participants. Either way they approached it – sheltered workshop or on-the-job training, providing training in construction was going to be costly for the business to support. In reality, until the business got bigger, it wasn't apparent how BOSS Enterprises would be able to run any sizeable training program.

Many of the BOSS participants who were hired by the enterprise did not stay for very long. The high turnover in BOSS participants might have occurred for a number of reasons. There were numerous, inherent challenges in bringing people who had not been able to work in the past, for any of a number of reasons – mental illness, substance use, homelessness, physical disabilities, or family obligations – and employing them in the type of work that BOSS Enterprises was doing. Turnover among unskilled workers in other construction companies where the GM had worked was high as well. Trainees weren't paid that well and the work was demanding. Job sites changed from day to day, workflow was inconsistent, and work schedules were irregular. Workers were expected to learn new skills and perform tasks according to deadlines. It seemed like the only BOSS participants who could work for BOSS Enterprises would be, according to the Training Manager and the GM, "the cream of the crop."

This is not to say that BOSS Enterprises did not have a positive effect on any of BOSS's program participants. One trainee found BOSS at just the right time – he was struggling with a drinking problem and his father's health was deteriorating. After his mother suggested he contact BOSS, he was hired into BOSS's Clean Streets program. From there, he moved to the Graffiti Masters program. When he learned of BOSS Enterprises,he was immediately interested. He wanted to work there, but he was told they did not have any room at that time. Several months after he first contacted the Training Manager, he was hired at BOSS Enterprises.

He was enormously satisfied with the work and the environment at BOSS. He continued to work at the business for almost a year, until he was injured moving furniture in BOSS Enterprise's office. Although he will not be able to do construction work in the future, he continues to have strong positive feelings for BOSS. His father recently died, and left him some land in Texas. When he is able to sell it, he plans to donate money to BOSS. He wants to help others get the kind of training and work opportunities he received from BOSS Enterprises.

Despite the injury he sustained, this trainee's experience at BOSS Enterprises is a success story. It is important to note, however, he was coming to the business from a unique position. While the trainee came to BOSS Enterprises through BOSS's on-the-job training programs, as had been envisioned in the original business plan, it is not likely that he developed the skills necessary to succeed at BOSS Enterprises from that experience. He had actually worked in the construction industry for 30 years prior to coming to BOSS Enterprises. He was accustomed to the demands and irregularity of construction work and had more skills and resources than the vast majority of BOSS's participant population. He earned less money at BOSS Enterprises than he had previously. His ability to succeed at BOSS Enterprises did not prove that the business could be successful with the majority of BOSS's participant population.

The majority of BOSS's participant population needed more training and assistance before they could succeed at BOSS Enterprises. Like the financial reports, questions about how to do job training lingered for a long time. In reflecting on what happened, BOSS's Executive Director noted that she should have raised money to run the training piece separately from the business rather than trying to do it under the same roof.

The distinction between training, trainees, apprentices, and employees in the business was not clear. The terms were used interchangeably. In the absence of the business's capacity to create long-term employment for BOSS participants, the business was hiring only a few BOSS participants, employing them for a short period of time,and referring to them as trainees.

BOSS had over 25 years of experience working with poor and homeless people. The organization provided emergency and support services to countless people who came to them from a range of circumstances and for a variety of needs. It should not have been a surprise to BOSS staff that it would be difficult to retain participants as employees in a business like BOSS Enterprises had become. Although the original business concept was that BOSS Enterprises would do work similar to what participants were already performing in the graffiti removal and street cleaning programs, by this point, the work was more challenging. The Executive Director realized later that it was a mistake to think that the population BOSS serves had these "high level skills." And she says, "We should have created a different business."

It took BOSS and REDF a long time to recognize that the training component of BOSS Enterprises was not working. The Executive Director of BOSS reflects, "We were depending on [REDF] to pick up on that stuff. It shouldn't have taken so long to determine that the projections were wrong." But REDF had never planned to get involved in helping BOSS develop the job training component. From the beginning, REDF limited the scope of its work by separating enterprise development from job training and working only with the business, assuming, perhaps wrongly, that the organizations knew more about operating job training programs than it did.

From the perspective of BOSS's Executive Director, the fact that the venture committee meetings continued to focus on financials "kept us from talking about strategies to train people to give them skills. We needed deep discussions of training, of marketing…. I don't think the business would have failed if we'd put the same amount of energy and arguing and thought and creativity into other parts of the business."

Marketing

Without clear financial statements and "without a clear plan," according to REDF's Business Analyst, "every venture committee meeting the question was raised of, where did sales come from?" BOSS Enterprises was not sure what their current market looked like. BOSS Enterprises had gotten and completed a number of jobs that had come its way through personal contacts and professional contacts, but to this point had done little explicit marketing.

The Employment Program Coordinator was in charge of marketing and sales for the enterprise, but it was just one of his many responsibilities. He assisted the business by cultivating relationships and making presentations to the business community. In addition to this networking, BOSS did a mailing of 3,000 brochures and placed an advertisement in the Yellow Pages.

The GM never understood the emphasis REDF's Business Analyst placed on marketing. He remembered that REDF was "after us to do marketing." And this was the type of "suggestion and mandate" he got from REDF

that "didn't jive with how you run a small construction company." In construction, he thought, you "market by doing the work." This led him to believe that REDF really did not understand the construction industry.

From REDF's Business Analyst's perspective, marketing means far more than deciding what type of brochures to print and where to distribute them. Creating a marketing plan would force BOSS Enterprises to identify a strategy – given that they wanted to both create profit and jobs, where could they make the sales and how would they make the sales in order to achieve this dual mission? She thought a marketing plan would help BOSS Enterprises focus on these critical issues.

In order to produce the marketing plan that REDF demanded, BOSS Enterprises hired a Farber Intern for the summer in 1997. The Farber Internship program is jointly funded by REDF and The Phalarope Foundation; the program provides summer internship opportunities for MBA students within the REDF portfolio.

Within a short period of time, the intern at BOSS became very frustrated. She felt like the GM was not clear on her role and purpose for being at BOSS Enterprises. Furthermore, she felt that she was not being given sufficient guidance and information about the business.

The intern did not think she would be able to provide BOSS Enterprises with a useful plan until she got answers to fundamental questions. Specifically, she saw conflict between BOSS's dual goal of generating income and providing employment opportunities within the type of business BOSS Enterprises was operating. The intern strongly believed that BOSS would have to make a decision about its main priority. Was the main goal of the business to provide income for BOSS? In that case, profit maximization would dictate the market segment they would go after. Or, was the main goal to create employment for BOSS participants? In that case, BOSS Enterprises would have to approach market segments that were more appropriate for the skill level of the enterprise participants. The intern was raising a common issue; all of the enterprises in the REDF portfolio were striving to balance what REDF describes as "the double bottom line" – profitability and social impact.

The issues did not get resolved in the course of the intern's time at BOSS Enterprises. She quit the internship before producing a marketing plan. The concerns she brought forward sparked a new round of conversation between REDF and BOSS. This episode ultimately confirmed to all that BOSS Enterprises needed a new business plan.

A New Business Plan

At the end of 1997, with the experience of the previous year behind them, a new team created a business plan that focused on new market segments. REDF's Business Analyst was heavily involved in the business plan research and writing as were others from the original Venture Team – the Organizational Consultant, Employment Program Coordinator, Training Director, BOSS Executive Director and the GM.

This was an important opportunity for REDF's Business Analyst to work closely with BOSS staff. This time the team focused much more attention on segmenting the market into types of work that could generate profit and those that would create more employment. For each market segment, the plan identified the ratio of skilled workers to unskilled workers. For each segment – janitorial/ construction site clean-up, deconstruction, interior and exterior painting, vacant space preparation, door and window replacement, and light construction – the plan also described marketing targets, gross margin, methods of bidding/estimating, and its relationship to other services BOSS Enterprises provided.

REDF's Business Analyst remembers the process of revising the business plan as a very positive, collaborative one. At the time, she felt renewed hope for a more productive REDF-BOSS relationship. In the period that immediately followed, however, this hope was not realized. To this day, she is unsure the GM used this plan as a road map for the business.

Frustration Builds

Just after the completion of the second business plan, communication between BOSS and REDF stopped. Although the business finally had a clear plan, more fundamental issues at BOSS occupied the time and attention of BOSS's Executive Director. She did not feel like REDF could be helpful in addressing the most critical issue BOSS Enterprises and BOSS were facing: Should she terminate the GM's employment?

The fact that BOSS's Executive Director withdrew from REDF at this time provides

some crucial insight into her perception of REDF's role in the business partnership. From the perspective of BOSS's Executive Director, "the communications broke down. [BOSS Enterprises] was so crazy and out of control…. I decided we needed to take care of our own stuff. We didn't meet with REDF for six months." She saw the break in communication as an opportunity for BOSS Enterprises to regroup, rebuild morale, and address pressing personnel issues. Conversations she held with other Executive Directors in the REDF portfolio led her to believe that when things went wrong, BOSS should "watch out." She was afraid of what might happen if REDF found out the extent to which things were going downhill with the business and business personnel. She did not trust that REDF was the kind of partner they said they were – through thick and thin. Because,as she saw it, REDF did not reach out and ask her what was going on, she felt safer keeping the funder at arm's length while significant changes loomed.

From the perspective of REDF's staff, they were confused about why communication had stopped. They contacted BOSS's Employment Program Coordinator to ask him to arrange the monthly venture committee meeting. When the meetings were not scheduled or were canceled, they assumed that it was due to scheduling conflicts. As a result,they were frustrated when they realized there were other reasons that prevented BOSS from scheduling the meeting.

REDF's staff and Business Analyst were not sure how to handle the gap in communication with BOSS. They were reluctant to place a direct demand on BOSS's Executive Director. When REDF's staff did contact BOSS's Executive Director, she informed them that "BOSS was going through a crisis and needed REDF to back off for a time."

Meanwhile, a private conversation between BOSS's Executive Director and REDF's Associate Director began. It was in that forum that REDF staff first realized the extent to which the Executive Director had grown frustrated with the quality of the GM's work.

In March of 1998, BOSS's Executive Director sent a letter to the GM that outlined the areas in which he needed to make changes. It included a number of complaints about his work performance ranging from his weaknesses in managing people to setting up systems, keeping records, and accounting. It also touched on the need for systematic training at BOSS Enterprises. The letter indicated that the GM was insubordinate – resistant to suggestions from BOSS's Executive Director and Employment Program Coordinator.

BOSS's Executive Director hired a management consultant to help turn the business around. After the fact, the Executive Director informed REDF that she had been looking for someone for some time "from the construction trades with a history of running a successful construction company who has also worked in the nonprofit arena." The consultant she found ran his own business for 15 years and served as the Executive Director of a nonprofit organization prior to coming to BOSS. He was hired for ten hours per week for a trial period of three months to pinpoint problems and find solutions for BOSS Enterprises.

The consultant diagnosed a number of problems with BOSS Enterprises:

1. There was no financial accounting system that identified the cost of jobs.

2. Jobs took longer than expected and were more expensive than budgeted because they were being done haphazardly. Tasks had to be redone that were not done properly the first time. The business did not have the skilled workers that jobs required.

3. The GM was underbidding projects. While most construction companies get 10-20% of the contracts they bid on, BOSS Enterprises was getting nearly 50%. This was a clear indication that the GM was not bidding correctly and was underestimating the administrative cost of doing jobs.

4. The GM was not a good team-builder, and there was a lot of tension among staff at the enterprise that made them an ineffective group.

The consultant confirmed that it was costing BOSS Enterprises more money to work on projects than it would if the employees had stayed home.

The Ramada Mistake

In the spring of 1998, BOSS Enterprises secured a $62,500 contract to remodel parts of

the Ramada Hotel in San Francisco. The problems that arose during this project forced BOSS to look even more critically at the GM's capacity for running the business. The GM underestimated the level of skill needed to complete the job. He needed to remove trainees who had been working on the project to bring in more skilled workers. According to the Training Director, the project was mismanaged. "The job became bigger and more complex than we realized and we were undermanned." The project was going over budget and going slower than expected. Then the GM got hurt on the job, and had to call in a friend to take over the management of the project. In the end, the $62,500 project cost BOSS Enterprises $75,000 to complete.

The GM did not communicate with anyone at BOSS about the problems that were surfacing. He felt like "it was better just to finish the job. It's in my nature to just finish it and get out." Looking back, he still does not understand why others would see this project as a turning point – a mistake that accelerated his departure from BOSS Enterprises.

The fiscal office staff was alarmed by what happened with the Ramada project. Not only was the project 20% over budget, but the GM had not issued invoices in a timely fashion. The agency's cash flow was adversely affected by having to advance such a large amount of money to the business.

After the problems with the Ramada project, BOSS's Executive Director dove into the management of the business. She mandated that she would approve all contracts over $5,000. Because of continued discrepancies between the enterprise's accounting system and the fiscal office, the Executive Director decided that all accounting for the business would be removed from the enterprise and brought under the responsibility of the fiscal office.

In July 1998 the Executive Director terminated the GM's employment. Half a year had passed since the Executive Director identified major problems with his management abilities. The business had been floundering for some time. When he left BOSS Enterprises, the few skilled workers – a carpenter and painter who had been employed by BOSS Enterprises – left the business with him.

Reconnecting with REDF

Formal contact between BOSS and REDF resumed at about the same time that the GM's employment was terminated. The venture committee meeting in May 1998 marked the first public conversation between BOSS and REDF for nearly half a year.

The relationship between BOSS and REDF was beginning to change. One major factor that caused this relationship to change was the "process appraisal" that REDF commissioned to assess the effectiveness of the REDF model. The process appraisal involved confidential in-depth interviews with Executive Directors and Business Managers of all the groups in the REDF portfolio.[2] BOSS's Executive Director was finally able to express her frustration with REDF as a funder. In particular, she expressed frustration with the dynamic between REDF and her organization. Rather than a partnership, she felt like REDF held all the power. Further, she did not feel that REDF had provided BOSS Enterprises with the assistance it needed. The business was struggling, and she felt that some of the responsibility for the troubles lay with REDF since REDF was developing its approach as it went along while BOSS Enterprises was "left to flounder."

In the process appraisal, REDF had exposed itself to critique and shown that it was willing to learn from its mistakes. REDF openly discussed the process appraisal findings with the Executive Directors as a group and talked about ways REDF could improve. One recommendation from the appraisal was that REDF communicate more clearly with the groups about the venture partnership and about REDF's perception of the enterprises' performance. This led REDF to compose individual "State of the Union" letters to each Executive Director.

In the letter to BOSS, REDF's Executive Director and Associate Director praised the business plan and the strategies outlined in the plan for achieving BOSS Enterprise's goals of generating profit and creating jobs. The major concerns REDF identified were:

1. The venture committee had met only sporadically and was ineffective in its role as an oversight body for the business.

2. The current financial reporting system was inadequate. It was not allowing the business to track performance by month, year-to-date or by job on a consistent basis.

In short, REDF expressed to BOSS that while its business plan was strong, the implementation of that plan had not been effective. REDF recognized that BOSS was going through a critical stage in trying to hire a new GM. Once that manager was in place, REDF urged that this person,

be given the authority to make decisions about enterprise operations, including staffing, bids, and overseeing the day-to-day work…. We expect that this new GM will have timely and accurate financial reports, including monthly budget to actual income statements, year-to-date budget to actual income statements, and reports on profitability by job.

The letter also indicated that after the next GM was hired, REDF wanted to be involved in helping BOSS Enterprises create a "turnaround plan."

BOSS's Executive Director appreciated this direct communication from REDF. From then on, BOSS and REDF communicated in a more honest and equal manner.

In retrospect, BOSS's staff wonders how REDF could state that the business plan was sound, given that there were still two critical issues that had not been solved 1) how to balance profit and job creation and 2) how to grow the training program. These issues would continue to plague the business into its next phase of development.

Rebuilding the Business

BOSS Enterprises needed to be built anew. With more than two years of hard work behind them, however, BOSS's staff and board, as well as REDF, were less optimistic that the business would be successful.

BOSS Enterprises began to look for a new GM in July 1998. Despite some lingering concerns shared by REDF's Associate Director and Business Analyst, BOSS's Executive Director decided that the consultant who had been working with BOSS Enterprises was their best candidate. BOSS's Executive Director recognized the skills that this person brought to the business. He seemed to be good at systems planning and organizational development. As a consultant, he had been a good staff facilitator. He pinpointed some crucial business mistakes that the previous GM had made. BOSS's Executive Director was hopeful that he would avoid making the same ones.

BOSS's Executive Director offered the second GM a salary that was commensurate with industry standards and his experience. She also gave him the mandate to, as he remembers, "do what you see fit" to get the business going. He started work in September 1998.

The Final Phase

The new GM saw significant challenges facing BOSS Enterprises. The first challenge was clarifying the business finances. The new GM had a license for proprietary software that enabled the business to track financial information in the manner that REDF asked and in a way that accurately described job costs. Soon after beginning work, he hired an office manager who had experience working for private industry as a controller. She audited the numbers that had been generated in the past. Although this was an arduous process, at the end of several long weeks, she was able to show the venture committee that there was not as much disagreement between the two sets of books as had been thought. She could not understand what had caused BOSS and REDF so much concern. She also thought QuickBooks would have been fine software to use to manage the business's financials. The real problem, as she saw it, was that the first GM did not have an office manager to help him keep track of the financials while he was out working on jobs. Within a short amount of time, she was able to do what had not been done in the past – produce standard financial reports.

The new GM obtained some financial autonomy for the business. At the GM's suggestion, the Executive Director agreed to separate BOSS Enterprise's financial accounting from the fiscal office. The Enterprise established a separate bank account, and was empowered to deposit revenue and write checks for business expenses. The Executive Director and the Board of Directors began to talk about spinning off BOSS Enterprises as an independent entity as soon as it was more financially stable.

The relationship between REDF and BOSS Enterprises began to change again when the new GM was hired. Although REDF's Business Analyst continued to meet with the enterprise staff to give her input to plans and decisions they were making, she sensed that the new GM resisted her sugges-

tions. While she offered more assistance, no one at the enterprise followed up to draw upon her skills or involve her more directly in the business. At REDF, the decision was made to focus her time and efforts on businesses in the portfolio that wanted and responded to her recommendations. Because BOSS had been unreceptive to her help in the past, REDF assumed that this assistance would not be missed.

The new GM prepared a revised business plan in December 1998 and submitted it to REDF with the request for another $100,000 grant. Like the plan created in 1997, it delineated the dual mission of BOSS Enterprises. More clearly than in previous plans, this plan described the relationship between BOSS and BOSS Enterprises, defined the roles of the different staff of BOSS Enterprises, and clarified financial management systems. The plan focused on three market segments: construction, deconstruction, and door and window replacement. In addition to addressing profit generation and job creation,the business plan described 90-day training cycles. Three trainees would work in the business for that period of time. If there were room to absorb them into the business, successful trainees would become employees at the end of their training period. Otherwise, they would be assisted with job placement outside of BOSS.

While 'things looked good on paper," according to the office manager, the training and employment goals proved difficult to realize. "It was hard to have three unskilled people all the time. The business could not have survived." Part of the problem, as she saw it, was that the jobs the GM brought in were too small, lasting only one or two days, and they offered little opportunity for trainees to learn new skills. As the office manager saw it, the business needed to have steady work in order to do training. "We needed to make a commitment to trainees as much as the business expected a commitment from them." The office manager watched in frustration as the GM and Training Manager made "fake" work to occupy the time of one trainee they retained.

The GM did not think it was possible to create employment for unskilled workers on the scale that BOSS's Executive Director was now demanding. He thought of the business as a training ground for BOSS participants but not for sustained employment. At the first venture committee,he was shocked at the news that one of the explicit goals for BOSS Enterprises was to create jobs for BOSS participants. The office manager remembered this meeting well. According to her, "I don't think he ever quite recovered," from this news. How could the GM not have known that this was an objective? It is not clear, especially given the fact that he had been involved with BOSS Enterprises for several months and did go through a rigorous interview before he was hired as General Manager.

The GM was fairly sure that BOSS Enterprises could not work as a job creation business. According to the GM, "For me, the bottom line was the number of skilled to unskilled workers in construction. Generally you need 4 journey-level tradespeople to every 1 trainee. [BOSS] was looking for 1 skilled worker to every 5 trainees." He thought these expectations would not be met – "You just can't do that in construction. The quality of the work would go down. The cost would go up." In addition, the GM did not think construction was appropriate work for the population that comes through BOSS for the reasons that had already been proven true. "It's stressful work where people are learning new skills. There's a deadline. They need to get to the job sites. They spend time getting to new places all the time…. They had personal issues. Some were injured. One had care-taking responsibilities. Out of four hired, only one was able to hang onto their job."

A new issue began to plague the business. The enterprise staff was frustrated with the GM's communication and work style. Unlike when things went awry with the first GM, this time, the Executive Director moved proactively to address conflicts that were brewing. She brought in an outside facilitator to help resume discussion among the enterprise staff. In facilitated meetings, staff raised serious concerns about the GM's ability to manage people.

Enterprise staff began to resign,sending a clear signal that things were not improving. The Training Manager, who had been with BOSS Enterprises since the beginning, resigned over a personal conflict with the GM. The office manager and a carpenter also chose to leave the business. BOSS Enterprises again was stripped down to a skeleton operation – with only a GM, a painter, and one trainee.

The Decision to Close Down

By this point, BOSS and REDF had invested over three years of effort into BOSS

Enterprises. For three or four months, the focus of the few conversations between BOSS and REDF was the question: Should we close the business? In May of 1999, with the assistance of REDF's Associate Director, BOSS's Executive Director composed a formal letter to her Board of Directors that outlined the reasons why she recommended closing the business.

First, from a financial perspective, it looked like BOSS Enterprises would not break even for another two years. Although the original projections BOSS had made for their very first business plan did suggest that the business would not break even for five years, actually working on the business for this long before seeing any positive return was too disheartening for the organization.

Secondly, in terms of creating employment for BOSS participants, the picture looked worse. Between 1998 and the first half of 1999, ten individuals worked in the business who came through BOSS or who were from BOSS's participant population. There were generally two or three of these workers at the business at a given time. But turnover was rapid as the jobs became more physically and technically demanding. Even if the business had grown substantially enough to create long-term employment, it was unclear that it would be an appropriate kind of employment for the vast majority of BOSS's participants. At the end of five years, if the business was able to bring in sales of $500,000 annually, it seemed likely that the business would create no more than five permanent jobs for BOSS participants. In contrast, in its third fiscal year, BOSS Enterprises was projecting revenues of $200,000 and was not retaining any trainees or BOSS participant employees for longer than a few months at a time.

Overall, it looked as though BOSS had chosen the wrong industry to pursue. Construction was not a feasible business for BOSS to run if it was trying to both create profit and provide employment. From the GM's perspective, the business could have either "generated a revenue stream or created jobs for the target population, but doing both was a challenge."

Reflecting on why REDF had not "pulled the plug earlier," REDF's Executive Director recalls that there were so many other issues – accounting, business operations, personnel – which masked the most fundamental problem with BOSS Enterprises – the market focus. REDF would not have invested in the business if the business plan had said this business can create profit or it can employ people from BOSS's participant population, but it can not do both.

BOSS staff also may not have invested their time and energy into this business idea if they had known it would create so few jobs. BOSS Enterprises required a lot of the Executive Director, Employment Program Coordinator, and head of the fiscal office, and distracted them from other responsibilities. Meanwhile, the enterprise had done little to advance BOSS's mission of ending poverty and homelessness – it was far from generating a profit to support BOSS programs, and it had not created sustained employment for BOSS participants. BOSS's board agreed that it was in the best interest of the agency to close BOSS Enterprises.

Ultimately, BOSS did benefit from this experience of operating BOSS Enterprises. The business created jobs and training opportunities for those who participated. The experience was helpful in pointing out some of the limitations of the agency's financial systems, which are currently being addressed. BOSS developed new relationships with individuals, businesses, business associations and other entities that are interested in working together to create more job training and permanent job opportunities. Furthermore, the organization gained valuable knowledge to guide them in future enterprises.

Having gone through this experience with REDF, BOSS is ready to try a different business approach in the future. As the Executive Director explains it, she is interested in focusing more on creating a value-based, employee-involved, and profit-sharing business venture. Business ideas, ranging from printing to food services, are percolating at BOSS now. Everyone involved in BOSS Enterprises – BOSS staff, board members, and REDF – learned and grew a great deal from their efforts. Reflecting on BOSS's potential to start a business in the future, REDF's Executive Director remarked that, like other entrepreneurs who have tried to start one business and failed, BOSS should have a much greater chance of success the second time around.

Cross-cutting Lessons Learned

In reviewing the cases of Agency A's Silkscreening Enterprise, BOSS Enterprises as well as the unpublished Agency C business case for an understanding of the cross-cutting lessons, it is important to place them in the larger REDF context. While these three groups did not continue with the REDF portfolio for a variety of reasons, seven other organizations, which by 1999 were collectively running 23 enterprises, have continued their participation in the portfolio. For these other seven groups, REDF's approach to venture philanthropy has generally worked. There are certainly areas for improvement and those have been documented in another chapter.[3] Generally, however, the REDF initiative has been instrumental in helping these social purpose enterprises accomplish both their business and social missions. During the 1998 calendar year, 73% of the groups in the portfolio were making a profit or reducing their losses according to plan. Approximately 600 individuals were employed from the groups' respective target populations. More than half of these individuals were either homeless or at risk of homelessness before becoming employed in a portfolio enterprise.

Where did these three groups differ from the rest of the groups in the portfolio? Did all of the others have stellar business plans and accurate financial reporting systems? No. Did all other portfolio enterprises have perfect production or customer service systems in place? No. Did all others comfortably shift into a new venture partnership relationship with a philanthropic funder? No. There were two key differences that served to differentiate the experience of these groups from that of the others.

First, all three of the groups who have left the REDF portfolio were young businesses—they were not yet in full operation when they joined the portfolio. In that sense they were the riskiest investments for REDF because the enterprises were untested. The second factor differentiating these groups is that they experienced a critical mass of obstacles in their attempts to operate social purpose enterprises. The combination of these factors differentiated their experience from that of others in the portfolio and contributed greatly toward making continued business operation untenable.[4] Finally, the stakes were high for these groups because they had received a significant investment in their young businesses and they felt like they were under a spotlight to perform. Most of their missteps were quickly noticed by a social investor (REDF) trying a new investment strategy and admittedly making some missteps of its own.

For others who are thinking about becoming involved with social purpose enterprises, either from an investor or from a practitioner perspective, these case studies offer eight take-away lessons to keep in mind. They fall into two categories: 1) Pre-Selection Process, and 2) Business Operations.

Pre-selection Process

1. Foundations should go beyond traditional foundation due diligence when screening nonprofit organizations for participation in a venture philanthropy portfolio.

When REDF was deciding to invite organizations into its portfolio, it did what most foundations do: met with the managers, looked at general operations and strategies,and made a decision to fund based on its belief in the management team and process – not the specific viability of the enterprise. With respect to each of the cases, REDF did not conduct a complete assessment and independent analysis of the businesses in which it was investing. REDF relied considerably on relationships and understandings with the organizations that developed during the earlier HEDF initiative when HEDF provided planning grants to these groups. In particular, REDF relied on the expertise that the enterprises themselves brought to the table. All three agencies presented REDF with business planning documents, but as it turned out,none offered realistic performance goals or financial projec-

tions. Had REDF originally brought in consultants with specific industry expertise to independently assess the businesses' projections, everyone involved would have had a clearer picture of the true possibilities for the enterprises in their respective industries. Not only would REDF have benefited as the investor, but also the enterprises themselves would have learned a great deal. Had REDF helped BOSS more clearly understand the trade-offs for what it was undertaking in the construction industry, for instance, it may have made different decisions from the start.

As mentioned above, one of the characteristics that made these three cases risky investments for REDF is that their enterprises were in start-up modes. In retrospect, it may have been more prudent for REDF to make its long-term investment explicitly conditional upon performance after two years. This kind of "evolving" due diligence would have clarified the investment relationship from the beginning and may have helped all parties more rapidly and openly identify and address problems as they arose.

2. The nonprofit must perform its own due diligence, in particular asking whether the organization is fully committed to continuously balancing the tension of the "double bottom line."

In order for the enterprise to be sustained in the long-term, the organization must be as committed to its business mission as it is to its social mission. This means it must be able to make the hard business choices when necessary, even if it conflicts with deep-rooted social service instincts. It means shedding traditional dualities of social good versus business profitability. It means embracing a process of moving toward a higher unity of opposites. When assessing their capacity for pursuing a double bottom line, the nonprofit should also recognize that every aspect of their organizational culture may be affected: management, programs, documentation of social impact, financial accountability, and relationship to investors. Agency A and Agency C were both passionately committed to their social missions, but they were never able to treat their business mission with the same level of commitment. Ultimately, they both viewed their respective businesses as another program in their organization. Neither ever became comfortable with business necessities and neither was ever able to make the commitments necessary to achieve small business development success.

BOSS had a different experience in trying to manage its double bottom line. In the end, it seemed more likely that BOSS Enterprises could be a profitable construction company than a social enterprise that employed a large number of participants on a sustained basis. This tipped the balance of the double bottom line too far from BOSS's social mission – so they closed the business.

For BOSS, closing the business was a direct result of the due diligence process. In the words of BOSS's Executive Director, sometimes a "'best practice' is to know when to fold 'em," when to close down an operation that is not succeeding in its goals and redirecting organizational efforts based on lessons learned.

3. The desire for revenue generation plus the desire to help vulnerable community members become employed does not equal social purpose enterprise.

All of the agencies had an interest in generating alternative revenue streams for their agencies. Moreover, all had an interest in helping low-skilled or high-risk people gain access to training and employment. However, those two interests do not necessarily mean the organizations were ready to support a social purpose enterprise, particularly in partnership with an enterprise investor like REDF. The organizations profiled are human service organizations and they are largely comfortable in that role. Two of the organizations—Agency A and C see the for-profit marketplace as their adversary and oppressor. If those feelings are so strong, REDF's motto of "Capitalism for a Cause" is not a theme song they will ultimately want to sing.

Effectively running an enterprise requires a complex mix of skills and capacities – in the areas of finance, accounting, marketing, production, business connection,and so forth. It may be that developing a more modest approach to income generation separate and apart from a more programmatic approach to

job training and placement is what these groups needed to pursue. Part of a nonprofit's due diligence process needs to include a serious questioning of what is really the right strategy to suit that organization.

Business Operations

4. For a venture philanthropy approach to be effective there must be full engagement in the venture partnership.

This lesson relates both to the investees and the investor. With respect to these three investees, none of the agencies were comfortable with or fully committed to the kind of venture partner relationship REDF was seeking. Agency C was fearful of funders. Agency A was distrustful of the power imbalance and of having outsiders participating with them in discussing strategic decisions. BOSS said that it was eager to have expert advice in the development of its enterprise but could not find a compatible way to communicate with REDF. Each of these organizations had difficulty making the transition to a new kind of funding relationship – and in communicating that difficulty back to their funding partner.

For its part as an investor launching a new and untested strategy, REDF was also unclear about its role as a venture partner given the fact that it was evolving an approach to philanthropy that is still very new and for which there is no "training manual." While the strategy was based on its prior experience, REDF was quite literally writing the book as it went along. REDF staff and Business Analyst vacillated between an aggressive and then more tentative approach. Sometimes they challenged the businesses and closely monitored their activities and other times, REDF stood back, not wanting to appear as meddlesome in internal affairs. The problem was the groups often experienced REDF's "evolving strategy," as inconsistency or lack of clarity in information requests. As an investor, REDF could have been more clear and consistent about roles and responsibilities, particularly with respect to these enterprises where there were early warning signs of trouble. As mentioned above, REDF could have considered instituting a system of investment that was conditional upon performance. Had it done so, it is possible that the process of determining those performance measures would have improved the clarity of expectations all the way around. The underlying point here is that REDF allowed a lot of time to go by while the groups were unable to meet basic expectations of financial reporting and/or venture committee participation and did not link performance to financial support. That time lag ultimately was to the detriment of the businesses.

5. It is essential to establish and maintain ongoing effective communications and relationships between and among all of the different partners: nonprofit, enterprise and investor.

The constellation of relationships and communication systems required for this partnership is complex. A breakdown in one area affects all other areas. For both Agency C's Temporary Services Enterprise and Agency A's Silkscreening Enterprise, the relationship between investor and investee never reached a sustainable level of trust and candor. After REDF engaged in its own self-assessment and self-critique, BOSS and REDF did achieve a high level of honesty and candor with one another, but that was already two years into the process with a lot of water under the bridge.

There was also significant tension between the enterprise and the nonprofit in all of the cases. The lines of supervisory responsibilities and decision-making authority were unclear. The enterprise wanted more autonomy to operate like a business while attending to its social mission and in at least two of the cases,the nonprofit did not want to relinquish any significant control of the business,especially if it meant any compromise to its social mission.

Communication between REDF and these agencies was challenging on a practical level, because REDF relies upon a technology that the organizations were not accustomed to using. Much of REDF's communication within the portfolio occurs via e-mail, which allows for frequent,direct,and efficient interaction. At the time of their involvement in the portfolio, however, none of the three agencies' Executive Directors used e-mail on any regular basis. Because REDF and these organizations did not develop an alternate system for

maintaining communication, they simply did not have an effective way to stay in touch as issues and problems arose.

The other principal way REDF communicates with investees is through Venture Committee meetings. These meetings tend to be business-like; there is some socializing, but the meetings are intended to focus on the business' bottom lines. For someone like Agency A's Executive Director, personal encounters are just that: personal. He likes to look people in the eyes when he communicates with them, or at least be able to hear their voices. He considers getting right down to business impolite. In these situations, REDF's communication style sometimes came across to the organizations as disrespectful or arrogant.

Communication that did take place between REDF and the agencies did not always deal with content in a way that would have been most helpful to both parties. When REDF staff ask questions or offer suggestions, they hope to be taken at face value and to be challenged when appropriate. Staff from these agencies did not always feel comfortable challenging REDF. They were more indirect and guarded in communicating with them,in part, because they were concerned that openly discussing problems might lead to the loss of a major investor. That discomfort is a reflection of the perceived power imbalance between the investor and investee, a challenge that is intrinsic to this kind of partnership.

Further exacerbating the perceived power imbalance between REDF and the groups who exited the portfolio, is the fact that all of the excused organizations are headed by people of color. These directors resisted "standard business practices" which they often associated with the "white world of business" and instead wanted to pursue alternative ways of doing business. BOSS, for instance, is now looking for ways to incorporate its core values of equality and social justice into its next business model, perhaps in the form of a cooperative or another way of profit sharing.

6. A business's management team must include people who possess a range of critical business skills.

This is especially true for the business manager but it is also true for other staff in management positions, such as salespeople or production supervisors. In order to attract and retain staff with strong business skills, it may be necessary to offer more competitive salaries than is typical for a nonprofit. It is also unlikely to be the case that a single business manager will possess all of the skills needed for operating a business. Finance, marketing, and personnel management are examples of different skill sets that are not likely found in one individual, but they are all essential for running a business. If the business cannot afford to hire multiple managers, it is important to make sure that either outside experts or other people in the organization can help fulfill those essential functions. None of the groups who have left the REDF portfolio had business managers with strong finance backgrounds, for instance, but they could have drawn more seriously on financial accounting support from the nonprofit much earlier in their process. Also, when entire skill sets are missing, an organization must be able to seek and accept help from outside experts.

7. The business must maintain adequate financial information systems for credibly assessing and supporting the health of the business.

This lesson has been learned every time a social purpose enterprise is examined,but it is a lesson that has obviously not yet been effectively heeded because it keeps re-emerging! In order to make sound business decisions, it is essential to have accurate financial information. Credible financial statements, particularly those that show trends over time,should be used to inform decisions about a range of business concerns – hiring, expansion, production, inventory – whether or not there is an investor who is requesting to see the information. The fact that there is an investor willing to provide problem-solving assistance, however, makes the need for financial data only more compelling. The absence of accurate financial reports and accurate projections for these three businesses made it almost impossible to understand the extent of the problems until the problems became acute.

It may be that the groups required a different type or intensity of technical support in this area than REDF was able to provide. As

part of the upfront due diligence process, it is important to recognize the financial systems gaps and identify the right match to meet those gaps.

8. For social purpose enterprises, seriously pursuing the business mission will ultimately provide more opportunity to pursue the social mission, not less.

All of the organizations resisted "standard business practices" when they went against their basic social service or social justice instincts. But, in the end, if they had been able to produce more accurate reports, plan for problems like cash flow and production capacity, and effectively draw on the advice of business consultants, they would have been much more likely to grow their business over time. For BOSS, seriously pursuing their social mission might have meant seriously pursuing a different business in order to employ larger numbers of their participants. Which is what they are now exploring. Still, in all cases, a healthy and financially sound business would have better positioned each of the groups to create greater numbers of employment and training opportunities for their target populations.

All three of the organizations that have left the REDF portfolio have reflected on the lessons of their first enterprise experience and are incorporating those lessons in ways that make sense for their respective organizations. REDF too has learned lessons along the way and is seeking to incorporate those lessons in its partnerships with other social purpose enterprises. This process of reflection leading to a process of correction is a key ingredient of successful social entrepreneurship. The REDF initiative was meant to be new, bold and experimental. By definition, an experiment means some strategies are bound to turn out differently than expected. From that perspective, these cases do not profile failure, they profile learning – and learning that is incorporated into practice advances organizations, communities and a new field of social investment.

Footnotes

1 An additional five people were interviewed for the case study for Agency C that is not published here.

2 See "Challenge of Change: Implementation of a Venture Philanthropy Strategy" in Chapter 2 of this book.

3 See "Challenge of Change: Implementation of a Venture Philanthropy Strategy" in Chapter 2 of this book.

4 For examples of how other enterprises in the portfolio successfully addressed some of the issues faced by groups who exited the portfolio, see Volume 1 of the REDF Box Set, *Practitioner Perspectives.*

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Chapter 4

Accounting Issues in the Social Purpose Enterprise

Accounting Issues in the Social Purpose Enterprise

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All small businesses encounter challenges when they attempt to perform accounting and financial reporting according to Generally Accepted Accounting Principles (GAAP). Businesses owned and operated by nonprofit agencies exist in a hybrid world of commercial and nonprofit needs, and as a result, they encounter unique obstacles.

Background

One of the central issues raised in New Social Entrepreneurs is financial performance tracking and reporting. How have nonprofit enterprises reported on financial performance in the past, and how should their accounting and reporting change to provide more useful information, as well as conform to GAAP? This book's chapter on True Cost Accounting points out that in the past, most evaluations of nonprofit-run enterprises around the country employed traditional program evaluation techniques such as case studies and organizational summaries, but lacked standard business financial reports.

Our work with nonprofit agencies starting businesses supports this finding: most businesses started by nonprofit agencies do not have appropriate accounting systems in place when they launch their venture. Furthermore, business and agency managers encounter complex challenges in establishing such systems once a business has started. As a result, financial reports for these businesses generally are either nonexistent, or are not

useful to the businesses' managers, boards, funders or employees.

The words "appropriate" and "useful" are important here. Most reputable nonprofit agencies are careful to account for the finances of all their programs, including their businesses. However, the information required by nonprofit managers, boards and funders to assess the success of a nonprofit organization is different from the information needed to track a business' performance. Nonprofit service organizations, for example, have traditionally measured the demand for their services by assessing program usage via client counts or hours of service provided, measures that are not reflected directly in the organization's financial statements. In businesses, such "demand" would show itself as revenue totals in the business' income statement. "Revenue" on a business' income statement has different implications than it does on a nonprofit agency's statement. The systems nonprofit agencies use to account for, report on and interpret their organizational performance are not appropriate or useful for assessing business performance.

Nonprofit-run businesses in the Roberts Enterprise Development Fund (REDF) have met numerous challenges in bridging this nonprofit versus business accounting difference. In 1996, REDF began working closely with agency and business managers to ensure that each business in the portfolio had accounting systems and reports that met GAAP and provided the information needed by both agency and business managers. Each of the original REDF portfolio agencies' accounting systems have been particular to that agency's structure, history, board and staff capabilities, mission target population, as well as to the nature of the business in which the nonprofit was engaged. Nevertheless, there have been underlying issues common to all or most of the organizations and businesses. In the course of two years of intensive work with the portfolio's businesses, the issues and roadblocks have become clear and some solutions have emerged.

Underlying Issues

All organizations, whether for-profit or nonprofit, encounter common accounting system questions:

- Which system?
- Who sets it up?
- How is it structured?
- Who maintains it?
- What information should reports show?
- Who receives which reports?

Some of the issues underlying these questions, however, are unique in nonprofit-run businesses. These challenges fall into the following interrelated areas:

- Should accounting systems be integrated within the agency system, or autonomous to the business?
- Fund accounting or business accounting?
- How do we account for social costs and subsidies?
- How do we track ownership, assets and liabilities?
- Who are these reports for?

Underlying issue #1:
Integrated within agency system, or autonomous to the business?

REDF portfolio businesses were all started and remain as programs of their parent nonprofit agency. This structure, similar to a corporate divisional profit center approach, helps assure that the venture remains directly related to the mission of the organization and makes it easy for the parent agency to provide assistance and resources to its emerging enter-

prises. In addition, by structuring an enterprise as one of its programs,agency can maintain close fiscal control over the business. REDF portfolio agencies operate businesses in order to create jobs and training opportunities that carry out the organization's nonprofit mission. Appropriately, agency directors want to ensure that businesses under their purview accomplish their mission-driven goals.

All REDF portfolio businesses were started utilizing whatever accounting software the parent agency had in place for overall agency accounting, probably as a matter of convenience. However, issues of control surfaced when (during REDF's first few months of "venture financing" involvement) REDF requested that all businesses in the portfolio maintain standardized accounting systems and financial statements. Meeting strong resistance to this from agency directors, REDF modified its position and agreed that it would not concern itself with which system, staff and procedures were used to generate financial reports, as long as separate income statements and balance sheets could be produced for each business. The result was that all agencies continued using agency software and staff to generate monthly financial information for their businesses. In several cases, businesses used separate accounting packages or spread sheets to generate preliminary or parallel accounting information, but in all cases, comprehensive business financials came from the agencies' central accounting department.

While this integration of business accounting with agency accounting maintained some efficiencies and provided agency management with a sense of control, it also resulted in complex problems for most of the portfolio businesses. Two exceptions were Juma Ventures and Youth Industry, the two agencies whose primary activity is running mission-driven businesses as opposed to a number of other programs in addition to the ventures. We speculate that these two agencies avoided the complexities and conflicts encountered by other older, less specialized agencies because both of these agencies were relatively young, and their accounting software and procedures were set up using business accounting models geared to meet their businesses' information needs.

In the other eight agencies,[1] traditional non-business programs commanded a larger portion of total agency budgets than did the business(es). Perhaps more importantly, accounting staff appeared to regard the agency's traditional programs and funders as "the main show"around which the organization revolved. Understandably, as far as the accounting staff were concerned, the needs of these "central" elements took precedence over the needs of the agency's business(es) when tasks were being prioritized.

These factors all contributed to business managers' frustrated attempts to get timely, accurate, appropriate information about the performance of their businesses. Some felt that their ventures had a "problem stepchild"identity within the accounting department on which they depended. This situation also contributed to tensions between REDF and some of the organization' executive directors. The differing needs of the business managers included:

- Timing: Business managers needed reports more often and on more of an "on-demand" basis than did their parent agencies' managers. It was critical for most of the businesses to see financial performance updates monthly; many needed specific updates weekly or even daily. Nonprofit agencies' accounting department systems and procedures had been set up to accommodate the agencies' original needs and generally could not (or would not) generate reports on the schedule needed by business managers (and by REDF).

- Ways of categorizing information: Business managers needed financial performance data grouped into detail categories different from the categories nonprofit managers' accounting staff had set up. Thus the agencies' chart of accounts (which defines the categories in which data will be tracked) were inappropriate for business tracking needs. See Fund Accounting versus Business Accounting, below.

- Types of reports: Business managers needed reports that differed from those that nonprofit agency or department managers needed. For example, business managers in product manufacturing businesses needed detailed product or job cost reports in order to analyze progress in containing costs; agency managers had no

need for such reports, but wanted detailed accounting of grant expenditures.

Underlying issue #2:

Fund Accounting or Business Accounting?

Nonprofit agencies must disclose which of their funds received and spent are restricted by donors to specific uses. They utilize fund accounting to do this. Fund accounting is an approach to organizing financial data into periodic reports. In fund accounting, each expenditure is allocated to a restricted project ("fund").One can imagine every expenditure, under fund accounting, carrying a little tag that names its donor or funder. Those expenditures with no "tag" or funding source, are pooled and must be covered by funding that is "unrestricted" (such as earned income, unrestricted grants, event revenue, etc.). Unrestricted funds are difficult to raise, and therefore pairing up funding sources with expenditures is central to financial management in nonprofit agencies.

By contrast, businesses receive income in return for goods or services. Once payment is received, business owners and managers decide how it will be spent. The source of the money does not determine its use. Pairing up sources of revenue with accompanying expenditures is not a focus of business financial management. What is of pivotal interest, however, is an expenditure's functional category (rent? utilities? direct labor? advertising?), and its monthly and year-to-date totals (both in absolute terms and as a percentage of total expenses or sales). These are measures that can be used to compare a business' performance to its past performance, to competitors and to industry benchmarks. While functional categories are generally budgeted and tracked by nonprofit managers, their importance is often overshadowed by a concern with funding sources.

Thus,a matter of paramount importance to nonprofit accounting staff is not particularly relevant to business managers and staff. And at the same time, information of paramount importance to business staff is of lesser or no importance to nonprofit oriented staff. Nonprofit agency accountants and managers ask "which funder/which fund will pay for this?" Business accountants and managers ask "which category does this fit in, and is the total for that category an appropriate proportion of the whole?" For eight of the REDF portfolio nonprofits, this difference in perspective created a continual disconnect between business managers and their parent agency's accounting staff.

This difference in perspective not only reflects two different ways of thinking about financial information; it is the basis for significant differences in the design of each accounting system's chart of accounts. To accommodate both needs, a chart of accounts must be designed with both in mind. The chart of accounts is an outline, a numbering system for all the categories into which financial transactions might fall. Most traditional nonprofit chart of accounts designate digits for labeling each expense by its funding source, but do not designate digits for labeling each expense by product category or by business location. Providing a numbering scheme that can do both requires design planning and an accounting system with room for the total digits needed. Some accountants articulate the need for this expanded capability as the need for a "three tier" chart of accounts, rather than the more limited "two tier" design.

Underlying issue #3:

How do we account for social costs and subsidies?

The challenge of tracking social costs and subsidies has been a major focus of REDF's work. Nonprofit-run businesses have costs not borne by "regular" for-profit businesses, and often receive revenue (subsidies) not received by "regular" businesses. All REDF portfolio businesses, for example, want to both create jobs and training opportunities for specific disadvantaged populations and to become profitable. Employing and training disadvantaged populations involves costs that businesses focused only on profit do not have. Subsidy revenue helps to offset these additional costs.

Both social costs and subsidy revenue need to be accounted for in looking at the overall finances of these businesses. Social costs (the premium each business pays to accomplish its social goals) should be differentiated from standard business costs and

subsidy revenue should be differentiated from standard business revenue. Such differentiation enables business and agency managers, staff and investors to compare each business' performance to industry standards and allows us to quantify the cost of the extra support needed to bring disadvantaged populations into mainstream job markets.

Most REDF portfolio agency and business managers have agreed upon the need to differentiate and track social costs and subsidies. Initially, some found it challenging to report on social costs/subsidies within business income statements, as well as to satisfy traditional funders' reporting requirements without confusion and double counting. While identifying subsidies is generally not complicated, determining and allocating social costs can be very complex. Great variations exist, from one agency to another, in what types of social costs are incurred and how these costs are tracked if at all. Other chapters in this book review these issues in greater detail.

REDF has worked with portfolio business/agency staff to better codify the thinking and process of accounting for social costs. all REDF portfolio businesses are tracking social costs and subsidies and 17 of 23 business include them in a portfolio-wide income statement format which differentiates social costs and subsidies (providing the "second bottom line"). While this effort clearly distinguishes REDF's work from the field, the challenges of identifying, quantifying, tracking and codifying social costs need further thought and discussion.

Underlying issue #4:
How do we track ownership, assets and liabilities?

A balance sheet is one of two reports needed to understand a business' financial performance and position. It shows what the business owns and what it owes. At the time the REDF initiative began, no REDF portfolio business had a balance sheet separate from the overall agency balance sheet. In a manner comparable to corporate accounting for subsidiary businesses,[2] the parent agencies showed their businesses' balance sheet accounts as part of a consolidated agency balance sheet.

If set up appropriately, a business' account totals can be shown both separately and as part of the parent agency's overall balance sheet. However, agency management and accounting staff were resistant to separating their business' balance sheet accounts from the pooled agency accounts. Reasons for this resistance included:

- the staff time and cost it would take to do so,
- fear of decreased flexibility in managing cash flows if cash accounts were more clearly delineated, and
- a general lack of motivation to change.

With many other more immediate challenges at hand, REDF agreed to delay its requirement that each business generate a separate balance sheet. In the two years since its initial request, REDF has supported several portfolio businesses' efforts to produce and maintain individual company balance sheets. The effort has been undertaken on a business-by-business basis. In some cases, the lack of easily accessible asset and liability information became an untenable barrier to understanding a business' performance. In others, expansion financing has required it. Most of the REDF portfolio agencies are now moving toward changing their accounting procedures to enable creation of separate distinct business balance sheets for each enterprise.

The lack of individual balance sheets has hampered day-to-day financial management, strategic business analyses and projections for the social purpose enterprises. It has also made it difficult to determine a return on investment (ROI) or social return on investment (SROI) for each business and for the portfolio as a whole. This issue is discussed in other chapters of this book.[3]

Underlying issue #5:
Who are these reports for?

Assumptions about who the customers for financial reports are strongly influence the reports' form, content and timing. Business owners and managers use internal financial reports to help them in their day-to-day, week-to-week decisionmaking.[4] Financial

performance is their key measure of success, the clearest way to get an "instant read" on the effectiveness of business activities. Financial reports are of primary interest to the business manager who knows how to use them.

In nonprofit agencies, financial performance is not the key measure of success (though it may be key to survival),nor is it the best way to determine whether an agency's mission is being accomplished. Thus nonprofit agency managers do not look to financial reports for timely feedback on the effectiveness of their efforts. Rather, agency financial reports (the timing of their issuance,their form and content) are designed to satisfy funders' requirements.

The difference between these two perspectives, each appropriate to the arena from which it emerges, can create friction between businesses run by nonprofits (their managers, staff and investors) and the agency managers and accounting departments to which they are intricately connected. Business reports may be issued on the same schedule and in the same format as agency reports adequate for management of a nonprofit agency, but severely inadequate for use in operating a growing business. At various points in the evolution of these agency-business systems, portfolio business managers have expressed extreme frustration with their agency accounting staff's inability to generate useful, accurate, timely financial reports. Operating without useful financial information has forced some managers to "fly blind."

Accounting Solutions That Work

As the previous narrative indicates, REDF portfolio agencies have tried several approaches to meeting nonprofit and business accounting needs that have not worked. These failed approaches can be summarized as:

- **Bad Idea #1:** Use two accounting systems (one run by the agency, one run by the business) that both track the business' performance but are not linked per GAAP. This description could be finished with "and spend hours and hours each month trying to reconcile the differences between the two." Agency and business managers will need to take advantage of their own social support services after subjecting themselves to this approach!

- **Bad Idea #2:** Track the business' performance with just one accounting system that is separate from the agency's system and not linked to it per GAAP. This description could be finished with "and hope for the best." Agency management will probably not have the correct perspective on business activity, or the assurance of financial system integrity that they would get from a linked system.

- **Bad Idea #3:** Use the agency's accounting system software, staff and procedures to track business performance even though it does not generate adequate business information. This description could be finished with "but it'll just be a matter of time." It will just be a matter of time before agency management gets some sort of surprise vis-à-vis the business—a surprise from which the nonprofit may never recover! Business managers may "have the sense" that costs are up, or that sales are down, or that a new market niche has promise. But because the business' financial reporting is inadequate, no one may know the extent of these trends until it is too late to do anything about them.

Accounting Solutions That Work

Is there any way to address the significant differences in accounting and financial reporting needs and perspectives between nonprofit agencies and the businesses they are spawning? What approaches can meet the needs of both nonprofit agency and market-based business? Here are a few that can work:

- **Good Idea #1:** Creation of a nonprofit agency solely dedicated to social purpose enterprise venture creation

As noted previously, those agencies whose primary programs are businesses employing disadvantaged individuals have oriented the set-up and maintenance of their accounting systems around their businesses' needs and thus have encountered few differences in agency and business requirements. Social cost accounting however, not a concept found in standard business accounting systems, is still uncharted water.

- **Good Idea #2:** Organization-wide accounting system/procedures that serve both agency and business needs

Several important changes have been instituted by agency-business duos, using the parent agency's accounting system, procedures and staff for generating the business(es)' financial reports. These changes include:

- Accounting software that has features needed by for-profit businesses (for example, the ability to issue reports prior to month-end closing). Modules required for the particular business (for example,manufacturing businesses will need an inventory module) must be provided. If the agency's accounting software cannot adequately support the business' needs, it must be replaced or this organization-wide approach will not work

- Augmentation or complete re-design of original chart of accounts to allow for categories needed by the business; a "three-tier" chart of accounts, rather than "two-tier" will provide the best, least cumbersome, long-term solution to meeting both agency and business needs.

- Hiring or appointing a dedicated accounting staff person(s) for the business' accounting processes. This person should not have to juggle other priorities and should be responsible for meeting the business' ongoing reporting schedule needs. This individual must report (at least partially) to the business manager(s).

- Clear delineation of policies, procedures, timing and responsibilities for all the agency accounting department tasks that involve business data.

- **Good Idea #3:** Business-specific accounting system/procedures, separate from but linked to the parent organization

In this approach, the business(es)' accounting transactions are tracked separately from its parent agency's. The business' accounting software may be industry-specific, and therefore require less customization. It is linked, via automatic export/import or via manual procedures, to the parent agency's software. Thus, period-end totals are entered in the parent agency's system and are subject to that system's double entry "checking" (these checks are built into both systems). This linking of two separate systems is being implemented by several REDF portfolio agencies.

Important steps in implementing such a system, and key system features are:

- A view of long-range agency and business plans should be available to accounting system designers

- Step-by-step planning of systems' linkage procedures prior to implementation;careful testing of demo software if the linkage is to be automatic

- Parallel operation of new (linked) system with old system until correct operation is assured

- Set-up and review of the system to ensure it meets GAAP (and review, in particular, of journal entries or other links between the business and the parent agency) by a CPA experienced in both nonprofit and private business accounting

- Education of business and nonprofit managers in reading and using financial reports

- Monthly review of business financials by appropriate agency staff (i.e. separation of systems does not need to limit agency managers' involvement and oversight)

Conclusion

Business accounting is an integral part of running a business responsibly. A business' financial reports are management's window onto what the business is doing and how it is performing. Without these reports, intelligent, proactive guidance of the business is impossible. Businesses have financial reporting needs that differ in some significant ways from those of nonprofit organizations. Therefore, any nonprofit agency planning to run a successful business must take special steps to ensure that these very specific reporting needs are met.

Footnotes

1 Asian Neighborhood Design, Barrios Unidos, BOSS, CVE, Golden Gate Community, Goodwill Industries, Jobs Consortium, Rubicon Programs.

2 Note that while corporations commonly use consolidation of financial statements across subsidiary businesses, they are not required to do so if consolidation does not provide improved disclosure. Consolidation is often not practiced when the asset and liability structure of a subsidiary is substantially different from that of its parent because doing so would make it difficult to understand the financial position of either.

3 Please see Chapters 8 and 9 for a more detailed discussion of these points.

4 It is true that many small privately owned businesses do not generate regular financial reports at all: often the only financial report a business owner has is a year-end income statement and balance sheet created as part of the business' annual tax statement. It is also true that many small businesses fail each year. Nonprofit run businesses, as part of organizations that receive public monies, must conduct more sophisticated financial reporting than typical small businesses. In addition, REDF and its portfolio businesses attempt to apply accepted business management and analysis techniques to increase the chances of success for each business.

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Quantifying Social Costs: A Case Example from Rubicon’s Buildings & Grounds Business

Quantifying Social Costs: A Case Example from Rubicon’s Buildings & Grounds Business

By Kim Starkey
Farber Fellow, 1998 - 1999

As a result of their commitment to pursuing both economic and social goals, social purpose enterprises will inevitably face social costs. Social costs are the additional costs, above and beyond regular business costs,that are incurred in pursuing a social mission. For instance, in providing training opportunities to its target population, Rubicon Programs’ buildings and grounds maintenance business faces two major social costs:

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- First, its employees are less productive than those in private sector firms, making labor costs higher.

- And, second, Rubicon's unique workforce requires extra supervision, making supervisory costs higher.

If the enterprise uses traditional private sector financial reporting, these additional social costs are not differentiated from ordinary business costs, distorting our view of the enterprise's performance: social costs remain buried in line items for standard business costs. For example, suppose that 30% of a manager's time is devoted to "extra" tasks necessitated by the challenges faced by the social purpose enterprise's labor force. Under traditional financial reporting, all of the manager's salary might be included in the "administrative expense" line item. Doing so, however, would overstate administrative expenses, and thus result in lower net income. Because social costs are the additional costs resulting from a *social* mission, they need to be differentiated from *business* operating costs in order to allow the business managers to understand what component of business activity is related to the core operation and what component reflects the pursuit of the social mission.

Therefore, a more useful approach to financial reporting for social purpose enterprises is to distinguish social costs from ordinary business costs. This goal can be achieved by calculating social costs and listing them separately. Thus, in the above example, 30% of the supervisor's wages and benefits would be placed into a separate line item called social costs. Social purpose enterprises within the REDF Portfolio do this with an income statement that has two "bottom lines:" the first net income line ("net income before social subsidies and costs") provides an accurate picture of how the social purpose enterprise is doing as a business. Social costs are shown beneath it. "Net income after social subsidies and costs" can then shed light on how the enterprise is performing as a social purpose enterprise.[1]

The Advantages of Accounting for Social Costs

Distinguishing social costs from ordinary business costs is advantageous for several reasons. First, "net income before social costs" reflects true business costs, thereby enabling managers of a social purpose enterprise to compare their performance with other players in the industry and make informed business decisions. Knowledge of the extent to which a social purpose enterprise is profitable as a business should shape every strategic and operational decision made by management. In addition, the ability to assess a social purpose enterprise as a stand-alone business can facilitate the development of a social purpose enterprise's competitive strategy. By making the social purpose enterprise's financials directly comparable to those of other similar businesses, managers will have a benchmark against which to measure business performance. Benchmarking is important because it can inform management about where cost reduction efforts may be possible and necessary in order for a social purpose enterprise to be competitive. Moreover, understanding a social purpose enterprise's financial performance vis-a-vis for-profit colleagues can help shape strategic decisions on issues such as pricing, expansion, market entry and exit, etc.

In addition to facilitating informed decision making on business issues, accounting for social costs facilitates informed decision making regarding the social mission. Each month, managers can weigh social costs against estimates of social impact. Moreover, managers can track social costs over time to ensure that social costs are increasing only to the extent that estimated social impact is also increasing. In some instances it may be possible to decrease social costs without detracting from the social mission. For example, in some social purpose enterprises, materials wastage

is high because employees have little experience and low skill levels. To the extent that this inefficiency is a result of the enterprise's social mission, it may be categorized as a social cost. Ongoing efforts to improve work habits can be enhanced by quantifying and tracking their effects.

How to Quantify Social Costs

While in future years the field will develop more accurate systems for identifying and charging social costs, at the present time quantifying social costs can be a subjective and ambiguous process specific to each venture. Sometimes,it is unclear what constitutes a social cost. Once social costs facing a particular business have been pinpointed, subjective decisions must be made when addressing the methodological challenges that arise in quantifying them.

It is important to involve a number of different people at all stages of the process of calculating social costs. This will remove personal bias from the process and will ensure greater accuracy. At the same time, however, one individual should be ultimately accountable for the work. That individual should oversee the process of involving a number of outsiders (funders, consultants, etc.) and insiders from within the social purpose enterprise. Collectively, these individuals can help with brainstorming and "thinking out of the box" while providing a useful reality check.

In the effort to accurately represent social costs in a social purpose enterprise's income statement, the degree of precision is a function of the amount of time invested. Given this relationship, it is important to clarify objectives in advance based on the individual circumstances of an organization and managerial goals. There are several key questions to consider, such as:

- Do you want a quick, back-of-the envelope estimate?
- Or is your organization willing to invest the time necessary to obtain a more accurate representation of social costs?

However an organization decides to weigh the importance of social cost accounting, it should consider using the four steps delineated below to determine what social costs to track and how to represent them.[2]

Step 1) Brainstorm the types of social costs that are significant for your business and assess the likely magnitude of each.

If the social costs facing your business are not immediately clear to you, it might be useful to begin your analysis by thinking about the nature of your business as reflected in the components of its cost base. For example, if you have a large number of trainees and labor is the largest component of your enterprise's cost base,then it is likely your most significant social costs are related to employee inefficiency or additional supervisory time. On the other hand, if you employ trainees and are manufacturing a product made with expensive materials, then wastage might be your most significant social cost.

To ensure you list all of the social costs relevant to your business, request input from as many of the business' staff as possible. These individuals can alert you to any dimensions you have missed or to instances where you have defined a social cost too broadly. Supervisors and other individuals who are involved in the day-to-day operations of the business can be especially helpful in analyzing the additional costs incurred by a social purpose enterprise carrying out a social mission.

Once you have made a comprehensive list of pertinent social costs, make a preliminary assessment of the likely magnitude of each social cost category. While these assessments need not be quantitative, they should at least rank social cost categories (e.g., "high", "medium", "low") in order of perceived importance. This could also be expressed as an estimated percentage of time or expense.

Step 2) Outline the methodology that could be used to quantify each type of social cost and pinpoint methodological challenges.

The next step is to outline the methodology that could be used to quantify each type of social cost. Most methodologies will encounter inherent challenges that should be noted and addressed where possible. Furthermore, it is also useful to outline alternative methods of quantifying each type of social cost.

Social cost accounting is more of an art than a science.A decision about how to quan-

tify additional supervisory costs, for example, might be made by balancing which approach will be most accurate with which approach will be most likely to be completed on a monthly basis. It is important the organization document the approach it will use; then, when management analyzes past performance and revises budgets, or when outsiders challenge methodologies, the organization's clearly enunciated assumptions will make it possible to understand and explain the resulting numbers.

Step 3) Decide which social costs to include in the analysis by weighing methodological challenges and the estimated magnitude of each social cost.

You probably will not end up quantifying all of the social costs that are relevant to your business. Some social costs are likely to be eliminated from your analysis because they pose methodological challenges that are too great or because they are extremely small. Most decisions about whether to include or eliminate a social cost from the analysis should be made on a case-by-case basis. The need to gather and track social cost data is offset by the challenge of doing so successfully. A decision to gather and track particular data makes sense when the costs being tracked are large in dollar impact and the methodological challenges are small. This dynamic is illustrated in the decision-making matrix [Exhibit 1].

On the other hand, it doesn't make sense to track a particular social cost if it has a small dollar impact and will entail large methodological challenges. All other circumstances require case-by-case decision making.

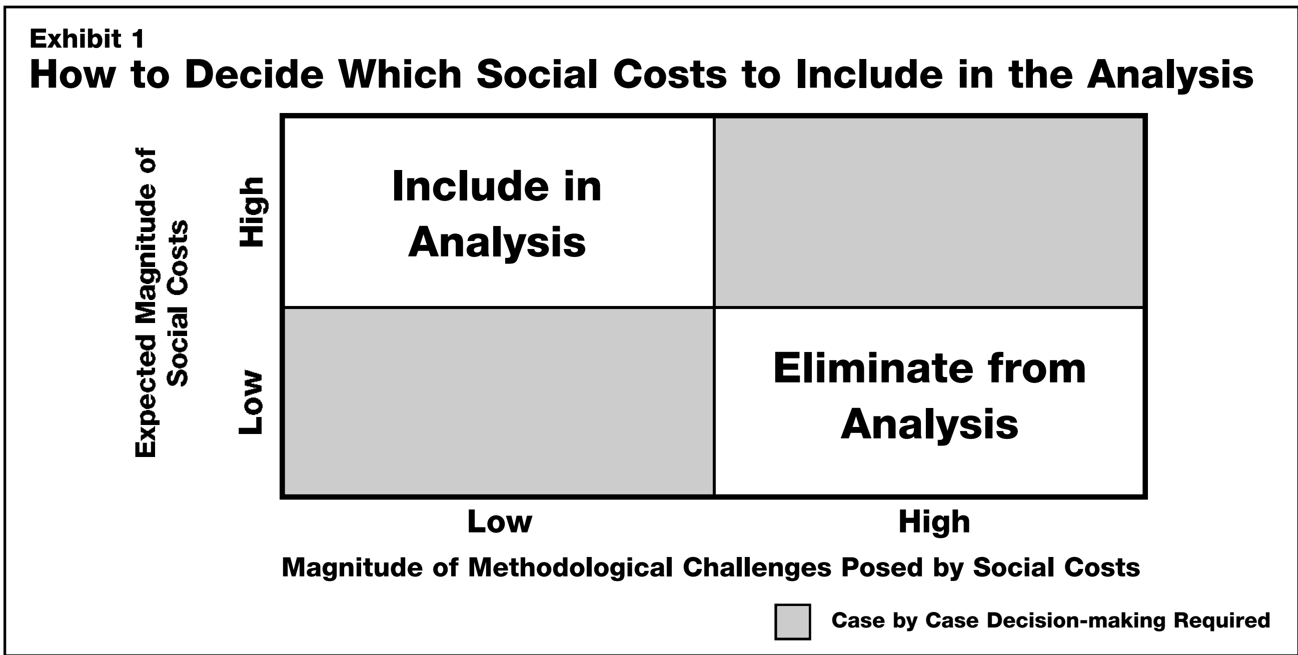
Step 4) Carry out planned methodology; represent social costs in income statement.

After deciding which social costs to include in the analysis, the business should carry out its planned methodology. Where time and capacity permit, it can also be useful to actually carry out two or three different methodologies for quantifying the same social cost. In this way, a social cost is assessed from a number of perspectives in order to ascertain the most accurate figures. If the figures obtained from each of the methodologies are similar, you can be more confident in your analysis.

You must work with your organization's accounting department to capture the total social costs in the income statement. In this endeavor, be careful to avoid double counting. In order to place social costs in a separate line item, one must subtract each social cost from the standard expense line item. In other words, the effort to capture social costs is not an exercise in discovering new costs but rather is a clarification of costs already represented in the income statement.

Exhibit 1

How to Decide Which Social Costs to Include in the Analysis



A Case Example from Rubicon Programs' Buildings & Grounds Business

Rubicon's Buildings & Grounds business was established in 1987 to provide janitorial and landscape maintenance training opportunities for mentally disabled people in Contra Costa County. Between 1994 and 1999,the business acquired several large landscape maintenance contracts that enabled it to create a substantial number of stable jobs and generate net revenues that have contributed significantly to the support and expansion of Rubicon's social programs. The business currently has 70 employees throughout the San Francisco Bay Area, 45 of whom are disabled or economically disadvantaged. During the 1998-1999 fiscal year, the business is expected to generate $3.5 million in revenues and $750,000 in net income that will be used to expand the business and support agency programs. In August of 1998, the director of Rubicon Buildings & Grounds decided that I, as the financial manager for all three of Rubicon's enterprises, would spearhead the effort to quantify Buildings & Grounds' social costs. In each step of the process I sought the guidance and perspectives of others, such as supervisors from the field, the director of the business, a consultant from Keystone Community Ventures, and the executive and associate directors of The Roberts Enterprise Development Fund.

My first priority was clarifying, at the outset,how much time we were willing to invest in order to be precise. The consensus was that we should choose a middle path in this tradeoff: while we wanted our accounting for costs to be reasonably accurate, I had limited time in which to complete the project. We agreed that, where necessary, I would use estimates. I approached each of the steps with this middle path in mind.

Step 1) Brainstorm the types of social costs that are significant for your business and assess the likely magnitude of each.

I worked with the director of Buildings & Grounds, supervisors from the field, and the consultant to brainstorm a list of the types of relevant social costs that would be useful in our analysis. Because Buildings & Grounds is a service business in which labor is the largest component of the cost base, the most obvious social costs involved labor and supervisory time. We listed the following social costs:

Type of Social Cost	Definition	Expected Magnitude of Social Cost
Allowance for Employee Inefficiency	The additional time needed to complete a job due to the disadvantaged nature of labor	High
Extra Supervisory Time Incurred	The additional time supervisors must devote to recruiting, supervising, counseling and paperwork due to the disadvantaged nature of labor	High
Wage Rate Premium	The difference between Rubicon's wage rate and the industry standard, due to Rubicon's mission	Medium
Wastage	Wasted materials (e.g., spilled fertilizers, pesticide, etc.) due to employment of a workforce that is still in training	Medium
Time devoted to funder activities	Time devoted by management to those funder events which does not add direct value to the social purpose enterprise	Low
Time devoted to nonprofit-related activities	Time devoted by management to nonprofit-related activities (e.g., giving tours to other nonprofits, etc.)	Low

Step 2) Outline the methodology that could be used to quantify each type of social cost; pinpoint methodological challenges.

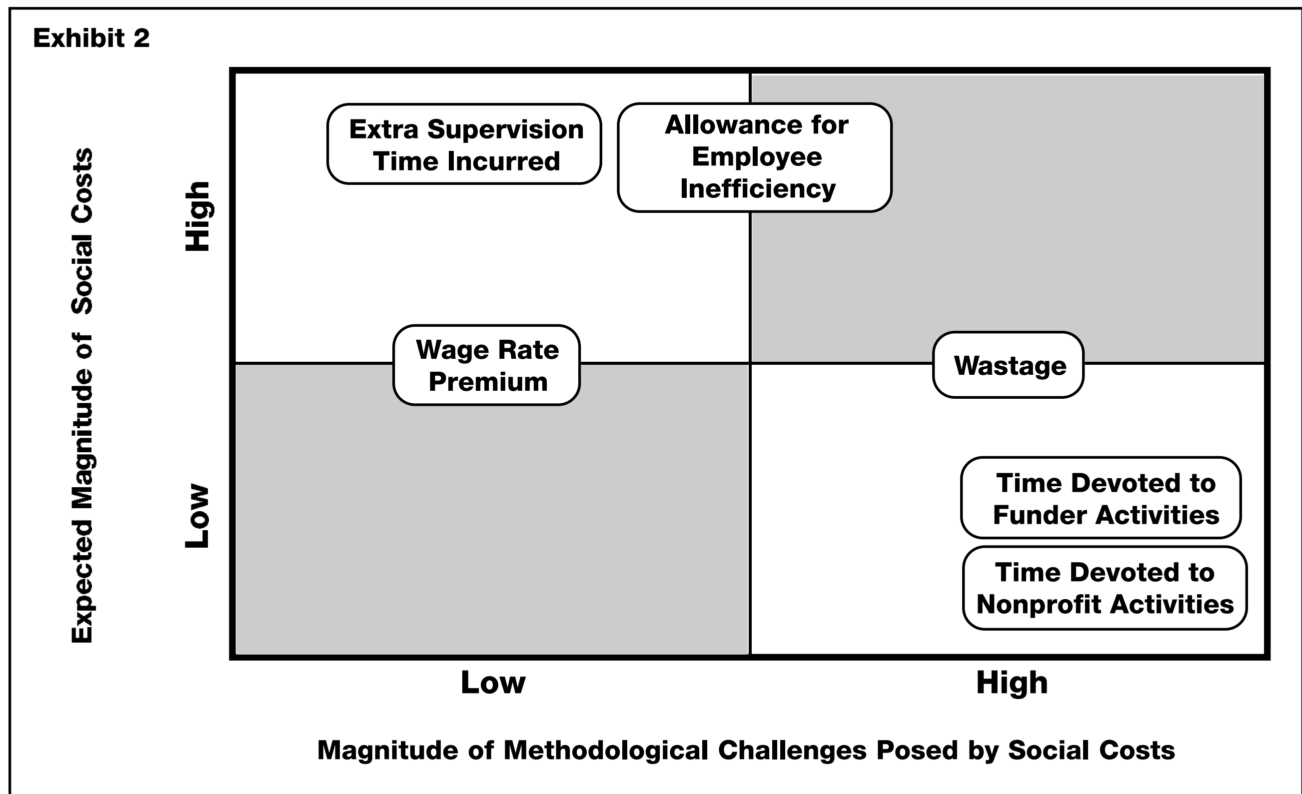
After listing the types of possible social costs, I outlined the methodology needed to calculate each type of social cost, and pinpointed the challenges of each.

Step 3) Decide which social costs to include in the analysis by weighing methodological challenges and the estimated magnitude of each social cost.

I then assessed each type of social cost in light of its likely magnitude (dollar impact) and the methodological challenges of measuring it, in order to decide which social costs to include in the analysis and which to eliminate.

A large expected magnitude (dollar impact) and small methodological challenges pointed toward inclusion of two of the social costs: extra supervisory time and allowance for employee

Type of Social Cost	Methodology for Calculating	Challenges of Methodology	Magnitude of Methodological Challenges
Allowance for Employee Inefficiency	Director of Buildings & Grounds estimates efficiency of each job	Estimates will be based on viewpoint of one person; time studies too time-consuming to perform	Medium
Extra Supervisory Time Incurred	Each supervisor interviewed and asked to estimate number of hours per week spent on activities related to disadvantaged nature of workforce	Based on compilations of opinions/surveys of supervisors; time studies too time-consuming to perform	Medium to Low
Wage Rate Premium	Research industry wage rate and compare with Rubicon's wage rate to determine whether Rubicon's pay rate policies lead to higher-than-market rates		Low
Wastage	Compare amount of materials purchased with estimate of amount needed; conduct surveys, interviews of workers and supervisors	Difficult to discern whether wastage due to disadvantaged nature of workforce	High
Time devoted to funder activities	Track time devoted by director of Buildings & Grounds to funder activities	Social costs of funder activities likely outweighed by benefits	High
Time devoted to activities necessitated by nonprofit status (e.g., giving tours to managers of other nonprofits)	Track time devoted to nonprofit-related activities	Social costs of nonprofit related activities likely outweighed by advantages of nonprofit status	High



inefficiency. Similarly, a small expected dollar impact and large methodological challenges pointed toward omission of two of the social costs: time devoted to funder activities and time devoted to activities related to the nonprofit status. By contrast, medium expected magnitude pointed toward case-by-case decision making for the remaining two types of social costs:wage rate premium and wastage. I decided to include wage rate premium because of its small methodological challenges. I omitted wastage because of its high methodological challenges.

Step 4) Carry out planned methodology; represent social costs in income statement.

Rubicon Buildings & Grounds is a contract business comprised of 12 total contracts. Because costs vary from contract to contract, I calculated social cost on a contract-by-contract basis. I placed each job on a separate spreadsheet that can be utilized and changed as pay rates or other contract circumstances change.

Methodology Used in Each Category Where Extra Supervisory Time Incurred

In order to calculate extra supervisory time incurred, I conducted interviews with supervisors. First I asked each supervisor to estimate the total number of hours per week that he or she worked. Then I asked each supervisor to estimate the number of hours per week he or she spent on the following activities:

Activity	Definition
1) **Recruiting**	Time spent advertising, finding, interviewing and hiring disadvantaged workers (time that is not necessary for recruiting workers from the mainstream labor market)
2) **Supervising**	Time spent supervising and training disadvantaged workers (time that is not necessary for supervising other workers)
3) **Counseling**	Time spent counseling and correcting disadvantaged/disabled workers (counseling that would not be necessary if the workers were not disadvantaged or disabled)
4) **Paperwork**	Time spent filling out forms, reports and evaluations of disadvantaged workers (paperwork that would not be necessary if the workers were not disadvantaged or disabled)
5) **Other**	All other tasks and activities

I wanted to ensure as much accuracy in these estimates as possible. Sometimes supervisors' estimates of their hours spent on the five types of activities was higher or lower than their weekly total hours worked. In each case I checked for discrepancies; when I found one, I helped the supervisor adjust his or her estimates. Once each supervisor and I both felt that the various estimates were as accurate and consistent as possible, I summed the hours spent on the first four categories (recruiting, supervising, counseling and paperwork) in order to obtain the total extra supervisory time incurred by each supervisor. I then divided the total extra supervisory time incurred by the total hours worked per week in order to express this social cost as a percentage of each supervisor's time.

Allowance for Employee Inefficiency

The allowance for employee inefficiency was calculated based on the director of Buildings & Grounds' estimates of the additional time needed to complete each job due to the disadvantaged nature of labor force. The director made these estimates according to an industry standard developed based on his past work experience in private sector buildings and grounds businesses. After the director had completed his job-by-job estimates of employee inefficiency, I met with the supervisors for each job. Without disclosing the estimates that the director had made, I asked each of the supervisors to make their own estimates of how long it would take their employees to finish a job, versus the time it would take employees in the private sector. For the most part, the estimates of the director and the supervisors were very similar. In instances where there were substantial discrepancies, I facilitated discussions to reach a consensus.

Wage Rate Premium

The wage rate premium was determined by calculating the difference between Rubicon's wage rate and an industry wage rate. We could have used any of a number of different sources to determine the industry wage rate, such as Department of Labor statistics, newspaper want ads, and listings of California state-wide wage rates. We ultimately decided that the wage rate information published in the San Francisco Occupational Outlook Report was sufficient for our purposes. This report provided high, low and median hourly wages for gardeners and groundskeepers in the Bay Area, with segmentations based on levels of experience. We found that Rubicon's hourly wages were not significantly different from the industry wage rate and therefore concluded this social cost was minimal, and not worth tracking.

Capturing Social Costs in the Income Statement

After completing my analysis of each of the three social costs we selected to track, I worked with Rubicon's controller to sort them out from the (regular) business costs and show them in the income statement. In this endeavor, we had to be careful to avoid double counting: in order to place social costs in a separate line item underneath net income, I had to subtract each social cost from the standard expense line item above net income. For example, because I determined that 18% of a crew leader's time was "extra supervisory time incurred," I subtracted 18% of that crew leader's wages and benefits from the standard labor expense line item (above net income) and then added the 18% into social costs, underneath net income. If I had not first subtracted the 18%, then a total of 118% of the crew leader's wages and benefits would have been charged overall. While the total amount spent on the crew leader remained the same, our new report shows us what net income for the business is, without the cost of extra time needed because of Rubicon's employee base. It also breaks out the cost to Rubicon of this additional time.

It is especially important to understand that efforts to report on social costs should result in a "wash:"the analysis is not discovering new costs, but instead delineating costs that already exist and showing them in a more useful way. This is a critical point for the reader to understand. Conducting a social cost assessment should not be viewed by business managers as a way to carry inefficiencies in the business operations or "bury" costs, since the total costs are still a part of the overall performance of the enterprise.

Conclusion

The case example from Rubicon's Buildings & Grounds shows how a business can be systematic, carefully enunciate assumptions, and document methodologies and calculations while quantifying social costs. At times this process may be difficult, but the benefits of quantifying social costs make it worthwhile. Distinguishing social costs from ordinary business costs enables managers to understand the extent to which a social purpose enterprise is profitable as a stand-alone business and in turn shapes important strategic and operational decisions.

In addition to facilitating informed decision making on business issues, accounting for social costs facilitates informed decision making regarding the social mission. For example, each month managers can weigh social costs against estimates of social impact and ensure they are appropriately in line. In instances where they are not in line, managers can undertake cost reduction efforts or can take steps to maximize social impact. More informed and effective decision making on business issues and the social mission ultimately enhances a social purpose enterprise's ability to achieve both economic and social goals. Social costs cannot be ignored, for they lie at the very heart of social enterprise.

Footnotes

1 This concept was originally introduced in *New Social Entrepreneurs: The Success,Challenge and Lessons of Nonprofit Enterprise Creation* in its chapter on True Cost Accounting. Copies of that book and other REDF publications may be found at www.redf.org.

2 For an overview of True Cost Accounting and additional issues involved with True Cost Accounting, please refer to Chapter 6 and Chapter 4.

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True Cost Accounting: The Allocation of Social Costs in Social Purpose Enterprises

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Introduction

The Roberts Enterprise Development Fund (REDF) is a social venture capital fund based in the San Francisco Bay Area. The REDF portfolio is made up of seven nonprofit organizations operating 23 social purpose enterprises[1] employing very low-income and homeless people. In its experience working with nonprofit managers to operate these businesses, REDF has become aware that traditional, nonprofit approaches to accounting would not generate the type of information necessary to effectively manage the businesses. Specifically, on the revenue side, traditional nonprofit accounting consolidates revenue sources (in this case, both sales and grant revenue). This distorts "true" sales figures, making it difficult to assess the performance of the venture. At the same time, traditional nonprofit accounting methods do not allow the standard costs of a nonprofit (what we refer to as "social costs"), to be adequately tracked and documented separate from those of a mainstream business in the same sector.

This inability to understand social program cost versus business enterprise cost makes it impossible for managers to develop an accurate assessment of the success or failure of the business. Without separating social program from business costs, one cannot assess how well the business is doing as a business. And, similarly, one cannot assess what true social program expenses are incurred by a social purpose enterprise, but not by its for-profit counterpart. In order to understand the true cost and benefit of engaging in social purpose enterprise development, accounting systems must be in place to provide managers with sound data upon which to make operational decisions. And such systems are critical to outside, charitable investors seeking accurate information regarding how funds are applied and what leverage they achieve toward the attainment of social goals.

This issue of achieving accurate accounting for social and enterprise costs has been a theme throughout the nine years The Roberts Foundation has supported nonprofit work in this field. The Foundation first presented its framework for "true cost accounting" in its 1996 report, *New Social Entrepreneurs: The Success, Challenge and Lessons of Nonprofit Enterprise Creation.* Other reports and publications of the Foundation explore various aspects of measuring the impact of social purpose enterprises and the role of philanthropy in supporting the development of the field.[2]

With the creation of REDF in January of 1997, The Foundation began working with its partner investees to formally analyze the challenge of accounting for the "true costs" and financial/social returns of operating a social purpose enterprise. That process has been called the Social Return on Investment Project and is fully described in this book's chapter on Social Return on Investment. Suffice it to say that without the ability to isolate the social cost of a social purpose enterprise, there is no way to fully understand what social returns may be generated by philanthropic or other investments. For this reason a True Cost Accounting Analysis becomes critical to both practitioners and philanthropic investors.

True Cost Accounting Analysis (TCAA)

This chapter, "True Cost Accounting: The Allocation of Social Costs in Social Purpose Enterprises," is the product of a crosscutting analysis of REDF portfolio organizations. The intent was to assess how various organizations have and are attempting to account for the social costs of their social purpose enterprises. It would be presumptuous to believe this small sample is completely representative of all organizations involved in the operation of social purpose enterprises. Nevertheless, the REDF portfolio does represent a good cross section of organizations presently active in the field. Many of the organizations in the REDF portfolio have operated such ventures for a number of years and have approached their work with a great deal of strategic intent. Historically, nonprofit organizations have not thought in terms of the social costs of their enterprise activities. They have, instead, operated with accounting systems that allow for "hidden" subsidies of losses or costs incurred as a result of their social mission. By contrast, REDF portfolio organizations have worked to establish accounting systems that move beyond that practice.

REDF's analysis of the use of "true cost accounting" among the enterprises in its portfolio yielded much data, and several noteworthy conclusions. Chief among them is the fact that due to the demands of operating any business venture, very few of the business managers have had the time, resources or inclination to do a thorough study of the social costs they incur in their businesses. Most social purpose enterprises inherit the operating and management information systems of their parent organizations and, naturally, since most nonprofits do not differentiate "social costs" as part of their accounting and MIS infrastructure, these systems are not in place for use by managers.

Even managers who have thought about the issues involved in social cost accounting and have attempted to break out some of these costs on their financial statements will readily admit they still have a long way to go. Defining what is and is not a social cost is a difficult task that often necessitates a level of detail in cost accounting that is well beyond current practice in the nonprofit community.

In actuality, most business managers are relying on their experience, gut feelings, limited time studies and observation of day-to-day activities to estimate their social costs. With few exceptions, the present "state of the field" is that managers will periodically

- estimate how much time they spend on mission-related issues as opposed to business issues,
- count up the hours their employees spend in special training sessions above and beyond industry standard training,
- calculate/estimate their productivity levels versus those of a mainstream business,
- compare the wages they offer with those at similar, for-profit businesses, and perhaps
- allocate the wage premium to social cost line items in their budgeting/accounting process.

Another practice is for managers to simply look over their entire operation and choose a percentage of operating costs that they feel honestly reflects their social costs. This percentage is then used as a general allocation ratio when separating social costs out on the income statement.

While the lack of systemization and rigor in this area makes it difficult to define specific frameworks that can be used for accurately quantifying social costs,it is clear that organizational structure is an important determinant of where these social costs can be found. The relationship between the parent nonprofit,the social purpose enterprise and the training programs that serve the employees of the enterprise is significant in alerting us as to where to look for social costs,and in telling us how accurate our social cost analysis will be. We now turn to such a discussion.

Nonprofits and Social Purpose Enterprises: A Typology of Organizational Structures

The social purpose enterprises in our study were all operated as programs of a parent 501(c)(3) nonprofit organization. We refer to such an organization as the "parent nonprofit." In no case were the social purpose enterprises for-profit subsidiaries of a nonprofit; nor were they independent for-profit corporations. In general, the organizations reviewed in this analysis fell into the three types: Integrated, Connected and Divisional. This section presents three fictitious organizations to represent each type.

In some cases the parent nonprofit's sole mission is to run small businesses as vehicles to train and employ members of some defined population. This type of enterprise is "Integrated." We will use the fictitious "Operation WorkFirst" as an example of this type of nonprofit.

> *Operation WorkFirst is a small, urban nonprofit operating a flower shop, sandwich cart and delivery service in BigCity, USA. They began operations in 1991 with the goal of providing on-the-job vocational training and support to disadvantaged young adults between the ages of 16 and 26. They focus all of their energy on hiring, training, mentoring and otherwise supporting these youth, preparing them to find employment and succeed in the mainstream labor market.*

Other parent nonprofits have more broad-based missions, and have multiple programs serving one or more constituencies. One or more of these programs may involve the operation of small businesses, while others may be social service programs independent of the business and serving a client population that may include, but is not limited to, employees of the business(es). This type of enterprise is "Connected." We will use "BC Services" as an example of this type of nonprofit.

> *BC Services is a 40-year-old nonprofit serving the homeless population of BigCity, USA. They provide transitional housing, a meals-on-wheels program, day care, mental health counseling, clothing repository and resume/cover letter/interviewing workshops for homeless individuals. Several years ago they started a painting business in order to provide employment and training to some of their clients. All of the employees of the painting business benefit from the entire range of BC Services programs. The training is integrated with the running of the business, and thus employees are learning on the job.*

A third type of parent nonprofit runs one or more small businesses for employment purposes, but also has a separate program for providing job-readiness and job-skills training to a broader range of individuals. Such an organization may also provide other services to the community and may be labeled as "Divisional." We will use "Community Chest" as an example of this type of nonprofit.

> *Community Chest is a large nonprofit serving multiple constituencies in BigCity, USA. They are organized into several "divisions," or program areas: Housing (providing transitional housing and assistance locating and securing housing), After-School Programs (providing after-school enrichment programs for children ages 4 to 18), Health Services (sponsoring a local clinic for health screening and referral), and Vocational Training (a three-month training program for hard-to-employ adults which helps prepare them for obtaining a job). Community Chest also started a business–BizKlean–several years ago, which hires graduates from its own and other vocational training programs to further assist them in acclimating to the work environment and to provide them with more mainstream work experience.*

Operation WorkFirst, BC Services and Community Chest are all nonprofit organizations with missions that have led them to start and operate social purpose enterprises. As such, these enterprises are held to a "double

bottom-line;" to be successful they must generate revenue (at least enough to cover their costs) and fulfill their social mission. All three of our example organizations have structured themselves differently, however. They represent the three types of organizational structure that we found in our research with the REDF portfolio.

Identifying Social Costs in Each Organizational Structure

There are numerous costs to running a social purpose enterprise that can be attributed directly to the sponsoring organization's social mission or the social mission of the business. Many of these are found within the business itself. Examples of the social cost often carried by a social purpose enterprise are:

- a lower level of productivity among employees,
- increased materials wastage,
- time spent addressing employees' personal issues,
- employee time spent with job counselors,
- employee time spent involved in support groups or other support activities,
- higher insurance rates that may need to be paid for certain types of employees,
- additional management and supervisory costs of managing such an enterprise,
- increased employee turnover.

The specific social costs incurred will vary with each organization and business depending upon the actual social mission of the parent nonprofit and other factors. Additional costs can be traced more directly to the training many employees need before they can start working at all.

Still other costs stem from the interaction of the business staff and the parent nonprofit staff:

- meetings to coordinate services and policies,
- presentations by the business managers to the nonprofit board,
- fundraising done by nonprofit staff for the benefit of the business,
- tours and site visits which take the manager away from the day-to-day responsibilities of operating the business.

Identifying all of these additional social or mission-related costs is no small task, and depends on how the nonprofit interacts with the enterprise, and how the relationship between the two is structured. To illustrate, we will diagram the structures of our three sample organizations.

Defining our terms:

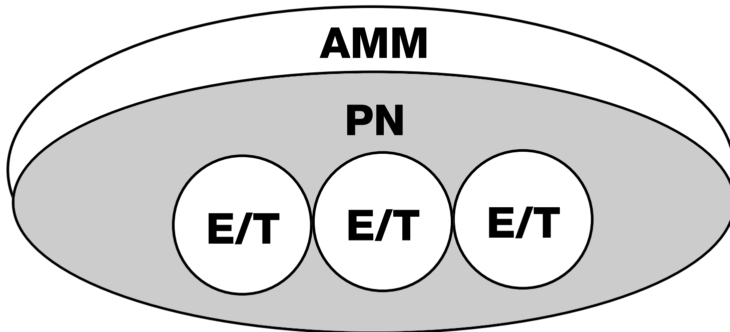
In the following diagrams,

- 'PN' will denote the parent nonprofit in each case. The parent nonprofit provides oversight of all programs, enterprises and activities run by or under the auspices of the nonprofit, and is headed by an executive team and a board of directors.
- 'E' represents a social purpose enterprise run by the nonprofit.
- 'P' represents other, more traditional programs run by the nonprofit.
- 'T' represents the vocational training element of the nonprofit's mission. 'T' can be either integrated with the operation of the business enterprise, or a wholly separate program.
- "AMM" represents the functions of accounting, MIS and management that

are often spread between the organizational entities.

Using these symbols, we can diagram our three sample organizations as follows.

Operation WorkFirst – An "Integrated" Organizational Structure



- Operation WorkFirst: a parent nonprofit operating three businesses,each with integrated training functions.

- Accounting, MIS, and management for the three businesses are done at the level of the parent organization. In an "Integrated" organization, separate financial statements may be prepared for each business, but are most often all prepared by the same central accounting person or department based on information gathered from the business managers.

In this type of organization, social costs for each business can be found in the consolidated financial statements of the parent nonprofit. All costs of the parent nonprofit are, in effect, social costs to the business, since the parent exists only to perpetuate the social mission of the businesses. While COGS, labor costs, training costs, etc. can be identified for each individual business based on its independent financial statements, the true social costs of the businesses will be found both at the business level and at the level of the parent nonprofit.

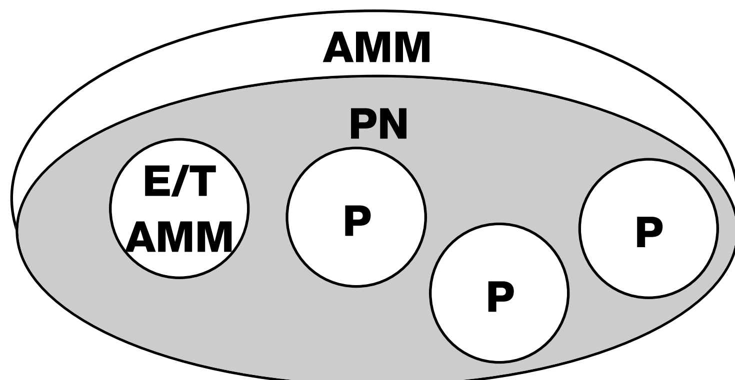
- BC Services: a parent nonprofit running one business and several other more traditional social service programs. All vocational training takes place on the job, within the business.

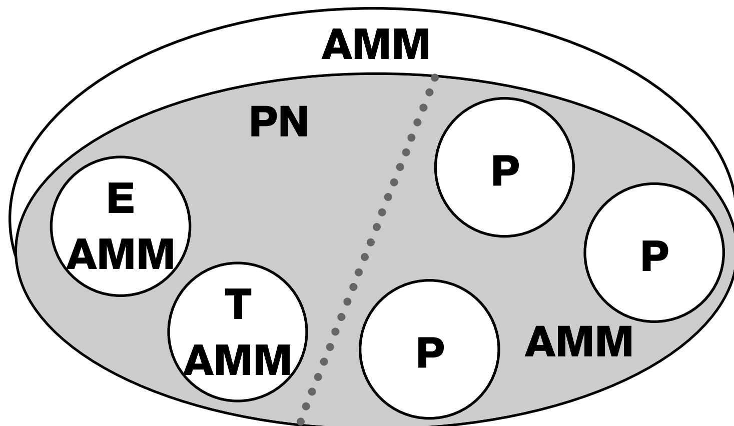
- Much of the accounting, MIS and management for the business is done within the business itself (though under the guidance of the parent nonprofit), with financial information then being fed to the parent nonprofit's central system, and integrated with the parent's reports.

In this type of organization, social costs for each business can be found in the financial statements of the business, as well as in the consolidated financial statements of the parent nonprofit. Unlike the integrated organization, however, not all costs of the parent nonprofit can be considered social costs of the business. Care must be taken to identify the resources of the parent that go to the business, and then to differentiate which of those resources should be considered business costs and which social costs.

A traditional small business, for example, would probably hire an accountant to prepare some amount of financial information. If the business manager handles his or her daily inflows and outflows, but then passes the files to the nonprofit's accountant for final report-

BC Services — A "Connected" Organizational Structure





ing, the cost of the parent's accountant should properly be considered a (business) cost of the business. On the other hand, if the development director of the parent nonprofit spends time soliciting donations of subsidy funds for the business, the cost of that person's time should properly be considered a social cost of the business.

Community Chest – A "Divisional" Organizational Structure

- Community Chest: a parent nonprofit organized into "divisions," or quasi-independent programs that operate apart from each other. A primary differentiator for our purposes is that the parent nonprofit operates a workforce training program that is separate from its business, and training is provided to non-employees of the business, as well as to employees and future employees of the business.

- As with the connected organizational structure, much of the accounting, MIS and management for the business is done within the business itself (though under the guidance of the parent nonprofit), with financial information then being fed to the parent nonprofit's central system, and integrated with the parent's reports. This is also the case for the training program, and may be the case for one or more of the other programs run under the auspices of the parent nonprofit.

In this type of organization, social costs for each business can be found in the financial statements of the business, the financial statements of the training program (assuming that at least some trainees from the program make their way into the business when they finish the training program), and in the consolidated financial statements of the parent nonprofit. Once again it is important to look carefully at the various costs (both social and business) incurred by each division, and by the "umbrella" of the parent. Costs attributable to the business or the enrichment of its employees should be allocated first to the business, and then to either the "business cost" or "social cost" category.

Allocating Social Costs – The Challenge

When an entrepreneur starts up a small business on his or her own, it is fairly easy to identify the costs of doing so. With few exceptions, the business itself bears all costs of operations. As we have seen above, it is somewhat different in the world of social purpose enterprise. A parent nonprofit, other social service programs, other activities run by the parent nonprofit, donors or volunteers may all bear some portion of the costs to make the business successful. If the mission of a nonprofit-sponsored business is to train, employ, and serve at-risk youth, for example, is the cost of educational enrichment programs that encourage the attainment of a GED a social cost of the business or a program cost of the parent nonprofit organization? At some point those analyzing appropriate costs must draw a line between one organizational program and another.

Our research has led us to one possible approach that may clarify these issues:

First, an organization must clearly understand and state its mission relative to the social purpose enterprises it operates. Is the mission to simply generate revenue for the parent nonprofit? Is it to employ a given population? Is it to both employ and train a given population? Or is it to employ, train and educate a given population?

Second, having clarified its social mission, the organization must then clarify the definition of success for its business. It is our

position that social purpose enterprises operated by nonprofit organizations must first and foremost embrace the core mission of operating *with no significant net loss* to the business. Presently, many social purpose enterprises operating in the United States operate at a loss—and that loss is often justified by management as "the cost of our social mission." This approach makes it both impossible to manage the enterprise with any true sense of business discipline and prevents organizations from ever being able to truly value the social cost carried by their enterprise.

We are not saying all social purpose enterprises must always operate on a break-even or profitable basis. In fact, some of the stronger organizations we have seen over past years are those that generate significant revenue from their activities, but still operate at some level of subsidy in order to achieve their social mission. What we *are* saying is that if practitioners expect to contract with market-based customers and identify themselves as social entrepreneurs they must have the ability to track all costs and revenues accurately before adding in the social cost they carry by virtue of their social mission and community commitments. In a phrase, they must understand and be able to quantify their "true" costs and not simply bury those costs within the financial statements of the organization.

Third, having clarified the core goal of the business, one may then address the business's social purpose. Is the mission to successfully transition people off welfare, and provide them with opportunities for long-term employment after they leave the social purpose enterprise? Or is it to provide transitional employment for the period of time that they are employed by the enterprise? This brings us back to the social mission of the nonprofit parent organization: if the mission is clearly defined, it will be easier to identify when an enterprise has succeeded in fulfilling its part of that mission and what costs it incurs in doing so.

Finally, the managers of both the parent and social purpose enterprise must agree upon what will be considered the "true" costs to the business enterprise of fulfilling that social mission. These costs are not always easily found within the typical business financial statements or information systems, and, in fact, a second type of report may be needed to accurately describe the total social costs being carried by the business.

Social Costs and Subsidies:

Before leaving this discussion of social versus enterprise costs, it must also be acknowledged that there are social costs that in many cases are carried by *neither* the business nor the parent nonprofit organization. These costs are those covered by nonprofits in the larger community that provide various supports to the employees of the social purpose enterprise. Such costs may be thought of as social subsidies and could include programs such as:

- Childcare
- Substance abuse counseling
- General support services
- Housing support
- Educational services

These are all very real social costs which may best be thought of as being carried by society, the provision of which help make for the ultimate success of the business and its employees or trainees.

In traditional, for-profit accounting such costs, and the fact that society will pay them, are largely taken for granted. While a mainstream business may budget for the cost of training employees on a particular piece of equipment or manufacturing process, it does not factor into its *own* cost structure the potential costs carried by the larger society and paid for largely by the taxes of individual taxpayers. Indeed, it is standard for-profit practice to off-load as much of one's cost structure as possible to outside entities—for example, the logging industry's use of the Forest Service to build access roads into wilderness areas slated for harvesting. A critique of this for-profit practice is beyond the scope of this paper, but its implications for social purpose enterprises are clear: those involved in the operation of social purpose enterprises must be aware of the existence of such costs, taking steps to assure they are honest about whether those costs contribute to the success of their own efforts, even though tracking the costs is beyond the current capacity of nonprofit information systems.

Getting There from Here: The Challenging of Incorporating a Social Cost Accounting System into Traditional Nonprofit Accounting Structures

As the field of "social entrepreneurship" has received increasing attention in recent years, and as the work of The Roberts Enterprise Development Fund has gained greater visibility, our office continues to receive numerous calls from practitioners engaged in various types of social purpose enterprise development. Many of these practitioners claim to be "doing what REDF does," yet, upon closer examination, we find the field to be highly fragmented, with many different approaches and various degrees of sophistication of analysis. In addressing the challenge of how nonprofits approach accounting for their social and enterprise activities, we have found it difficult to successfully frame the field's best practices and approaches to social cost accounting. Moving from current practice to greater incorporation of social cost accounting systems would appear to involve four primary considerations:

Time Frame:

The transition from current to future practice will take place over a period of years. The current state of nonprofit accounting and management information systems is relatively poor. Nonprofit organizations have historically been funded to provide services and address charitable needs—not account for cost centers and allocate resources accordingly. Improving management and accounting practice in the nonprofit sector has been a goal of organizations such as The Management Center and The Support Center, in partnership with others, for many years. Despite these efforts, we have a long way to go.

For the purpose of The Roberts Enterprise Development Fund, we view this process as taking place over a five-year timeframe. During this period it has been our intention to evaluate the accounting systems represented in our own portfolio and assist our funded organizations in achieving the highest level of confidence possible. Many REDF organizations are on their way to meeting that goal well in advance of the five-year period. We set that limit to reflect our awareness of the degree of complexity involved in analyzing an organization's financial reporting system, designing more effective systems and getting those systems on-line and in use by operations managers.

We encourage our funding colleagues to support such a multi-year strategy with their own grantees and, when possible, jointly with other funders. This is not a goal foundations will achieve simply by placing "accurate accounting systems" as one more criteria by which funding is awarded. It will take many years of honestly assessing current systems and building better ones before the field will achieve the standards we are calling for. However, with those standards in place, those involved in the field will be in a better position to successfully argue for increasing both financial commitments and the expected outcomes achieved through those philanthropic dollars.

Accounting Systems Development:

Current accounting systems assist managers and funders in monitoring the operations of nonprofit organizations running social purpose enterprises. The accounting systems of these organizations fall along two tracks: business accounting and social cost accounting. Presently, in our own portfolio, there is greater expertise at managing the business accounting systems than the social cost accounting systems. From the contacts we have had with other organizations across the country, we suspect the degree of development in these areas in the field as a whole is even less advanced. Initially, we have assessed how well these systems operate within the REDF portfolio and are developing strategies with each organization to create better, more accurate systems with the high degree of automation needed to be of real use to both managers and those who invest in their work.

Degree of Integration:

Initially, most organizations begin with one nonprofit accounting system in place. These systems often have various degrees of accuracy and provide little in the way of meaningful data for use by business managers.

As one step to securing the information they seek,some managers layer secondary systems to track the business operations of the organization. These systems are seldom well integrated into the larger organization and often do not reflect the total cost of managing a social purpose enterprise. The accuracy of their social cost estimates is questionable in that they are often based on "gut" assessments. However, they represent an improvement over many of the systems otherwise in use and are best thought of as a transitional stage in accounting system development.

With such dual systems in place, however, organizations are positioned to conduct formal time studies that may be used to generate annual "allocation ratios" for use in assigning social and business costs. Such studies may be implemented at various points (annually, quarterly, etc.) in order to gauge various costs incurred during that time and assign those costs to the appropriate cost center, whether social or business.

The ultimate goal is the creation of a wholly integrated accounting system that accurately tracks the business functions, the social costs of the enterprise and any additional social costs of the parent nonprofit. Such systems will provide a full and accurate picture to all involved regarding the revenue and expense picture of the organization and its various programs/businesses.

Investment Grade:

Finally, with these systems successfully in place, the field will be able to establish standards that could lead to formal investment grades for nonprofit organizations. These grades could be the composite valuation of an organization's ability to achieve its stated goals, both social and business. Organizations with lower investment grades might be those in a start-up or expansion stage, which encounter greater program and organizational risk. Others which have proved not only the integrity of their program design, but the management of their organization, could be viewed as "higher" grade and worthy of support in addressing their needs to expand and sustain their efforts. A companion chapter addresses the concept of social return on investment in greater detail; suffice it to say, however, that unless we increase the accounting and general management standards for the field as a whole, our ability to intelligently choose our "investments" in the social and charitable future of our communities will be greatly limited.

Conclusion

This chapter has presented three organizational "types" for understanding how nonprofits structure their accounting systems and the degree to which those systems provide managers and outside investors with accurate, reliable data upon which to base decisions. Our vision for the field is based on the assumption that social purpose enterprises operated by nonprofit organizations require accounting systems able to accurately track the "true" costs of pursuing a social mission through a market-based business. We conclude by challenging the field to increase the accepted standards of practice and embrace a more sophisticated approach to accounting for the social investments required to achieve the community goals of a social purpose enterprise.

The Development of Social Cost Accounting Systems

TIMEFRAME (T=FY)	T_0			T_5
	The Field	The REDF Portfolio		
ACCOUNTING SYSTEMS DEVELOPMENT Business Accounting Systems: Social Cost Accounting Systems:				
DEGREE OF INTEGRATION	Overlapping systems with no capacity to appropriately track or assign true social or business costs	Dual Business Social Costs (Estimates)	Dual (Time Study)	Integrated (Operating Systems)
INVESTMENT GRADE	No standards to accurately grade organization or operating systems across the sector	Grade BBB	Grade B+	Grade A

Footnotes

1 Presently, the field makes use of terms such as social purpose businesses, nonprofit enterprise, training businesses and a number of others to refer to a nonprofit organization operating a revenue generating venture as part of its social mission. This chapter uses the term "social purpose enterprise."

2 In addition to the referenced book, other related documents are available through the REDF office or from our web site at www.redf.org.

Chapter 7

Webtrack and Beyond: Documenting the Impact of Social Purpose Enterprises

Webtrack and Beyond: Documenting the Impact of Social Purpose Enterprises

Profile of a Management Information System

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with

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Introduction

Nationally and locally, nonprofit organizations are experiencing intense program pressure as well as funding incentives to enter into and/or step up involvement in the areas of job training, creation, placement and retention. Both public and private funding sources are increasing their financial support for nonprofits engaged in a variety of economic development strategies. This shift in funding emphasis is based on the belief that improving skills and providing access to employment is a more effective path to long-term independence for people living on the margins of our economy than the "traditional" model of social services, which is more likely to encourage dependency on human service and welfare systems. Many nonprofit organizations have found that the mainstream nonprofit job training and placement system is not effectively meeting the needs of homeless and very low-income individuals, just as for-profit businesses are not effectively meeting their needs for basic employment opportunities. And many of these organizations have shifted their focus and are searching for market-based strategies that help support long-term independence and self-sufficiency. Intuitively, this thinking makes sense. It harkens back to the adage, "Give a person a fish, and they eat for a day; teach a person to fish and they fish for life."

But is the nonprofit version of "fishing for life" true? Can this belief be borne out empirically? For the unemployed and underemployed people now being courted by the growing nonprofit economic development movement, the key question is: Are these new market-based strategies any more effective than the strategies left behind? Do these employment strategies work for some and not others? What are the real benefits to these job creation and job training approaches and what are the obstacles? And importantly, how and when can we answer these questions?

Interestingly, this renewed emphasis on economic development strategies as a means to foster self-sufficiency has as a backdrop another trend in the funding and nonprofit world, namely evaluation, and more specifically, outcome evaluation. As discussed elsewhere in this book, the nonprofit capital market has historically rewarded the *process* of the sector's work as opposed to *outcomes* that resulted from it. However, there is a shift underway in the nonprofit capital market.

For the past decade, there have been growing expectations among funders — public and private — that nonprofit organizations have a responsibility to be more accountable for the outcomes of the programs and services they provide. Supporters of nonprofit organizations want to know if funded programs are making a difference and what difference they are making. They want to know how people's lives change as a result of participating in a given program or initiative. They want to hold nonprofits to a high standard of performance and want nonprofits to report on their progress toward achieving measurable and meaningful outcomes.

The results of this emphasis on outcome-based funding and program evaluation have been mixed. Outcome evaluation has often proven a complicated undertaking for already overburdened nonprofits. And funders have often had unrealistic expectations about the ability of nonprofit organizations to credibly measure outcomes. After all, nonprofits have generally employed people who possess social service, not social science, skills. Even those organizations capable of producing evaluation data often did so in a way that was more ceremonial than utilitarian. They generally did not develop management information systems with the intention of informing practice, in part because the emphasis on evaluation has been so externally driven.

As a result, for many nonprofits the foray into evaluation proves frustrating and time consuming, often failing to produce much benefit for either the nonprofit or its funders. Still, the evaluation movement has not gone away; if anything, it has gained steam in recent years. Increasingly funders want accountability, and nonprofits are grappling with the challenge of creating systems of measurement that are meaningful as well as cost effective.

The field of social entrepreneurism is at the intersection of these two trends—one advocating for more market-oriented employment strategies to move people from dependency to independence, and the other supporting evaluation measurement and increased accountability for philanthropic and public-

sector program investments. In many ways, the intersection of these trends is a logical one given the increasing popularity of "business-like" approaches to the nonprofit sector. Funders and other supporters of nonprofit organizations are increasingly aware of the fact that they are "investors" in social programs and want to know the return on their investment.

Along with other foundations, The Roberts Enterprise Development Fund (REDF) is at the forefront of "investing" in social purpose enterprises. REDF maintains a portfolio of seven nonprofit organizations that collectively operate a total of 23 businesses. Each of these enterprises is managed against a double bottom-line: a social mission to employ low-skilled and/or formerly homeless individuals and a business mission to operate on a profitable basis. The benefits and challenges associated with these enterprises and The Roberts Enterprise Development Fund in general are thoroughly presented in other papers[1] and are not the focus of this chapter.

Our focus is the presentation of REDF's innovative approach to gathering, analyzing and disseminating information on social impact and business operations. This chapter is essentially a case study of the REDF management information system, written from the perspective of the team that developed the system. While our work focuses specifically on exploring how best to establish benchmarks of success for new market-based employment strategies,it will also be of interest to those who seek to develop meaningful measures of accountability and impact within the nonprofit world. It will also provide insight into a system that generates data for use in the calculation of a social return on investment (SROI).[2]

This chapter begins by detailing the philosophical principles underlying the REDF approach to information management. This is followed by an explanation of the components of the information gathering system, and a description of the process and stages of development of the information system. Finally, the chapter presents the challenges REDF has encountered along the way and concludes with lessons learned about how to effectively implement an management information system of this type.

Background on The Roberts Enterprise Development Fund

The Roberts Foundation established The Roberts Enterprise Development Fund in January 1997 as a philanthropic venture. Its mission is to: "raise the standards of excellence and integrity in the nonprofit and philanthropic community nationwide through the development and dissemination of innovative approaches to address critical social issues."

In order to pursue that mission, REDF has pioneered an approach to charitable giving known as "venture philanthropy." This practice involves the application of fundamental venture capital principles to the field of philanthropy. As such, REDF makes philanthropic investments in a portfolio of seven San Francisco Bay Area nonprofit organizations operating social purpose enterprises. These organizations receive core financial investments from REDF in addition to a full complement of other support, including:

- capital grants for the business,
- targeted business analysis and assistance,
- involvement and partnership with REDF through Venture Committees,
- organizational capacity-building through the Farber Interns and Farber Fellows Program,
- business networking through Partners-for-Profit, and
- access to and training in the use of technology and outcome measurement.

Evaluation as Management Information

Consistent with venture capital practices employed by the private sector, REDF established a management team to oversee its portfolio, track trends and address a variety of management issues. Central to REDF's work is the desire to understand the impact of its investments, from a business as well as social perspective. To that end, REDF invited our evaluation and management information consulting group to be part of the management team from the Fund's inception. REDF's Information Management Team (known as "IMT") includes REDF staff, a business analyst, technology experts and specialists in nonprofit evaluation.

From the beginning, REDF's Executive Director was clear that while he valued information, he had a resistance to the notion of "evaluation." He was concerned that too often nonprofit organizations view evaluation as another hoop to jump through in order to satisfy funders and don't generate information of practical use to program managers. He wanted an information gathering system that would provide meaningful data and be useful to (and used by!) the nonprofit organizations.

This led the "evaluators" on the IMT to revise our own nomenclature, to look for different ways to describe the collection and analysis of data in order for all REDF participants to appreciate the value and application of information. We avoided using the word "evaluation," instead using names that describe the various components and purposes of the work, such as "business operations analysis," "ongoing social impact assessment," and "management information." This change in language has in fact helped to continually remind our consulting team that this is not business as usual for us either. We are engaged in a process of developing a new and different kind of information system with REDF and all the groups in the portfolio — a system that in many ways has more in common with business operating systems than nonprofit evaluation systems.

The principles guiding the development of REDF's information system are in some ways familiar to us as research and organizational consultants, and in other ways, have been new and challenging. We have never slipped into anything remotely like a "data collection maintenance mode" in our REDF work. This is because the REDF initiative and businesses are too dynamic and the information system, in order to maintain relevancy, must keep pace with the needs of managers for real time data upon which to make decisions regarding both their business and social program operations.

Four principles have guided development of REDF's management information system to date:

1. ***Informs Decision-Making***- The information gathered should be directly related to practitioner activities and objectives. The information system will therefore build organizational capacity, rather than be a drain on organizational resources in order to meet external demands.

2. ***Timely Feedback*** - Information should be available in a timely way, so practitioners (and REDF) can use it to make adjustments in real time. One of the vehicles for accomplishing this is the use of appropriate technology.

3. ***Easy to Understand*** - Without compromising the integrity of the data,the information is analyzed and presented in a way that is easy to understand and digest. This has meant effective use of graphics, charts and color presentations.

4. ***Ongoing Reflection*** - REDF and the groups in its portfolio should continually reflect on the information, its meaning and relevance. This has required an essential balancing of data collection consistency (in order to conduct credible trend analysis) with flexibility at every stage of the system's development.

A Two-Pronged Information System: Business Operations and Social Impact

There are two parallel tracks to the REDF management information system. One concerns the effectiveness of business operations and the other is focused on social impact. Both tracks are management tools intended to assist both program and business managers. And both tracks make use of a customized web-based communication system, which REDF has named "WebTrack." WebTrack is a private area on REDF's web site, accessible only to those individuals and groups directly involved in portfolio activities. WebTrack is designed to support efficient communication of information about business operations and social impact between each of the businesses and the Information Management Team. It is also the vehicle for jointly preparing and sharing agendas for monthly Venture Committee meetings.

This section describes the different aspects of this two-pronged information system.

Business Operations

For all REDF social purpose enterprises, there are standard financial indicators that measure the financial health of the business. In addition, each business identifies other operational indicators that are of particular interest to them. Our consulting team has assisted each business in defining each business indicator and developing the necessary processes for collecting those data. Exhibit 1 at right shows the standard business performance indicators all REDF enterprises collect as well as examples of the kind of customized indicators some businesses have also chosen to track.

On a monthly basis, each of the businesses enter their business operations indicator data onto a customized data entry form which they access from their private web page maintained via WebTrack. With a push of the button, those data are electronically sent to the information consultants; within three business days, the trend analysis for each indicator is posted back up on the business' web site for viewing.[3] The trend analysis compares actual data with targets for each indicator, as shown in the examples provided in Exhibits 2 and 3. The targets have already been established by the Business Manager

Exhibit 1

Business Operations Indicators for the REDF Portfolio

Standard Financial Indicators

- Gross sales monthly
- Gross sales year-to-date
- Gross profit monthly
- Gross profit year-to-date
- Net profit before social costs and subsidy monthly
- Net profit before social costs and subsidy year-to-date
- Net profit including social costs and subsidy monthly
- Net profit including social costs and subsidy year-to-date

Examples of customized monthly Operations Indicators

(these indicators differ by enterprise)

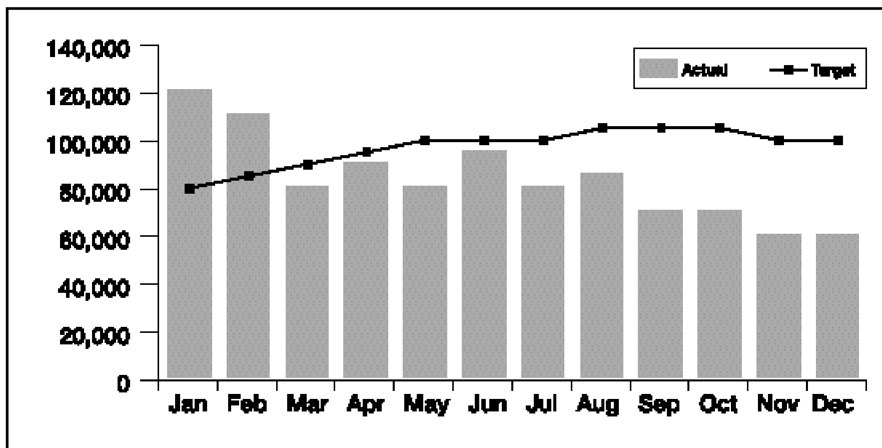
- Customer satisfaction
- Cost of goods sold
- Cost of direct labor
- Number of sales calls monthly
- Timely completion of jobs
- Revenue per square foot
- Inventory reliability
- Inventory turnover rate
- Production wastage

and/or Executive Director and are based upon projections included in the individual business plan(s).

The projected targets represent a business' plan for effective and efficient operation of the venture at given points in time. The targets can vary monthly to reflect different seasonal expectations (for instance, an ice cream scoop shop might expect lower sales in the winter months), expansion plans (which might cause increases in costs before commensurate increases in sales), or other vagaries of the market in a particular industry. Again, it is important to stress that the targets are not externally imposed; they are set by the business managers themselves in consultation with senior management and investors.

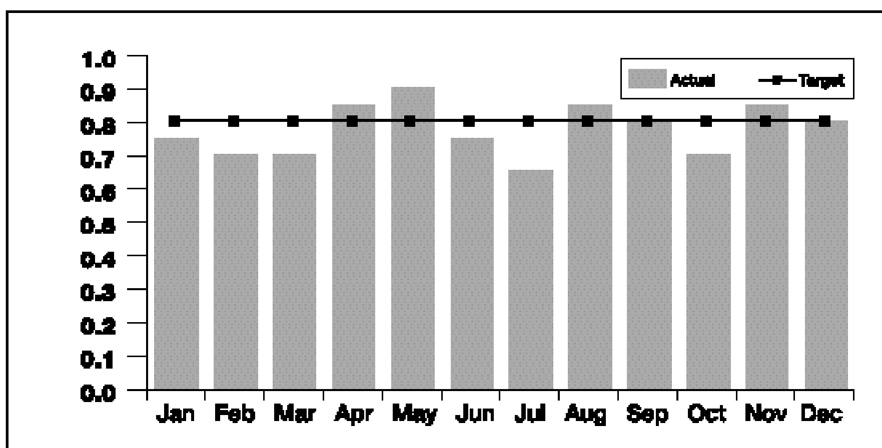
This business indicator component of the WebTrack system also allows for the production of a portfolio-wide analysis of REDF. For the REDF Information Management Team, we produce a portfolio-wide trend analysis for each standard indicator as well as monthly Pareto charts that graphically identify the source of variance from target to actual financial performance. These are all posted on the REDF IMT's private web page.[4]

Exhibit 2
Monthly Gross Sales — Actual Versus Target



	Actual	Target
January	120,000	80,000
February	110,000	85,000
March	80,000	90,000
April	90,000	95,000
May	80,000	100,000
June	95,000	100,000
July	80,000	100,000
August	85,000	105,000
September	70,000	105,000
October	70,000	105,000
November	60,000	100,000
December	60,000	100,000

Exhibit 3
Customer Satisfaction — Actual Versus Target



	Actual	Target
January	0.75	0.80
February	0.70	0.80
March	0.70	0.80
April	0.85	0.80
May	0.90	0.80
June	0.75	0.80
July	0.65	0.80
August	0.85	0.80
September	0.80	0.80
October	0.70	0.80
November	0.85	0.80
December	0.80	0.80

The businesses use the information on their private pages whenever it is needed. Some managers use it to reflect on their expectations of performance or identify problem areas in need of attention. Others use it to assess performance during their monthly Venture Committee meetings with REDF. And a number of groups use the trend analysis in presentations to Board of Directors or other stakeholders. The REDF management team itself makes use of the reporting system to track portfolio performance as a whole, and as a management tool for identifying strengths as well as trouble spots across the portfolio.

Social Impact

While assessing business performance is important to these groups, achieving a social impact is at the heart of their mission. There are two levels of the social impact component of WebTrack. The first focuses on compiling basic aggregate employee information across all agencies. In order to ensure consistency, the businesses worked with members of the IMT to develop a fixed set of demographic and employment indicators. As shown in Exhibit 4,information gathered includes such factors as:

- Age
- Gender
- Ethnicity
- Disability status
- Homelessness status
- Number of employees entering and departing the venture
- Reasons for departure
- Other relevant data

Each organization collects this data for its employees and feeds that information into the quarterly reporting system. This quarterly report provides the investor with the employee profile for each enterprise and the portfolio as a whole.

Exhibit 4

1998 Aggregate Employee Data for Businesses in REDF Portfolio

	Quarter 1		Quarter 2		Quarter 3		Quarter 4		1998	
	Jan-Mar	%	Apr-Jun	%	Jul-Sep	%	Oct-Dec	%	Total	%
REDF Portfolio Employees									**544**	
Continuing from Last Quarter	239		265		279		276			
New This Quarter	110		94		69		32		305	
Rehires This Quarter	0		0		0		3			
Total Employees This Quarter	**349**		**359**		**348**		**311**			
Full-Time or Part-Time Status										
Full-Time	149	43	154	43	146	42	135	43		
Part-Time	175	50	166	46	167	48	146	47		
Unknown	25	7	39	11	36	10	30	10		
Employees Who Left This Quarter	84		80		72		55		291	53
Reasons for Leaving										
Education	4	5	2	3	5	7	3	5	14	5
Vocational Training	6	7	10	13	13	18	3	5	32	11
Other Employment	33	39	35	44	24	33	20	36	112	38

Exhibit 4 (continued)

	Quarter 1		Quarter 2		Quarter 3		Quarter 4		1998	
	Jan-Mar	%	Apr-Jun	%	Jul-Sep	%	Oct-Dec	%	Total	%
Employees Who Left This Quarter										
Reasons for Leaving *(continued)*										
Life Circumstances	18	21	11	14	10	14	8	15	47	16
Fired or Laid Off	23	27	15	19	15	21	12	22	65	22
Other Reason	0	0	7	9	5	7	9	16	21	7
Employees Continued to Next Qtr	**265**		**279**		**276**		**256**		**253**	**47**

Pay Per Hour *(All Target Employees This Quarter)*										
Minimum Pay	$ 5.15		$ 5.75		$ 5.75		$ 5.75		$ 5.15	
Maximum Pay	$20.00		$14.59		$14.59		$17.00		$20.00	

New Employees

	Quarter 1		Quarter 2		Quarter 3		Quarter 4		1998	
	Jan-Mar	%	Apr-Jun	%	Jul-Sep	%	Oct-Dec	%	Total	%
Demographic Characteristics										
Race/Ethnicity of New Employees*										
African-American	119	34	37	39	13	19	6	19	175	32
Alaskan Native/Native American	1	0	0	0	1	1	0	0	2	0
Asian/Pacific Islander	33	9	6	6	12	17	6	19	57	10
Hispanic	59	17	14	15	18	26	6	19	97	18
White	99	28	25	27	21	30	14	44	159	29
Multiracial	19	5	4	4	2	3	0	0	25	5
Other	2	1	0	0	0	0	0	0	2	0
Unknown	17	5	8	9	2	3	0	0	27	5
Total	**349**		**94**		**69**		**32**		**544**	

Age Ranges of New Employees*										
Under 16 years old	7	2	1	1	5	7	0	0	13	2
16-22 years old	133	38	29	31	30	43	19	59	211	39
23-39 years old	101	29	26	28	15	22	9	28	151	28
40-54 years old	58	17	14	15	16	23	3	9	91	17
55 and over	5	1	0	0	3	4	1	3	9	2
Unspecified	45	13	24	26	0	0	0	0	69	13
Total	**349**		**94**		**69**		**32**		**544**	

Gender of New Employees*										
Female	114	33	36	38	19	28	11	34	180	33
Male	225	64	58	62	50	72	21	66	354	65
Unknown	10	3	0	0	0	0	0	0	10	2
Total	**349**		**94**		**69**		**32**		**544**	

Exhibit 4 (continued)

	Quarter 1		Quarter 2		Quarter 3		Quarter 4		1998	
	Jan-Mar	%	Apr-Jun	%	Jul-Sep	%	Oct-Dec	%	Total	%
Other Characteristics of New Employees*										
Disabled	108	31	51	54	26	38	11	34	196	36
Incarcerated/Hospitalized year prior to hire	26	7	15	16	4	6	1	3	46	8
At Risk for Homelessness	175	50	66	70	33	48	24	75	298	55

Training Component: *2 programs linked to businesses*										
Number of Trainees	23		51		50		34			
Transfer to Employment at Enterprise	4		0		1		3			
Transfer to Other Employment	7		6		3		28			

** Total does not include rehires*

The second level of information tracking associated with social impact is an intensive social impact study. The purpose of this level of analysis is to shed light on the long-term impact of the employment experience in the REDF social purpose enterprises, assessing their effectiveness as a strategy for moving people from dependency to self-sufficiency. Whereas all 23 businesses participate in the aggregate data collection described above, a subset of 20 businesses participate in this employee-specific information-gathering effort. At present, they do so on a voluntary basis. Participation in this element required a substantial amount of additional data collection, but also held out the opportunity to obtain new and valuable information. (The groups were so interested in this social impact tracking effort that while REDF initially invited 11 businesses to participate so as not to overwhelm the businesses with information demands, the agencies themselves requested that additional businesses be included in the effort).

Participation in the intensive social impact assessment involves collecting individual-level data at six-month intervals for a two-year period (continuing to track the individual post-employment in a REDF Portfolio business, in most cases). The information gathered includes detailed characteristics of individuals at the time they begin employment, allowing REDF and the enterprise to definitively track change over time.

For example,this element of the data collection will yield insight on whether individuals with a history of sporadic employment are more or less likely to benefit from this model of employment training than those who have a history of chronic unemployment. Collecting data on an individual basis provides the capacity to identify correlations between employee characteristics and outcomes. Furthermore, this analysis lays the foundation for comparing impact with type and amount of investment required — thus creating the framework for a social return on investment (SROI) calculation.

As with the business indicators, the intensive social impact study includes a core set of indicators collected across the full sample of agencies. These core indicators are presented in Exhibit 5 below.

Exhibit 5

Core Social Impact Indicators

Core Indicators

- Job retention
- Job placement
- Job promotion
- Wages
- Barriers to employment
- Reliance on public assistance
- Utilization of social services
- Housing stability
- Self-esteem
- Personal support
- Involvement in the criminal justice system
- A full complement of demographic characteristics

In addition,each business developed a set of customized indicators, reflecting special needs and interests of a given venture's employee pool. For example, one group working with high-risk youth was particularly interested in substance use among its employees, while another group employing people with a history of mental illness had a particular interest in tracking their clients' use of psychiatric services.

REDF supported the development of interview instruments as well as the creation of an automated database system for each group. As with the business indicator data, this system is designed to utilize Internet communication capabilities and provide feedback in real time. The information will be analyzed and provided to each enterprise in a customized form as well as compiled for use by REDF in calculating its social return on investment. While this effort is underway, we will conduct a literature review in the field to collect comparable impact data from different employment strategies and be in a position to compare the social impact of the social purpose enterprise with that of other employment training and self-sufficiency strategies. While this meta-analysis will not provide the same level of rigor offered by a true comparison group, it will provide a useful framework and backdrop for analyzing the results of the REDF initiative, both in terms of human benefit and with respect to quantifying social costs and benefits over time.

Creating the Journey Along Our Information Highway

Creating this information system has been both challenging and exciting each step of the way. In order to develop a truly useful system, it was necessary to balance the constituent interests of seven diverse organizations as well as the investor, while maintaining the integrity of a consistent data collection effort. The process has been more time- and resource-intensive than originally imagined. Before choosing an approach, other models for similar ventures, including Pioneer Human Services in Washington State, were examined. While the REDF system design benefited from the work of others, it was still necessary to design a system to meet the unique needs and requirements of the REDF Portfolio.

The business indicator WebTrack system took approximately six months to develop and implement. It continues to undergo refinements as targets change, businesses mature and different information needs emerge. While the relatively straightforward quarterly employee reporting system was completed after a two-month development process and beta test, the more intensive individual-level social impact information system has taken a full year to develop. It has involved enormous effort, significant financial resources, and countless consultations with each group on every aspect of design and development.

Our journey along this information highway is far from complete, but already we have learned a great deal about what it takes to develop a comprehensive system of this sort. By sharing the details of each stage in this process, we hope to make this experience a useful one for others seeking to develop the appropriate tools for tracking social impact over time. In the REDF experience, the steps of this journey included the following components:

- Assessment of Organizational Capacity
- Gathering and Cataloguing Indicators of Interest
- Designing and Re-Designing the Information Tracking System
- Implementation of the System
- Provision of Ongoing Technical Support
- Execution of System Analysis and Feedback

- Continual Re-Assessment of MIS Requirements

We address each of these in turn.

Assessment of Organizational Capacity

For both the business and social impact components of WebTrack, the consulting team conducted an assessment of organizational capacity for each REDF group. This assessment revealed that more than half the organizations lacked formal written indicators for both business operations and employee outcomes. While all of the organizations were interested in demonstrating effectiveness and were eager to create an assessment system, very few were actually systematically collecting information in order to inform practice when this effort began.

Gathering and Cataloguing Indicators of Interest

In addition to the core set of four financial indicators established by the REDF business analyst as described earlier, IMT members worked extensively with each enterprise to develop unique business operational indicators that would provide useful information related to their own business practices. This process involved multiple meetings with the business manager from each enterprise and, in some cases, other staff. The IMT worked with each business to identify targets for each indicator and then assisted in identifying or developing a method for measuring progress toward meeting those targets. For example, one business was interested in diversifying its client base; the IMT worked with them to develop a system for tracking revenue by client type on a monthly basis. Although the consultation process was time-consuming, the success of WebTrack hinged on the quality of information gathered and the decisions made at this stage of development.

The process of identifying the social impact indicators, while similar to the business indicators process, was much more extensive. The first step involved meeting with each group's business manager and/or Executive Director to develop a list of expected social outcomes. These lists were then compiled into a matrix of expected outcomes by enterprise for REDF's review and input. Using this list, REDF staff selected the outcomes where there was a critical mass of interest identified by REDF funded organizations and these outcomes then became part of the core information set for the portfolio. REDF also wanted to ensure these indicators would produce all the data REDF itself would require for calculating a social return on investment.

Through this process, some organizations ended up having a small number of indicators added to their reports that they themselves had not generated for their own enterprise. Most of the groups accepted the value of and need for a core set of indicators that could be shared across the portfolio. One organization resisted adding specific indicators that it had not itself identified, believing that they were not appropriate to their population and program. This stimulated a series of discussions about the "requirements for participation" in the assessment. In the end, although REDF offered to drop the additional indicators,the organization opted to incorporate them instead, understanding the value of the information for itself and the larger portfolio.

Designing and Re-Designing the Information System

The mechanics of developing the business indicator information system were fairly straightforward, requiring analysis but not instrument development. The system for measuring social impact, on the other hand, required a considerably greater level of effort. Once it was clear what information was needed, it was necessary to develop questions that would capture that information, using methods that would not be overly burdensome to the organization. The first step was to develop an interview instrument for the core social indicators and distribute it to each organization for review and comment. After incorporating suggested changes, IMT members worked with each enterprise to develop questions that reflected their specific areas of interest and additional social outcomes.

During this phase, groups had the opportunity to incorporate questions that were important to them as program managers as well as questions they needed answered for other contract reporting purposes. For

example, one group emphasizes vocational training in addition to enterprise employment. They added questions about specific job skills and employment history to meet reporting requirements for a public contract under which they operate a portion of their program. By designing the system to incorporate additional indicators for other purposes, REDF is hoping to reduce any duplication of effort on the part of the participating organizations and provide a streamlined system for information gathering and use. In many cases REDF supplemented its funding of the agencies to facilitate this approach. The end goal is an integrated MIS[5] capable of generating custom reports for a variety of investors and stakeholders.

To ensure its utility, the instrument was pilot tested in each organization. In some cases this resulted in a need to refine the core set of indicators — not an easy task. Changing questions because of one group's pilot test frequently had implications for other groups. This made for an iterative process of adaptation, with careful coordination and ongoing communications with each organization. In addition, the process of automation had to wait until all the instruments were finalized. The alternative — changes to the system at a later stage — would have resulted in frequent modifications to the database programming effort at great cost, potentially to the integrity of the system itself.

Implementation

Once the design was complete, the focus shifted to implementation. With the business indicators as well as the quarterly employee reporting, the first issue to arise was the need for timely and accurate data submission. During the first six months of implementation, about one-third of the groups did not submit their information on time or submitted incomplete or inaccurate data. It was found that these difficulties were often signs of other performance issues within the business such as a faulty accounting system, ineffective staffing, inadequate staff training and capacity, or outdated client/employee-tracking systems.

This early experience highlighted the need for quality control. Because of these concerns, six months into the process, the consulting group met with each of the enterprises to assess the usefulness of the system and ask for recommendations. Overwhelmingly, enterprise staff of REDF funded organizations expressed that the system was useful, particularly the analysis charting trends over time. They also offered constructive suggestions to eliminate other parts of the analysis they viewed as less useful in their work. Their suggestions were implemented and the IMT continues to monitor the effectiveness of the system, making refinements as needed.

With respect to the more intensive social impact system,the issues that have arisen thus far largely concern who conducts the interviews. There are important legal concerns regarding an employer asking certain personal questions of employees even within the context of a social purpose enterprise. These are not insurmountable: a social service provider within an agency can conduct the interview as long as the information provided is never used to make a personnel decision in the business.

Regardless, the question of who conducts the interviews has a direct bearing on organizational resources. Follow-up interviews in particular can be extremely resource-intensive because they generally require significant time locating and contacting individuals, even when incentives are provided.[6] Some of the groups wanted their own staff to conduct all of the interviews — baseline and follow-up — while others did not feel they had enough internal resources for any interviews at this time. For its part, REDF wanted to ensure that the follow-up effort remained a high priority, regardless of who assumed the responsibility.

The groups were presented with a choice: the baseline interview and data entry process could either be conducted by in-house agency staff or by an interviewer retained by the IMT consulting group. Either way, the organization would have access to the information. The choice was really more a function of readiness and organizational capacity. For a few of the businesses with a lot of activities on their plate,it was a relief to delegate this information gathering effort for the time being. All of the other groups were prepared to conduct the interviews themselves, viewing this as an opportunity to build their internal management information capacity. The IMT consultants provide training for their staff in interviewing techniques and continue to offer

groups ongoing technical assistance in administering the interviews.

Because it is such a significant undertaking, the follow-up tracking and documentation process is being spearheaded by the IMT consulting team on behalf of all the groups until there is common agreement that a particular group is ready to take on the follow-up responsibility. At such time, the follow-up effort will be transitioned to the individual organizations in the portfolio.

Ongoing Technology Support

Information Technology (IT) specialists have been an essential part of every stage of the REDF management information system development in order to ensure effective and appropriate use of technology resources. First, these IT specialists helped equip all of the groups with the basic hardware and software needed in their operations and provided them with e-mail capacity and Internet access. Next, the IT specialists prepared the customized reporting forms for the businesses' financial and operational indicators on the WebTrack system. Now, they are customizing databases for the organizations to track social outcomes. For many organizations, the involvement of these IT specialists has allowed them to use technological resources to a far greater extent than ever before. In some instances, organizations have contracted independently with these IT specialists to develop other information systems, some client-related, some donor-related, but all concerning management information in one form or another.

Analysis and Feedback

All of the thinking and preparation at the beginning of the process has direct payoff when it comes time for analysis. The targets were already set for the business indicators, the WebTrack system was in place on the REDF web site, and the software application to graph the trends was built and customized for this process. IMT members were thus able to download all information sent by REDF organizations, add it to an existing data set, graphically depict the trends for each indicator and post them on the web site — all within three business days. The technical aspects of the system have fallen into place; the remaining challenge is to ensure that the businesses effectively use the information to inform practice.

In order to help ensure the organizations make full use of the data and that data interpretation is accurate, the organizations are directly involved in data analysis. For example, with the quarterly reports, summaries were prepared for individual organizations to review. In reviewing the information of one of the businesses, we discussed why the upper end of the wage range was substantially higher for that business than many of the others. We learned that some of the "target population employees" in the business had developed enough skills and experience to be promoted into supervisory positions and command wages commensurate with those new responsibilities. Knowing the story behind the numbers provided a fuller understanding of the employees in that business and shed light on the larger issues related to movement in the labor force.

For the more intensive social impact assessment, it is anticipated that the pre-planning will again pay off. IMT members will be analyzing the information based on an organization's and REDF's hypotheses of change. If the statistics and demographic data are to be significant to the organization, they must be accompanied by important questions, such as:

- What does this mean to you?
- What story do you read in these facts and figures?
- What other questions do you have to add to this data set?
- What other social impacts can you describe that illustrate, corroborate or contradict the findings from the data?

This is the starting point for interpretation. IMT members will then piece each of the stories together to get a clearer picture of the whole in order to better understand whose lives are changing, in what ways, and over what period of time.

Continual Re-assessment of Information Needs

Nonprofit organizations and their information needs are changing all the time. New

funding sources emerge which can influence nonprofit organizational development, strategic directions and associated information needs. Internal forces, such as a Board of Directors, new executive leadership, or a new management focus can also demand new information. Similar to REDF's expectation for the businesses — that they will continually incorporate new information and allow it to influence their practice — throughout the development of the information system itself we have faced an ever-changing environment and have had to incorporate new information and new demands along the way. This will be an on-going process of reassessing and even reinventing the system to meet changing needs and demands.

Lessons Learned

We have learned several fundamental lessons so far in this process. We feel they are worth noting for those who have an interest in designing an effective management information system in partnership with nonprofit organizations. These lessons fall under three main headings:

- Time: It takes an enormous investment of time to develop a system that balances the sometimes conflicting needs of multiple constituencies. This is particularly true if one is seeking to involve nonprofit organizations in the design and development of the system, as opposed to a more traditional evaluation method of sending in "independent" evaluators to assess a program's effectiveness. The process of system design must accommodate the managers' schedules since there are countless competing priorities for their time.

- Resources: The development of the system has required a significant investment of financial resources. It has been necessary to involve experts in a range of areas, including data collection, technology, and legal issues. In addition, The Roberts Foundation provided incentives for the employee interviews, compensated the organizations for the time needed for systems development and is now going to cover the cost of follow-up interviews. It is estimated that from 1997 to 1999,REDF will have invested close to $800,000 in the portfolio nonprofits to build these systems. In order to make the system fully automated, an additional amount in excess of $1,000,000 will be required. REDF is presently working to identify other funding partners to underwrite this process of development.

- Flexibility: Perhaps the most important lesson we have learned is the need for flexibility: there is no fixed template to guide this work, or "off the shelf" program to implement. Rather, every aspect of the system must be designed to give way to the changing environment and to respond to the needs of the organizations as they arise.

A recent development illustrates the primacy of flexibility:

The IMT recently learned that many of the groups no longer needed to utilize the full complement of information available on the WebTrack business indicator system to manage their business operations. It was learned that while WebTrack had been instrumental in helping groups jumpstart their business information gathering efforts, over recent months many of the businesses had moved to an even more frequent — daily or weekly — review of financial data. The businesses still see a vital need for WebTrack and the business indicator trend analysis it produces, particularly for looking at historical information, making future projections and demonstrating business results to investors. But with respect to day-to-day business information needs, many of the groups are now beyond WebTrack. REDF views this as a success and is working with the portfolio to refine the WebTrack business indicator system to continually meet these new emerging needs — for example to fully automate the reporting system itself.

With respect to the social impact information system, the groups are also in a different place. They are greatly looking forward to using WebTrack for accessing social impact information. The groups anticipate the social impact data WebTrack supports will add significant value to the organizations and their social purpose enterprises. They have a strong interest in generating credible social impact data, participating in ongoing analysis of the data and identifying meaning and implications for practice.

The lesson here is that it is essential for a management information system to be dynamic and for its developers and users to exercise maximum flexibility to stay relevant. WebTrack is an essential foundation of the REDF Portfolio information management system. It provides a consistent platform for data communication and a jumping-off point for even more complex and frequent information usage. It helps provide answers to important practical questions, and sometimes helps to frame new questions that move the groups and this system to its next level of capacity and sophistication. The information exchange process is in itself a moving target and so our goal has become to continually build "WebTrack and Beyond."

Finally, it is clear that the task of creating the perfect information system is never fully accomplished because responsive nonprofit organizations operate in a dynamic human world. New programs must always be developed, and they often demand new sources and types of information. These changes inevitably involve additional financial investment, as well as additional staff and consultant time. But, as one of the Executive Directors recently explained, "...maintaining the centrality of evaluation and information in the enterprise keeps groups focused on outcomes and on measuring progress towards accomplishing their goals. This process of generating and reflecting on information in itself adds ongoing value. It helps groups to identify and then focus on the work that is most effective in accomplishing both their social and their business missions."

The WebTrack system will continue to be refined as The Roberts Foundation and its investees move forward into the future. Working together to build information systems that generate data with high integrity is clearly viewed as benefiting both the investor and investee — and that fact will allow players on both sides of the table to continue to improve the quality of their efforts over the years to come.

Footnotes

1 The Roberts Enterprise Development Fund: Implementing a Social Venture Capital Approach to Philanthropy, Stanford University Graduate School of Business,October 1998 and Chapter 1: The Roberts Enterprise Development Fund: A Case Study on Venture Philanthropy.

2 Please see Chapter 8: Social Return on Investment, for a more detailed discussion of SROI.

3 Because of the potential sensitivity of the information, each business has a password-protected, private web location that no one outside of their business or the REDF IMT can access.

4 Because of the sensitivity of this collective information, only members of the IMT and George Roberts (the donor) have passwords to this private web page.

5 Management Information System

6 Twenty-dollar incentive coupons are provided by REDF to compensate interviewees for their time during each follow-up interval. About half of the groups have also requested that their employees be offered incentives for participating in the baseline interviews. REDF has responded affirmatively to all of these requests.

Social Return on Investment: Exploring Aspects of Value Creation in the Nonprofit Sector

Social Return on Investment: Exploring Aspects of Value Creation in the Nonprofit Sector

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Executive Overview

s discussed in the chapter on Nonprofit Capital Markets, there are increasing numbers of new players entering the field of philanthropy. These new players are joining many previous donors in demanding not simply greater operational accountability from those organizations to which they provide contributions, but a greater capacity to document the social and other impacts of their charitable giving. These new donors speak not only of "measurement" and "outcome funding," but rather of "social return" and the ability to document the "added- value" of their philanthropic investments.

Perhaps more importantly, it is our contention that the true impact of the collective work taking place in the nonprofit sector is grossly *under-valued* by those both within and outside of the sector due to an absence of appropriate metrics by which value creation may be tracked, calculated and attributed to the philanthropic and public "investments" financing those impacts. In the for-profit sector, one speaks of Price/Earnings Ratios and Portfolio Fund Performance. Indeed, at the close of every day one knows exactly what financial returns have been generated by "the market." By contrast,nonprofit organizations have no equivalent metrics by which to lay claim to the value created through their labor. This lack of transferable metrics underlies an array of issues confronting the sector, ranging from difficulties in fund-raising to an inability to provide personnel with adequate compensation. As the nonprofit sector continues to compete for limited charitable dollars it becomes increasingly important that we be able to understand not simply that a program is a "good cause," but rather that its social returns argue for increasing our investments in their work.

To date, the knowledge base driving an SROI analysis is still evolving. While Dennis Benson has done some ground-breaking work in advancing an understanding of return on investment frameworks applicable to the public sector and there have been several efforts to present a "snap-shot" analysis of how one might calculate a social return on investment for individual nonprofit organizations, these efforts have been isolated. An overall conceptual and practice framework for using such metrics on an ongoing basis within a portfolio of philanthropic investments has yet to be advanced. Therefore, this chapter addresses issues related to the understanding and measurement of Social Return on Investment (SROI).

The authors begin by introducing the challenge of calculating SROI and identify three types of value creation generated by social purpose enterprises; these include: Economic, Socio-Economic and Social. The focus of the balance of the chapter is on value creation taking place at the Socio-Economic level and the documentation of that value creation through the application of an SROI framework.

The Roberts Economic Development Fund (REDF) makes use of projected SROI to evaluate capital grant requests made by organizations in the REDF Portfolio. A sample capital grant request analysis is presented to demonstrate the concept in practice.

Beginning in the summer of 1999, SROI templates will be used by REDF to begin the establishment of an ongoing measurement of SROI within its portfolio. With such a framework in place, the argument is advanced, the "return" on philanthropic "investments" may then be calculated on an ongoing basis for this philanthropic portfolio of the Roberts Foundation.

The chapter concludes with a discussion of the theoretical and strategic limitations and challenges of applying an SROI analysis to philanthropic investments.

In approaching this discussion, it is important for the reader to understand that the proposed metrics and framework of analysis are changing and becoming more refined by the day. Indeed, by the time this paper is released, the REDF SROI Analyst will have finalized yet one more iteration of our financial templates by which we will quantify SROI. This paper and our own work are not presented to our colleagues and critics as a fait accompli, but rather a true work of action research. A second, follow-up paper will be published in the fall of 2000 that will present not only our first Portfolio Report, but a discussion of the problems encountered in applying our methodology. REDF has consistently presented its work with candor and honesty concern-

ing its challenges and limitations. We look forward to continuing to do so and offer the following two chapters as additional contributions to the ongoing work of not only those engaged in Social Entrepreneurship and Venture Philanthropy, but to the Nonprofit Sector as a whole. Finally, we welcome the reader's comments and observations for how this approach may be improved and where its weaknesses are found. This framework is not the answer, but is offered as one more step along the way. We look forward to hearing your comments regarding how it may be improved and to learning how you are moving to document the social impact of your own work.

Introduction

The challenge of tracking social impacts and calculating a foundation's "social return on investment" (SROI) are both issues which have been of increasing concern to many in the philanthropic and nonprofit communities. In 1996, The Roberts Foundation presented its initial framework for calculating a Social Return on Investment in our report entitled, *New Social Entrepreneurs: The Success, Challenge and Lessons of Nonprofit Enterprise Creation*. That framework used a modified discounted cash flow analysis in an effort to calculate the impact achieved through a foundation grant and document the economic value of the social purpose enterprises the foundation had supported.

While this effort was a meaningful, well-received, first step, we have come to view that initial framework as needing improvement in the following areas:

- The framework presented was useful in calculating the return on investment achieved by an individual foundation's grant, but did not allow for consideration of all investments (e.g., subsidies) underwriting an enterprise activity and was therefore felt to be lacking as a measure of total social return on investment for a nonprofit organization;
- The framework made use of three discount rates (0% to represent the cost of capital for grant funds, 3% for a Program-Related Investment and 9% for the standard market cost of capital), but did not address the challenge of using traditional means of calculating an appropriate discount rate, for example through use of the Capital Asset Pricing Model/Weighted Average Cost of Capital (CAPM/WACC) formulas;
- In its 1996 report, the framework was used by the Foundation to analyze a single investment, but was not tied to operating financial templates that could be updated on a regular basis. Thus, calculation of rates of return could not be continually adjusted based upon the actual performance of an investee organization—a key aspect for assessment of ongoing value creation in the nonprofit sector.

With these and other considerations in mind, over the course of 1997 the Roberts Foundation (under its new initiative, the Roberts Enterprise Development Fund or "REDF"), spent significant staff, investee and outside consultant time discussing how best to approach the overall issue of "evaluation" and the calculation of a social return on investment. It was concluded that:

- Evaluation, as generally practiced in the nonprofit sector, tended to be retrospective; did not inform practice by tying performance directly to making changes in practice; and is primarily externally focused (e.g., what did we say we were going to do in our proposal and did we, in fact, do it?);
- Evaluation as a concept, therefore, was less helpful than information management in support of practitioners' efforts to serve populations with complex needs;
- With an effective information management system in place both investees and REDF could assess the business and social activities of REDF-funded organizations more effectively; and

- Such a system could generate social outcome information of interest to investees, while laying the foundation for the Fund to track SROI more effectively.

After nearly a year of planning and design, in the first quarter of 1998 REDF "went live" with WebTrack, an information management system based on operational indicators developed by enterprise managers with the staff of BTW Consultants[1] and REDF. This system began with a primary focus on business operations—data that is now being used to inform business practice. At the conclusion of 1998, WebTrack's second component, that of social outcome indicators and data tracking, was completed.

WebTrack is an Internet-based information management system designed for and with REDF Portfolio investee organizations. The social outcome component of the system, based in part upon the templates developed to track business operations, is designed to provide information regarding the social and training program operations. As this system becomes fully operational, it will be possible for investees and REDF staff to assess progress toward fulfilling the social mission of our work. While critical to quantifying SROI, the documentation of social impacts is both complex and "process intensive." Therefore, this document presents a brief description of the WebTrack system, but does not fully discuss it. A companion chapter, "WebTrack and Beyond: Documenting the Impact of Social Purpose Enterprises," describes this social outcomes data system and design process in full detail.

As the WebTrack information management system was being developed with the organizations in the REDF Portfolio, other REDF staff turned their attention to the challenge of developing both the financial frameworks and social metrics for assessing individual grantee SROI and a portfolio SROI for the REDF initiative as a whole. This effort is known as The SROI Project.

The SROI Project

The SROI Project runs from February 1998 through summer 2000, at which point preparations will be made to release the first REDF Portfolio Report. That report will present both our analysis of the initial social impacts of REDF-funded organizations and the refined framework by which the Fund intends to calculate its SROI on an ongoing basis.

The task of assessing a foundation portfolio's SROI is extremely complex, involving a number of areas of study. While the process requires input from investee organizations, it has been staffed by REDF, making use of existing businesses' financial reports and other relevant documents in order to minimize the time and resource impact on investees.

The SROI Project is divided into the following four sections:

True Cost Accounting Analysis (TCAA)

Before one can attempt to understand social costs (and benefits) as a whole, one must understand how individual organizations currently track such expenses and charge such expenses to the appropriate cost center. The TCAA assessed REDF funded enterprises' current state of accounting for social, business and other costs. This analysis provided us with a baseline understanding of present practice, while it assisted us in developing a framework capable of comparing "apples to apples." The prior chapter entitled "True Cost Accounting: The Allocation of Social Costs in Social Purpose Enterprises" was written by Heather Gowdy and presents this framework.

Capital Structure Issues and Analysis for Social Purpose Enterprise

Any single investment of grant equity and the returns generated by that investment must be understood in terms of the other investments, debt and equity that support

the organization. Over the summer of 1998, a REDF Farber Intern, Jay Wachowicz, examined the overall capital structure of a sample group of REDF Portfolio organizations. Together with REDF's executive director, he applied business valuation frameworks to each social purpose enterprise and its parent corporation. In July of 1999, REDF's staff was joined by Suzi Chun, a Farber Fellow serving in the position of SROI Analyst. Jay and Suzi's work build on REDF's past efforts in this area and form a significant part of the material presented in the following pages.

Social Outcome Analysis and Summary

With the WebTrack system fully functioning, data will be generated showing the aggregate social impacts of funded organizations. As the process unfolds over coming months, specific outcomes experienced by individual participants will also be measured. In the future,this system will have the potential to provide "real-time" feedback to operations managers but will initially be tracked in six-month increments. REDF, together with REDF Portfolio organizations and partnering funders, will work over coming months to achieve real-time reporting. In addition to helping practitioners, the evolving information system provides the foundation for a database upon which a social return may be calculated[2].

SROI Portfolio Analysis

As we move through 2000, REDF and its investee organizations will be positioned to release regular reports that, in addition to documenting the qualitative impacts of supported activities, will also document the economic value of those social impacts. Overall SROI for the REDF Portfolio can be calculated using these data, aggregated. An initial portfolio report, written in partnership with REDF investee organizations, will be completed in the summer of 2000. That report, in addition to presenting our SROI figures, will also discuss the limitations of the approach and the challenges for future research.

Increasingly, nonprofit organizations and the foundations that support them are under fire to document the effectiveness and value of their work. It is our position that supporting tax-exempt organizations,especially those engaged in social purpose enterprise development, makes sense not simply from a general, charitable perspective, but on the basis of sound,investment logic.

The fundamental premise of our work is twofold:

> First, that ***a philanthropic dollar invested in the social mission of a nonprofit today generates future economic and social returns in excess of the initial value of that dollar;*** and
>
> Second, that ***social purpose enterprises—and many tax-exempt, nonprofit organizations—are creating significant value for society which goes largely undocumented and is vastly under-appreciated.***

To date, the sector has been unable to present a cogent, well-structured framework for *ongoing* measurement of the value created by the nonprofit sector. As a result, much of the social and financial impact generated by social investments of grants and other resources is undervalued by community members, funders, practitioners and government leaders. This inability to define and understand social and economic value has made for a serious information gap and a lack of objective performance assessments. In the absence of these measures, effective allocation of financial and other resources is hindered, which, in turn, limits the sector's ability to pursue improvement of community living standards and other long-term goals.

REDF has always placed significant emphasis on documenting the social and economic value of the work engaged in by portfolio organizations. The SROI Project is our effort to move the quality of both our own work, and that of the field, to a higher level.

Quantifying the Immeasurable: Fundamental Concepts of Value Creation

Shifts in the Capital Market

This paper presents a general framework for understanding and calculating social return on investment. The fundamentals are easily grasped. The chapter entitled "The U.S. Nonprofit Capital Market: An Introductory Overview," presents a detailed discussion of current trends within the capital markets that fund the activities of the nonprofit sector. The reader is directed to that chapter for a more complete discussion of shifts taking place in that market.

To understand the application of the SROI framework, one must first understand that the current nonprofit capital market is undergoing significant transformation. Historically, the U.S. nonprofit capital market has been:

- ***Charity Oriented*** - Emphasizes the good feeling and potential tax benefits a donor may receive from making charitable gifts to a nonprofit
- ***Process Focused***- Pursues such questions as "How many clients were served?" or "How many people attended a training session?"
- ***Based Upon External Evaluation Measures*** - Tends to be retrospective, oriented to meeting the needs of external players such as funders, and does not directly inform the work of program or operations managers

Together, these factors have helped create the nonprofit capital market that has evolved over past decades and have fostered resource allocation decisions often driven largely by politics, perception and persuasion as opposed to more objective criteria.

However, increasingly the nonprofit capital market is moving away from a "charity" orientation and toward one that views grants and donations as a form of investment in the nonprofit sector and the various communities served. The evolving nonprofit capital market is increasingly:

- ***Investment Oriented*** - Views each investment in relation to the overall capital structure of the nonprofit organization, not as a separate grant that stands on its own;measures the return on that investment in terms of social earnings and against a measure of social return on investment
- ***Outcome Focused*** -Attempts to enunciate the fundamental value proposition of the nonprofit "investee" and focus upon measuring what specific value was created as a result of the philanthropic investment in support of that value proposition
- ***Internal MIS Based*** - Maintains a prospective orientation—assessing what is projected to take place and what has happened in the immediate reporting period, rewarding effective execution by managers and, perhaps most importantly, creating a management information system that directly informs the work of practitioners over time, as opposed to simply justifying their activities to external players

Because of these trends, the nonprofit capital market and those who operate within it must begin to understand, enunciate and quantify the value creation of the social sector in a whole new way.

Understanding Types of Value Creation in Social Purpose Enterprises:

In the words of J. Gregory Dees, Kauffman Foundation Social Entrepreneur in Residence, the term entrepreneurism "came to be used to identify some individuals who stimulated economic progress by finding new and better ways of doing things. The French economist most commonly credited with giving the term this particular meaning is Jean Baptiste Say. Writing around the turn of the 19th century, Say put it this way, 'The entrepreneur shifts resources out of an area of lower and into an area of higher productivity and greater yield.' Entrepreneurs create value."[3]

For social entrepreneurs operating social purpose enterprises, this value creation process simultaneously occurs in three ways along a continuum, ranging from purely Economic, to Socio-Economic, to Social:[4]

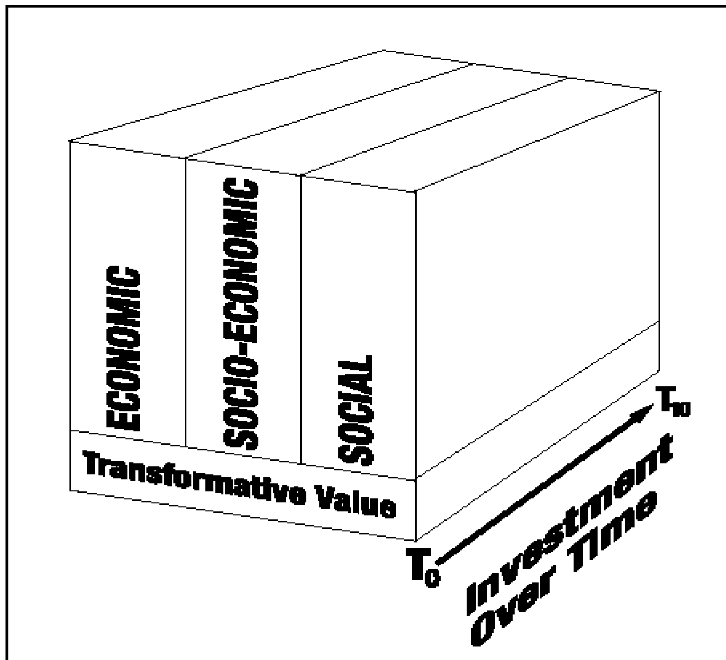
We will first briefly discuss the two extremes of this continuum, but focus most of our discussion on Socio-Economic value creation, the arena in which both economic and social value are considered. It is this combined value creation process that an SROI analysis attempts to measure.

Economic Value

Economic value is created by taking a resource or set of inputs, providing additional inputs or processes that increase the value of those inputs, and thereby generate a product or service that has greater market value at the next level of the value chain. Examples of economic value creation may be seen in the activities of most for-profit corporations, whether small business, regional or global. Measures of economic value creation have been refined over centuries, resulting in a host of econometrics, including return on investment, debt/equity ratios, price/earnings and numerous others. These measures form the basis for analyzing most economic activity in the world.

Social Value

Social Value is created when resources, inputs, processes or policies are combined to generate improvements in the lives of individuals or society as a whole. It is in this arena that most nonprofits justify their existence, and unfortunately it is at this level that one has the most difficulty measuring the true value created. Examples of Social Value creation may include such "products" as cultural arts performances, the pleasure of enjoying a hike in the woods or the benefit of living in a more just society. To quote J. Gregory Dees again, Social Value is "about inclusion and access. It is about respect and the openness of institutions. It is about history, knowledge, a sense of heritage and cultural identity. Its value is not reducible to economic or socio-economic terms".[5] Social Value can be found in anti-racism efforts, some aspects of community organizing, animal rights advocacy and folk art. It has intrinsic value, but can be difficult to agree upon or quantify.



The three types of value being created by the REDF Portfolio (Economic, Socio-Economic and Social) should be understood as being created over a specific investment time frame. In this case, that time frame is over a 10 year period. Furthermore, all three types of value should be understood to rest upon a fourth dimension of value creation — that of Transformative Value. The central purpose of the nonprofit sector is to create some type of change — to transform our society and world for the better. Transformative Value becomes the basic foundation upon which the other three types of value are based.[6]

Understanding Frameworks for The Measurement of Socio-Economic Value

We have already stated that measures of Economic Value are standardized and support the basis for most economic activity in the world. And we have also acknowledged that in the Social Value arena there are factors that are indeed beyond measurement, yet clearly are of value and worth affirming. In between these two poles of value creation lies Socio-Economic Value.

Socio-Economic Value builds on the foundation of Economic Value creation by attempting to quantify and incorporate certain elements of social value. An entity creates Socio-Economic Value by making use of resources, inputs, or processes; increasing the value of these inputs, and by then generating cost savings for the public system or environment of which the entity is a part. These cost savings are potentially realized in decreased public dollar expenditures and partially in increased revenues to the public sector, in the form of additional taxes. Examples of activities that generate Socio-Economic Value are supported employment programs for the disabled or homeless, job training programs or other initiatives that provide employment for those presently receiving public support and divert individuals away from public systems and toward private markets. We posit that value creation in this arena can be measured using a social return on investment metric, social earnings calculations and other evolving metrics discussed in this chapter. While not the focus of this chapter, variations on an SROI metric may also be applied to environmental, educational and other areas of interest and activity to the nonprofit sector.

In this context, it is important to understand that:

The core SROI analysis, as presented by REDF, does not attempt to definitively quantify and capture ***all*** *aspects of the benefits and value that accrue as a result of a successful program, but rather to identify* ***direct****, demonstrable cost savings or revenue contributions that result from that intervention.* And, with that documentation in place, an SROI analysis argues that the nonprofit should be at least *partially* compensated and/or credited for the value it creates in the marketplace. Public sector "pay for performance" and other trends are a move in this

direction, but need to be taken one step further, with social impacts being tied back to the "investment" required to achieve such impacts.

While the SROI framework presented in this paper focuses primarily upon the creation of metrics by which to quantify Socio-Economic Value, the reader should note that the REDF information system is simultaneously attempting to track much more than the value of cost savings to the public system. As the reader will see in a review of the information and tracking survey found in this chapter's appendix,REDF and its portfolio organizations are also tracking an array of other factors including such challenging areas as shifts in personal self-esteem—factors that fall mainly within the category of Social Value.

In the same way that an informed investor does not simply look at a single number in order to understand the worth of a particular investment, REDF encourages those involved in the application of an SROI analysis to seek out and use other tools with which to understand the value being created by a particular organization in which one has invested or is considering an investment. By combining a Socio-Economic measure of value with other measures, one may then begin to understand the full return being leveraged for participants, stakeholders and society at large.[7]

Finally, an SROI analysis is not simply a traditional form of cost/benefit analysis documenting that for every dollar spent on "X," "Y" number of dollars are saved. Rather, it analyzes both the cost savings generated by any given social program and the effects of investing limited "social funds" in one form of social activity as opposed to another, with varying costs of capital. The REDF SROI analysis potentially may include views of both the cost of that investment and the relative return generated by competing investment opportunities in the nonprofit capital market.

The balance of this chapter presents in detail how that analysis may be undertaken in the area of social purpose enterprises.

An SROI analysis does the following

- examines a social service activity over a given time frame (usually five to 10 years);
- calculates the amount of "investment" required to support that activity and analyzes the capital structure of the nonprofit that is in place to support that activity;
- identifies the various cost savings, reductions in spending and related benefits that accrue as a result of that social service activity;
- monetizes those cost savings and related benefits (that is to say, calculates the economic value of those costs in real dollar terms);
- discounts those savings back to the beginning of the investment timeframe (referred to as "Time Zero") using a net present value and/or discounted cash flow analysis; and then
- presents the Socio-Economic Value created during the investment time frame, expressing that value in terms of net present value and Social Return on Investment rates and ratios.

General Overview of an SROI Analysis

The exhibit on the following page illustrates the overall framework for the social return on investment calculation. The return may be measured as a ratio such that the present value of the net benefits is divided by the present value of the total costs or may be calculated based upon a return on investment calculation using an agreed upon a discount rate or range of rates.

The net benefits of an investment in a social purpose enterprise are comprised of two "cash flows." The first cash flow is generated from the operations of the social purpose enterprise itself. The business cash flows are forecasted out 10 years and to perpetuity and are then discounted back to a present value figure. The second cash flow is a calculation of the total net savings to society, which is to say the economic value of the program's social impacts. For our purposes,the term "society" refers specifically to those governmental entities upon which the social "cost" of poverty

SROI Calculations

($000's)

Time Period											
0	1	2	3	4	5	6	7	8	9	10	Perp
Business Cash Flow											
$3,182	250	380	420	510	620	750	840	950	1,170	1,290	1,400
Social Benefit Cash Flow											
$2,373	200	254	328	412	496	589	653	786	816	920	1,000
Net Present Value											
$5,555											

Present Value of the Benefits / Present Value of the "Costs"*

Social Return Ratio

(NPV Bus. Cash Flow + NPV Social Benefits) with IRR calculation provides:

SROI Rate

** = Present Value of the "costs" in this case is the grant equity contributed to the organization by government and foundation sources*

falls. Creating social and socio-economic value clearly is of benefit to individual program participants and communities and we also recognize that the immediate burden of poverty falls upon families and communities. However, the actual dollar expense of social and other programs accrues to the public sector which is supported by taxpayer dollars and, thus, society at large.

To quantify this net savings, REDF has hired BTW Consultants to track on an ongoing basis the costs of unemployment and the reduction of these costs as a result of employment within the social purpose enterprises. The net savings to society is made up of the additional tax dollars generated from the operations of the business and the reduction in unemployment costs, the new wages of the employees, and additional dollars the enterprises used associated with their social mission, less any grant and philanthropic investment dollars. Wages and the additional dollars used for the enterprises' social mission, while costs to the enterprises, are considered benefits to the employees. This cash flow is forecasted out 10 years and to perpetuity and is then discounted back to a present value figure using a range of discount rates. The new tax dollars, net savings, and business cash flows are discounted using the appropriate discount rates and then summed to form the total benefits to society. This figure represents the performance of the organization—its Socio-Economic Value.

The net present value of the benefits is divided by the total costs of the organization. The total "costs" represent the philanthropic dollars invested during a given year or other investment time frame. This final figure represents one of the performance measures of the organization—its SROI ratio.

Another performance measure is the SROI rate, which is calculated by performing Internal Rate of Return (IRR) calculations based on the total Socio-Economic Value and total "costs."

These measurements are for the organization and grant dollars in total. The framework to be used for the calculation of an individual "investor's" SROI is addressed in Calculation of Nonprofit Share Value and Equity Ownership, presented in Chapter 9.

How REDF Uses SROI to Assess Current Investment Opportunities

A central premise of this chapter is that all forms of charitable giving constitute a form of investment in the nonprofit sector. With an SROI framework in place, investors are now in a position to use SROI analysis as a tool to assist in decision making with regard to the large number of investment options available in the nonprofit sector. In the same way for-profit investors consider their overall investment goals, their appraisal of the managers of a given venture and internal rate of return/net present value projections when weighing an investment decision, the SROI framework may allow charitable investors to engage in the same type of considered analysis.

In the case of REDF, core investments are made in each organization included in the REDF Portfolio. Those investments are made against a variety of criteria, which in most cases include a projection of SROI returns. Each REDF organization is also able to apply for additional investments to support capital expansion to make possible the execution of the funded business plan. All capital grants are evaluated with reference to their potential SROI return. The assessment is a base-line evaluation of projected returns and includes the fundamental measures of socio-economic value in the REDF context: tax dollars saved as a result of individuals leaving public assistance and income taxes paid as a result of wages earned by employee/trainees in the social purpose enterprise.

The first section of the template on the following page presents a summary of the information presented in following sections. The analysis addresses two issues:

- What increase in Economic Value will be created through the investment? (eg. How does the social purpose enterprise benefit from the investment?)

- What increase in Socio-Economic value will be generated by the investment? (eg. What is the economic value of the social impacts?)

In addition, analysis is made concerning what the potential negative effect may be should the investment request be denied. The effort here is to understand the relative pros and cons of a given investment opportunity.

It is important to note that, as presently constituted, SROI analysis does not allow investors to consider the relative value of competing investments from different sectors. For example, a program employing at risk teens with an SROI of 34% is not necessarily “better” than an adult program providing transitional employment as well as educational support, but with an SROI of 22%. Such a use of SROI would constitute an effort to engage in an “apples to oranges” comparison. However, the present system would potentially allow for cross comparison within a similar sector—say, for example, two related youth programs employing teens from a given neighborhood.

At present, while REDF makes use of this template to assess capital requests of each organization in its portfolio on a “deal by deal” basis, at this time REDF itself does not have the capacity to assess the relative value of each investment. Furthermore, at present REDF does not evaluate how each investment will affect the SROI performance of the portfolio as a whole. With the institution of ongoing SROI analysis, the Fund will have the ability to convert to such an investment tracking system.

REDF Analysis of Returns on a Proposed 1999 Capital Investment

Name of organization - business: A Really Great Nonprofit Organization Changing the World

Amount requested for 1999: $100,000

Planned use of amount requested funds: Provide down payment for purchase of building housing a Social Purpose Enterprise in SF

	1998	1999	2000	2001	2002	2003
Net Business Income	na	$42,000	$61,718	$73,730	$85,743	$67,910
Net Social Benefit	na	$48,100	$46,175	$53,550	$63,564	$71,179
Total Business & Social Benefit		**$90,100**	**$107,893**	**$127,280**	**$149,307**	**$139,089**

Cost of cap."A"	**0%**	**NPV at 0%**	**$520,669**
Cost of cap."B"	**3%**	**NPV at 3%**	**$451,739**
Cost of cap."C"	**9%**	**NPV at 9%**	**$343,969**

NPV Calculations

Overview of business growth with vs without investment

	1998 (actual)	1999, without investment	1999, with investment	2003, with investment	With investment: % growth, 1999-2003	With investment: Estimated 1999-2003 growth attributed to investment
Sales	$309,605	$163,043	$356,000	$433,009	21.63%	$269,966
Net income	$40,000	-$111,700	$53,407	$82,600	54.66%	$194,300
Net income as % of sales	12.92%	-68.51%	11.80%	19.08%		
Target population jobs (FTE) annually	8	6	9	12		

With investment:

Projected business performance

	1998	1999	2000	2001	2002	2003
Sales	$309,605	$356,000	$375,252	$394,505	$413,757	$433,009
Net income	$40,000	$53,407	$67,150	$93,950	$103,450	$82,600
Net income as % of sales	12.92%	15.00%	17.89%	23.81%	25.00%	19.08%

Estimated business performance attributed to investment					
	1999	**2000**	**2001**	**2002**	**2003**
Sales	$192,957	$204,513	$217,111	$231,191	$250,459
Net Income	$42,000	$61,718	$73,730	$85,743	$67,910

Social Benefits						
	1998	**1999**	**2000**	**2001**	**2002**	**2003**
# Target pop. jobs annually (FTE)	8	9	9	10	11	12
Hours per week	320	360	360	400	440	480
Avg. target pop. wage rate	$6.00	$6.20	$6.20	$6.20	$7.00	$7.00
Total target pop. payment	$96,000	$111,600	$111,600	$124,000	$154,000	$168,000
Tax rate	15.00%	15.00%	15.00%	15.00%	15.00%	15.00%
Federal taxes from new jobs	$14,400	$16,740	$16,740	$18,600	$23,100	$25,200

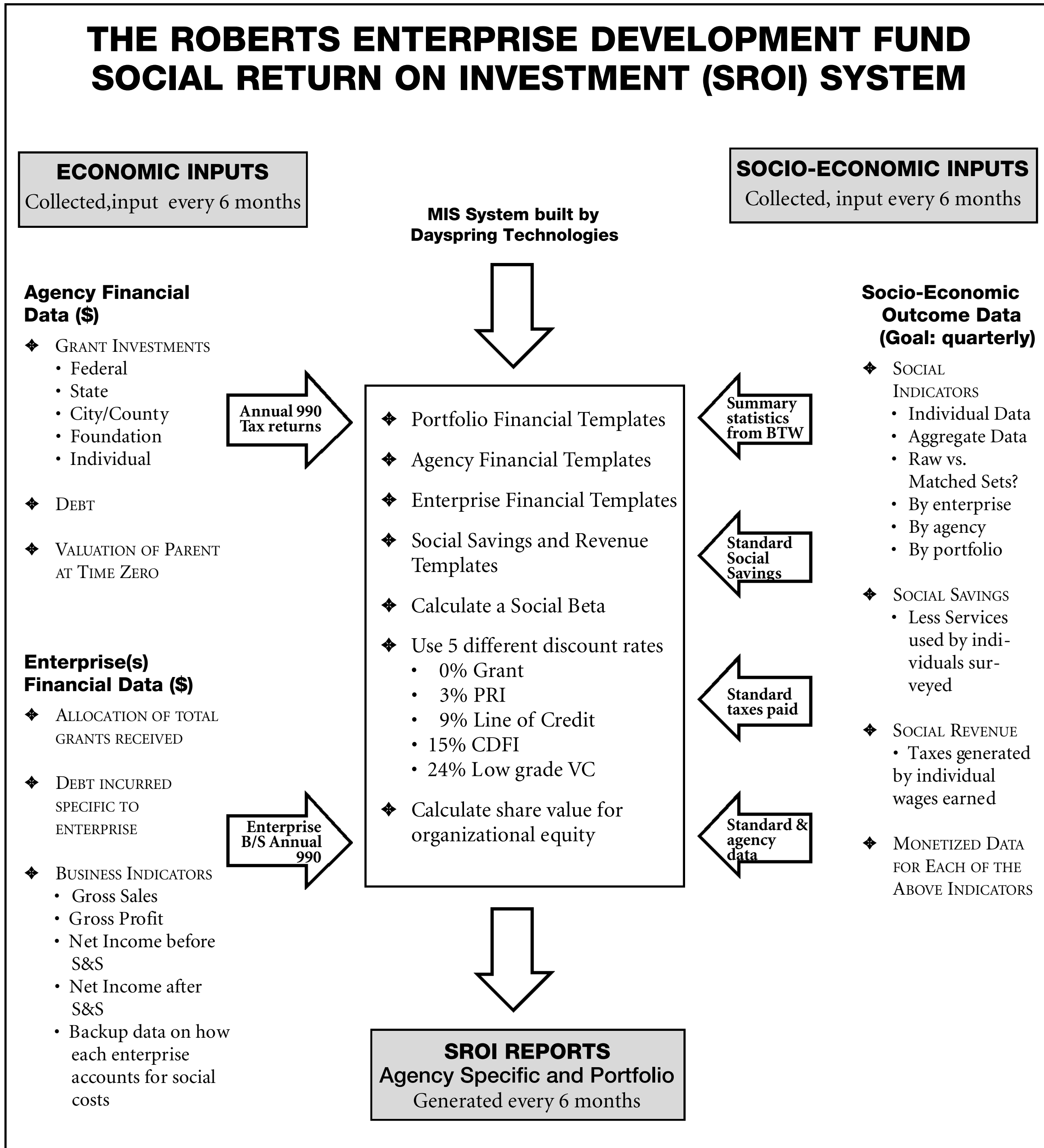
Estimate of social welfare system savings (partial):						
	1998	**1999**	**2000**	**2001**	**2002**	**2003**
Food stamps @ $1440/ person annually	$11,520	$12,960	$12,960	$14,400	$15,840	$17,280
TANF @ $6,000/ person annually	$48,000	$54,000	$54,000	$60,000	$66,000	$72,000
System savings (partial)	$59,520	$66,960	$66,960	$74,400	$81,840	$89,280
Estimated social costs **	$30,961	$35,600	$37,525	$39,450	$41,376	$43,301

** Assumes social costs absorbed by the business are 10% of sales

	1998	**1999**	**2000**	**2001**	**2002**	**2003**
Net Business Income	na	$42,000	$61,718	$73,730	$85,743	$67,910
Net Social Benefit	na	$48,100	$46,175	$53,550	$63,564	$71,179
Total Business & Social Benefit		$90,100	$107,893	$127,280	$149,307	$139,089

How REDF Is Building an Information Management System to Track Ongoing Investment Returns

As presented in the previous section, the mechanism by which projected investment returns are assessed is in many ways fairly basic. Moving from assessment to ongoing documentation and tracking is more complex, even if it is simply an extension of that framework. The chart below presents the various components of the information system by which individual REDF organizations document social impact and REDF as a whole will



track its Social Return on Investment for reporting in 2000.

The system processes two forms of quantitative information—Economic and Socio-Economic:

Economic inputs are tracked and evaluated based on the financial and accounting information systems of the organization. These Economic inputs include:

- grant investments,
- debt carried by the nonprofit, and
- the overall valuation of the Parent organization at Time Zero.

To this agency-wide information is then added enterprise specific financial data:

- grants for the social purpose enterprise,
- debt specific to that enterprise, and
- a variety of business indicators, including social cost information.[8]

Socio-Economic data is tracked through a system developed in partnership with REDF Portfolio organizations and BTW Consultants. Each individual entering the program is surveyed with regard to the social and other programs they participated in prior to employment in the enterprise. This information is tracked on a six-month basis, both individually and as an aggregate. The social savings of these individuals (calculated based upon decreasing uses of publicly funded programs) is then also calculated, as is the amount of taxes generated by the individual while employed in the social purpose enterprise and after employment in the enterprise. A sample of the complete survey is provided in the appendix to this document.

Business ABC, Parent Organization XYZ

NPV and SROI Calculation

	Discount Rates	NPV	2000P	2001P	2002P	2003P	2004P	2009P	Terminal Period
Net Income			190,159	222,491	255,766	289,741	324,151	491,901	480,517
+ Depreciation			17,849	18,027	18,208	18,390	18,573	19,521	19,716
- Change in NWC			26,779	27,900	29,067	30,281	31,546	17,345	8,747
- Capital Expenditures			5,000	5,250	5,513	5,788	6,078	5,198	5,717
Business Cash Flow	15.95%	$750,663	$176,229	$207,368	$239,394	$272,061	$305,101	$488,879	$485,769
+ Public Social Savings			460,204	460,204	469,408	478,796	488,372	539,202	549,986
+ New Taxes			66,717	68,719	70,780	72,904	75,091	87,051	87,921
+ Wages			444,782	444,782	458,125	471,869	486,025	563,437	580,340
+ Social Expenses			1,976	2,055	2,137	2,223	2,289	2,578	2,578
- Grants/Subsidies			840,000	870,350	901,817	934,441	962,474	1,083,588	1,094,424
Total Social Benefit	0%	$1,251,696	$133,679	$105,409	$98,634	$91,350	$89,303	$108,679	$126,401
	3%	$221,139							
	9%	$171,667							
	15%	$143,467							
	24%	$119,738							
WACC Rate	25%	$118,606							

	SROI Rate	NPV	2000P	2001P	2002P	2003P	2004P	2009P	Terminal Period
TOTAL BUSINESS AND SOCIAL CASH FLOWS	**14.57%**	1,211,408	309,908	312,908	338,028	363,411	394,404	597,558	612,169

Discount Rates (Social)	Total Business Value	Business ROI Ratio	Social Benefit	Social Benefit ROI Ratio	Total Socio-Economic Value	SROI Ratio
0%	$750,663	17.30	$1,251,696	9.39	$2,002,359	46.14
3%	$750,663	17.30	$221,139	9.04	$971,802	22.39
9%	$750,663	17.30	$171,667	8.44	$922,330	21.25
15%	$750,663	17.30	$143,467	7.94	$894,130	20.60
24%	$750,663	17.30	$119,738	7.39	$870,401	20.06
25%	$750,663	17.30	$118,606	7.36	$869,269	20.03

These data are then run through a set of financial templates that allow for assessment of individual social purpose enterprises, each of the organizations in the REDF Portfolio and, finally, the REDF Portfolio as a whole. A sample financial template with SROI calculations is included on the previous page and continued above. Together with the documented social indicators, Social Return on Investment calculations will then be made at each level in order to assist practitioners and investors in understanding the capital structure required to achieve certain social goals and the degree to which such goals are achieved over time.

As of this date, the information system to track Economic Inputs is fully operational. The information system necessary to track Socio-Economic Inputs is operational, but with varying degrees of specificity throughout the REDF Portfolio. For example, while REDF and its member nonprofits are able to track all aggregate data, not all 23 of the portfolio enterprises are able to report on specific, individual data. This data would be necessary for a complete and comprehensive assessment of ongoing SROI and will be available in the fall of 2000.

Two Significant Challenges in SROI Analysis: Determination of An Appropriate Discount Rate and Allowing for "Degree of Difficulty"

The Importance of Discount Rates and the Cost of Capital to SROI Analysis

A key issue for the SROI valuation process is the determination of an appropriate cost of capital, that is to say, the discount rate to be used in valuing future cash flows. The determination of an appropriate cost of capital to be used in an SROI evaluation is critical;if the cost of capital is overestimated,the calculated total value of the organization is undervalued. Conversely, if the cost of capital is underestimated,the total value of the organization will be overvalued. The cost of capital extends credibility and validity to the estimation of the nonprofit's total value in both social and economic terms.

Generally, when organizations do not have the means to calculate an accurate cost of capital they will use an arbitrary return based

upon the historical market return; generally the figure ranges from 10 to 12 percent. However, the nonprofit sector has no comparative market rates to use in our calculation of an appropriate discount rate,and so one must establish an agreed upon discount rate by other means.

In our research, we were not able to find significant information on how those engaged in advancing frameworks for calculation of SROI are determining their discount rate. The dominant assumption appears to be that one should assume a discount rate that is viewed as "conservative," in that there are no market comparables against which to compare risk exposure. Therefore, many have embraced a discount rate tied to either a 30-year Treasury Bond rate, or some other standard Municipal Bond rating with an "A" grade. A 30-year (as opposed to 2, 5 or 10-year period) bond is selected since the benefits of the social program are projected to be permanent. This is the rationale adopted by one foundation that used a 6.92% discount rate (i.e., Cost of Capital) in its assessment of the ROI generated by that foundation's grants.

In a separate, and extremely comprehensive, review of the social and economic impacts of Coastal Enterprises of Maine, this issue is explored further:

"The selection of a discount rate is a particularly critical step in benefit cost analyses of programs with benefits extending far into the future. A somewhat lower rate of discount would be defensible for CEI's programs, for three reasons:

- No earnings growth has been built into the future estimates of benefits.
- Interest rates have been low for some time and are not expected to rise appreciably in the near term.
- Economists argue that a "social rate of discount" is appropriate for projects that generate a large volume of unquantifiable social benefits. The "social" rate is lower than the market rate of interest."[9]

Having so stated, the authors then embrace two discount rates, 5% and 9%, for use in their analysis and simply turn to a discussion of how to connect shifts in business performance to programs of CEI.

For the purposes of the REDF SROI framework, we will endorse a strategy that on the one hand accepts the current limitations of the field, but on the other challenges us to create more accurate discount rates for use in calculation of SROI.

In the for-profit sector, interest rates are not simply estimated, but set as the relatively logical outcome of complex calculations.[10] These calculations entail a variety of elements relating to the "cost" of capital, risk exposure of that capital and the length of time that capital will be in use before it is returned to the investor. As stated elsewhere, because there are no market comparables against which to compare the degree of risk involved in social purpose enterprise development, we are not able to make use of the Capital Asset Pricing Model or Weighted Average Cost of Capital (CAPM/WACC) analyses—but that does not mean we should not try. As standards are put in place over coming years and historical performance of social ventures tracked, we will then be in a position to establish market comparables for use in such analyses. Complete descriptions of CAPM/WACC are beyond the scope of this paper, but are available in most business or finance textbooks. And the authors look forward to continuing our efforts to successfully operationalize such approaches in our own work.

In the absence of such frameworks, we have no choice but to continue with the basic approach presented in our analysis of 1996,[11] with some expansion. In the REDF SROI framework, we will use a range of discount rates reflecting the following market comparables:

- 0%: A zero discount rate reflects the cost of capital represented by philanthropic grants. While there may be an opportunity cost of sorts, those funds come from a foundation's annual payout requirement, may not themselves be invested in the marketplace and, to the recipient, represent "no or zero cost" capital.[12]
- 3%: A three percent discount rate reflects the rate usually carried by a foundation Program-Related Investment (PRI).[13] PRI funds are taken out of a foundation's corpus or giving budget and "invested" in nonprofit efforts, either housing, business lending or other activities. Although they

are usually secured at some level and there is a pay back period, they represent access to "low-cost" capital to the investee.

- 9%: A nine-percent discount rate represents an average of a standard, fully secured personal loan. If one were to take out an equity line of credit on one's home in order to launch a small business venture, depending upon the degree of additional debt and a variety of other factors, 9% would be an average discount rate applied.

- 15%: A 15 percent discount rate represents the rate charged by many community development financing institutions extending credit to local small business owners in lower income or targeted communities. In such communities, it is argued, the cost of capital is less important than the access to capital and the transaction costs of processing and managing small business loans is high enough to warrant rates of between 12 and 15 percent. Since social purpose enterprises target specific populations in order to achieve particular social goals, such a rate would seem appropriate to include in our range.

- 24%: Finally, we must address the fact that social purpose enterprises represent a significant amount of risk to the investor. Unlike traditional social service or training programs where one "knows" with some degree of confidence that a given number of individuals will be trained and complete the program, those investing in social purpose enterprises are not simply investing in the process of a group of folks receiving services. They are investing in both a process of service delivery and the building of a small business enterprise. One is vested in the organization, its business and the individuals one hopes to assist—and as such opens oneself up to a wide array of direct and indirect risk factors.

  In attempting to establish an appropriate discount rate to reflect that risk, the closest approximation is that of venture capital and the "hurdle rates" pursued by such investors. A central strategy of venture capital investors is that across a portfolio of investments one may have two or three that significantly under perform, four or five that perform at "acceptable" market rates and then two that may "hit a home run." Those final two may return from 50 to more than 150 percent on the original investment. It is that return that brings the performance of the portfolio as a whole up to the overall hurdle rate sought by the venture capital fund managers.

Two Points to Consider:

First, in setting its range of discount rates,REDF could simply use the standard endorsed by the field. Such a standard is to assign a discount rate of no more than 9%, the highest figure we found in use by other practitioners. We have "raised the bar" on the discount rate issue for one fundamental reason: whatever rate we are finally able to calculate at some future point, social purpose enterprises carry with them a significant amount of risk exposure. Any discount rate applied to this field must in some way address the need for this risk premium. We would prefer to do so through application of CAPM/WACC frameworks, but without the ability to do so, we must settle for whatever market comparables seem appropriate. The application of small business lending rates and modified venture capital rates seems most realistic.

Second, by committing ourselves to discount rates which may be two to eight times those used by other practitioners, we will have the "negative" effect of driving down the projected rate of return for REDF investees and the REDF Portfolio as a whole when viewed in comparison to those other practitioners. For example, the previously cited foundation that used a 6.92% discount rate reported unadjusted SROIs ranging from 877.04% to over 1690% for philanthropic funds. By contrast, REDF SROI calculations, both projected and emerging actuals, report a significantly more "conservative," though still impressive, range, usually between 25 and 100 percent.[14]

While we feel our numbers more accurately reflect the true carrying cost of the risk exposure represented by our philanthropic investments, a direct comparison with others will not provide an accurate understanding of the actual value generated with REDF dollars. As practitioners and funders move to report their Social Return on Investment, it will be critical for players to embrace a single process for valuation of the cost of capital as well as a standardization of inputs brought to the calculation of a given portfolio's SROI.

Allowing for a Measure of the "Degree of Difficulty": A Definition of "Social Beta"

Why Calculate a Social Beta?[15]

A social return on investment analysis offers a means of assessing a nonprofit organization's performance in serving its target population. If this type of performance assessment is to facilitate comparison of "apples to apples," however, it must take into account that certain populations are more difficult to serve than others. Some nonprofits serve targeted members of the general population (such as youth or displaced workers), while others serve specific at-risk and/or high-risk populations (such as the homeless youth or formerly incarcerated adults). At-risk and high-risk populations, compared to their counterparts in the general population, need a more complex set of social services,may require a greater level of effort and resources from the social service provider, and often carry greater risk of "failure" or face compounded challenges.

Overview of the Concept of "Beta"

In the Capital Asset Pricing Model (CAPM), beta is a quantitative measure of an investment's volatility relative to the overall market. Thus, beta serves as a primary indicator of a particular investment's degree of risk to the investor. Interpretation of an investment's beta relies upon comparison to the overall market, which, as the reference point, has a beta of 1.0. Thus, an investment with a beta of 0.75, for example, is expected to produce returns at 75% of the market rate; conversely, an investment with a beta of 1.75, is expected to produce returns at 175% of the market rate. In essence, the market rate of return provides the benchmark for interpreting beta.

Beta values are calculated based upon regression models that assess the degree of linear correlation between an investment's return and overall market returns. When these two sets of returns are plotted against each other, the regression analysis fits a line through the plotted points and measures the slope of the line. Beta is the slope of this regression line.

As part of the SROI analysis, three methodological approaches are being developed by REDF for use in exploring the possibility of applying the concept of beta to the nonprofit sector. Each of these methods produces a statistic (a coefficient of risk in the first analysis and social betas with different applications in the second and third analyses) to provide potential "investors" in the nonprofit sector with a quantitative assessment of an organization's expected rate of social returns as well as indicate the degree of risk inherent in working with a given target population.

The foremost limitation in attempting to apply the concept of beta analysis to nonprofits lies in the lack of a market-based benchmark by which to compare the result. The rest of this section presents three experimental approaches that in various ways account for this limitation. The first two approaches(the coefficient of risk calculation and risk-return social beta analysis) do not require a market-based benchmark as they rely solely upon intra-agency information,introducing a measurement of risk based on social factors. The third approach most closely resembles the CAPM beta analysis, where investment returns are regressed on market returns;however, in the absence of a nonprofit stock market, a proxy nonprofit market is constructed with the composite information across organizations in the REDF Portfolio augmented with information from other organizations serving lower-risk populations.

Comparison of the social return on investment across social service agencies must take into account this population "risk factor" which indicates both the need for a greater investment in the high-risk individual as well as the potential for a greater social return on that investment. As described below, calculation of a beta is one approach to understanding risk. In our case we would propose the development of a "social beta" for use in SROI calculations. Accounting for the "degree of difficulty"[16] in serving a given population is the purpose of calculating a social beta. An organization's social beta would serve as a risk rating given the population it serves. The social beta calculations proposed here are experimental; they represent our current best thinking in theory and

will be tested in practice in coming months. Each analytic process will be tested and refined based on these results.

The processes proposed below for calculating a social beta will yield three statistics with distinct applications:

- **A Coefficient of Risk Associated with Serving a Given Target Population** will be constructed. This coefficient will be generated for all target populations served by REDF portfolio organizations and will indicate the degree of difficulty in providing services to that population given their social risk factors. It can be used in financial and other equations to adjust for the degree of challenges a population poses to a nonprofit. As the coefficient of risk increases, the degree of difficulty in serving a population also increases. In this way, nonprofit organizations calculating social returns on investment will be able to allow for their serving more difficult populations and addressing greater social challenges instead of being rewarded for "creaming" or targeting easier client groups in order to assure increased social returns.

- **A Risk-Return Social Beta Analysis** will generate a social beta rating of internal performance. This beta indicates the level of social return an organization can be expected to yield given the levels of risk presented by its target population. This risk-return social beta is useful as a rating of the organization's performance, accounting for how difficult it is to serve its population.

- **A Social Beta Coefficient of Relative Return** will be produced from the Relative Return Social Beta Analysis across organizations in a Nonprofit Marketplace. This social beta coefficient most closely resembles the betas calculated for stock market investments. A relative return coefficient is calculated for an individual agency but interpreted in the context of how an overall "nonprofit marketplace" is expected to produce returns. The higher the relative return beta, the greater the organization's expected returns relative to the overall market.

Determining a Coefficient of Risk Associated with Serving a Given Target Population

Social "risk" refers to the number and complexity of barriers to functioning (i.e., carrying out essential components of a healthy and productive life) that a given population faces. As the number and complexity of issues increases, the degree of difficulty for the nonprofit organization in serving that population likewise increases. Barriers to functioning, or "risk factors," would include severe economic disadvantage, homelessness or unstable housing, chronic unemployment, substance abuse issues, and mental health issues, among others. The level of severity and combination of these factors comprises the degree of risk to an organization in providing services to a population. Consider the example of homeless and runaway youth (a high-risk population requiring a great number of social services) compared to youth attending summer camp (a lower-risk population requiring few social services,if any).

What this approach to risk calculation might not allow for, however, is those organizations that confront a variety of external risk factors affecting the impact of their program. For example, a program working with urban youth may have some things in common with its suburban counterpart (such as the general challenges of youth, media influences, "latchkey" issues, etc.), yet must also address other factors present in an urban environment. This question will be the subject of further

discussion and analysis, but initially might be dealt with by focusing SROI analysis and the use of a social beta upon groups sharing certain basic characteristics, such as urban/rural, youth/adult and so forth.

Using the Social Impact Survey (the instrument developed by BTW Consultants with REDF Portfolio organizations to track and quantify social costs), information is being gathered on an individual basis on the risk factors faced by those employed in REDF portfolio enterprises.[17] A weighted composite index of risk will be constructed that assigns a numeric value to all relevant factors. These factors include severe economic disadvantage, homelessness or unstable housing, chronic unemployment, substance abuse issues, and mental health issues. Other characteristics, such as age, will likely be factored into this index to account for the degree of effect of the presenting problem in the individual. Individual client/consumers can then be given a risk score based on the set of factors they report, which can in turn be brought to scale for a target population, producing a coefficient of risk associated with serving that population.

Weighted Average Cost of Capital Formula

Cost of capital = [debt/(debt+equity)*r_{debt}] + [equity/(debt+equity)*r_{equity}][18]

Entering the following information into the WACC formula, the cost of capital equals 9.225%

Debt = $250,000

Equity = $750,000

Cost of debt (rdebt)= 9.6%

Cost of equity (requity) = 9.1%

WACC = .09225 or 9.225%

Introducing the Coefficient of Risk (R) to the WACC formula

Risk-Adjusted Cost of Capital = R{[debt/(debt+equity)*r_{debt}] + [equity/(debt+equity)*r_{equity}]}

Nonprofit A: Homeless Youth Center		**Nonprofit B: Youth Summer Camp**	
Debt = $250,000 Equity = $750,000 Cost of debt (rdebt)= 9.6% Cost of equity (requity) = 9.1% **WACC = .09225 or 9.225%**		Debt = $250,000 Equity = $750,000 Cost of debt (rdebt)= 9.6% Cost of equity (requity) = 9.1% **WACC = .09225 or 9.225%**	
Coefficient of Risk (R) = 1.7		Coefficient of Risk (R) = 0.6	
Risk-Adjusted Cost of Capital:	**(WACC)*(R):** (0.09225)*(1.7) = 0.1568 or **15.7%**	**Risk-Adjusted Cost of Capital:**	**(WACC)*(R):** (0.09225)*(0.6) = 0.0553 or **5.5%**

This coefficient of risk will serve as a coefficient in calculating a social purpose enterprise's appropriate discount rate through the Weighted Average Cost of Capital (WACC) formula. In the WACC formula,the coefficient of risk adjusts for the degree of difficulty posed to a nonprofit in serving a given population. A higher coefficient of risk (R) indicates a higher degree of risk, which consequently increases the cost of capital (*as illustrated on the previous page*).

In this sample calculation, the coefficient of risk for the Homeless Youth Center is 1.7 compared to 0.6 for the Youth Summer Camp program. The Homeless Youth Center's coefficient of risk is higher, accounting for the higher level of risk involved in serving its target population. When the coefficient of risk is applied to an interest rate of 9%, for example, the resulting interest rate for the Homeless Youth Center is 15.7% (0.09*1.7 = 0.15) compared to 5.5% for the Youth Summer Camp program (0.09*0.6 = 0.054).

The coefficient of risk will also serve as a component in calculating an organization's risk-return social beta, as described below.

Risk-Return Social Beta Analysis at the Individual Agency Level

The first approach to deriving a social beta for a nonprofit organization draws upon information from an individual organization and does not require a benchmark for interpretation. This type of analysis is a risk-return assessment; it will produce a beta value that indicates expected return given the degree of social risk to the organization in working with its target population. This analysis can be applied to any nonprofit organization as well as, with minor changes, to social purpose enterprises run by nonprofit organizations.

The coefficient of risk discussed above constitutes the first component of this analysis. Social return on investment (the very focus of this paper) is then built off that calculation of risk. Putting these two concepts (coefficient of risk and social return on investment) together, a nonprofit organization's social beta can be determined by regressing return on degree of risk. This analysis plots return at each point of risk and fits a line through the plotted points. The beta value is the slope of the line. Thus, a beta of 1.0 indicates that return increases one unit for each unit increase in risk. A beta lower than 1.0 would indicate a lower return given the level of risk and a beta higher than 1.0 would indicate greater return given the level of risk.

As the exhibit below illustrates, Nonprofit Organization A serves homeless youth and has a risk-return social beta of 1.7; this means they serve a high-risk population and produce high social returns. Nonprofit Organization B provides summer camp services and have a risk-return social beta of 0.6; they serve youth who are not at-risk and produce low social returns.

	Population	Risk-Return Social Beta
Nonprofit Organization A	Homeless Youth	1.7
Nonprofit Organization B	Youth in Summer Camp	0.6

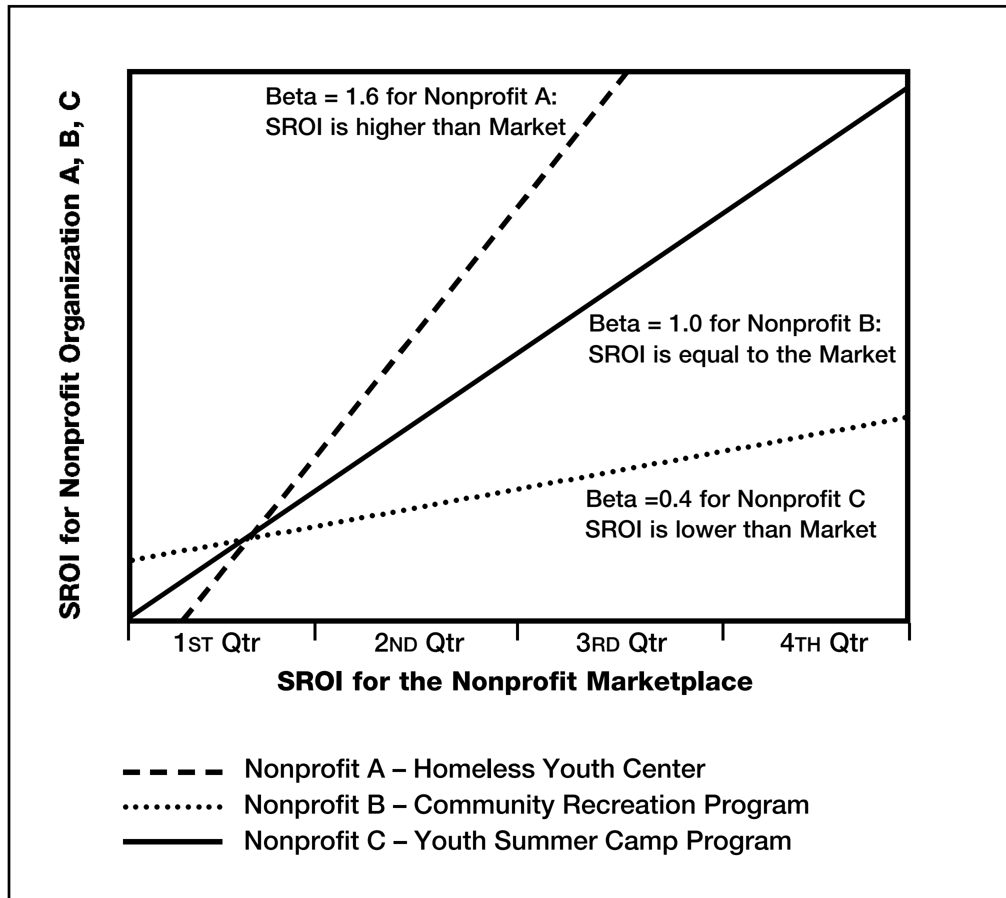
Just as beta indicates in CAPM,this social beta provides an indication of a nonprofit's potential performance relative to risk in serving its target population. The higher the beta value, the higher the level of return despite high levels of risk presented by the population; strong-performing nonprofit organizations would have high social betas.

Relative Return Social Beta Analysis Across Agencies in a Nonprofit Marketplace

In the corporate sector, information on businesses' historical performance is maintained and used as the basis for calculating several important indicators,including beta. To date, the same information is not maintained on organizations in the nonprofit sector. While REDF is developing such a database of historical performance for nonprofits in its portfolio, until this database is adequate, the lack of historical information must be accounted for experimentally.

The second approach to a social beta analysis brings the concept to the level of a nonprofit marketplace, where it becomes useful for relative assessment of SROI across nonprofit organizations. Bringing the social beta concept to scale raises the issue of a market benchmark by which to compare the individual organization.

In the absence of a nonprofit stock marketplace, a synthetic reference group will be



constructed. The aggregated information collected from all organizations in the REDF Portfolio will serve as a starting point for this reference group. However, since populations served by REDF portfolio organizations are on the highest end of the risk scale, this data set will be augmented with information from other organizations serving lower-risk populations.

Calculating the market comparison beta for a given nonprofit requires regressing the organization's rate of return on the rate of return for the reference group as a whole. This analysis would provide a beta for the organization that could be used to assess its risk relative to the marketplace (as represented by the synthetic reference group).

In this analysis, a beta of 1.0 indicates that the organization performs at precisely the same rate as the nonprofit marketplace reference group (represented by Nonprofit B, a Community Recreation Program, in the illustration at bottom, preceeding page). By extension, a beta lower than 1.0 would indicate that the organization produces a social return on investment at a rate that is lower than the reference group (represented above by Nonprofit C, a Youth Summer Camp with a beta of 0.4) while a beta higher than 1.0 would indicate that the organization produces a social return on investment at a rate that is higher than the reference group (represented bottom, preceeding page by Nonprofit A, a Homeless Youth Center with a beta of 1.6). The following depicts each of these scenarios.

In sum, a "social beta" can assist both investors and practitioners in understanding the relative risk exposure represented by different types of programs. The use of social betas as a part of the SROI analysis helps provide a framework for assuring that populations with increased needs and demands are not penalized in the context of an SROI assessment.

Responding to the Potential Limitations of an Applied SROI Analysis of Social Purpose Enterprise Development

Criticisms of efforts to engage in an SROI analysis fall into two general categories: technical and strategic.

Technical criticisms

In this category, the core issue is one of whether financial metrics developed to capture and reflect valuation in the commercial sector can be effectively transferred to the nonprofit sector. In numerous discussions with the loyal opposition, the authors have discussed their interest in applying both Capital Asset Pricing Model and return on investment techniques, but have been challenged by shortcomings of each as they relate to this particular application.

The use of CAPM is particularly difficult in that it speaks to an understanding of risk (volatility) and risk diversification grounded in a presumption of somewhat efficient capital markets with the elements of "common" information and investment market liquidity—factors allowing for an analysis of market comparables—which are not currently present in the nonprofit sector. The CAPM makes use of a market risk premium calculation that may or may not be applicable to nonprofit capital market valuation. For example, the way one calculates the appropriate market risk premium is based upon an examination of historic performance—and, of course, in the nonprofit sector with no common financial metrics or history of performance in the marketplace there is no basis upon which to establish such a market risk premium. Critics state this fact makes CAPM inapplicable to an SROI analysis and without a "true" value of cost of capital makes SROI analysis unusable.

In the future, this problem will be addressed by the creation and endorsement of market standards to which nonprofit organizations that want to access capital in this market will have to adhere. These standards will, over time, generate the measures of historic nonprofit performance by which a "Social Risk Premium" or "Social Beta" may be calculated. Presently, however, one is forced to employ an extremely conservative discount rate with minimal reflected risk or some continuum of graduated rates. In our framework, we make use of the latter. Until the field has enough data to calculate a discount rate that more accurately reflects the true degree of risk undertaken by such programs, there seems no other choice than that of applying a range of discount rates for present use in SROI calculations. However, having said that, we must acknowledge that such an approach is second best. Ideally, we should work toward the creation of standards that will allow for use of CAPM or other agreed upon measures.

A second technical consideration is that Internal Rate of Return (IRR) calculations are based on actual dollar cash flows which carry a specific, market-based valuation. Because the economic value of the cash flows used in the SROI calculation is an "imputed" or assumed value, it is technically a non-traditional application of IRR and we identify it to the reader as such.

Furthermore, while in future years nonprofits may be able to sell their social cost "receivables," in 1999 you cannot take your receivables and sell them to a third party. Because they have no true economic value aside from that of "cost avoidance," they technically have no true worth in a NPV/IRR calculation.

It is our contention that as nonprofits begin to document the true degree of their value creation they may then begin to engage public sector and other funding sources in discussions regarding how to tie funding to demonstrated impact—thereby creating actual dollar cash flows in support of the service made possible by the nonprofit's capital structure—investments in capital which may then be evaluated based upon an SROI,as opposed to simply providing a service to a target population or community of concern. Recent years have seen a marked increase in "pay for performance" contracting and outcome funding approaches in the nonprofit sector. As funding streams come to be driven more by actual outcomes than by proposed intentions, a real dollar revenue stream will then be created to eliminate this problem of using an IRR based upon imputed economic value to analyze SROI. Such a cash flow stream would be converted to a measure of "social earnings," in the same way for-profit earnings are calculat-

ed. However, for the present analysis, we will presume socio-economic returns do have value, acknowledge it as imputed value and, having done so, use this imputed value to calculate a measure of socio-economic worth for use in SROI analysis.

A final technical issue is that of causation, namely:

> How can a single nonprofit take credit for a life change in an individual client who may be the focus of any number of known or unknown intervention efforts?

This is perhaps the most central and meaningful challenge to those who would apply SROI in their work. There are several ways we may begin to respond to this challenge.

First,nonprofit organizations must create internal accounting systems that allow them to track social costs within their organization and tie those costs to their own program offerings.[21] Having established internal integrity to their accounting and management information systems, they may then begin to isolate the value added by related programs that may be contributing to individual success. In the case of the REDF Portfolio, program/financial/social cost audits were conducted in each organization (including its social purpose enterprise) in an attempt to document what percentage of a given program was the domain of a given nonprofit. That percentage could then be used to calculate relative rates of return on a per program basis.

A second approach to this challenge is to have in place, a formal, high-end client data tracking and documentation process. With such a management information system designed and on line, program staff can track and record all program contributions made by other organizations and significant others, separating out various benefits accordingly in the SROI calculation.

However, the creation of such a management information system is no small task. REDF, in partnership with other funders and its investee portfolio, is currently embarking on an effort to create this type of comprehensive, integrated MIS across its portfolio. As previously stated,other REDF documents discuss this issue in greater detail.

While the improvement of MIS used by nonprofits may address the concern of how to isolate the relative value of various program contributions, other factors must also be understood as making contributions to positive Socio-Economic Value creation. For example,a young person may be participating in an effective program that re-unites him with his parents. As a result of this reunification, the family develops better communication, remains together, and the youth goes on to lead a productive life. The question must be asked: Was this benefit a result of the program or the parents?[20]

The answer may easily be both. From our perspective we would propose that the value generated by the program's activities on behalf of reunification be measured in terms of SROI and Socio-Economic Value, as described in this paper and other chapters of this book. In turn, those extremely difficult to quantify contributions made by a parent to a child would fall under the category of Social Value and be captured through the use of some qualitative assessment. This is not to say the parent does not contribute value, but rather that it is an investment and a return of a different type (social as opposed to socio-economic) than that of the nonprofit organization. As Dennis Benson has so aptly observed:

> "When you invest $1,000 in your mutual fund and receive a return for this investment, do you presume that your investment was directly or indirectly involved in influencing that return? Of course not. You had planned to invest this sum, and your main question is whether an alternative investment would have provided a greater return. If you wish your investment to play a causal role, then you would find it necessary to add a number of zeros to your investment amount. At that point you may find yourself making things happen."[21]

As previously stated, a basic premise of the REDF SROI analysis is, in fact, that there is a fundamental socio-economic value to which each organization may lay claim—the organization's total SROI. Each investor in that organization, each "owner" of equity, may then also lay claim to degrees of that return which are comensurate with the amount of their investment, that is to say, the nonprofit shares they control. This idea is expanded upon in the next chapter.

It should be noted that while this may begin to address the question of how to approach issues of allocating *investor* equity, what remains to be addressed is a discussion of how to convert organizational equity into either employee or client equity. The issue in this regard is not simply how to calculate a nonprofit employee stock ownership plan, but whether and how to credit program *participants* with the "return" they deserve for their work in making possible their own success as individuals in recovery, or working to improve their lives in other ways. That question remains to be pursued in future papers; however, as individual investors with various stakes in an organization may lay claim to a range of returns on their investment portfolio, the fundamental social earnings of the organization remain unchanged—regardless of whether those earnings are designated to individual program participants or outside investors such as foundations.

A final, and very significant, technical criticism is that the accounting rules promulgated by the Financial Accounting Standards Board (FASB) for nonprofit corporations differ from those of for-profit corporations. Funds received in one year must be "booked" that same year and are not viewed as investments in capital or equity, but rather as revenues to the organization. Since there is no "true" basis for viewing investments in the equity of a nonprofit organization, an analysis of social return on that equity becomes tenuous in practical, present day terms.

The implications of these criticisms are sound and not to be avoided. However, at the same time what is presented in these pages is a framework for an analysis of social return that maintains one foot in the present and one in the future. The framework is based upon fundamental valuation and financial return metrics used in the for-profit sector. These metrics have been applied to the creation of social value in order to develop a better understanding of how that value is created in the nonprofit sector. Wherever possible, the authors have sought to make their analysis transparent to the reader, identifying places where critical assumptions have been made and problems in the subsequent analysis may arise. In the future, as more attention is directed to this area of SROI analysis, it is hoped that more effective approaches to overcoming these accounting limitations may be advanced in order for both practitioners and "investors" to engage in a more informed and accurate assessment of the value being created by both.

Strategic Criticisms

With technical criticisms initially addressed, we may turn our attention to the strategic criticisms raised by others. In these days of market obsession and a "business rules" cultural context, some feel the movement in recent years to quantify social impacts and measure outcomes is both misled and ill-fated. And, indeed, there are times when such critics are correct and their cautions should be heeded; namely we are concerned that:

> In the rush to quantify all programs and justify every charitable dollar, there is the very real danger of poorly designed tools being applied inappropriately by low-skilled, though well intentioned, individuals— whether nonprofit practitioner, independent evaluator, governmental agent or foundation program officer.[22]

First, it must be recognized that there is a very real danger (already witnessed) of increasing numbers of foundations and government funders demanding measurable outcomes from nonprofit practitioners without also providing the investment of financial support necessary to build credible information systems that might track those outcomes. And without such investments in the managerial capacity and information management infrastructure we run the risk of leaping off cliffs in our haste to artificially justify and validate one approach over another.

This is a real threat we must all seek to avoid. In the case of The Roberts Foundation, our interest in documenting the impact of our philanthropic investments has been matched by a capital outlay of over $750,000 to assist in building the required information system to track social and financial data. That initial investment has recently been augmented by $500,000 from the Charles and Helen Schwab Family Foundation and an additional $100,000 from the Surdna Foundation of New York.

Second, there is also the risk that we may simply be replacing one flawed system with

another. Even the best-intended efforts can easily be subverted by human nature. Once standards are established and reporting systems in place, people will no doubt discover ways to "cook the books" and falsely document performance. By way of example,it was recently reported that in one school district a few unscrupulous teachers systematically falsified the answer sheets and grading of some of their students in order to appear more successful than they actually were in taking state "educational quality" exams.

And, of course, many caseworkers in traditional human service nonprofits are accustomed to the "monthly scramble," whereby charts are pulled, back-of-the-envelope calculations made and "evaluation" reports submitted to outside funders. The creation of broad-based standards of measure in the nonprofit sector could well end up being received as simply "the next hoop to jump through." Admittedly, in a matter of only a few years professionals could easily develop an array of impressive ways to fool the system and misreport performance results. Or organizations could simply claim to be serving one population while actually serving another, thereby performing better then their cohort and generating a higher SROI. Indeed, there are those who would claim that this already takes place today.

One way in which this issue may be addressed is to engage in an "inside out" creation of both social indices and systems of measurement, as opposed to the traditional "outside in" approach whereby an "objective" evaluator is brought in to pass judgement on practitioners. Through a process of mutual exploration, REDF organizations have themselves enunciated what measures they feel best reflect the goals of their programs. These indices have been mutually agreed to by both practitioner and funder. And an accurate, computer-based data reporting system created to track performance over time. With a vested interest in knowing whether or not their efforts are having the intended impact, practitioners are more significantly motivated to assure the integrity of the data and to then modify approaches with reference to the information generated.

Furthermore, while concerns about the integrity of information systems are certainly valid, it does not necessarily follow that one system of measures cannot be improved upon over another. We must improve the current system, even if we know there will be flaws in our evolving systems of measurement. If we accept that there is Economic Value and Social Value—and that Economic Value is measurable, while Social Value remains fully immeasurable—we must accept that we will never be able to more fully understand the true value of much of the work presently taking place in the nonprofit sector.

The authors and The Roberts Foundation are not willing to accept such an idea and will work to assure full transparency in our analysis so that all who would attempt to understand our measures and statements of value creation will be able to openly examine our assumptions and claims. By taking progressive steps toward greater and increasingly accurate measures, we will at least be moving in the correct direction. And by making that analysis fully available to others, we will be able to openly discuss its shortcomings and strengths.

A third strategic concern is the previously discussed difficulty of assessing the relative value of differing programs or nonprofit strategies. For example, one may have two youth programs under consideration; one works with "at-risk" out of school (but school age) youth in the inner city and the other provides after-school tutorial and recreational programs to urban "latch-key" kids. Can a single SROI assess the comparative value of two distinct programs? This challenge is even more significant if one is comparing nonprofit work in completely unrelated areas of interest—for example, environmental versus educational programs. Can an SROI analysis ever generate a single figure by which two competing philanthropic investment opportunities may be compared?

Two approaches might help address this issue:

First, as standards are developed and applied in the field, similar programs may be grouped into related sub-sectors or cohorts. In the same way that a for-profit investment strategy recognizes differing rates of return between a Small Cap Fund and a Bond Fund, similar related funds and sub-sectors in the nonprofit capital market could also be so identified.

Second, one element in the calculation of any rate of return is that of risk and risk premiums: the greater the degree of risk expo-

sure,the higher the risk premium. Within an interest rate calculation, risk is reflected in the beta used to calculate the discount rate. In the same way that Olympic divers are awarded higher point scores for the degree of difficulty inherent in a given dive, nonprofit organizations could receive greater reward for undertaking more significant risks.[23] As previously discussed, it is not unrealistic to envision a time when nonprofits might operate with reference to "Social Betas" that reward greater degrees of difficulty represented by working with homeless youth as opposed to operating a summer day camp for elementary age children. Both have a degree of difficulty and carry a certain risk exposure, but they are different and should be valued as such.

The challenge in calculating such Social Betas is not to be ignored. Establishing a beta that truly reflects the risk entailed by a specific organization's pursuit of its social mission driven goals may be extremely difficult to translate from one organization to another—even if both organizations target similar populations. While practitioners and investors may be able to work together to agree upon common assumptions to guide such a beta analysis, there is always the danger that some will orient themselves to meeting funder definitions of risk and mission as opposed to those that have true community value from the practitioner or community stakeholder perspective. The discussion of Social Betas presented in the previous pages attempts to recognizee that fact; however, we must also acknowledge that the present system is currently driven by funder priorities and definitions of which strategies are most appropriate. If those experimenting with SROI analysis take great care not to simply replicate the existing problems and engage practitioners in an honest discussion of risk and reward as we move forward, perhaps we will create a system that is at least not as dysfunctional as certain elements of the present one.

Closely related to the previous concern, the fourth criticism is that the proposed SROI framework, being grounded in economic development, naturally lends itself to modified econometric measures, whereas other program activities, such as artistic or recreational programs, are not so easily analyzed. While falling short of the Social Value activities previously discussed, these areas of nonprofit activity are felt to be more difficult to assess, the "returns" more challenging to quantify.

This fourth criticism may be expanded upon when one considers the fact that the SROI framework as presented presumes those involved in the analysis represent some level of cost to the public system—for example, those receiving general assistance or other public support. However, there are those who are so far outside society's mainstream that they received virtually no public support, making an SROI analysis based upon public sector cost savings inapplicable to their situation.

Were we presenting the SROI framework as some form of definitive measure of value, we would be concerned by these and other limitations one may identify. However, our position is that, on the whole, traditional frameworks for understanding value creation in the nonprofit sector have not been adequate. The SROI framework is presented as simply one way to understand value creation. Given that it has evolved out of our work in the field of social purpose enterprise development,it is only natural it reflect that discipline and have limited direct applicability across the board in a variety of other contexts.

We do feel, however, that while it is not directly applicable to other areas of work, the fundamental tenets are, namely, that all nonprofit organizations, regardless of activity, can develop and apply appropriate metrics to assess the relative worth of their efforts—whether economic, socio-economic or social. If one never attempts to create new metrics, one will never have such metrics to apply. Which leads us to the final concern.

The fifth and final area of strategic criticism is that many practitioners and funders are simply not willing to begin the dialogue at all. These individuals would rather defend existing "evaluation" measures than assess whether those measures are as useful as possible or truly capture the full value of their work. There are certainly many gifted and talented individuals steering foundation and governmental funds into excellent programs and organizations in the nonprofit sector. However, it would also appear that some individuals are more comfortable with their positions than with the idea of acknowledging the potential for program failures or funder shortcomings and taking steps for changing both.

For example,in a recent list-serve discussion one of the authors of this paper challenged the integrity of the field's evaluation systems and metrics, only to have a respondent to his post chafe at the perceived slight and state that he "shuts down" when anyone challenges the integrity of his reporting. Such delicate sensitivities do not serve the nonprofit sector well. If we cannot question and challenge the dominant approaches to documenting the effectiveness of organizations that address poverty and social problems in this country, we are clearly in much worse shape than many have thought.

Furthermore, it makes no sense to create systems of reporting and accountability when decision-makers on both sides of the funding table may disregard the information or are largely unaccountable to the donors they represent or communities they serve. Overcoming this challenge remains an important part of the change process for creating widely embraced systems able to track and calculate social impacts, and is yet one more reason nonprofits and funders alike will be disinclined to attempt this task.

The Imperative of Pursuing SROI Strategies

Each of these concerns and criticisms is valid to a point. They are raised by intelligent individuals with the same strong commitment to social change as the advocates of SROI analysis. And it would be easy to simply accept their observations as a rationale for not moving ahead with implementation of an SROI framework.

However, with these factors in mind,simply because a task is difficult or represents a shift in thinking does not mean one should not pursue it. We strongly suspect that the work of the nonprofit sector has historically been grossly undervalued. In many instances, we have simply accepted the notion that there are no metrics by which the value created in the nonprofit sector may be assessed.

There are a number of significant efforts currently in process to create better management information and tracking systems for use by both nonprofit managers and those who invest in their work. Such efforts range from the leading work of Coastal Enterprises in Maine, to that of the Corporation for Enterprise Development in Washington, DC, to Pioneer Human Services in Seattle, and beyond.[24]

However, on the whole the sector has not aggressively addressed how to measure or track the value created by nonprofits, whether social or economic. Rather than apply itself to the challenge of isolating, quantifying and documenting the unique and nuanced value creation process taking place in the nonprofit sector, the field,as a whole,has simply allowed a resource allocation system to evolve which is grounded more in politics, persuasion and perception than rational analysis or the application of standards to which the work of the sector could be held.

This is not only intellectually lazy; it is morally wrong. Increasing numbers of nonprofits compete for a wide variety of often decreasing financial supports. This is a time when we expect even the poorest among us to justify their receipt of TANF or General Assistance benefits through measurable outcomes of a changed life. We cannot simply award grants because an organization has a gifted grant writer or director with a vision that enthralls. We must tie financial support with the demonstrated impact of the actions made possible by such support.

We should not compare different strategies in words alone, but in numbers and metrics that capture socio-economic value, for we are talking about making investments of scarce resources in efforts we hope will create yet greater social, economic and other value—which does, in turn, lend itself to at least some level of measure and analysis. Numbers and rates of return are not the only tools we may take to this task, but are a good starting point for understanding what is and is not subject to analysis.

There are four additional reasons we should attempt to quantify and measure the work of the nonprofit sector:

First and perhaps foremost, ***efforts to quantify the economic value of nonprofit activities help lay the foundation for the creation of management information systems that managers and others involved in program operations may use to isolate problem areas and develop more effective oversight of their intervention strategies.*** The majority of nonprofit, tax-exempt organizations active in this country do not have information systems sophisticated enough to engaged in the type of analysis presented in this paper. While this is the status quo, it cannot remain so. Any effort to track the long-term impact of

a program requires the establishment of data systems that can continually feed information back to program managers and others involved in the development and execution of various intervention strategies. With such client/consumer information systems in place, managers may receive real-time feedback upon which to base decisions regarding the structure, goals and components of their programs.

Managers want such information and will work hard to guard the integrity of reporting systems they view as valuable to their own effort to provide clients, customers and program participants with high quality services. Foundations and public sector funders must make the commensurate investment in capacity-building and administrative infrastructure necessary to create and maintain such information systems. To make social investments in strategies with no documentation or impact assessment capacity is almost as bad as not making any investment at all.

Second, ***meaningful efforts to quantify the true value of various nonprofit activities have the potential to help advance the creation of significantly greater community ownership and accountability.*** In order to establish meaningful measures, debates need to be held, assumptions challenged and nonprofit managers assisted in more clearly enunciating their own strategies for change. While this can certainly be a "closed" process, the opportunity exists for engaging a much broader segment of our society in these same debates regarding expectations, outcomes and measures of success. This process of defining outcomes could easily involve a cross-section of our communities. In so doing we have the potential for re-engaging citizens in the work of a nonprofit sector presently dominated by professionals paid to address social problems on behalf of those same communities and our society at large. The process of enunciating community goals for social and other programs presents us with a powerful tool for community organizing and civic empowerment.

Third, ***the larger outcome of such efforts lays the groundwork for embracing standards and commonly shared values for performance in the nonprofit sector.*** Presently, there are only the vaguest cross-cutting standards in place by which nonprofit organizations may be measured or to which they may be held accountable. By engaging professionals and community residents in a process of enunciating expectations and goals, through establishing systems of measurement to track performance toward those goals, we may move the sector as a whole toward a day when standards (but not mindless standardization) are widely understood and broadly embraced.

It is easy to be overwhelmed by the issues such an effort would raise and to simply stop before such a system could be created. We have already posed a number of such questions and others remain:

- How does one compare the relative value of two seemingly similar programs?
- What operating systems need to be in place for all nonprofit accounting systems?
- How do we know a program is approaching its work with the appropriate balance of administrative and program supports?

Regardless, we believe that the creation of performance standards, necessary for the long-term success of calculating any individual organization's social return on investment, will only improve the overall performance of the sector as a whole.

This process could be pursued and achieved in a variety of ways. In other writings we have called for the creation of a "Moody's Socio-Economic Credit Area" that would score and rank a wide array of nonprofit organizations, assigning what would in essence become nonprofit bond ratings to help guide the charitable investments of donors and government funders.[25] Organizations such as GuideStar and the National Charities Information Bureau are working to develop both financial reporting standards and nonprofit financial ratio analysis by which potential funders and individual donors may assess relative "philanthropic investment" opportunities. Regardless of how they are pursued, the potential value of standards against which to measure our efforts is an important reason to support the creation of strategies for the calculation of SROI.

Finally, this evolving pursuit of standards and quantified measures of outcomes will ultimately lead to a more significant infusion of capital to support the work of the nonprofit sector. The initial source of such capital may be the public sector, as grant making and contract awards become increasingly based upon the ability of competing nonprofits to present credible documentation of how their efforts result in significant social impact and cost avoidance on the part of government programs and funding streams. These funds would then constitute a true revenue stream that could be viewed as a form of a cash flow generated by virtue of investments in the nonprofit organization providing services to clients and social benefit to the community.

A central part of the SROI analysis is built upon the notion that the economic value of social programs comes in the form of costs presently being carried by one industry (say, for example, community corrections or emergency health services), being decreased by another (for example, jail diversion or primary health care programs). When nonprofit organizations develop the management information and data systems required to accurately calculate SROI they will, in the process, be building the documentation with which we can engage public sector funders in discussions regarding reimbursement of expense and services contracting based on the actual, as opposed to projected or poorly documented, impact of social and other programs. By layering a financial analysis template on top of these systems, we will then be able to understand how investments of nonprofit capital are tied to the achievement of social return.

While the initial capital could be found in the public sector, of ultimately greater significance are the potential funds that might be generated in private capital markets made up of individual donors and investors. These funds could then be leveraged to the greater benefit of the nonprofit sector. Presently, various groups and causes compete for the same individual donor dollars with little reference to objective criteria of performance or measures of return for those donor dollars. Through the creation of SROI and related systems, we have the potential of developing an approach to our work that directly rewards performance and increases the effectiveness of the nonprofit sector as whole.

Additional Readings in Social Return on Investment and Related Frameworks

If you made it through this chapter, you may also be interested in these other efforts to measure value creation in the social sector:

Documents you may be interested in reading:

- *Evaluating Social and Economic Effects of Small Business Development Assistance: Framework for Analysis and Application to the Small Business Assistance Programs of Coastal Enterprises, Inc.* (1996) by Josephine LaPlante, Edmund Muskie Institute of Public Affairs, University of Southern Maine, Box 9300, Portland, ME, 04103-9300, (207) 780-4863.

  An absolutely excellent presentation of both the challenge of evaluating "impact" and a review of a variety of approaches to doing so. Presents frameworks for assessing the impact on people's lives, as well as benefits to government/society. This report is the most thorough, current review of literature and issues we have seen to date.

- *High Performance Nonprofit Organizations: Managing Upstream for Greater Impact*, (1999) by Christine Letts, Allen Grossman and William Ryan. Wiley and Sons.

  While not focused upon Social Return on Investment issues, this primer is on how nonprofit management may best address the challenge of setting and achieving organizational and program goals. It is an excellent addition to the library of anyone interested in how to achieve the most effective results for one's charitable dollar.

- *Return on Investment: Guidelines to Determine Workforce Development Impact*, (1996) by Dennis Benson, Appropriate Solutions, Inc. 511 Garden Drive, Worthington,OH, 43085-3820, (614) 840-0466 (Document Distributed by: National Association of Workforce Development Professionals,202-887-6120).

  In his treatment of the subject, Benson outlines three types of ROI (ROI to Taxpayers, Disposable Income and Economic Impact), while making a concise

and user-friendly presentation of the basic concept of ROI and how it may be applied to workforce development programs.

Related work you should know about:

- Success Measures Project
(Kathy Tholin, SMP Project Director, Development Leadership Network, 601 S. LaSalle Building, #D-514, Chicago, IL, 60605, (773) 486-8804).

A practitioner-driven process, the SMP is a multi-year initiative to create a commonly embraced set of measures by which community development practitioners may assess the impact of their work. Operating through a number of working groups, practitioners are proposing potential success measures in the areas of housing and business development, as well as comprehensive community initiatives. The goal of this ongoing effort is to publish a Success Measures Guidebook in 2000. While it does not tie these measures back to the capital investments required to achieve the stated impact, the SMP represents a significant effort by practitioners to specify how best to assess the impact of community development efforts.

- SmithOBrien
(www.smithobrien.com)

SmithOBrien is a management consulting and research firm that helps companies operate responsibly, in ways that quantifiably increase profitability. S/O's services are built on a simple premise: organizations that build mutually beneficial relationships with all stakeholders— including employees, customers, the community, and the environment—uncover opportunities for, and eliminate barriers to, competitive advantage. They have developed two interesting approaches to valuation of both economic and non-economic factors: The Corporate Responsibility Audit and the Econometric Impact Index. Both these tools are used to assist for-profit corporation and governmental leaders in their decision- making process.

- London Benchmarking Group
(www.philanthropy.org/benchmarking/contents.html)

The push for greater accountability and measurement of social impacts is not only coming from the foundation and practitioner communities, but is increasingly reflected in the work of the business community as well. The London Benchmarking Group is a working group of for-profit corporations developing templates for quantifying the impact of corporate community involvement and related activities.

- Balanced Scorecard

Presented in an article by Robert Kaplan and David Norton, published in the 1996 January-February issue of the Harvard Business Review, the Balanced Scorecard approach is not a form of SROI, but does present a framework for understanding value creation process of both for-profit and tax-exempt organizations. The Scorecard measures performance against four perspectives—financial, customer, internal business processes and learning and growth—in order to understand what drives performance and how organizations achieve improved performance. The Balanced Scorecard approach has been used to assess performance of such organizations as The Special Olympics, United Way and New Profit, Inc.

- Public Health Research

Many of us are generally familiar with the application of cost/benefit analysis in the arena of public health services (a dollar spent on polio vaccine generates $25 in benefit to society, etc.). Given the significant work already done in this field, a review of how public health practitioners understand social/health impacts is of value to those exploring concepts for valuing social impact alone. Of particular interest are the following articles:

"Toward the Incorporation of Costs, Cost-Effectiveness Analysis and Cost-Benefit Analysis Into Clinical Research," Brian Yates, Journal of Consulting/Clinical Psychology, Vol.62,#4,1994.

Clinical Decision Analysis, Chapter 8: "Clinical Decisions and Limited Resources," Weinstein and Fineberg.

"500 Life-Saving Interventions and Their Cost-Effectiveness," Tammy Tengs, et al., Risk Analysis, Vol.15, #3, 1995, pg. 369.

SOCIAL COSTS SURVEY

The following social costs survey was developed by REDF Portfolio investees with BTW Consultants. It reflects the strategy, priorities and populations of the REDF Portfolio. While it is provided by way of example, the reader should be cautioned that the process of developing such tools is in many ways more important than either the tool itself or the ultimate data such a tool may generate. If the process is forced or if managers and other staff are not fully invested in the process, the data will be subject to the classic problem of "garbage in, garbage out." Each organization in the REDF Portfolio was offered the option of either being funded to conduct the interviews internally or having BTW Consultants conduct the interviews. Future REDF publications will discuss how these tools—both the survey and web-based reporting systems—were developed and the challenge of doing so.

REDF Portfolio Business Name Baseline Employee Survey

Date: _____/_____/_____

Interviewer: ____________________________________ Employee Name: ________________________________

Name of REDF Portfolio Business:

- Name of Business A
- Name of Business B
- Name of Business C
- Name of Business D

Employee I.D.

First 3 Letters of First Name: ____ ____ ____

First 3 Letters of Last Name: ____ ____ ____

Date of Birth: ______ / ______ / ______
month day year

INSTRUCTIONS TO INTERVIEWER

Please read the following to your client before starting this assessment:

Thank you very much for taking the time to speak with me today. This interview is part of a study of how Name of REDF Portfolio Organization programs that provide work opportunities make a difference in people's lives. Also, by speaking with people like yourself directly, we can better understand what kind of support you need in order to become successfully employed.

Everything we discuss will be kept confidential, which means that there will be no way of linking your name to your answers. I would like to ask you some questions about your current housing situation, your work history and the kinds of support services you use. There are also some general questions about how you describe yourself and your situation.

Some of these questions are personal. However, I would appreciate your honest answers, remembering that everything will be kept confidential and that your answers will not be used in any way to influence decisions made by your business manager or supervisor. Still,if there are questions you are uncomfortable answering, please let me know and we will skip that question and continue with the interview.

The interview should take about 20-30 minutes. Do you have any questions before we start?

Living and Housing Situation

1. How would you describe where you live? *(Check one)*

❑ In a rented apartment
❑ In a rented house
❑ In a house you own
❑ Public housing complex unit
❑ In an SRO Hotel
❑ In a transitional living program (halfway house)
❑ In a group home
❑ Shelter
❑ In an institution (jail, detention facility, hospital, treatment facility or other: ______________________)
❑ With several different friends and family members ("sofa-surfing")
❑ Street / Homeless
❑ Other: (specify)______________________
❑ No answer

2. How many people do you live with (not including yourself)?______________

❑ No answer

3. How satisfied are you with your current living situation?

❑ Very satisfied
❑ Satisfied
❑ Neutral – neither satisfied nor dissatisfied
❑ Dissatisfied
❑ Very dissatisfied
❑ No answer

Comments: ______________________
____
____
____

4. What do you currently pay for your monthly housing costs?

$ ____________________ per month

❑ Unsure
❑ Not applicable
❑ No answer

5. In the past six (6) months have you received Section 8 subsidy to help pay your housing expenses?

❑ Yes
❑ No
❑ Unsure
❑ No answer

Employment / Benefits

The following questions refer to jobs you may have had before getting a job with this REDF Portfolio business.

6. Approximately how many jobs have you had in your lifetime (not including your job with this REDF Portfolio business, if applicable)? _______
(If none, enter zero and skip to question 10)

❑ No answer

7. What was the longest period of time you've ever held a single job? _______ months

❑ No answer

8. Have you ever received a promotion?

❑ Yes
❑ No
❑ No answer

9. Have you ever been fired from a job?

❑ Yes
❑ No
❑ No answer
❑ Not yet employed by REDF Portfolio business.
Skip to question 15.

These next questions ask about your employment with this REDF Portfolio business. (If the interviewee has not yet been hired by REDF Portfolio business, check here ❑ and follow instructions in box.)

10. When did you begin working at REDF business?

Date: _____ / _____ / _____
mo day yr

❑ Not applicable
❑ No answer

11. In the past month, on average, how many hours did you work each week at this REDF Portfolio business? ________hours

❑ No answer

12. What is your hourly wage* at this REDF business? $___________/hour
**including tips,commissions,etc*

- ❑ Don't know
- ❑ No answer

13. What is your estimated annual salary* at this REDF business? $___________/year
**including tips,commissions,etc*

- ❑ Don't know
- ❑ No answer

Approximately how much income do you make per month from these work sources, added together? $_________/month

14. Do you receive income from any other work that you do?

- ❑ Yes
- ❑ No
- ❑ No answer

Use of Social / Support Services

15. Do you have health insurance, including private insurance or Medi-Cal?

- ❑ Yes
- ❑ No

16. Who pays for your health insurance?
(Check all that apply.)

- ❑ Self
- ❑ Employer
- ❑ Covered by spouse/parent/family member's plan
- ❑ Medi-Cal F How many months have you been on Medi-Cal? ______ months
- ❑ How many times have you used it in the past six (6) months? _____ times
- ❑ Other: ___________________________

17. Please specify if you have:
(Check all that apply.)

- ❑ Medical insurance
- ❑ Dental insurance

18. Does this insurance include coverage for any other family member's care?

- ❑ Yes
- ❑ No
- ❑ Unsure
- ❑ Not applicable
- ❑ No answer

19. During the past six (6) months, how many times have you gone to the emergency room for medical treatment? ______ times

20. Have you,in the past six (6) months, been to a public health or community clinic?

- ❑ Yes
- ❑ No
- ❑ No answer

Approximately how many times in the past 6 months? _________

21. During the past six (6) months have you received or used any of the following?

AFDC / TANF

- ❑ Yes
  # of months: _____________
  Approx.amount received monthly
  $ _____________
- ❑ No

Food stamps

- ❑ Yes
  # of months: _____________
  Approx. amount received monthly
  $ _____________
- ❑ No

Supplemental Security Insurance (SSI)

- ❑ Yes
  # of months: _____________
  Approx. amount received monthly
  $ _____________
- ❑ No

General Assistance (GA)

- ❑ Yes
  # of months: _____________
  Approx. amount received monthly
  $ _____________
- ❑ No

- ❑ None of the above
- ❑ No answer

22. Have you, in the past six (6) months, participated in any type of substance abuse treatment program (AA, residential or outpatient)?

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

23. Have you, in the past six (6) months, participated in any type of mental health program or counseling?

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

24. Have you, in the past six (6) months, gotten bags of groceries from a community food bank, eaten meals at an agency, or received food from another source?

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

25. Have you, in the past six (6) months, accessed any other support services in your community, such as shelter services or case management?

❑ Yes
❑ No
❑ No answer

(If Yes) What other services have you used?

Case Management

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

Outreach/Drop-in center

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

Housing (shelter, group home, transitional living)

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

Legal/advocacy services

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

Other

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

Other

❑ Yes
Approximately how many times in the past 6 months? __________
❑ No
❑ No answer

Criminal Justice History

26. Have you ever been convicted of a crime?

❑ Yes
❑ No *(Skip to Question #29)*
❑ No answer

27. Have you been convicted of a crime in the past six (6) months?

❑ Yes
❑ No
❑ No answer

28. Are you currently on probation or parole?

❑ Yes
❑ No
❑ No answer

For this next section I will read a statement, and I want you to tell me how much you agree or disagree with the statement. The choices are:

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

How I Feel About My Life

29. There are a lot of people I like to hang out with.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

30. I like to get together with friends as much as possible.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

31. I have people in my life who really care about what's happening to me.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

32. If for some reason I were put in jail, there are people I could call who would bail me out.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

33. If I were sick or hurt bad and I needed someone to take me to the hospital, I would have no trouble finding someone.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

34. If I were hungry and had no money to buy food, there are people I know who would give me food.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

35. If I were in trouble and some people were going to try to hurt me, there are other people I could get protection from.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

How I Feel About Myself

36. I feel that I have a number of good qualities.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

37. Overall, I am happy and satisfied with myself.

- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

38. Overall,I feel that I am a failure.

- ❑ Strongly agree
- ❑ Agree a little

- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

39. At times, I think I am no good at all.
- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

40. At times, I feel useless.
- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

41. I feel socially accepted.
- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

42. I have a lot to be proud of.
- ❑ Strongly agree
- ❑ Agree a little
- ❑ Neither agree or disagree
- ❑ Disagree a little
- ❑ Strongly disagree
- ❑ No answer

Please tell us about yourself

The next several questions are about your background. Again what you include here is confidential and your name will not be included with this information. If there are any questions here that you feel uncomfortable answering, please let me know and we can skip them.

43. Indicate respondent's gender:
- ❑ Male
- ❑ Female

44. How old are you today? ________
- ❑ No answer

45. What is your race/ethnicity? (Interviewer: Ask question as worded and allow respondent to specify race/ethnicity. Code their answer into one of the categories below)
- ❑ African American
- ❑ Asian/Pacific Islander
- ❑ Latino/a
- ❑ Native American / Alaskan Native
- ❑ White
- ❑ Other (specify)__________________________
- ❑ Multi-ethnic (specify) __________________________
- ❑ No answer

46. What is the highest level of education you have achieved? *(Check one)*
- ❑ Middle school / Jr. high school graduate
- ❑ Some high school
- ❑ G. E. D. / high school graduate
- ❑ Some college
- ❑ Associates' (AA) degree
- ❑ Bachelors' (BA) degree
- ❑ Masters' (MA) degree
- ❑ Doctorate
- ❑ Don't know
- ❑ No answer

47. Have you attended any post-high school trade/technical training?
- ❑ Yes
- ❑ No
- ❑ No answer

a. Did you complete / receive certificate?
- ❑ Yes
- ❑ No
- ❑ No answer

48. Prior to your involvement with this REDF Portfolio business, had you ever participated in a job training program such as JTPA (Job Training and Placement Assistance)?
- ❑ Yes
- ❑ No
- ❑ No answer

Did you get a job as a result of joining this program?

Name of Program:

____

How long were you employed?

- ❑ Yes
  # __________ months
- ❑ No
- ❑ No answer
- ❑ Unsure

Name of Program:

____

How long were you employed?

- ❑ Yes
  # __________ months
- ❑ No
- ❑ No answer
- ❑ Unsure

Name of Program:

____

How long were you employed?

- ❑ Yes
  # __________ months
- ❑ No
- ❑ No answer
- ❑ Unsure

Name of Program:

____

How long were you employed?

- ❑ Yes
  # __________ months
- ❑ No
- ❑ No answer
- ❑ Unsure

Name of Program:

____

How long were you employed?

- ❑ Yes
  # __________ months
- ❑ No
- ❑ No answer
- ❑ Unsure

49. Do you currently have any dependent children (children 17 years old or younger who you are financially responsible for)?

- ❑ Yes
  Number of Children ________________
  Ages of Children ___________________
  ____
- ❑ No
- ❑ No answer

50. How often (if ever) during the past six (6) months have the following things made it difficult for you to find or keep a job?

Lack of childcare

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Lack of transportation

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Need for education/skills training

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Adult family member who needs care

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Unstable housing

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Cultural/language issues

- ❑ Regularly

- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Legal issues

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Physical health issues

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Emotional health issues

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Other ____________________

- ❑ Regularly
- ❑ Sometimes
- ❑ Almost never
- ❑ Never
- ❑ No answer

Interviewer Comments/Observations: ____________________

Contact Information

READ: You may be contacted in 6 months to complete a follow-up to this questionnaire. If you agree to come back for the follow-up interview you'll be given a [gift certificate, voucher, etc]. We'll be asking some similar questions to those I just asked you to see if things have changed for you over time. So I want to make sure we'll be able to reach you in 6 months.

If you have a phone number, in whose name is the phone listed? ____________________________

What is your phone number? (___________) ___________—_____________________

Is there another phone number where you can usually be reached?

(___________) ___________—_____________________

- ❑ Telephone (whose? ______________________)
- ❑ Pager
- ❑ Voicemail
- ❑ Other: _______________________________________

To what address could we send you a notice in 6 months to schedule a follow-up interview?

Address:____ Apt.#_________________

City: ____State _____ Zip:_____________

In case we have trouble reaching you, we would like to have the names of two people (such as a grandparent or parent) who would most likely know how to reach you or who you keep in close contact with. The only reason we would contact these people would be if we cannot locate you when we do our follow-up evaluation.

FIRST CONTACT:

Name: ____

Relationship ____

Address:____ Apt.#_________________

City: ____State _____ Zip:_____________

Phone: (___________) ___________—_____________________

SECOND CONTACT:

Name: ____

Relationship ____

Address:____ Apt.#_________________

City: ____State _____ Zip:_____________

Phone: (___________) ___________—_____________________

Footnotes

1 During prior periods, evaluation services were provided by Harder+Company Community Research, however, in 1998 the principals involved in the REDF work launched their own firm, BTW Consultants.

2 See "WebTrack and Beyond: Documenting the Impact of Social Purpose Enterprises", Chapter 7 of this book.

3 "The Meaning of Social Entrepreneurship," J. Gregory Dees, paper published in October, 1998.

4 The reader should know that Mark Moore of the Hauser Center, Kennedy School of Government, (Harvard University) has presented a framework for understanding "Business Value" and "Public Value." Business Value focuses primarily upon issues of financial and competitive performance. Public Value addresses issues such as Legitimacy and Support, as well as such factors as Social Capital, Advocacy, Client Services and Channels for Self Expression (such as volunteerism, board participation and other forms of engagement). The REDF framework focuses primarily upon understanding Socio-Economic Value, as defined in this paper, and was conceived apart from Dr. Moore's substantial work and contributions to the field.

5 These quotes are taken from a personal email from Greg Dees to Jed Emerson as they debated the nature of Social Value and efforts to describe its essence.

6 While this specific definition of Transformative Value is the author's, the label itself was coined by Chris Letts of the Hauser Center, Kennedy School of Government,(Harvard University).

7 The consulting group of SmithOBrien has developed what it calls a "Full ROI Assessment" which attempts to conduct just such an analysis of for-profit corporations.

8 Please see the chapter on True Cost Accounting for a description of this issue.

9 *Evaluating Social and Economic Effects of Small Business Development Assistance: Framework for Analysis and Application to the Small Business Assistance Programs of Coastal Enterprises*, Josephine LaPlante, Ph.D., Edmund Muskis Institute of Public Affairs, University of Southern Maine, pg. 215.

10 While this is generally the case, it must also be acknowledged that loan officers and lending institutions do have a great degree of flexibility when it comes to how loans are structured and what rates are charged for loaned capital.

11 For a presentation of this initial framework please see *New Social Entrepreneurs: The Success, Challenge and Lessons of Social Purpose Venture Creation*, published in 1996 by The Roberts Foundation and available at www.redf.org.

12 It should be acknowledged, however, that these funds are not truly "no cost" to the grant recipient in that most nonprofits invest significant staff and board time and resources in soliciting and meeting the demands of outside funders, whether foundation or governmental. While technically such funds do not carry a discount rate, realistically they do come with some degree of expense.

13 Please see the chapter entitled, "The U.S. Nonprofit Capital Market: An Introductory Overview," for additional information on PRIs and how they fit within the capital structure of nonprofit organizations.

14 It has also been argued that, in fact, the appropriate starting point for calculating a discount rate for use in an SROI calculation is negative 100% given that no principal is returned to the investor/foundation. This issue will be addressed in future SROI papers, but for the present,since the standard for the field is not to assume a –100% starting point we will save that issue for future discussions.

15 The following overview of Social Betas was written by Steven LaFrance of BTW Consultants, in consultation with Fay Twersky of BTW Consultants and Jed Emerson.

16 To our knowledge, the idea of applying a test of "degree of difficulty" in SROI analysis was first advanced by Carol Guyer of the James C. Penny Foundation.

17 For a full discussion of the information management activities undertaken by REDF with its portfolio, please see Chapter 7, WebTrack and Beyond.

18 For a discussion of Equity values in this context, please see the Chapter 9.

19 Please see the chapter entitled, "True Cost Accounting" for further discussion of this challenge.

20 In truth, the question is even larger than that: Was it the program, the parents, the peers, the teacher and so forth. For the purpose of simplicity, the issue is causality and we will simply leave it at that!

21 *Return on Investment: Guidelines to Determine Workforce Development Impact*, Dennis Benson, Appropriate Solutions,1996.

22 This is not an actual quote, but simply a concern of the authors!

23 This analogy was first made by Carol Guyer, of the James C. Penny Foundation.

24 See "Documents You May Be Interested in Reading" in the following pages for a brief presentation and references to the work of several organizations that may be of interest.

25 Please see "Grants, Debt and Equity: The Nonprofit Capital Market and Its Malcontents," a chapter in *New Social Entrepreneurs*.

Chapter 9

Riding on the Bleeding Edge: A Framework for Tracking Equity in the Social Sector and The Creation of a Nonprofit Stock Market

Riding on the Bleeding Edge: A Framework for Tracking Equity in the Social Sector and The Creation of a Nonprofit Stock Market

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Based upon either the creation of an SROI framework or other greater ability to measure the creation of socio-economic value in the nonprofit sector, we now present a vision of our future that some might view as radical or bleeding edge:[1]

We propose that a number of forces are moving which make it possible to envision a time when the nonprofit sector organizes itself to support a Nonprofit Stock Market.

This idea, while obviously entailing a number of significant challenges, will become increasingly viable due to the following factors, each of which builds upon the other:

First, with the significant transfer of wealth from Baby-Boomer parents to their children over coming decades, it is estimated that over $4 trillion will change hands between generations. These funds will be controlled by individuals who have benefited greatly from the rise in the stock market of past years. They understand investing and demand accountability. They have the ability to contribute significant amounts of new capital to the nonprofit market; however, they distrust much of the existing system available to them to guide their giving.

Second, these new donors will demand new forms of information to steer their investments in the nonprofit sector, in the same way they demand information regarding their for-profit investments. The reality is that the nonprofit sector in many ways represents an illiquid capital market where a lack of objective information prevents the market place from attracting new and possibly larger amounts of capital. In the absence of such objective information, those who seek funding are forced to compete by means of pleas and pitches—not by the presentation of a rational explanation of why their particular strategy has been most effective or should receive increased financial support.

Third, the information and analysis increasingly demanded by potential donors will become readily available in credible forms not available in the past. GuideStar and related efforts will become more refined and through their efforts "raw" financial information regarding individual nonprofits—in the form of on-line access to IRS-990 forms and other data—will become readily available to donors in search of "objective" information. While GuideStar is working to assure that information they provide donors about nonprofits is well organized and has integrity, the raw data will be available to any who would download it, thereby making it susceptible to misuse and misinterpretation.

Fourth, the nonprofit sector will therefore increasingly need a process whereby organizations sharing similar areas of interest and strategies will be drawn into a discussion of standards, measures and analytic frameworks by which this new information will be weighed and assessed. The nonprofit capital market is already showing signs of this shift from charitable giving to a demand for philanthropic investing in social change strategies with a demonstrated track record of success—this trend will only continue and those managing nonprofit organizations will have to create a coordinated response.

Fifth, in future years the combination of available raw financial data and the efforts to establish performance standards will lay the foundation for the creation of organizations (both for-profit and nonprofit) that may operate in the manner of "nonprofit rating services." These entities will analyze data, assess industry standards and then "rate" the performance of nonprofit organizations competing for funds in the capital market.[2] There are increasing numbers of consultant organizations conducting "social audits" of for-profit corporations in order to inform both managers and shareholders about the performance of the corporation, and the same approach will evolve in the nonprofit sector.

Sixth, over the next decade, with these forces in motion, nonprofit organizations and those supporting their work will be forced to increase the capacity of the sector to create information management systems that can track social impact and performance measures embraced by the sector. As is the case with the REDF WebTrack System, these information and data tracking infrastructures will become increasingly viable as one way to measure both performance and the social return on investment generated by philanthropic and public sector funding. This "objective" data will be complemented with more qualitative, social impact reporting to form a baseline against which others will have to compare their own efforts.

Seventh, for the first time we will have the ability to describe an Industry Index for a given area of nonprofit activity. For example, there could be a performance index for youth programs serving different youth with varying presenting issues. Namely, we will be able to tie investments to results and compare organizations within a given market segment or cohort.

Eighth, we will come closer to understanding what elements of Social Value truly are beyond measurement. These areas will be vetted and supported on the basis of their uniqueness and intrinsic worth. Within a given organization or segment, we may be able to isolate elements that are immeasurable and value them for what they are. We will understand that it is the combination of both Socio-Economic and Social Values that creates the rationale for the sector as a whole and the legitimacy of supporting its development and work.

Finally, we will be able to more directly link documentation of social impact with grant making, individual donations and other funding decisions. But that is not all. We will build more rational arguments for increasing the availability of funds to various programs and under-capitalized areas of the nonprofit sector based on the social share earnings. In the future, we will be able to create systems that may more fully compensate nonprofit managers and service providers for actual demonstrated increases in the Socio-Economic Value they help create. Some may think it a terrifying concept to pay social workers based on the amount of Social or Socio-Economic Value they create. But increasingly we may be able to, based on this Socio-Economic Value created, track the social equity being generated in the sector through the shifting worth of any given organization's social share value—set by its generation of social earnings in the nonprofit market place.

With these metrics in place, individual charitable "investors" will be able to track the performance of their investments and even engage in trading shares at various class levels or leaving shares to heirs who would inherit a legacy of philanthropy. By extension, donors sharing similar interests might organize themselves into groups, similar to donor advised funds operated by many community foundations. These groups could organize their philanthropic gifts or investments into pools of similar nonprofits, each of which would meet baseline performance and social return criteria. These groups would then become the equivalent of charitable mutual funds—receiving investments, tracking social, socio-economic and economic "returns" to the investors. In this way, we have the potential to create a Nonprofit Stock Market wherein organizations receive annual performance reports tracking the activities of the sector over each quarter, year and decade.

In such a market, donors may purchase equity "ownership" in nonprofit organizations, tracking the social earnings and SROI of their charitable portfolio in the same way they would any other investment of capital. Through a variety of offerings, we could for the first time define the various returns and instruments lying along the continuum moving from socially responsible, for-profit investing to charitable giving. In so doing we will create an expanded capital market with new players bringing greater and greater amounts of capital into the nonprofit sector as they buy and sell "shares" in "community futures" and related commodities.

Other chapters in this book have addressed the challenge and opportunities of building management information systems to track social impact and value creation. With these systems in place, we may then pursue a shift to performance and outcome funding based upon the sector's true SROI. As performance comes to be tied directly to funding, moving funding decisions away from "grants" and toward "reimbursement for social value generated," it may even be possible to create actual financial cash flows to convert the projected socio-economic value of social programs to real economic value in the market place. Such a process would convert the imputed value of an SROI analysis into true,financial value that may then be tied back to the original investment that made that value possible.

As the balance of this chapter describes, how value creation is assigned—whether to investor, community, program participant or nonprofit in the form of organizational equity—will need to be determined.

Regardless, there is now the potential to:

a) quantify the economic value generated by nonprofit organizations,

b) return that economic value to those that created it (e.g. nonprofit organizations

and their various community investors/ stakeholders) and

c) create a system by which nonprofits could be capitalized today based upon their projected future "social earnings" in years to come.

Now, for some the notion of a Nonprofit Stock Market may be the ultimate incarnation of a social nightmare whereby the effort to quantify value creation in the nonprofit sector has run fully amok. And, to be sure, there are certainly many challenges to be overcome if we are to achieve the ultimate potential represented by such an initiative. However, the fact that a goal carries some degree of risk does not mean we should not attempt to attain it. In the end, we will not be able to quantify everything. And there are certain efforts that should receive our charitable support simply because it is the "right" thing to do. However, the more we are able to quantify and track the social return on investment of those efforts that are quantifiable, the more we will appreciate and treasure the value of those things which are not.

Social Share Value, Social Earnings and Equity Ownership

How would this system of "investing" in nonprofits operate? How would a donor (whether individual, foundation or government) be credited for the value the investment makes possible? To begin addressing these questions, we must first understand how the current nonprofit capital market operates.

In traditional forms of philanthropy, a variety of funders might support various components of a nonprofit's operations. If a single foundation is fully underwriting the cost of an organization's development or a given program, that foundation will document the work of the program, taking "credit" for the effect of its grant in its annual report or similar documents. In essence, the foundation is reporting on its social return on investment.

In those cases where multiple foundations are supporting the same program, all funders report the total numbers generated by the program as being the "return" on their grant. Therefore, three funders providing $25,000, $50,000 and $100,000 grants to the same job-training program making 230 placements would all report that their grant support helped make 230 placements possible. This approach makes no allowance for assigning appropriate returns to funders taking greater risk or investing significantly greater resources in a given organization or strategy. Nor does it reward "social investors" for investing greater amounts in a given organization, save for possible "naming opportunities" or the generation of a modest side-bar in a local newspaper acknowledging a large grant.

While it is important for individual foundations to track the specific returns generated by their charitable investments,it must also be acknowledged that no single investment generates the total return. For example, a nonprofit may provide job-training, counseling and child-care services to its client customers. These services are all administered by the organization's managers, and while each program participant may access services differently, it is the composite impact of the organization's work that makes for the success both of individual participants and the organization as a whole.

Therefore, rather than simply attempting to calculate a return on the individual grant made by an outside foundation, it is more useful for funders to understand their investment as contributing to a total return that is, in effect, leveraged against other investments made in that same time period. What any foundation grant "buys" is not simply the single program funded by that foundation. The funder is also "buying" the added value of the organization's administration (which may or may not be covered

by the grant), other programs from which the funded program benefits, and other elements that make for the success of a given nonprofit organization.

In addition, it should also be understood that there is a residual value of all prior investments—what we call “organizational equity”—which constitutes the social value of the nonprofit organization and, collectively, the sector as a whole. While all philanthropic investments (e.g. grants) come into the organization in the form of cash assets and these assets may be spent down, over time they also build intellectual capital within the organization itself (i.e. “We know how to work with this population” or “We know how to build this type of affordable housing”). In our framework, during the investment period, the value generated accrues to the investor, but at the end of the investment period (e.g. when a grant is not renewed) the value created is retained by the nonprofit itself. In this way the organization builds not only “hard” assets in the form of buildings and equipment, but “soft” assets in the form of goodwill, intellectual capital and staff expertise.

As stated above, several dilemmas surface in attempting to structure this analysis:

How does one assign equity value for each investor in a given year?

How does one account for a prior year’s philanthropic investments?

Is it possible to calculate the residual value of such investments as the organizational equity any nonprofit brings to the table?

If so, how does one then track additional investments in future periods?

In an effort to begin to address these questions, the following section of this chapter presents a framework by which philanthropic “equity” investments may be viewed, measured and valued relative to a variety of shareholders and the nonprofit “owner” (e.g. the nonprofit organization itself).

The Fundamentals of For-Profit Equity Structures

We must first understand how equity and investments are treated in the for-profit sector. A sample scenario for the assignment of equity in a for-profit start-up is presented as follows:

An entrepreneur starts a business with an initial investment of $1,000,000. Over the course of that year, the assets of the business are applied in the market place and the value of those assets increases by $200,000, providing for a year-end total value of $1,200,000 for the business, with no change in ownership position.

Beginning Year 1	Total Value	Percent Ownership
Owner 1	$1,000,000	100%
Asset Value Increase	$ 200,000	
End Year 1	$1,200,000	

At the beginning of Year 2 a partner is introduced who brings an additional $1,000,000 to the table. Owner 1 retains the increase in value from Year 1, but her equity position is decreased to accommodate the presence of the new partner. The business value increases by $800,000, for an End of Year 2 value of $3,000,000.

Beginning Year 2	Total Value	Percent Ownership
Owner 1	$1,200,000	54.55%
Investor 1	$1,000,000	45.45%
Total	$2,200,000	100.00%
Asset Value Increase	$ 800,000	
End of Year 2	$3,000,000	

At the beginning of Year 3 another investor is introduced who also brings an additional $1,000,000 to the table. Owner 1 and Investor 1 share the $800,000 increase in value from Year 2 in accordance with their equity positions in the enterprise.

Beginning Year 3	Total Value	Percent Ownership
Owner 1	$1,636,400	40.91%
Investor 1	$1,363,600	34.09%
Investor 2	$1,000,000	25.00%
Total	$4,000,000	100.00%
Asset Value Increase	$1,000,000	
End of Year 3	$5,000,000	

During Year 3, the value of the assets increases by $1,000,000. At the end of Year 3 the trio share the increase in value of $1,000,000 based upon their percentage ownership position:

End of Year 3	Total Value	Percent Ownership
Owner 1	$2,045,500	40.91%
Investor 1	$1,704,500	34.09%
Investor 2	$1,250,000	25.00%
Total	$5,000,000	100.00%

At this juncture, the return on investment is calculated as:

End of Year 3	Calculation	Return on Investment
Owner 1	($2,045,500-$1,000,000)/$1,000,000	104.50%
Investor 1	($1,704,500-$1,000,000)/$1,000,000	70.45%
Investor 2	($1,250,000-$1,000,000)/$1,000,000	25.00%

The REDF Nonprofit Equity Framework:

Application of Social Earnings to Nonprofit Calculations of Equity and Social Return on Investment

This for-profit framework is similarly invoked for the assignment of nonprofit share value. At Time Zero, Owner 1 is understood to be the nonprofit organization itself, with subsequent "owners" including foundations, donors, community residents or other philanthropic investors. The investments made in this enterprise generate not only a financial return on investment, but also create net social cost savings for society. As demonstrated in other chapters of this book, those savings then constitute the basis for calculating the social return on investment to all shareholders—both community and investors (foundation, governmental, etc.).

Our first step in the nonprofit application of a share value framework is to recalculate the equity ownership position as presented above. Let us assume in our example that at Time Zero we have two equity owners: the nonprofit corporate owners and a single foundation investor. The total value of the organization is estimated at $5,554,654 which is the example used in the social return on investment framework presented earlier.

How does one account for prior year investments, such as grants made in 1994? Is it acceptable to calculate the residual value of such investments as the organizational equity any nonprofit brings to the table? For the purpose of our present analysis, we have decided to "freeze" the assets of the organization at Time Zero and equate any residual value of prior grants as being "gifts" to the organization and have labeled them as "organizational equity." Any grants received in Time Zero may be thought of as current year investments in order to assign share value at the first point of analysis.[3] As additional grants are received, they are viewed as assets of the organization and assigned a "balanced" value of a given number of shares.

At the close of Year 1, the owners want to raise additional capital to support the pursuit of their social mission. They understand that if they do so, they will have to reduce their ownership position by a certain amount—in our example,25%.

If this were a for-profit capital raising effort,upon issuance of the shares to the market (what is known as an "initial public offering") and assuming the investment bankers priced the issue perfectly, one million shares would be issued at $5.554 each. Because the two owners will maintain 50% ownership, each will be assigned ownership of 250,000 shares at $5.554. This amount is equal to 50% of the total estimated value of the nonprofit organization. The publicly issued shares and the privately held shares sum to equal the estimation of the firm value: $5,554,654.

In this sample calculation, we will assume there is "perfect" market information, such that all known information is disseminated throughout the investment community. For purposes of demonstration, we are assuming no insider information exists which might have an effect on share value beyond that of the underlying assets.[4]

Therefore, in this example, the only factors that affect the share price are the actual performance of the business operations and the net social benefit to society. As presented in the previous section, at Time Zero there are projections made regarding the future economic and social returns in subsequent years. These projections, together with the actual asset base of the nonprofit at Time Zero, form the basis for calculating share value of the organization as a whole. Going forward, the organization's overall assets and value will change as new investments are made, retained earnings are generated by the business and social impacts created through the operation of its programs. Any increase or decrease in these values will affect the share price accordingly.

This is best illustrated with the following example:

Total Number of Shares	**1,000,000**
Original Price/Share	**$ 5.55**
Value Business Operations	**$3,182,056**
Net Social Value	**$2,372,599**
Total Market Capitalization	**$5,554,654**

Time 1

Beginning Value	**$5,554,654**
End of Year Value	
Business Operations	$3,684,930
Net Social Benefit	$3,469,321
Total	$7,154,251
Change in Value from Time1 to Time 2	
Change in Business Operations	$ 502,874
Change in Net Social Benefit	$1,096,722
Change in Total Value	$1,599,597
Change in Share Price	
Inc/Dec Price Per Share *(Change in Total Value/# of Shares Outstanding)*	1.600
New Share *(Old Share Price + Inc/Dec Price Per Share)*	7.154
Change in Share Return	
Total Percentage Change	28.80%
Business Return	9.05%
Social Return	19.75%

The REDF Nonprofit Equity Framework has been designed to replicate a quasi-stock market such that only two pieces of information affect the share value: profits and net social benefit to society. Any increase or decrease in value between the two will affect the price per share.

In this example, we started with 1,000,000 shares outstanding at a price of $5.554. The total market capitalization or value of the outstanding shares is $5,554,654. After the first time period the business produced an increase in operating profits of $502,874 and an increase in social benefits of $1,096,722. Thus the value of the organization has increased by $1,599,597. Interpreting these results, shareholders would increase their selling price in the market place to reflect the increase in firm value. Because 1,000,000 shares are outstanding each share would rise in price by $1.60 resulting in a new share price of $7.154, calculated by dividing the rise in value by the number of shares outstanding.

In applying this for-profit scenario to the nonprofit sector, at least two significant issues need to be addressed:

First, ***how does one allow for prior year investments?***
The example assumes one can "freeze" values at Time Zero[5] in order to create a baseline against which future valuation may be calculated. This assumes, therefore, that all prior grant and other investments made in the organization remain with that organization in the form of organizational equity. In the for-profit example, this is best thought of as the owner's initial investment. In Time One (when new, outside philanthropic investments are received), the equity structure is revised to reflect both the new investment and the presence of a new shareholder.

An additional reason to set Time Zero as a baseline for nonprofit equity assignments is that the vast majority of nonprofit organizations have no management information system in place to track social impacts or the leverage of prior investments. Therefore, most estimations of value are inherently flawed and unreliable. The authors assume that, similar to REDF's investment in developing an accurate management information system for its investee organizations, those attempting to implement this approach to share valuation will have similar systems available to generate future data with the integrity to calculate business and social return.

A second significant issue is ***how to create a nonprofit "anti-dilution" clause to protect the community organization from losing equity control of its activities.***

For example, over a 10-year period the organization will receive more and more grant and other funds to support its work. While the initial position of the organization as controlling 100% ownership at Time Zero may be initially acceptable, over time that position will decrease with the addition of each new philanthropic investor. This creates a possible scenario where the organization may ultimately have virtually no claim on the social and other returns generated through its own work.

At this time our framework is simply a tool for financial analysis of social return on investment and does not translate to true "equity ownership" of the nonprofit involved, but the intellectual challenge remains:

How do we create a framework to assure the investors do not end up in control of the organization as opposed to the community of which it is a part?

The following illustrates the nonprofit dilemma of equity ownership dilution as a result of obtaining outside financing.

The nonprofit is incorporated with $1,000,000 of organizational equity financing.

Time Zero	Total Value	Percent Ownership
Nonprofit	$1,000,000	100%
Asset Value Increase	$ 200,000	
End of Year	$1,200,000	

Upon the initial success of the organization a foundation or other entity decides to contribute $1,000,000 to the nonprofit. The nonprofit retains the $200,000 increase in value from the beginning of the year to the end.

Beginning Time 1	Total Value	Percent Ownership
Owner 1	$1,200,000	54.55%
Funder 1	$1,000,000	45.45%
Total	$2,200,000	100.00%
Asset Value Increase	$ 800,000	
End of Time 1	$3,000,000	

At the beginning of Year 1, the nonprofit is valued at $2,200,000. By the end of Year 1, its value has increased by $800,000 to $3,000,000. The nonprofit and Funder 1 share the increased value based upon their equity ownership percentage. In addition, at the start of Year 2 a new funder contributes $2,000,000 to the nonprofit.

Beginning Time 2	Total Value	Percent Ownership
Nonprofit	$1,636,400	32.73%
Funder 1	$1,363,600	27.27%
Funder 2	$2,000,000	40.00%
Total	$5,000,000	100.00%
Asset Value Increase	$1,200,000	
End of Time 2	$6,200,000	

Again the increased value of $1,200,000 is distributed based upon the equity percentages. The Year 3 equity position is described below.

Beginning Time 3	Total Value	Percent Ownership
Nonprofit	$2,029,160	32.73%
Funder 1	$1,690,840	27.27%
Funder 2	$2,480,000	40.00%
Total	$6,200,000	100.00%

Funder 2 now retains the majority equity position. The nonprofit no longer maintains the majority interest and control.

While a potential challenge, ownership dilution may be addressed in the following three ways:

First, we do not expect the funder will continue its commitment to the organization indefinitely. Many foundations make one-time grants or will only commit support for up to three years. REDF, engaging in a venture capital approach to social purpose enterprises, incorporates a much longer time horizon for capital support and technical assistance, up to seven years or more. Throughout this time period the funders may obtain a substantial portion of the equity ownership. However, upon completion of the relationship and assistance, the nonprofit could assume the equity position of the individual funder.

For example, Funder 1 decides to end the funding relationship with the nonprofit. Therefore, the 27.27% equity ownership formerly held by the funder is passed to the nonprofit.

Beginning Time 3	Total Value	Percent Ownership
Nonprofit	$3,720,000	60.00%
Funder 2	$2,480,000	40.00%
Total	$6,200,000	100.00%

In this way, ***the REDF framework conceptually assigns equity ownership to funders as a means of quantifying the social return on philanthropic dollars, not as a means of thwarting the control, direction, makeup of management or the pursuit of social mission.***

A second approach to the ownership issue might be the conversion of individual donors (those providing annual contributions in support of a nonprofit) to nonprofit shareholders who would, in effect, "own" the nonprofit. Presently, many nonprofits claim to be community-based, but in reality are governed by boards of directors who often have little direct connection to the affected community. A "community nonprofit shareholder" approach could both broaden true community ownership and act as a vehicle for nonprofits to raise additional capital.

Finally, nonprofits could issue various classes of stock (Senior, Preferred, etc.) which could have voting or non-voting status depending upon financial and other factors, such as residency. In these ways the "ownership" could remain with the community in question.

Conclusion

Clearly, the vision and ability to create an operating Nonprofit Stock Market that trades nonprofit shares is many years off and, perhaps,unattainable. There are many significant challenges to the creation of a Nonprofit Stock Market, ranging from the formidable task of creating information systems with adequate integrity to track real social value to issues of how to assign appropriate "ownership" positions to various financial and nonfinancial stakeholders. Indeed, it is most likely that the idea may simply remain that—an idea for what a nonprofit future could hold.

Regardless, nonprofit organizations are seeking new sources of capital, working to create secondary markets for the loan portfolios of community development/finance institutions and pursuing evolving relationships with forprofit and other partners. A vision of our future that includes social mutual funds, nonprofit bond markets, and, yes, a Nonprofit Stock Market may have the long-term effect of helping us step out of our present paradigms. These visions of our future may help us to understand new relationships, funding opportunities and ways of advancing our progress toward the achievement of greater social and economic justice. We offer these thoughts as part of our effort to advance new ideas to help inform our work in coming decades.

Footnotes

1 Indeed, one reviewer concluded that our vision was downright wacky! It is, of course, good to know we've still got it!

2 We first raised this idea in the chapter entitled, "Grants, Debt and Equity: The Nonprofit Capital Market and Its Malcontents," found in *New Social Entrepreneurs* at www.redf.org.

3 It should be acknowledged that not all grants should be viewed as investments in that some grants may be made in support of or reimbursement for the provision of services and are a form of "third-party payment" more than they are an "investment." This distinction will be explored in future documents.

4 The reader should recall, however, that without commonly endorsed standards, there is no present liquidity and no perfect market information upon which potential nonprofit "investors" may rely.

5 In investor parlance, Time Zero represents today, Time One is a year from today and so forth, going forward to the end of the investment period.

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Chapter 10

The U.S. Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and Funding Instruments

The U.S. Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and Funding Instruments

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Foreword

In recent years, major shifts have taken place in the nonprofit sector:

- The Advent of Devolution, whereby federal authority and funding for an array of social, educational and other programs is being transferred to the states
- The Rise of Social Entrepreneurism within the sector which, while still evolving, in all its versions embraces some blending of business skill and perspective with community and social values
- The Evolving Practice of Venture Philanthropy, a new framework for giving driven by new donors who, having created significant economic wealth in recent decades, are now turning their attention to charitable issues—often making use of the very skills that made for their success in the for-profit sector to guide their work in the nonprofit sector, and
- The growing awareness that even in this, our longest period of sustained economic growth in decades, the United States is still confronted with the reality that for many Americans prosperity is not just around the corner, but rather in a completely different community of which they are not a part.

Many are concluding that the approaches of the past, while important to numerous efforts at addressing critical social problems, are in need of expansion, revision and re-design.

This chapter was written following a series of discussions held by funders concerned with developing a deeper understanding of their role in the nonprofit sector during this period of transformation. It presents a basic framework for understanding the work of funders and practitioners, and the resources that connect the efforts of both. It uses as its basic frame of reference the for-profit capital market, drawing parallels and lessons from that comparison.

This chapter is an effort to help inform the thinking of those concerned with understanding the strategic use of philanthropic capital in the pursuit of charitable goals. It is offered as a contribution to the refinement of basic ideas regarding philanthropy, as an attempt to minimize confusion regarding the wide array of players and types of support they both require and provide, and as an effort to achieve general consensus regarding how funders are approaching the challenges of being effective players in the field. The paper's primary audience is funders and individual donors whose efforts support much of the activity in the nonprofit sector. Regardless, it is hoped the ideas and conceptual framework presented will be of interest to a much wider audience, including practitioners, public policy advocates and others concerned with the development and implementation of funding strategies that may result in greater social returns for valuable philanthropic "investments."

In recent years, the philanthropic community has increasingly addressed itself to questions regarding its effectiveness. Greater attention is being given to concepts of "strategic" philanthropy, "outcome" funding, engaged grant making and grant making for effective organizations. Indeed, it would seem there is a growing sense that the approaches of the past have not resulted in the change or impact funders have sought. In some ways, it would appear many people feel something is lacking in the current approach, but we seem unable specifically to state what. Some would have us believe there are not enough funds to support the potential and necessary growth of the nonprofit sector—but we must ask by what standard they make this claim. Others would say limited resources make it difficult for successful programs to "go to scale"—yet we are not clear on exactly what "scale" means or why it is thought to be of value. And still others state that existing resources are not being allocated effectively overall—however, we seem to lack the metrics to assess this supposition and take appropriate steps to respond.

Indeed, it should be understood at the outset that while the American philanthropic tradition is decades old, in many ways the Nonprofit Capital Market is neither matured nor fully developed. Therefore, our understanding of that market is still evolving. This chapter does not seek to provide definitive answers to the array of challenges confronting

the Nonprofit Capital Market, many of which are detailed in its conclusion. Rather, it is offered as a starting point, a frame of reference that may help inform future discussion and debate.

Our position is that the nonprofit sector benefits from a rich variety of approaches to philanthropy, ranging from traditional Classical to emerging Venture Philanthropy and beyond. It is the composite of these various understandings of and approaches to philanthropy that gives the philanthropic field as a whole its richness. And it is the difference in the field's many approaches which gives rise to the need for greater definition and understanding among its many actors.

Furthermore, as the United States prepares for a major transfer of wealth to an aging generation of "Baby Boomers," and successful entrepreneurs of recent years seek out new challenges in the pursuit of their personal philanthropy, many newcomers are entering the ranks of the philanthropic community. By providing a basic overview of how funds flow through this charitable market place and the various instruments used by funders to assist in the work of the sector, we hope that those new to the field will be supported in making informed and effective contributions to many issues of collective concern to our society.

We welcome all those who would work to better define the Nonprofit Capital Market. It is only through common debate, discussion and analysis that we may hope to better understand how it operates and the opportunities it holds for us all—funder, practitioner or concerned stakeholder.

The author would like to thank Greg Dees, Christine W. Letts and Ed Skloot for their contributions to this paper. He would also like to acknowledge the significant efforts of a group of leaders that emerged from a Wingspread Conference on Social Entrepreneurship organized by the echoing green foundation and sponsored by the W.K. Kellogg Foundation and Johnson Foundation. This Nonprofit Capital Market Working Group reviewed and commented on this document. They include: Morgan Binswanger (Creative Artists Agency Foundation), Patty Burness (Entrepreneurs Foundation), Jim Pitofsky (echoing green foundation), Tom Reis (Kellogg Foundation), Steve Roling (Kauffman Foundation), Paul Shoemaker (Social Venture Partners) and Melinda Tuan (The Roberts Enterprise Development Fund).

Introduction to Capital Markets and Philanthropy

In the for-profit community, much has been written about the structure and functioning of capital markets. Business ventures at various stages of development require different types of capital, as well as other coordinated support, to move from start-up to sustainability. Historically, discussions of funding in the nonprofit sector have touched primarily on grants, annual fundraising campaigns, direct mail and endowment funds. Only recently have these discussions evolved toward a realization that the resources supporting the work of the nonprofit sector are more than simply a variety of charitable fundraising efforts, but actually form a distinct capital market—The Nonprofit Capital Market. Dollars used to support community and other nonprofit activities, while "charitable," are still capital investments of precious resources. As such, it is critical that these investments be managed with the same strategic thinking and due diligence one would apply in the for-profit financial services and investment communities.

While this Nonprofit Capital Market shares some elements with its for-profit counterpart, there are a number of significant differences between the two. As opposed to financial returns, the "returns" sought by donors are for the most part social returns on investment. Nonprofit organizations, by their very nature, may not provide a direct financial return to those who invest in them. Nonprofits are often under-capitalized or hold few "hard" assets and may

therefore be perceived as representing greater risk to commercial lenders. Finally, nonprofit organizations must learn to operate without, or create replacements for, the access to equity investments that form the financial lifeblood of for-profit corporations pursuing business strategies.

Despite these limitations, billions of dollars are directed each year to thousands of nonprofit organizations pursuing goals in the fields of economic development, education, the environment and human services, to name but a few. A complete, definitive analysis of the Nonprofit Capital Market and its various actors is beyond the scope of this paper; however, institutions such as the Hauser Center for Nonprofit Institutions at Harvard University, Independent Sector and other organizations, as well as individual researchers, are generating more and more information on the nonprofit sector and the capital market that supports it.[1] At a minimum, it must be acknowledged that the Nonprofit Capital Market of the past will not be that of the future.

While government funding will continue to remain the cornerstone of support for many nonprofit organizations, the rate at which government funding increased between 1992 and 1996 was only 2.9% as compared to 8.4% between 1987 and 1992. Many of the projected cutbacks of government support have yet to be enacted however, such cuts may be easily anticipated in coming years since a growth rate of 2.9% at best allows for the rate of inflation. By contrast, private contributions grew at an overall rate of 3.3% from 1992 to 1996 as compared with only 1.4% from 1987 to 1992.[2] When the wealth creation of the past 15 years is considered together with the significant wealth transfers anticipated as a result of the Baby Boomers' inheritances being realized, the Nonprofit Capital Market will likely continue to undergo serious shifts over coming years. Some experts project this wealth transfer to exceed $1 trillion over the next 20 years. The funds that move through this capital market come in a variety of forms, are controlled by different types of funding institutions and are "invested"in nonprofits that fall across a wide continuum of size and capacity.

This section presents a basic framework for understanding the Nonprofit Capital Market,[3] discusses the types of organizational players active within it, and outlines the various capital instruments used to support the sector as a whole.[4]

Fundamentals of the For-Profit Capital Market

There are a number of ways for-profit, small businesses meet their needs for the capital investment required to "bootstrap" the start-up and expansion of their venture. One classic scenario is as follows:

> *An individual with vision sees an opportunity in the market place and has an idea for some product or service offering she feels will be better than other offerings presently available to customers. She approaches friends and family members for support, offering either a loan payback (with a fixed rate of return) or an equity position (an unsecured investment with some type of owner share in the business provided in exchange for the requested funds). This is known as "first stage" or start-up financing.*
>
> *As the enterprise grows the owner requires access to funds to support the cash flow requirements of a growing business. These funds may be used to support the purchase of additional equipment, fund lease improvements to an expanded production or other space, and any number of other front-end expenditures that must be made if the venture is to develop to its next level of growth.*
>
> *The business may finance this expansion incrementally through small lines of credit or more substantially through securing outside, equity financing. This is commonly referred to as "stage two" or "mezzanine financing." Three sources of funding may be available at this point. The owner may find a "business angel" (usually an individual with some significant amount of personal wealth to invest*

in promising start-ups). This "angel" will often provide not only the funding required, but will often also offer technical assistance and access to his or her own business networks in order to leverage additional contracts and industry contacts.

A second source of funding may come from venture capitalists. Venture capital funds provide significant capital investment and access to industry support for the growing business. In exchange for these funds, the business owner will surrender a significant amount of equity. Venture capital funds operate with fairly aggressive goals for return on investment and, in exchange for their pursuit of significant returns, take on substantial risk that the funded venture will perform at a low-rate of return or generate a loss.

A third source of funding is available through a variety of small business loan programs. For example, the owner may apply for 7-A lending (loans awarded through local banks, but secured by the Small Business Administration) or, depending on her credit rating, the owner may pursue a traditional small business loan from a bank or credit union. These types of financing are not mutualy exclusive and may be undertaken together.

Finally, many larger businesses will further diversify their funding through issuing bonds, stock offerings or other, more sophisticated forms of debt and equity to underwrite capital requirements. Even if the business remains "privately held" (i.e. does not offer its stock to the general public), an array of equity options may be offered individual investors. With access to this last, final stage of financing, most businesses in America become fully mature in the capital market, able to finance capital requirements through a variety of investment and loan instruments which trade financial risk for the promise of some level of future financial return. If the capital instrument is a loan, it is tied to a fixed rate of return and usually secured with some underlying assets of the corporation.

Capital requirements beyond what may be directly supported by debt underwritten with assets may be met through additional equity offerings, such as various classes of shares. These additional offerings, while usually unsecured, offer an ownership position in the business and the possibility of greater, future financial returns.

While this scenario is relatively common, it does not represent the only way capital is secured by for-profit corporations. Indeed, a very small number of companies actually qualify for venture capital support and many of America's leading corporations never received any investments from the venture capital community. Most corporations in America still grow their ventures through some combination of

1. Equity raised from a small circle of investors ("friends, family and fools," as the saying goes!)

2. Internally generated funds (e.g., various operating surpluses that may be booked as retained earnings)

3. Bank loans and/or other public or private debt offerings.

It has become popular in recent times to glorify the "initial public offering" that makes the founders rich and secures additional amounts of operating and other funds to support business expansion. However, the truth of the matter is that many corporations never go public and are made successful through bootstrapping their capital requirements with very modest initial investments. In this way, there is great similarity between the capital development of for-profit and nonprofit corporations.

With regard to securing commercial lines of credit, it is important to understand that depending upon the type of business and industry in which it operates, there are certain percentages of "debt to equity" which are considered prudent and reasonable. Banks, in assessing whether a given corporation is creditworthy, will assess such factors as the debt/equity ratio in order to evaluate the relative risk in any given loan proposal. Taken together, the amount of debt and equity present in a business that underwrites the financing requirements of the corporation is referred to as the business's "capital structure."

In addition to assessing the debt/equity and other relevant ratios, of perhaps equal importance is the analysis of cash flow. A business can sustain high levels of debt service if the cash flows of the enterprise are sufficient to cover both its debt and operating fund requirements. Indicators of cash flow for a business

may be found by assessing EBIT (Earnings Before Interest and Taxes) and EBITAD (Earnings Before Interest, Taxes, Amortization and Depreciation). For obvious reasons, a lender or investor will look more favorably upon an investment opportunity with strong cash flows and significant debt than one with little debt, but no cash flow.

Access to investment capital and cash flow funds are not sufficient in and of themselves for success. However, it is that capital structure, together with the presence of talented management and staff along with a little luck in the form of market timing, which makes for success or failure in the for-profit world. The various players, investment instruments and institutions that bring various amounts and types of capital to the table together form what is known as the capital market.

The following sections of this paper use the for-profit capital market as a basis of comparison with the Nonprofit Capital Market. At the outset, however, it should be recognized that one central, historic difference in the source of funds for these two markets is the role played by the public sector, which is to say the role played by governmental funding. The nature of this role and the degree to which government should support community and other activities of the nonprofit sector are certainly topics up for continuing debate. However, the presence of the public sector in providing direct funding (e.g., capital) to nonprofits is significantly different from what is seen in the for-profit capital market.

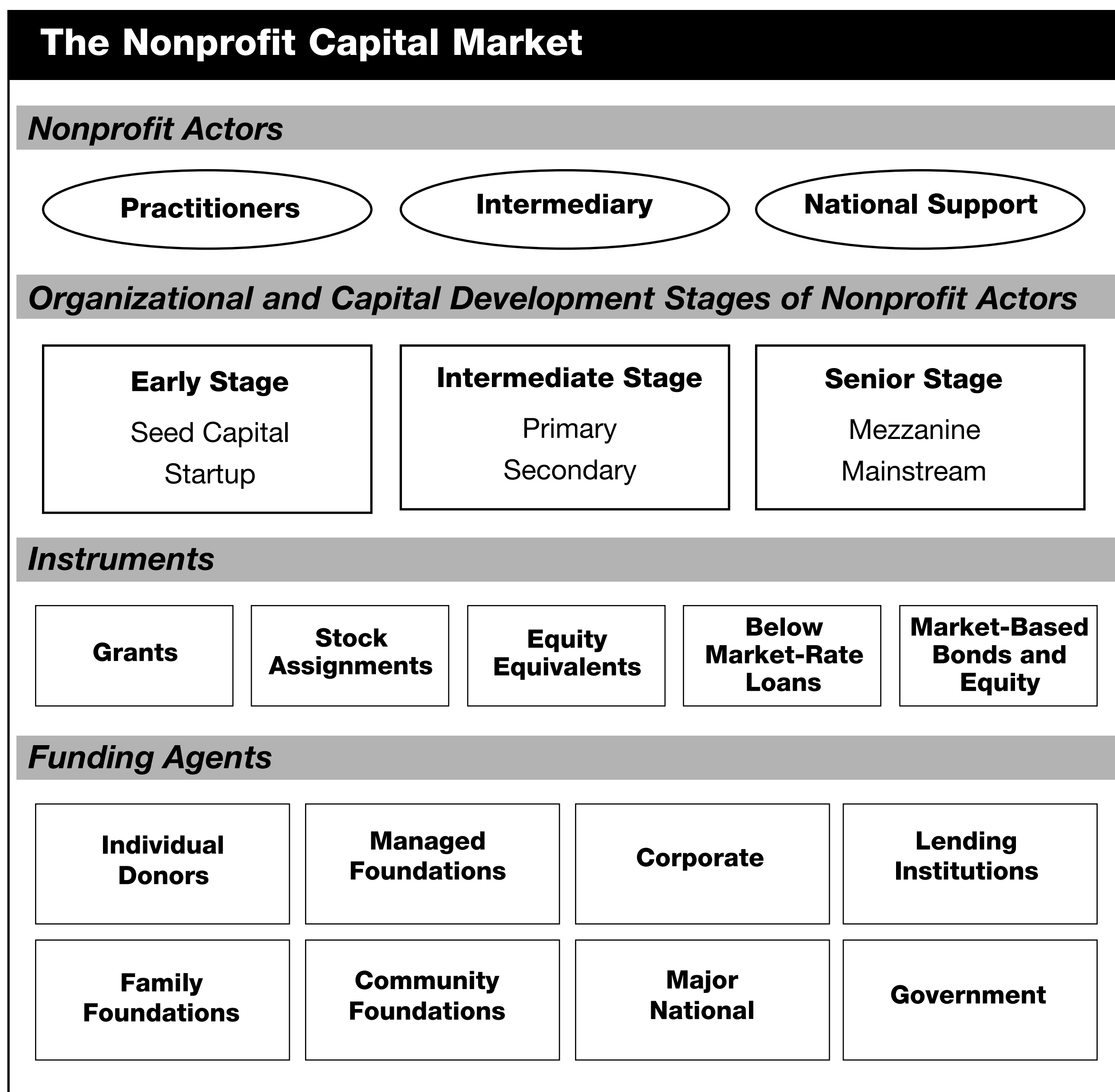
Certainly, the government provides an array of supports to the for-profit community (such as SBA loan guarantees, direct contracting opportunities, tax and regulatory abatements, vendor relationships and a host of subsidies in the form of everything from the building of roads through Forest Service land to the federal funding of basic research); however, as a direct actor in the capital market itself, federal and state government has and,in all likelihood, will continue to fund the overwhelming majority of activities in the nonprofit sector. This fact has a significant and major impact upon the Nonprofit Capital Market and its actors.

Before leaving the for-profit market place, we must acknowledge that increasing numbers of for-profit businesses are adopting “socially responsible” business practices and becoming more community-oriented in their pursuit of traditional, for-profit goals. While there is ongoing debate regarding the true social impact and future implications of both socially responsible businesses and socially responsible investing, the fact is that increasing numbers of for-profit managers and entrepreneurs are reflecting upon the community impact of their economic activities. While the focus of this chapter is the interactions of nonprofit organizations and philanthropic “investments” in contributing to strengthened communities, families and environments, the real impact and potential social or other benefits of the traditional, commercial sector cannot be overstated either.[5]

Stages of Nonprofit Organizational and Capital Development

The Nonprofit Capital Market may mirror many of the elements of the for-profit market, however there are a number of differences. Traditional frameworks for understanding the for-profit market are useful, but must be modified to accommodate the legal, organizational and equity limitations of the nonprofit sector. The following outline is a modification and extension of the traditional for-profit stages of capital financing widely referenced by business financiers. In this case, the modified framework applies to nonprofits and is loosely based upon a for-profit framework presented in "A Study of the Availability and Sources of Venture Capital in Maine."[6]

In general, it must be understood that nonprofit organizations move through various stages of development and capacity. The type and form of capital required to support the work of a variety of nonprofit organizations along this continuum differs as well.



Early Stage Organizations:

Seed Capital

Seed Capital is small amounts of funding used to develop a basic concept and begin to build a base to qualify for start-up funding. It may be used for initial program development and assistance in creating an organization or program, but usually not for actual start-up of the venture. This type of funding is provided in order to give practitioners the "time to think," convene planning sessions with other practitioners or consumers of services and potential stake holders, or run "trials" to test an idea.

Start-up Funding

Provided to organizations that have demonstrated potential and initial marketing of a concept or program idea, Start-up Funding assists groups that require funding to "go the next step." In theory, at this level, organizations have conducted basic research on their concepts, have assembled key managers and advisors, have developed an enterprise or organizational development strategy, and are ready to move toward initial implementation of their idea or program initiative. In practice, many groups may have successfully addressed some of these factors, but often have others that remain unaddressed.

Intermediate Stage:

Primary

Having demonstrated the potential value of their concept, organizations use Primary Funding to "roll out" their program. While their program has demonstrated the potential to achieve significant social impact, Primary Funding is placed in organizations which are felt to have clear potential, but have up to this point lacked the support necessary to fully execute their strategy.

Secondary

Building upon the demonstrated success achieved with Primary Funding, Secondary Funding support enables the organization to further build capacity and expand program offerings. Secondary Funding allows organizations to grow their initial program or organization significantly, but for the most part,it does not provide "stable" capital resources to guarantee a sustained presence in the market place. Many nonprofit organizations are successful at achieving this stage of expansion, but confront significant capital market and organizational barriers to moving beyond it to Senior Stage support.

Senior Stage:

Mezzanine

Provided to organizations in order to "go to scale," Mezzanine Funding supports significant expansion of current operations, replication of programs to other geographic areas and other development activities. Funds at this level are used to support expansion of office and program space, inject needed working capital or improve program operations.

Mainstream

At this stage of funding, an organization has "made it." Mainstream funding means the organization is viewed as financially "sound"and, while there may continue to be program modifications, the fundamental "product" or program of the organization is viewed as credible and providing significant value to society.

Furthermore, organizations at the Mainstream capital stage will have:

- A Diverse Base of Financial Support

  Organizations receive funding support from an array of sources: foundations, government, individual donors, fee-for-service contracts, earned income and annual fundraising events. This diversity helps protect the organization from shifts in the Nonprofit Capital Market.

- Commercial Lending Relationships

  Organizations qualify for lines of credit, major capital and equipment loans and other forms of traditional lending from mainstream banking and other financial institutions.

- Individual Sponsors

  Organizations may have developed large membership or sponsor pools that provide, through direct mail or other means, ongoing contributions. While this support usually comes in smaller increments (ranging from annual contributions of $25 to $1,000),the size of the pool is often great enough to provide a major source of general operating support.

- Self-Capitalization/Earned Income

  Organizations may have grown earned income and "for-profit" activities to the point of being able to re-direct net income from those ventures into supporting the parent corporation and its social purpose. These sources of capital support may take the form of for-profit subsidiary corporations or "social purpose" enterprises that, while generating surplus income, also employ a target population in fulfillment of the organization's charitable purpose.

While the above continuum of funding required by the nonprofit sector is offered as a helpful framework for discussion of the Nonprofit Capital Market, it should be understood that organizations may actually fall simultaneously at various points along the continuum. For example, a parent nonprofit may itself have achieved the level of Mezzanine Funding, while a given program being developed by that same organization may languish at the Start-up Funding level. One implication of this shortcoming in the traditional approach to the funding of nonprofit organizations is that whereas many nonprofits may be successful at receiving start-up support, the availability of general operating support is often lacking. This reality makes it extremely challenging to secure the necessary financing to expand core capacities necessary for a parent organization to manage replication or expansion strategies. Indeed, part of the traditional challenge for nonprofit managers has been that of finding adequate support for the many diverse programs often housed within a single organization while maintaining the general operating support necessary to manage such programs.

A Capital Caveat: Market Shifts and Player Positioning

Over the past 40 years, many nonprofits achieving a matured, Mainstream level of capital development have relied upon government funding as one significant source of capital to support the national expansion of their work and/or replication of program models. The philanthropic community has, in many ways, evolved its own approaches to nonprofit organizations to support this goal of a future government "take-out." Increasingly, however, government funding will no longer play the role of primary provider of Senior Stage, Mainstream capital support.

Indeed, in a recent address at a national community wealth forum, former Senator Bill Bradley described the role of government funding as one of testing interesting, social programs, nurturing those programs through early stages of development and then taking them to the private sector for long-term funding support.[7] This perception of the relative roles of government and private sector funding is exactly the reverse of the role understood by many of those in the foundation community who have historically viewed themselves as the front-end funder of community ideas and government as the long-term supporter of such programs.

Considerable media and other attention has been brought to bear upon the long-term implications of these shifts in the role and structure of government funding in the Nonprofit Capital Market. In fact, the Nonprofit Capital Market Working Group, which has contributed to this chapter, could not agree as to whether government actually has played the central role in providing the majority of capital for nonprofits to go to scale, whether or not government funding will continue to play a central role in supporting nonprofit organizations or what the real long-term impact will be upon the Nonprofit Capital Market and its actors. Clearly, this is an area in need of further research and analysis.

While there is a need for further research into the specific role and functioning of government support within the nonprofit sector, the fact remains that shifts are taking place in the Nonprofit Capital Market. New players are entering the market, older players are re-

assessing their support, and competition for what funds are available in that market will only grow more fierce as the nonprofit sector continues to grow. The current and future implications of these facts cannot be overstated. Even though the actual dollar reductions in government funding have yet to work their way fully through the Nonprofit Capital Market (for example, while welfare reform will have a long-term effect of decreasing funding available for public assistance and other programs, the short-term effect actually has been an increase in funding of state welfare programs), many believe that this shift in the role of government funding has helped precipitate a crisis in the Nonprofit Capital Market.

And as a result of this perceived crisis many nonprofit organizations will have to significantly alter their understanding of what a "successful" nonprofit capital structure may look like—namely different amounts of government support and expanded types of capital support from other sources. Additionally, private funding actors in the capital market will be forced to reconsider their role and position in the market place. The balance of this chapter will address who these changing actors and investors are, how they interact, and the very real challenges confronting them as they seek to fulfill the mission of the nonprofit sector.

The Nonprofit Capital Market: Actors and Investors

The Nonprofit Sector is made up of thousands of organizations, each addressing a range of issues and whose work is supported from an array of sources. While such diversity is what makes the sector strong, it can also challenge anyone (whether funder, nonprofit professional or layperson) attempting to understand how to interact with and support the organizations within it. There are scores of books and many institutions that attempt to capture the richness of the sector and a full presentation of it is beyond the scope of this paper.[8] In addition to other efforts, such organizations as the Program on Nonprofits and Philanthropy at the Urban Institute, the Institute for Nonprofit Organization Management and the Foundation Center are each engaged in identifying and analyzing the wide array of players in the nonprofit sector. More specifically, Project 180 (New York,NY) is involved in a "mapping" process that will attempt to identify and categorize various players and trends in the nonprofit sector, with particular focus upon those engaging in the emerging practice referred to as social entrepreneurship.[9]

However, for the purpose of this discussion,the Nonprofit Sector is made up of those who do and those who fund the doers. While there are, as will be presented below, some examples of blending between these roles, in general the sector consists of

- Nonprofit Organizations (which is further divided among three groups: Practitioner, Intermediary and National Support), and

- Funding Agents (Individual Donors, Family Foundations, Managed Foundations, Community Foundations, Major National Foundations, Corporate Foundations, Governmental Funders and Lending Institutions).

The following section will briefly present and attempt to define each of these actors in the Nonprofit Capital Market.

Nonprofit Organizations

Practitioner

The heart of the Nonprofit Sector is those organizations engaged in the direct pursuit of

a charitable or social purpose. These can range across fields as diverse as social service delivery, to education, to cultural arts,and the environment. Practitioners may engage in advocacy around an issue, but also may be involved in directly addressing the issue itself through the operation of a program or provision of services. For example, environmental groups include those attempting to change environmental public policy and those creating public land trusts to preserve wilderness or endangered habitat. Youth programs may support after-school tutorials, summer recreational activities or direct street outreach to homeless youth. Cultural arts groups may sponsor writers, underwrite performances or operate in schools to bring the wonder of arts to young people.

Practitioner organizations generally fall into three categories: community-based, community-based/nationally affiliated and non-place based. Community-based organizations are active in a single geographic area, whether neighborhood or regional, while non-place based organizations operate without reference to a specific,individual community. An example of a local, community-based organization would be a traditional community development corporation, charged with advancing the economic vitality of a given neighborhood. An example of a community-based/nationally affiliated organization would be the Girl Scouts or Big Brother/Big Sister that, while working through local chapters,are advancing an overall program across the nation. Non-placed base organizations include Greenpeace, Amnesty International or the American Cancer Society.

The main link among all practitioner groups is that they are attempting to address directly an issue of societal or community concern—they are,in every sense of the term, "doing" the work of the sector.

Intermediary

Intermediary organizations are support organizations that work to bring added resources to the efforts of the practitioner community. These resources may include financial support, technical guidance or network support for a particular initiative. Intermediary organizations may operate at either a regional or national level, and they work with a number of practitioner organizations. Examples of intermediary organizations are The Enterprise Foundation, The United Way, The Corporation for Supportive Housing (CSH), or the Local Initiatives Support Corporation (LISC).

Many Intermediary organizations operate within the classic approach to community and organizational development in that they embrace a "model" which has been found or is believed to be effective in addressing an issue. The Intermediary then moves to implement that particular model through a variety of local affiliates. Examples of this approach are:

- LISC's Franchise Initiative (which is implementing a model of community economic development that focuses upon linking for-profit, national franchisors with local, for-profit individual entrepreneurs); or

- CSH's Supportive Housing Initiative (which works with community-based organizations to create a national network of nonprofit-managed affordable housing programs that offer on-site support services).

Other intermediaries operate within models which promote a "sectoral approach," a regional economy approach, or other similar strategies—all of which are conceived in one region and brought to another for execution by local organizations. In order to support the practice of their model, many intermediary organizations also provide technical assistance to help local practitioners involved in model replication.

Intermediary organizations may be thought of as a type of "hybrid" organization between "doers" and "funders," in that they often receive grant support from foundations that they then re-grant to organizations that then actually provide a service or program. In this way, Intermediaries are actors in the Nonprofit Capital Market. Since they in turn receive their funds from foundations or governmental sources, they are not truly a funding agent in their own right. In addition to the provision of funding, intermediary organizations also provide various levels and forms of technical assistance, managerial

education and training, and general information. In many ways, the traditional role of intermediary organizations shares some elements in common with that of "venture philanthropy," presented later in this document. What distinguishes one from the other is the degree of donor involvement, the basic conceptual framework within which they operate and other factors discussed below.

In recent years a new form of intermediary organization has evolved that operates programs providing the nonprofit sector with both leadership and organizational development assistance within the context of a strong market-based orientation—something not seen in traditional intermediary organizations. Social Venture Partners, Eureka Communities, the echoing green foundation, Grace, The Fund for Social Entrepreneurs, New Profit Inc., and The Denali Initiative all represent efforts to support individual, social entrepreneurs while increasing the operational capacity of the nonprofit organization of which they are a part. This "integrated" approach to intermediary functions (whereby funding, leadership training/support, administrative capacity and a host of other issues are addressed simultaneously) represents a promising strategy for maximizing both the leverage of philanthropic investments and the potential for future social returns.

National Support

National support organizations are those organizations active at the national level in support of a field as a whole. These would include national associations, "think-tanks" or policy organizations. National support organizations may act as a convening entity for practitioners, intermediaries and funding institutions. While some national support organizations are active in direct advocacy around a given issue, they often act in a wide variety of ways to address issues raised by their member or constituent organizations, whether with regard to public policy, funding, research or general efforts at "building" the field.

Examples of national support organizations are the National Congress on Community Economic Development, The Child Welfare League of America or the Community Development Venture Capital Alliance.

Funding Agents

Across the table from nonprofit organizations sit an array of individuals, foundations and institutions that provide financing which allows the nonprofit to pursue its work. Funding agents include:

Individual Donors

While not technically a funding "agent," individual donors form the basic building block of the Nonprofit Capital Market, constituting financial support well in excess of foundations and other sources of grants/contracts. In truth, an individual donor is anyone who makes a charitable gift to a nonprofit; however, in this case we are referring specifically to those high-net-worth individuals who make substantial gifts to nonprofit organizations. Developing a solid base of individual "small donor" support is important in the diversification of any organization's funding base. Individual donors constitute 83% of private giving in the United States and as such represent a major source of diversified funding for nonprofit organizations attempting to take their efforts to greater size and sustainability. However, while significant on an aggregate level, such donors' personal leverage is largely fragmented, remaining at the "Do I renew at $50 or $100?" level. Until such time as these individual donors may be organized as nonprofit "share holders," their ability to leverage influence within the sector is largely diluted.

High-net-worth donors, on the other hand, have an immediate impact upon both an individual organization's activities (through directly underwriting a particular program) and, increasingly, upon the larger Nonprofit Capital Market itself through their ability to underwrite large-scale, multi-organization funding initiatives. They may begin their activities by making initial charitable gifts to individual nonprofit organizations or various "causes," or may move directly to the establishment of a family foundation or other funding vehicle through which to make larger, more strategic charitable contributions.

Family Foundations

Family Foundations (a subset of Private Foundations) are established by high-net-worth individuals willing and able to endow an

ongoing institution to carry out their support of the nonprofit sector. Family foundations are usually endowed at some level and, in adherence with IRS tax codes, must annually disburse 5% of their assets. While most foundations use grants as their primary charitable investment vehicle,increasing numbers of foundations are examining how to more creatively support the causes that interest them (for example,through Program-Related Investments and other instruments discussed below). Family foundations can range greatly in both size and culture. Some maintain large,fully staffed offices, while many others are staffed on a volunteer basis by family members or managed for a fee by the foundation's trustees or attorneys.

Managed Foundations and Philanthropic Advisor Services

An emerging actor in the Nonprofit Capital Market is the Managed Foundation and Philanthropic Advisor Service. Managed foundations are those foundations, often family foundations, which are collectively managed by a single organization specializing in such services. Philanthropic Advisor Services are those independent foundations that make use of individual advisors (often legal trustees, individuals with personal experience in the field of philanthropy or other independent actors) to guide their grant making activities. Depending upon their operating structure, both Managed Foundations and Philanthropic Advisor Services make it possible for donors to receive individual attention and assistance, but do not require the presence of full-time staffing for each individual foundation or donor.

This form of organization is increasingly important as "new" donors come to the market seeking guidance, yet wanting to maintain influence or control over fund distribution. This approach to managing foundation activity is also important in that those who coordinate such funds have the potential to broker a number of independent foundations to a single philanthropic transaction. Examples of Managed Foundations and Philanthropic Advisor Services are The Tides Foundation (San Francisco, CA), The Philanthropic Initiative (Boston, MA), and Pacific Foundation Services (San Francisco, CA).

Community Foundations

While a relatively recent growth segment of the Nonprofit Capital Market, Community Foundations have existed for a number of decades and provide an important vehicle for the support of nonprofit organizations, as well as a way for donors to target their support. Established with "independent community" boards, community foundations maintain an endowment, but also offer individual donors the potential for the creation of donor-advised funds. Under this structure, an individual donor makes a charitable contribution to the foundation, which then controls the capital; however, the donor may then act to "advise" the foundation on how those funds should be disbursed and through what strategies. As the name implies, community foundations seek to reflect not simply the wishes of the donor, but broader issues and concerns in the region of which they are a part.

Private Operating Foundations

A variation on the traditional private foundation, private operating foundations are those that do not make grants to outside organizations, but rather directly fulfill their charitable purpose through the direct operation of programs or other activities that advance their cause. Private operating foundations usually set aside designated funds for a defined program managed by the foundation. An example of a private operating foundation is the Schwab Foundation for Learning, founded by the Charles and Helen Schwab Foundation. The Schwab Foundation for Learning provides counseling, support services and an array of programs specifically targeting the needs of the learning disabled.

Major National Foundations

With household names like Rockefeller and Ford, large national foundations are those most often identified by the general public as involved in philanthropy. These institutions, in addition to funding important capital and other campaigns, may play an important role in matching locally committed funds. In addition,they have the perspective that comes from operating at a national level that often allows them to see connections and opportunities present in various regions of the country. With the benefit of size, however, come

challenges of pursuing appropriate philanthropy that supports and augments, but does not replace,that of local communities. Major national foundations have had a significant impact in helping to both replicate successful regional programs and support broad public policy initiatives to inform the larger society of critical social, health, environmental and other issues.

Corporate Foundations

For-profit corporations establish Corporate Foundations as a vehicle to engage in charitable support of nonprofit organizations. They also may have a parallel mission of advancing the goals and marketing strategies of the parent corporation. While in some cases corporate foundations are endowed, many have budgets tied directly to the financial performance of the parent corporation.

In addition to providing direct financial support, corporate foundations also have the ability to leverage significant contributions of goods, services and volunteers. Indeed, while the majority of corporate philanthropy is pursued through charitable giving, increasing numbers of corporations are examining how to engage in "strategic"[10] philanthropy to leverage the total resources of the corporation in support of a charitable goal. For example, such efforts might include not simply grant support, but the mobilization of large numbers of volunteers, the outsourcing of contracts to nonprofit social purpose business ventures, or the practice of loaned executives to assist in nonprofit marketing, financial analysis or other areas of need. While similar to traditional "pro bono" efforts,strategic corporate philanthropy represents an approach to philanthropy that allows the corporation to have a much greater impact in the nonprofit sector than grants alone might allow.

Governmental Funders

In the "old days" (i.e. prior to 1980!), many of those involved in the field of philanthropy liked to view themselves as the "venture capitalists" of the nonprofit sector who would seed initial ideas which would then be replicated and provided significant funding by public sector funders. No more. As devolution and anticipated cutbacks in government funding become the norm,many governmental funders view themselves as those seeding ideas and local or private sources as the vehicle for ongoing financial support. Since governmental sources of funding far outstrip those of the philanthropic community, government remains an important source of capital for the nonprofit sector. However, learning how to blend the two streams of capital remains a challenge as both foundations and government maintain their own categories of interest and terms for organizations seeking to receive financial support.

Lending Institutions/Credit Unions

Organizations that provide lending support to nonprofits remain an important and evolving component of the capital market. These consist of either mainstream commercial lenders or nonprofit lending institutions, such as community development finance institutions and revolving loan funds. Many of these groups provide loans at market rates of return,though others charge rates greater than the market average—reflecting the greater levels of risk sometimes involved in lending to nonprofit organizations. For the most part, these loans historically have been made to support affordable housing, commercial real estate development or, increasingly, small business development, but have been largely unavailable for the support of nonprofit general operations, cash flow or social purpose enterprise development. The lack of capital for these areas represents a gap in the capital market for those nonprofits lacking assets that might secure such loans or engaging in activities, such as business development, that are viewed as too risky to be supported with loaned capital.

Recent Developments in the Nonprofit Capital Market

As is true of most markets, the Nonprofit Capital Market is not a static organism, but is dynamic, with new players entering, old ones exiting and new approaches to philanthropic strategies coming into play. While there are a number of trends one might identify, it would seem important to acknowledge at least three at this point.

Of increasing concern among those who create family foundations is the issue of control and whether a foundation established to operate in perpetuity will continue to reflect the vision and values of its primary donor. Recently, more foundations have been established with a strategy that includes a clearly stated "sunset" clause requiring that all the assets of the foundation be disbursed within a given, usually relatively short-term, time frame. Claude Rosenberg[11] has done a great deal to challenge conventional wisdom as it relates to the pursuit of philanthropy and the role of foundations in advancing such efforts. The Rosenberg Foundation, Annenberg Foundation and Aaron Diamond Foundation are all examples of foundations that, to various degrees, are pursuing or have pursued strategies which include the total disbursement of the foundation's assets within a set time frame. While viewed as radical by some, this perspective addresses many of the concerns held by high-net-worth individuals regarding how their assets will be used in the years following their passing.

A second strategy being pursued by foundations is the creation of centers and other organizations specifically founded to support the broader development of the field or area of interest. Similar in many ways to the medical research organizations established by John D. Rockefeller, Sr., these centers move well beyond the traditional "naming opportunity." Foundations implementing this approach directly assist in the shaping of a field through convening, educating or supporting the research of leading practitioners to address emerging issues in their field. Examples of this practice are the Center on Entrepreneurship (created by the Kauffman Foundation), the Aspen Institute (created largely through the support of foundations interested in research on the nonprofit sector), and Wingspread, a conference center founded by the Johnson families. These institutions work to foster better thinking and practice in the nonprofit sector as a whole.

Largely as a result of the influx into the philanthropic community of "new wealth" created in recent years, the Nonprofit Capital Market has recently witnessed the emergence of a new and challenging approach to philanthropy, Venture Philanthropy. Given the impact of this strategy and its much-debated place in the market, Venture Philanthropy will be addressed in a separate section following the discussion of investment instruments below.

The Nonprofit Capital Market: Investment Instruments

The primary link between nonprofit organizations and funding institutions is the capital that moves from one to the other. A basic premise of this document is that all forms of charitable support provided to nonprofit organizations represent forms of charitable investment in those organizations. The specific form taken by these investment instruments can vary in source, size and structure.

Furthermore, just as capital in the for-profit capital market moves along a continuum, so, too, does capital in the nonprofit market. It must be recognized at the outset that funding institutions may use an array of investment vehicles to achieve their organizational goals. By extension, the financially healthy nonprofit organization will have a mix of funding represented on its financial balance sheet—grants, loans and program-related investments all play a role in capitalizing successful initiatives in the nonprofit sector.

Before approaching any discussion of capital investment instruments used in the nonprofit sector, it must first be acknowledged that in the nonprofit sector the distinction between capital investment and operating revenues is much less clear than in the for-profit capital market. In many cases, "investments" in the nonprofit sector often are used to cover current operating expenses and in such cases resemble business revenues more than "capital investments." Investors in for-profit corporations will cover operating expenses temporarily, usually during start-up or expansion stages when operating cash flows are expected to be

negative. However, these investors expect that operating revenues in the business eventually will exceed operating expenses. This expectation is not common with nonprofits. Beyond these limited time periods, for-profit capital investments usually are intended to cover specific capital expenditures for such things as property acquisition, equipment purchase, long-term research and development, etc. Each of these represents cash outflows not regarded as "expenses" for a given accounting period. Banks and other lenders may extend short-term loans to cover such expenses as well, but these loans generally are not considered part of the overall capital structure of the organization.

A basic premise of this chapter is that those who support the operating expenses of nonprofit organizations (foundations, individual donors, etc.) are making investments in the nonprofit organization. In fact, one might also argue that just as many for-profit businesses, such as HMOs or auto repair shops, receive cash inflows from third-party payees (such as government revenues, insurance companies, corporations buying benefits for employees, etc.), nonprofits do as well. These revenues often cover the operating expense of an organization providing services, programs or support to others who often do not pay the full cost of such services. This fact and its impact upon the operation of the Nonprofit Capital Market are worth noting and clearly require further research.

It is the author's position that program grants or third-party reimbursements do, in fact, represent nonprofit operating revenue, whereas grants received as part of a multi-year, organizational development strategy represent social and capacity-building capital investments. Additional inquiry into this distinction and the specifics of how it is reflected in the capital market is needed. For the purposes of this discussion we simply will acknowledge the existence of this "blurring" between revenue, investment and third-party payees. For the time being, we will overcome this potentially complicating issue by simply saying that all cash inflows to the nonprofit will be viewed as "investments," unless they are the result of explicit contractual payments or the result of fees for services rendered.

Regardless, as will be discussed below, while the presented investment instruments are all part of the Nonprofit Capital Market, it is widely felt that the market itself (as it is presently constituted) does not offer enough capital in the size, form and appropriate stages needed by the nonprofit sector. This is reflective of the fact that the Nonprofit Capital Market is in many ways neither fully developed nor mature. The for-profit capital market has evolved over a period of centuries, whereas nonprofit organizations have existed for a matter of decades and organized public support of their efforts for perhaps fewer years than that. As a result, the Nonprofit Capital Market lacks certain types of funding at exactly those places where the market place and its actors could make the most use of it. The challenge of addressing those gaps and developing more effective capital instruments is a major focus of this chapter.

However, before addressing the inefficiencies of the nonprofit market place, we must first understand the fundamental investment instruments presently in use. Those instruments are: Grants, Stock Assignments, Equity Equivalents, Below-Market Loans (PRIs), Market-Rate Loans and Lines of Credit, and Market-Based Bonds and other Equity Investments.

Grants

The most popularly used and understood charitable investment instrument is the grant. Grants are made to nonprofit organizations following an application process and some level of due diligence by the grant making institution. Grants may be of any size, ranging anywhere from under $5,000 to $1,500,000 and above.

Because grants will not be paid back to the funding institution and carry no interest rate, they are often viewed by actors in the market as "free" or "no-cost" capital. This assumption is deceptive, however, in that the application process by which grants are awarded and the "strings" which may be attached to such funds can quickly turn a "free" capital instrument into very "expensive" form of capital.

For the most part, grant funds are used to support the delivery of a program offering or nonprofit product. Therefore, grant support is often "money in, money out" for the recipient organization. Donors give funds in order for those funds to be applied

directly in support of the stated "cause" and generally do not want the organization to "sit" on those funds any longer than is necessary. On the whole, the effect of grants is that, unless specifically targeted for such, they do not provide assistance to the organization's overall effort to expand its operating or administrative capacity.[12] Grants may be used to acquire real estate or equipment that may then be carried on the organization's books as an asset. However, for the most part, grants represent a "liquid" investment that comes in one year and is gone the next.[13]

Given that grant dollars dedicated to project as opposed to general operating support represent a significant part of the Nonprofit Capital Market, it is no wonder practitioners find it difficult to build assets or the overall financial health of their organizations. This reality represents a critical factor effecting the Nonprofit Capital Market—namely, that the grant-making strategies of a majority of funders have not adequately targeted the development of the assets of the organizations pursuing our nation's community, environmental or social values. Indeed, most funders do not view their grant-making activities as true investments, but rather as charitable program or other support targeting a specific project or provision of services. While it may be unfair to state it in such bold terms, one wonders if unless and until the funding community embraces an understanding of grants as a form of charitable investment, the Nonprofit Capital Market will continue to be significantly hindered in its capacity to support the efforts of practitioners in pursuing their vision for individual organizations, local communities and society as a whole.

Stock Assignments

While still rare, as a result of the stock market boom of recent years some organizations and donors find the gift of stock to be an increasingly attractive charitable investment instrument. While not as liquid an asset as a grant, stocks may be sold by the nonprofit organization or held in the hopes of securing an appreciated value over time.

One intriguing twist on this historic practice is being pursued by the Entrepreneurs Foundation (Menlo Park,CA), which is soliciting contributions of stock from emerging entrepreneurs in Silicon Valley. These entrepreneurs make a contribution of 1% of their total shares early in the formation of their corporation. This contribution then grows over time, creating an expanding endowment for the foundation, which will then use its annual disbursement to support its work with social entrepreneurs managing local nonprofit organizations.

The "Equity Gap" and Use of Equity Equivalents

As stated earlier, most for-profit businesses carry some mix of debt and equity. Depending upon the type of business and the overall financial health of the corporation, certain target ratios (such as the debt/equity ratio) are used to measure how much debt a business can sustain. Debt is usually tied to some underlying asset of the corporation, with various lenders taking a position relative to those assets. Subordinated debt, for example, takes a secondary position to senior debt that has "first dibs" on the liquidation of any assets in the event of bankruptcy. It should be noted, however, that all debt has a priority claim (before that of any shareholder) on cash flow of the corporation.

The problem is that any business will probably require more capital than it can or is profitable to borrow. Therefore, business owners often sell a part of the ownership in the company in return for additional capital needed to make up this difference. While there are various forms of equity, such investments are unsecured and fully at risk. Those holding that equity hope to receive a market-rate or better return. For-profit investors are willing to take exposure to risk in exchange for possibly greater financial returns in the future. This is the central difference between lending and investing.

Nonprofit organizations must work under the same economic rules and realities as their for-profit counterparts; however, nonprofit organizations must overcome two fundamental challenges to building the "capital structure" necessary to support their work:

- Nonprofits are prohibited by law from providing "private inurement" to outside or internal investors—thus eliminating the profit incentive for potential investors of capital.[14]

- Most funds provided to nonprofit organizations are immediately used to achieve some short-term program or other goal. The "return" generated by the organization's capital is most often a social return on investment as opposed to a financial one.

Depending upon whether one's perspective is as an investor or practitioner, this situation creates either an "equity gap" or an "asset gap" in the financial/capital structure of nonprofit organizations. This gap represents the fundamental challenge of capitalizing nonprofit organizations—it is the very reason an activity is considered charitable and pursued by a nonprofit corporation. There remains some debate as to whether it is appropriate to term this lack of funds a "gap" since grant funds may be used to operate nonprofit organizations and, as described below, there are various ways one may structure financial support of nonprofits to address the essential need for capital support. However, the existence of this gap in financing is and will remain a central challenge for practitioners and those involved in supporting their work.

Regardless of how this gap might be addressed, it should be understood that in a traditional for-profit business the increasing value of the corporation is entered on the financial books initially as profit and later as retained earnings. Traditional, for-profit corporations receive both outside equity investments and generate internal equity through these retained earnings. The nonprofit sector, by contrast, has very little, if any, capacity to generate such retained earnings as a vehicle to capitalize the corporation and fund future expansion. In many ways it is this "double-whammy" of an inability to secure outside equity investments together with the chronic inability of most nonprofits to generate internal equity that creates the "equity gap" and is a central challenge in adequately capitalizing nonprofit corporations.

To further hinder the nonprofit manager in her efforts to build her organization's financial health, when such funds do accrue in the nonprofit world they are most often viewed as "surpluses" or fund balances—terms and accounting practices which don't lend themselves to building the assets of an organization. It is no surprise, therefore, that these funds are most often used to fund a program or operating expense within a given year and that the "charitable assets" of the nonprofit sector are seldom viewed as investments or cultivated as such.

However, that gap may be filled, at least in part, through the use of "equity equivalents." An equity equivalent is a grant made to a nonprofit with the provision that it is "recoverable." While some PRIs (discussed below) are unsecured, all recoverable grants are unsecured—with payback usually pegged to the nonprofit enterprise achieving certain financial benchmarks at some agreed-upon future date. Therefore, they are fully "at risk" and in that way play a role similar to for-profit equity investments—thus, the term "equity equivalent." The "payback" on an equity equivalent to the philanthropic investor comes both in the form of principal and social return on investment (SROI), whereas for a grant the payback is simply SROI, and in a PRI it is (at least in theory) principal plus interest.

In this way an equity equivalent is not truly an equity instrument in the for-profit sense of the term (since in the for-profit sector the investor would be rewarded with a significant risk premium of some type); however, since they are unsecured injections of investment capital, they function in a manner similar to equity for the nonprofit enterprise. The amount of the equity equivalent (e.g.,. the principal invested) may be recovered at some future date and revolved back into the support of charitable work. In this way the recoverable grant plays the role of long-term equity, allowing the organization to pursue its social mission and build capacity. However, as previously stated, an equity equivalent does not guarantee either a return on principal or pay interest on the use of that principal, both of which are present in the structure and application of Program-Related Investments (PRIs). In fact, many PRIs do play a role similar to equity equivalents (given their extended terms and high risk status as loans); as discussed below, however, there is the expectation that they will be paid back regardless of whether the funded project is a success and since they are entered into as secured financing vehicles are fundamentally loans and not equity.

Below-Market Loans (PRIs)

The next step up from recoverable grants or other equity equivalents is below-market

loans. Any donor or institution may make a loan to any other organization that carries interest payments below the market rate. When made by business people, such loans are referred to as a "favor" or as having made "a really stupid loan" (since the market rate of return is much greater and one could earn better returns elsewhere). However, when a foundation engages in this practice it is referred to as a program-related investment! Under a PRI,funds may be taken out of either the foundation's annual grants budget or its endowment; however, if funds are paid back, they are usually returned to the foundation's endowment or corpus.

Pioneered over 20 years ago, largely through the efforts of John Simon of the Taconic Foundation, the John D. and Catherine T. MacArthur Foundation and the Ford Foundation, PRIs open up the potential for foundations to bring significant,new infusions into the Nonprofit Capital Market. While these loans carry an interest rate which is below the market rate (usually ranging from 2-4%) and have an extended payback period of seven or more years, they are often secured by assets or other means. In this way, PRIs allow nonprofits to access needed capital, while tying that capital to assets of the nonprofit organization. The funds, while carrying some significant degree of risk, are not as risky as an unsecured loan, recoverable grant or other equity equivalent.

It is interesting to note that while often thought of as a strategy for foundations to "extend" the impact of their endowment through lending as opposed to simply providing grant support,PRIs that are not paid back to the lending foundation may be "charged" by that foundation as contributing to the 5% annual grant payout requirement.

Along this line, it is also interesting to note that the interest rate structure for most PRIs runs completely counter to traditional lending or investment practice. In the "real world" of investing, deals are governed by the law of "high risk,high reward," yet in this case the nonprofit sector functions with greater reference to its own law of "high risk, low reward." While on the one hand this is understandable in that traditional commercial lenders won't come near many of these deals, so there really is no market for such loans and they therefore have no true value in terms of their potential future rate of return, on the other hand these loans do not reflect the true market realities that govern capital and economics. By contrast, loans originated by many nonprofit loan funds often carry a market risk premium that in some way compensates for the greater risk of making loans to high-risk, nonprofit clients.

Market-Rate Loans and Lines of Credit

Once a nonprofit organization has achieved a certain scale and capital structure, it may qualify for market-rate loans and lines of credit. These types of capital are most often used to finance either cash flow and working capital requirements or the acquisition of property. Such forms of capital carry standard market terms and interest rates. Furthermore, they require that the organization have sufficient assets to underwrite the loans in case of default. While not available to all, such capital is an important part of an organization's capacity to finance its efforts and build its balance sheet over time.

Market-Based Bonds and other Equity Investments

A final, and for some perhaps unachievable, stage of the Nonprofit Capital Market is that of bonds and true equity investments. Many hospitals, educational institutions and museums are able to secure this type of "high-end" financing. There are many types of bonds potentially available to nonprofit organizations as a means of securing expansion and other capital. Market-based bonds might include secured and unsecured bonds, various types of municipal bonds and industrial development bonds. Such instruments are in many ways out of reach of most smaller or developing nonprofits and may require fairly sophisticated financing;however, they do provide one option for securing significant,long-term capital resources for nonprofit organizations.

While rare,joint ventures and other equity partnerships are also a consideration for some nonprofits. In this scenario, a subsidiary, for-profit corporation would be formed and outside investors brought to the table in partnership with the nonprofit. Up to the present, few groups have developed the degree of sophistication required to structure

and manage such deals. With the influx of business managers into the nonprofit sector with for-profit finance experience, the market may see an increasing number of such capital structure "deals" in the years to come.

The Role of Venture Philanthropy in the Nonprofit Capital Market

In recent years, the Nonprofit Capital Market has witnessed the growth of a new approach to philanthropy, popularly referred to as "venture philanthropy." Other documents are available which discuss the fundamental tenets and practice of venture philanthropy, as well as how the core principles of venture capital funding and management support might be applied within a philanthropic setting.[15] For the purpose of this document, let us simply say that venture philanthropy is not a fad approach to funding limited to individual, fringe players, but is increasingly influencing a wide variety of actors in the Nonprofit Capital Market: community foundations, individual donors, corporate foundations, and other institutions.

Venture philanthropy's basic aspects include such elements as:

- Multiyear funding support
- Attention to organizational capacity-building
- Use of "new metrics" as a management tool to inform better practice
- Use of "new metrics" to calculate a Social Return on Investment that focuses upon the outcomes resulting from philanthropic "investments"
- Awareness and pursuit of appropriate exit strategies
- Deeper, more engaged relations between the funder and practitioner
- A "portfolio management," as opposed to "isolated grantee," approach to grant making
- Awareness and application of grants as capital investments

While the above factors represent important qualities of a venture philanthropy practice, it is critical to understand that the basic strategy of venture philanthropy may be applied in a variety of nonprofit contexts to address the full breadth of players present in the practitioner community. Individual venture capitalists and venture philanthropists maintain specific focus and expertise within a given area of interest (high technology or supported employment, for example); however, it is their investment strategy that really distinguishes their work from that of "classical" philanthropy. While it is a generalization, in some ways, venture philanthropy is less concerned with what social issue or challenge is being addressed than it is with pursuing an effective approach to how relevant capital and other support are provided to nonprofit practitioners.

This difference in orientation represents a fundamental contrast between the approach of intermediary organizations previously described and that of venture philanthropy. Intermediary organizations focus upon a particular area of interest (for example, community economic development) and how a particular model may be applied within it (for example, franchising or supported employment strategies). By contrast, venture philanthropists focus upon building the capacity of the practitioner to execute their framework and grow the ability of a given organization to sustain its work in the nonprofit sector.

Clearly, venture capitalists are successful in part due to their in-depth understanding of a given market and ability to see how a particular business strategy may bring very real value to that market place. Having made that commitment to a particular market, however, for-profit venture capitalists shift their emphasis from what is supported to how their support is provided. They are, in a phrase, fully engaged investors. Venture philanthropy is naturally concerned with the application of

innovative strategies to addressing social and other issues of societal concern; however, the values presented above reflect an approach to the support of organizations pursuing those strategies that is fundamentally different from that of both "classical" philanthropy and traditional intermediary organizations—namely, it is a form of engaged grant making which is felt to bring greater long-term value to the nonprofit market place.

Finally, it must be acknowledged that much recent debate in the philanthropic community has focused upon whether a classical or venture philanthropic practice is "better." However, such discussions miss the fundamental point that both approaches are necessary for the proper operation of the Nonprofit Capital Market. Just as the for-profit capital market includes venture capitalists,local bank lending institutions, mutual funds and investment banks, the Nonprofit Capital Market must also affirm the relative value of all its players, each of which fulfills a need within that market and operates with reference to its own "investment" goals.

Examples of foundation initiatives that pursue a venture philanthropy approach are Social Venture Partners (Seattle, WA), The Roberts Enterprise Development Fund[16] (San Francisco, CA), the Entrepreneurs Foundation (Menlo Park, CA) and the Robin Hood Foundation (New York, NY).

Challenges of the Nonprofit Capital Market

Financing the growth of any small, for-profit business is not easy. Attaining the owner's vision takes tenacity and often requires significant financial risk. The potential and promise of independence and financial reward are what make the risks worthwhile. Financing nonprofit ventures may be even more difficult, for two main reasons.

First, as previously stated, nonprofit organizations usually lack adequate assets with which to secure (or underwrite) loans. Many such organizations are "grant driven," with funds being made available annually in return for the fulfillment of commitments made by the organization to provide certain services or programs to the community—often to "consumer markets" which do not have the funds to otherwise pay for those services. Youth programs, food banks and low-income health centers are just a few examples of such programs.

In many ways nonprofit activities are driven by the fact they have no primary financial market capable of supporting such work—this is what makes them "nonprofit," since you can't make money off it. To wit, most nonprofits operate with "weak" balance sheets, carry few assets (such as buildings or other holdings that might be used to underwrite loans) and are often without large endowments that might fund enterprise or other social purpose activities.

Organizations that do have real estate assets with which to secure a loan often have used that existing asset to secure lines of credit to support the operating cash flow of the agency. This is often necessary due to the "risky"nature of supporting an organization with grants that may or may not be renewed the following year. However, this situation has the secondary effect of making those assets unavailable to finance other organizational priorities, for example, a new program start-up or expansion of a social purpose enterprise.

A second barrier to providing capital to nonprofits is the lack of equity/asset options, previously discussed. When a nonprofit "goes out of business," all of its assets are distributed to other, existing nonprofit organizations to continue the pursuit of charitable works. Remaining assets may not be sold to or given to outside investors, although in the event of bankruptcy they may be sold off to cover the outstanding debts of the organization. (The exception, of course, is that a nonprofit may liquidate its assets at market-rate prices in order to pursue its mission through other means. One example of this practice is that of nonprofit hospitals converting to for-profit corporations and endowing major health care foundations. While controversial, this practice is legal and does allow for the sale of a nonprofit's assets to outside investors.)

A counterpart to this lack of equity/asset options is the fact that to date there has been little demand for such options; most nonprofit organizations want those funds for current operations and programs as opposed to supporting the accumulation of assets. This lack of demand serves to underscore and, in some ways, support the lack of equity/asset options available to both potential philanthropic investors/ donors as well as nonprofit practitioners.

Business "angels" or other individuals who might otherwise fund various stages of a business start-up are rarely interested in taking on such a nonprofit "high-risk, no-reward" proposition. Even though a nonprofit may have some access to "loan dollars" through buildings or other assets, it cannot secure true equity investments—the life blood of any business enterprise. The gap in financing represented by this lack of equity is what we have termed the "equity gap" in the nonprofit sector. "Equity gap" is not meant to infer that the Nonprofit Capital Market itself is without access to such equity or equity equivalents, but rather that individual nonprofit organizations themselves experience a gap in their capital structure which in the for-profit sector is filled by equity injections from various sources. The existence of this gap stands as a critical challenge for most nonprofits attempting to pursue their social mission whether through traditional means or non-traditional strategies, such as the creation of market-based, social purpose business ventures.

In addition to these core challenges, the Nonprofit Capital Market itself is further hobbled by the following:

- Absence of market standards
- Lack of proven "Return on Investment"
- Market fragmentation
- Grant making in isolation
- Insufficient resources and capital market imbalance
- Various investors, various instruments
- Development of an emerging knowledge base
- Need for additional Nonprofit Capital Market research
- Learning versus funding
- Teaching funders to learn
- The tension between market cost capital and community-based need
- Market "insiders" versus market "outsiders"
- Market hype versus vision grounded in practice
- Atrophied investor relations
- Going to scale

We will briefly address each of these issues in turn:

Absence of Market Standards

One reason the for-profit capital market works as it does is that there are baseline standards for accounting, valuation of businesses and overall measurement of success. The nonprofit sector's lack of these is perhaps the single most detrimental factor preventing the expansion of philanthropic investments in the nonprofit sector. While there are emergent efforts to engage in "outcome funding" and the creation of standards by which to track "social return on investment" or SROI,[17] for the most part the nonprofit sector is driven more by politics, persuasion and perception than by any objective measure of success or capacity.

Examples of efforts to create standards by which comparative philanthropic investments may be weighed are seen in the work of the National Charities Information Bureau, the development and use of a "balanced score card" approach to standards and, more specifically, the work of GuideStar.[18] NCIB promotes standards for reporting and GuideStar posts not only the 990s of many nonprofit organizations, but also a number of "nonprofit ratios" by which the performance and resource allocation of organizations may be compared. These admittedly modest beginnings are a good start and must be taken even further. If the sector is to create a more effective capital market, the challenge of standards

will have to be addressed successfully and used to the advantage of quality programs in order to minimize the presence and financial support of poor programs.

Lack of Operating MIS to Track and Analyze "Social Return on Investment"

In addition to a lack of broadly embraced operating standards for the field, the nonprofit sector as a whole lacks management information systems with the ability to link the work of individual actors in the sector accurately with the impacts to which they lay claim. Many organizations operate programs and claim success of program designs based largely upon anecdotal information as opposed to having adequate information systems in place to track outcomes and draw connections between a given intervention or program and the social impact sought. With the rise in "effective grant making" and other funder interest in assessing the true impact of charitable funds, the Nonprofit Capital Market may be shifting toward a market that demands accountability. However, in order for the nonprofit players in this market place to make such a shift in operating systems and approach, significant investments in the design and installation of appropriate management information systems and evaluation methods will be required. Otherwise the "impacts" reported by most groups to outside funders would be simply estimates or projections as opposed to true measures of success.

Coupled with the inability to track SROI is the present inability to accurately analyze and attach investor value to social returns. Evolving frameworks for tracking SROI do attempt to assign "share value" to such returns, which may then be tied to the actual philanthropic investments made by individual investing agents. However, the challenge of rewarding added risk or proportional contribution remains significant. At present,a funder who makes a grant of $150,000 at the beginning of Year 1 is forced to "value" the impact of their grant on the same relative basis as one who makes a $5,000 grant in month 11 of Year 1. Without the capacity to assign relative risk and reward,the full potential of calculating SROI may be limited in its application.

While it would be easy to embrace SROI and other quantitative frameworks as "the" way to measure the impact of philanthropic dollars, such tools are only part of the process of accessing the true value presently being created in the nonprofit sector. Other approaches that build upon more traditional program evaluation and assessment tools also have their place in efforts to gauge impact and the added value created by nonprofit organizations. These, perhaps more qualitative, approaches must be further developed and refined in concert with evolving SROI and other approaches in order for the informed grant maker to fully appreciate the total impact of their grant making. Clearly, such approaches to evaluation are grounded in sound analysis and measurement; however, even something as basic as the personal story of a client or a hike through a wilderness area can expand upon and more fully reflect the actual effectiveness of strategic philanthropy. The advocacy of MIS/SROI approaches to measuring impact should not be to the exclusion of other evaluation strategies, but should augment and provide greater support for existing approaches in which the philanthropic community has already invested.

Market Fragmentation

While the for-profit capital market should certainly not be thought of as some well-oiled, smoothly running machine, it does operate with greater efficiency than its nonprofit counterpart. It must be acknowledged that fragmentation and inefficiencies significantly hinder the Nonprofit Capital Market. Those seeking resources must pass through a labyrinth of organizations, foundations and intermediaries, attempting to cobble together funds from a variety of sources with often competing priorities. One foundation supports endowments, while another won't make grants to organizations with "too many assets." Diversity is a healthy aspect of any system, but systems that are not able to build upon and coordinate their diverse elements soon break down into entropy. Despite efforts by the Council on Foundations (through the creation of a small number of foundation libraries) and some regional associations of grant makers who have helped present general information to assist those seeking funding, the Nonprofit Capital Market

remains an extremely challenging market to access for those smaller nonprofits already hindered by limited staffing capacity.

While there are those who celebrate the fragmentation of the market as a good and natural by-product of "the destructive creativity of capitalism," many players on both sides of the nonprofit capital table view such fragmentation as creating significant inefficiencies in the nonprofit market that force resources to be spent on activities that do not contribute either social or economic value to the nonprofit sector. Many of those involved in funding the nonprofit sector feel that a major challenge confronting the Nonprofit Capital Market is that of how to organize itself more effectively so that one investment may build upon the next to maximize both the efficient use of charitable resources and the added value of various charitable investments.

Grant Making in Isolation

A counterpart to the overall fragmentation of the Nonprofit Capital Market is the fact that a single grant maker can make a grant which launches a new initiative or program that may quickly take on its own life,usually attracting enough funds to stay alive if only for the short term, yet not enough to achieve real scale or sustainability. Grant makers, driven by their own vision and needs for market recognition, often neglect such basics as communicating with other funders and practitioners. Such practices may make for limited success, but in a sector with many linked players and relatively scarce resources overall, grant making in isolation can restrict the potential for strategic development of both individual organizations and the field as a whole.

Of equal concern are occasions in which one funder has seeded an initiative and seen it through its early years only to conclude that the effort was not as successful as had been hoped. Rather than publicly acknowledging that fact and sharing its lessons with the larger market place, a funder may exit a funding relationship with an organization, only to have that same organization then use its prior funding relationship to promote and secure new funding from another agent in the market, a funder who may be unaware of the initial foundation's dissatisfaction with the outcomes of its investments. While this may simply be an example of "buyer beware," much of what is supported in the market receives grants by way of reputation and perceived value.

At this time, in the absence of any broad standards or metrics by which funders may assess various grant making opportunities, each funder must engage in significant due diligence prior to awarding support. This fact makes it especially difficult for individual donors lacking in full-time staff to understand the full risk and potential of their individual donations. While in some ways this is simply reflective of the spirited independence of individual foundations and donors, the process of due diligence would be greatly facilitated by greater information-sharing and networking among those in the funding community in order to assure resources are directed to more effective organizations, while helping to prevent those with the best "spin" and grant writers from continuing to receive support.

Insufficient Resources and Capital Market Imbalance

In part as a result of the lack of standardization by which to evaluate the various investment opportunities present within the market, the majority of resources within the Nonprofit Capital Market tend to aggregate at one end of the sector—grants targeting support of Early and Intermediate Stage organizations. In addition to the imbalance created by this focus on grant making as the primary capital instrument,the foundation community's emphasis on "new" approaches and "innovation" in the nonprofit sector also creates a market "pull" toward Start-Up and Primary Stage organizations as opposed to those requiring Mezzanine or Mainstream support for the expansion of proven strategies and program initiatives. In addition, adequate resources may be lacking in both areas of development as a result of nonprofit leaders' limited access to the funding process or other factors effecting access to the market. There may be an overall tendency for the market place to move toward start-up and "new" initiatives; at the same time, there may also be segments of the nonprofit sector that for a variety of reasons will never be able to fully access opportunities to secure funding which might otherwise be available. In this sense, there may be questions of both a market imbalance and resource insufficiency.

Various Investors, Various Instruments

The capital market imbalance described above is further complicated by the fact that no single investor is limited to any single range of investment instruments. While it is true that foundations tend to make grants and lending institutions make loans, individual investors may make grants, loans or equity investments in any given nonprofit actor. Community foundations may make Program-Related Investments and grants. Indeed, any funding agent may make a grant of $5,000 or $500,000, and may also make a loan, recoverable grant or program-related investment.

While it would be helpful to have clear definitions of what types of instruments may be used by which investors, of greater value to the overall operation of the market would be more clearly delineated avenues by which the charitable investments (grants, loans and equity) of all actors in the market would be moved from one level of development to another. Regardless of which investors are active at which levels of the Nonprofit Capital Market, organizations moving from Start-Up to Primary to Mezzanine stages should be provided with more strategic access to those capital investors necessary for their long-term success and sustainability.

Development of an Emerging Knowledge Base

Those interested in understanding more about the Nonprofit Capital Market and how to be active within it must network through a variety of individual players, accessing a document here and a book there. The field is only now beginning to develop a formal knowledge base to inform those who would like to become more active as funders and to guide those seeking resources. There is no single model or approach to use in pursuing this practice and our understanding of the field is itself evolving. If we are to increase the number of investors active in the Nonprofit Capital Market, greater effort will need to be made among all those involved to document the process (both success and failure) and share information more widely than we have before.

One significant obstacle to creating this knowledge base is the tension between a funder's interest in funding an outcome versus openness to learning from an attempt to pursue a given outcome. If the Nonprofit Capital Market moves in the direction of demanding outcome measures and the overall quantification of impacts there is the very real danger that the field will lose any ability to support the creation of a learning environment wherein various experiences may be openly discussed and lessons shared. If the funder approaches the process in the role of customer ("purchasing" an activity that will have a certain outcome),the nonprofit will be positioned to document the fact that the "service" and its intended benefit were indeed achieved. What happens if the nonprofit's original strategy needs to be revised? What if the outcome is different from what was funded? There are many challenges to the creation of a learning process that will be of greatest benefit to both funder and practitioner. The sector will need to build in provisions to assure that learnings are documented and shared, as not hidden and viewed as failures.

An emerging impediment to the creation of a shared knowledge base in the field is the growing presence of fee-for-service consultants (nonprofit and for-profit). This pool of consultants is drawn from a number of disciplines, including nonprofit organizational development, small business development, philanthropic advisors and many other areas of practice. While there are some efforts to gather case studies and share information, as the intellectual capital of the field expands that knowledge could be controlled less by the sector or those who have funded these "learning opportunities" than by consultants who move from client to client—in essence selling the learning they have gathered from working with one nonprofit to their next client in need of such knowledge. Care will need to be taken to assure that as funders, practitioners and consultants work together the greater benefit of such partnerships accrues to the field and not consultant organizations.

Need for Additional Nonprofit Capital Market Research

Important as the "action research" represented by case studies and the gathering of lessons from the field of practice may be, there is also the need for additional basic research into the general field of philanthropy as it relates to "investing" in the nonprofit sector and the

various techniques for doing so. For example, understanding more about how charitable use assets may be used by foundations to support the work of practitioners and fulfill their social mission is an important and emerging area of both tax and practical research.

Many are familiar with the creation of charitable use assets—for example, houses donated for use as museums (engaging assets in the pursuit of a given mission) or ownership of the Kansas City Royals by a community foundation (engaging in the creative assignment of assets). But one wonders about other ways foundations could engage in more aggressive use of functionally related businesses such as credit unions or even manufacturing plants located in low-income neighborhoods. The fact is there are a variety of ways one may engage in both mission-directed assets and creative asset assignment. Such strategies could provide opportunities for joint ventures, the creation of community wealth and the charitable investment of foundation funds in vehicles that would provide some degree of financial return together with a direct social impact and return on investment. Additional research is necessary to assess not only what the possibilities of such uses of charitable capital might be, but also to support the wider dissemination of these possibilities to others in the Nonprofit Capital Market. What needs to be researched is how viable such options are and what legal,tax and other hurdles need to be overcome in order to make the best use of them.

Learning Versus Funding

As more foundations attempt to become more "engaged" in their philanthropy, new questions are being raised with regard to how a foundation may on the one hand seek to learn and grow from its relationship with a grantee, while on the other hand, remain in a decision-making role with regard to whether to continue funding the grantee. In the pursuit of closer relations between funders and grantees, there is a fundamental conflict between encouraging an open, honest relationship with a grantee portfolio and grantee fears of losing funding if they are truly open about their challenges and shortcomings. While this is true in many areas of grant making, it is especially true for those pursuing a Venture Philanthropy approach to the use of charitable dollars. How to build a learning culture to support the growth and development of the field, while also acknowledging that funding decisions are made based on the perceived and actual capacities of a given grantee to achieve its goals, is an ongoing challenge for both grantees and those who would support their work.

Teaching Funders to Learn

The foundation community of the United States invests billions of dollars in an array of community strategies targeting any number of issues of community concern. This is a significant responsibility and it is no wonder funders strive to involve some of the "best and the brightest" in the process of allocating charitable dollars. Unfortunately, this can often lead to an expectation of success that may have the unintended consequence of stifling opportunities for true learning between and among funders. Seldom does one hear a funder discuss problems of a given strategy or funding experiences wherein the foundation made a series of fatal errors in a "bad" grant process. Without greater openness to and support for the creation of a true learning environment, the funding community will never capture the full value of many of the experiences it makes possible through its financial support. Cultivation of the learning environment is necessary for change to take place and practices to improve. Foundations need to embrace the concept of learning for themselves as much as they promote it for their grantees.

The Tension Between Market Cost Capital and Community Needs

At its core, the fundamental challenge confronting the nonprofit market place is the reality that the return on investment is both social and economic. Understanding more about this tension and how it may be overcome is an important challenge. In many ways, the nonprofit sector evolved in response to the deficiencies of market-based capitalism. There are very sound and understandable reasons why investors don't place their capital with nonprofit organizations. Some of these reasons are definitive and grounded in the basics of economics, but others simply require greater investments of intellectual capital to overcome

perceived limitations. Through committing ourselves to thinking more creatively about historic problems, we have the potential for overcoming at least some of those problems. For example, Caroline Williams, in a recent paper entitled "Financing Techniques for Nonprofit Organizations: Borrowing From the For-Profit Sector,"[19] presents a number of creative and innovative ideas that should be considered. In addition, understanding how to factor in "community value" as a part of the investor definition of return and measure of return is an important challenge that needs to be a part of this discussion. This issue merits more attention from both the for-profit and non-profit communities.

Market "Insiders" Versus Market "Outsiders"

The saying is well known: "Foundations fund people, not paper." The Nonprofit Capital Market is in many ways driven by personal relationships. Funders who have confidence in certain grantees promote those grantees to other actors in the market. Individuals without connections or access submit "over the transom" proposals. As we move toward efforts to formalize the Nonprofit Capital Market, it is imperative we assure full and broad participation by a wide range of practitioners in order to assure healthy diversity in the market place. Presently, those who know how to "work the system" have the greatest success and little strategic effort is made to aggressively bring communities of color and those who "don't fit the mold" into the mix. We should view this period of growth as an opportunity to bring more and diverse players to the table as a way of teaching others how to leverage greater resources through a more attuned understanding of the nonprofit capital investment game. In addition to teaching others how to more effectively operate within the market, such efforts would have the added benefit of allowing those making grant making decisions to become better informed of the many options and strategies being pursued outside the mainstream network of more easily identifiable players. Greater effort in this area would be of benefit to both funder and grant seeker.

Market Hype Versus Vision Grounded in Practice

While vision is what sustains a people in times of need, vision alone is not adequate for achieving our goals. Vision must be grounded in the realities of practice, experience and history. In the aftermath of The New Era Foundation, the United Way scandal and a history of funding experiences where nonprofit organizations were perceived as not having achieved their stated missions,[20] the potential is great for "over-hyping" both the Nonprofit Capital Market and the players active within it. Some might say that a degree of "promotion" is good for the sector and just a part of how any marketplace of ideas should function. However, in the nonprofit sector, where charitable funds are precious and many donors and practitioners are sincerely searching for "a better way," the risk of losing funds on ill-conceived or overly risky ventures is great.

While there are certainly many creative and talented actors in the nonprofit sector in roles as funders and practitioners, there is a danger in our forgetting that ours is an emerging practice. In our rush to raise new funds, advocate new approaches to "old" problems and enlist others in our efforts, we should not forget to provide ourselves both a margin for learning and a commitment to building upon the actual experience of practitioners. If we neglect to do so, we will raise expectations beyond what we may be able to deliver and may well miss out on the potential for creating a learning community from which we can all benefit. It is a given in the for-profit market that there will be winners and losers. In the nonprofit market we have an ethical responsibility to help assure the responsible use of funds and pursuit of innovation.

Atrophied Investor Relations

The for-profit market is controlled to some degree by clearly enunciated, legally grounded terms that govern relations between investors and invested organizations. By contrast, grant proposals and personal relationships guide the Nonprofit Capital Market. This has led to the evolution of relationships between funder and fund seeker which are burdened with "spin," increasing the distance between those with the resources and those who require them. The development of honest, open investor relationships is difficult, yet critical to

the success of our efforts to both formalize and expand the Nonprofit Capital Market. And although understanding how to cultivate and manage such relations will take time, the benefits to be gained by both nonprofit organizations and funding institutions cannot be underestimated.

Going to Scale

As various players compete for funding in the Nonprofit Capital Market there is an emerging tension between the commitment to taking successful programs "to scale" and that of supporting a diverse range of strategies at various sizes. While it may be clearly of value to build upon success, a drive to go to scale may be motivated solely by the notion that "bigger is better." This tension between growth and stasis involves values related to our definitions of success, impact and worth in the sector. Perhaps "going to scale" is less important than an organization's achieving "appropriate scale"—and having access to the appropriate resources to do so. In some cases, this may mean an organization with demonstrated success receiving adequate funds to expand its work to other communities across the country and perhaps internationally. For others, scale may be a question of the organization's sustainability; funding may instead be targeted at enhancing the management and funding capacity of the nonprofit. This issue deserves greater attention in the near term, lest we risk losing opportunities to support community-based solutions in our drive to replicate proven successes of the field.

Conclusion

This chapter has presented a basic introduction to the Nonprofit Capital Market, its players and investment instruments. As our nation anticipates such substantial shifts as governmental devolution of funding and authority, the generational transfer of billions of dollars from parents to children and the critical needs of communities left behind in past decades of historic economic expansion, it is imperative those active in the nonprofit sector move to achieve greater, demonstrated success in our field.

The fundamental challenge of the Nonprofit Capital Market is not simply a function of applying more resources to problems, but of applying appropriate resources in strategic ways that will provide us with the return sought by all: funder, practitioner and community representative. Building upon the success of the past and the innovation of the present, we can only anticipate increased social return on the investment of charitable dollars in our future.

Footnotes

1 Excellent resources for understanding the sector include "America's Nonprofit Sector: A Primer" by Lester Salamon and "The Nonprofit Almanac" published by The Foundation Center.

2 This information is taken from the Independent Sector's Web Page,www.independentsector.org.

3 See chart of page 193.

4 This document, while written for and with the Nonprofit Capital Market Working Group, draws in part upon concepts and language presented in other documents published by The Roberts Foundation: specifically, the Foundation's work in the area of Social Return on Investment and its book, *New Social Entrepreneurs*. Copies of these documents are available at www.redf.org.

5 For additional information on socially responsible business activities, please contact Business For Social Responsibility or the Social Venture Network, both located in San Francisco, CA.

6 "A Study of the Availability and Sources of Venture Capital in Maine," produced by the Finance Authority of Maine, published in March 1995.

7 Community Wealth Creation Forum, October 1996, Washington, D.C.

8 For those interested in understanding the full breadth of the Nonprofit Sector, a good initial resource is the Independent Sector Web Page (www.independentsector.org).

9 It should be understood that the focus of this document is on those entities organized and operated exclusively for "religious, charitable, scientific, testing for public safety, literary, or educational purposes" or for other purposes as described within section 501(c)(3) of the Internal Revenue Code. Such entities are further categorized as "public charities" (generally thought of as the organizations that do good works and to which you and I may give tax-deductible contributions),and "private foundations," which are the organizations that generally fund public charities. Therefore, this document will not address organizations such as trade unions, mutual insurance companies, country clubs and some types of cooperatives. Even with this restriction, the focus of our discussion addresses thousands of nonprofits working in the areas of education, social services,the environment and so forth.

10 Also referred to as operational philanthropy.

11 Mr. Rosenberg, a well-respected investor and philanthropist, is the author of *Wealthy and Wise*, a book providing guidance to individual donors considering both the amount of and strategy most appropriate for their philanthropy.

12 This fact speaks directly to the "operating revenue" versus "capital investment" issue discussed above.

13 For a discussion of the "liquid" versus "dedicated" attributes of the Nonprofit Capital Market, please see "Grants, Debt and Equity: The Non-Profit Capital Market and Its Malcontents," found in the book, *New Social Entrepreneurs*, ordering information for which may be found at www.redf.org.

14 A distinction should be made here between providing a "direct financial return" and distribution of surplus funds. Technically speaking, nonprofits may provide a direct return to investors, as long as it is fixed interest at or below market-rate and is the result of an "arms-length" transaction. As discussed elsewhere, while nonprofits may issue bonds and borrow, they may not distribute or promise to distribute net surplus (net income) or their net assets to "investors" or others who control the nonprofit. However, when in line with their mission,nonprofits may provide funds directly to outside individuals (such as in the form of scholarships or other financial awards).

15 In the January/February 1997 issue of the Harvard Business Review, Chris Letts, et al,published *"Virtuous Capital,"* an article comparing the strategies of venture capitalists with those of foundation programs. In 1998, Stanford University's Graduate School of Business released *"The Roberts Enterprise Development Fund: Implementing A SocialVenture Capital Approach to Philanthropy,"* a case analysis of how one foundation has executed a focused strategy of venture philanthropy. Copies of the case are available through the REDF office and the Stanford University Graduate School of Business. And "When Pigs Fly," an article by Bruce Sievers, Executive Director of the Walter and Elise Haas,Jr. Fund, which critiques venture philanthropy as an approach for charitable support of nonprofit organizations,is also an interesting read.

16 Stanford University's Graduate School of Business has recently released a case study of the Roberts Enterprise Development Fund, analyzing both venture philanthropy and the issues raised by foundations' pursuit of such an approach. Ordering information is available through Stanford University and the offices of REDF:www.redf.org.

17 The Corporation for Enterprise Development (with the support of the Annie Casey Foundation), the Roberts Enterprise Development

Fund (of The Roberts Foundation) and other players are moving to promote frameworks to measure and quantify social return on investment. As these and other frameworks are formed and endorsed by the sector as a whole, the "metrics" by which standards may be created will evolve, moving toward the creation of standards and benchmarks against which competing investment opportunities may be measured. The REDF SROI framework is presented in a companion chapter of this book and the CFED document is available through their office (Washington, DC).

18 See www.ncib.org and www.guidestar.org for additional information on each of these organizations and their approach to establishing standards for the nonprofit sector.

19 "Financing Techniques for Nonprofit Organizations: Borrowing from the For-Profit Sector," was written by Caroline Williams for Creative America, a report by the President's Committee on the Arts and Humanities, Washington, D.C.

20 Recent polls have listed "nonprofit organizations" as close to used car salesmen in the degree of trust the American public has for their statements and actions.

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Five Challenges in Social Purpose Enterprise Development

Five Challenges in Social Purpose Enterprise Development

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Introduction

The 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 nonprofit 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.

Numerous writers have discussed the broader aspects of this transformed and transforming nonprofit sector.[1] Our own work has focused upon the emergence of New Social Entrepreneurs (individuals involved in the community application of business practice).[2] 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.[3] 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[4]

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.[5] 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."

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Chapter 12

The Venture Fund Initiative: An Assessment of Current Opportunities for Social Purpose Business Development and Recommendations for Advancing the Field

The Venture Fund Initiative: An Assessment of Current Opportunities for Social Purpose Business Development and Recommendations for Advancing the Field

Executive Summary

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The Venture Fund Initiative was made possible through the support of

The Rockefeller Foundation

The Clark Foundation

J.P. Morgan Trust

The Roberts Foundation

The Surdna Foundation

The Tiger Foundation

National support for the Initiative was matched locally by

The Bader Foundation

The Chicago Community Trust

The Durfee Foundation

The Community Foundation for Greater Atlanta, Inc.

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Abstract

Over recent years, increasing numbers of nonprofit organizations have begun to engage in a variety of efforts to plan, launch and manage social purpose businesses. For the most part,these efforts have been pursued on an individual basis, with little or no systematic communication and learning between similar groups in the same city or at the national level.

The Venture Fund Initiative was a mapping and exploration process which took place in six cities:

Ann Arbor

Atlanta

Chicago

Los Angeles

Milwaukee

New York

The purpose of the initiative was to provide organizations operating social purpose businesses with the opportunity to examine the organizational and external obstacles limiting their business development efforts. Based on that assessment, focused discussions were then held with leaders in the business, business-school and philanthropic communities.

These discussions were targeted at identifying what existing and new resources could be more effectively mobilized in support of the work of nonprofit organizations operating earned-income and social purpose businesses.

This initial report presents the findings from four out of the six cities and recommendations for the creation of local support mechanisms to assist social purpose businesses in achieving greater scale, sustainability and impact.

The report also suggests several sector coordination, learning and support functions that could assist practitioners in expanding supported employment opportunities for very low-income people and in generating new sources of earned income for nonprofit organizations.[1]

A complete copy of The Venture Fund Initiative report may be downloaded from the REDF web site, www.redf.org.

Introduction

he Venture Fund Initiative was a strategy and mapping process that began in January of 1998 in six cities:

Atlanta
Ann Arbor
Chicago
Los Angeles
Milwaukee
New York City

The goal of the initiative was to support community and regional efforts to evaluate the capacity of and challenges confronting nonprofit organizations operating social purpose businesses. These business ventures were launched in recent years to provide transitional and permanent employment to very low-income individuals and/or to generate new sources of revenue to support the sponsoring organizations' social mission. This report summarizes the work in four of the six sites; the experiences of Ann Arbor and Atlanta, whose efforts were not yet completed by the drafting of this report, will be incorporated in later versions.

Background and Rationale

It seems that once every decade, the nonprofit, government and foundation worlds rediscover social purpose business development.[2] Many of the original community development corporations founded in the 1960s included business ventures as a part of their overall strategy to engage in community economic development. These efforts joined other activities of social service organizations, many addressing the needs of people with disabilities, to operate supported employment enterprises. A number of organizations, such as Goodwill Industries, the Salvation Army and other well-known institutions have achieved laudable success in their efforts to operate revenue-generating businesses.

Despite these anecdotal achievements, the experiences of those organizations attempting to launch social purpose businesses have rarely matched expectations. Indeed, for every successful venture,there have been a significant number of failures, and the overall legacy of initiatives in this area has been poor. Despite this history, the vision of blending a social purpose with sustainable,market-based businesses is still being pursued by increasing numbers of nonprofit organizations.

Critics might argue that the United States is currently in the midst of yet another "rediscovery" of social purpose businesses doomed to fail. But unlike past efforts in which motivation for job creation and business development came from broadly conceived governmental and foundation initiatives, current efforts are being undertaken "from the bottom up" by a new breed of social entrepreneurs—despite the reservations and occasional inability of many funding bodies to support such work.

This emerging class of nonprofit managers views social purpose business as a means to secure opportunities in the changing marketplace, in which traditional grant funding is being reduced and government services cut back. Moreover, prior efforts by nonprofit organizations to operate business ventures were frequently launched without the involvement of for-profit partners from the business community. Today's ventures benefit from substantive and sustained involvement of those successful in their for-profit pursuits,through their industry and management expertise as well as their links to potential customers and financing sources. Their participation as advisors, board members or managers does not assure success; however, it does reinforce the use of sound business practice in the operation of social purpose businesses.

Well-intentioned nonprofit staffs who often found themselves hamstrung by a lack of fundamental business skills have, in fact, launched many efforts. Increasingly, today's social entrepreneur brings not only a command of nonprofit management skills to the enterprise effort, but also business-development skills. Many social workers are complementing their degrees in community work with MBAs or are learning business skills through other avenues. In addition, numerous social purpose businesses are now managed by individuals with MBAs and direct

experience in the for-profit sector, a rarity in prior years. As a result, nonprofit businesses are now operated with a sharper focus on meeting the demands of the market and with the knowledge that they cannot afford to repeat the lessons of the past.

Supporting the Emergence of New Social Entrepreneurs

The Roberts Foundation began its work in this arena in 1989 and is regarded as a leader in the field of social purpose business development. The lessons of the Foundation are documented in *New Social Entrepreneurs: The Success, Challenge and Lessons of Non-profit Enterprise Creation*, which details the Foundation's experience and that of its grantees.[3] The response to the book from the nonprofit, foundation and business communities has far exceeded expectations and confirmed the great demand for practical information about enterprise development in the nonprofit sector.

In the two years since the book's release, The Roberts Foundation has come to serve as a broker of information and "intellectual capital" exchange between practitioners of social purpose businesses. In the fall of 1997, these conversations led to the realization that many organizations across the nation were pursuing an array of business development strategies in isolation. A unique opportunity was at hand to develop a more effective approach to the field of social purpose business development, supported employment and earned income.

In response to this opportunity, a group of national and local funders came together to support The Venture Fund Initiative (VFI). The Initiative was a mapping and exploration process that enabled staff of The Roberts Foundation to work with conveners and nonprofit practitioners in six cities to assess existing local markets, resources and capacity for social purpose business. The aim was to explore the need for and feasibility of improved support mechanisms for social purpose businesses in these sites. Each site's process involved local social entrepreneurs as well as representatives from the foundation, business and academic communities. Each process was led by a local organization that directed the planning effort in concert with practitioners from the community. This draft document includes the findings from four of the six cities and suggests strategies for the creation of support systems for local enterprise activities.

The Mapping and Exploration Process

A series of sites was selected for participation in the Venture Fund Initiative based on

- the presence of talented social entrepreneurs
- an organizational infrastructure supportive of the concept of social purpose businesses and capable of acting as a convener to facilitate the six-month process
- the presence of existing social purpose businesses in the city under consideration and
- potential funding partners.

In each city, participating practitioners were identified who were operating revenue-generating businesses in support of their mission, which were either centered on job training and employment for low-income individuals or earned income for the parent nonprofit.

The exploration process was based on the assumption that there is no set model for engaging in social purpose business development. Rather, there are certain business fundamentals that cut across the field and core issues of capacity and development that organizations must address if they are to operate a successful social purpose business. Those business fundamentals and nonprofit capacity issues are expressed differently depending upon the regional economy, the array of resources available locally, and the composition and experience of those nonprofits involved in the sector.

Appendix A outlines the five critical elements of successful social purpose business development. Those five elements appear across the field and include

- organizational capacity
- managerial ability

- market definition and penetration
- capital mix and availability
- investor relationships.

Based on this core outline and with the guidance of the executive director of The Roberts Enterprise Development Fund, each site developed its own framework for approaching the analysis of local capacity and opportunities. What follows are the lessons drawn from this exploration and reports from each city, which map out how those elements are arrayed in each location.

Facilitation of this process was both challenging and rewarding. Representatives from the convening organizations were brought together in months One and Five of the six-month period. In addition, staff from The Roberts Foundation visited each city in order to participate in and contribute to discussions taking place at the regional level. Extensive use was made of email, phone and, to a lesser degree, an initial web site in order to ensure communication between each site and the lead facilitator, Jed Emerson.

While the specific experience of each city differed, the practitioner was the starting point for the discussion in all sites. Therefore, organizational and enterprise audits were the core of the process and provided the basis for subsequent conversations with those outside the organizations involved (such as business people and foundation officers). Given the importance of the enterprise audits to frame an understanding of local organizational capacity and limitations, a sample audit outline is included at the end of this executive summary.

Matching grants were awarded to organizations at each of the six selected sites. These grants were leveraged with local funds (both to ensure "buy-in" and as an investment in the future process) in the form of a 3:1 match. The funds covered local staffing and administrative costs associated with the Initiative. The total cost per site averaged $40,000, and grant disbursement was managed by The Enterprise Foundation.

In reviewing the sections from each city, two points should be kept in mind. First, the summary reflects the experience of a given city in assessing both current capacity and limitations of pursuing social purpose business development. While each site pursued sound strategy and mapping in its planning, each site executed a *different* process designed by the local conveners in concert with local practitioners and national facilitators. Therefore, each section of this document's outline, presentation and form of analysis varies to reflect these local conditions.

Second, each summary was derived from a comprehensive report on each site.[5] These documents range from 40 to 70 pages and provide greater detail concerning the local market for social purpose business. For obvious reasons, summary statements from each region are most effective for the purpose of this chapter. And, as stated earlier, reports from both Atlanta and Ann Arbor (both of which are still in process) will be added to future versions of this document.

The Importance of Social Purpose Business Development as a Community Strategy

A common assumption is shared by all six cities and those involved in supporting this effort: the practice and expansion of social purpose business development is important for both the nonprofit sector and the communities it serves. Because this assumption is not necessarily widely shared, it is worth addressing before presenting the experience of the Venture Fund Initiative.

Practitioners, funders and advocates of social purpose business development feel this pursuit is important for the following reasons:

The mainstream labor market,in a time of historic lows in the nation's unemployment rate, still cannot absorb and support the employment and training needs of homeless, very low-income and chronically unemployed individuals. A for-profit business is not a training center. The primary purpose of a for-profit corporation is to create wealth for its investors—not jobs for the poor or untrained. Social purpose businesses offer unemployed individuals the opportunity to train in market-based environments, yet with the support and flexibility needed by individuals facing serious or multiple obstacles to standard job training or mainstream employment. Transitional employment in a social purpose business is provided to individuals deemed inappropriate for traditional job training and placement programs and

unwanted by the labor market. It provides a critical path for those who neither meet traditional for-profit hiring needs nor fit into nonprofit training programs. For many, such employment can be a bridge to traditional employment.

In the next century, nonprofits will not be able to rely exclusively on governmental funding sources, limited foundation resources or the charity of individual donors and must identify alternative sources of financial support to help fulfill their program and social missions. Currently, there are over 600,000 nonprofit organizations pursuing a wide variety of social and charitable missions to benefit this country. As federal funding decreases and local funding comes under increasing strain, nonprofit organizations must diversify their funding base to decrease their risk of having inadequate resources to pursue their missions. Social purpose business development must take its rightful place as another financing option—next to individual contributions, government contracts, foundation grants and program-related investments—in the future capital structure of the nonprofit sector.

The community application of business skills and practice is not isolated within an organization's business venture, but rather acts to increase the overall management skill and expertise of the nonprofit, reaping broader benefits for other charitable investments. Nonprofit organizations that operate social purpose businesses usually must do the following in order to succeed:

- improve their accounting systems
- create more effective information and data management systems
- increase the level and sophistication of their overall management.

This process of operational improvement is driven by the requirements of the market; however, it has the "spillover" benefit of contributing to the broader success of organizations pursuing a social mission. Investing in nonprofit capacity to successfully manage earned income and supported employment ventures means investing in those same organizations' ability to pursue their broader social and charitable mission more effectively.

Current foundation support of social purpose business development tends to be made on a grant-by-grant basis, without leveraging earnings from multiple players or coordinating efforts to assist nonprofit organizations in achieving their goals. Initiatives such as the VFI provide funders with more effective ways to leverage grant dollars and other support. Although individual successes have taken place, what is needed to improve the practice and impact of social purpose business is the establishment of support mechanisms to meet the special needs of business ventures that achieve market as well as social returns. While foundation grants and program-related investments have been important in supporting the efforts of individual practitioners, the following are still needed:

- Nonprofit organizations running social purpose businesses benefit from networking with each other to improve management and industry-specific practice, as well as participate in collaborative efforts to address the specialized challenges of pursuing a "double bottom-line."

- Isolation and the lack of information about the field of social enterprise have made it difficult for businesses run by nonprofit organizations to access resources of the business academic community and the larger business community; a coordinated strategy could effectively leverage a variety of resources in support of the field's expansion and the success of individual nonprofit organizations.

Based on the emerging success of individual practitioners, the field is now in a unique position to move both the standards and the execution of the practice to a new level of confidence and sustainability in the marketplace.

Finally, the support of this emerging field is important for the following reason:

If the market alone were adequate to meet the needs of the nonprofit sector, the nonprofit community would not now show

the rapid expansion in the number of organizations attempting to leave the historical security of traditional funding for that of earned income and supported employment. Small business development is hard—in risking a family's nest egg, the failure rates are great, and the uncertainty of the marketplace is greater. However, social purpose business development is *harder*. For those operating such a venture to earn income that may be directed in support of a charitable mission, there is a constant battle between social and profit goals. For those starting businesses as a vehicle to provide supported employment to the marginally employable, the task of engaging a labor pool already excluded from the mainstream labor market is a constant challenge.

The only reason to take on such challenges is to address one of the four factors stated above. As the field grows and increasing numbers of nonprofit managers take up these strategies, those who have gone before can provide great value to the field by sharing their lessons with others and acting as mentors. The Venture Fund Initiative has been one step forward in this process, and it provides an important launching point for the support of local practitioners, as well as an opportunity to assist in the development of the field as a whole.

General Findings and Lessons of the Venture Fund Initiative

While the goal of the VFI has been to provide practitioner groups in six cities with an opportunity to assess local capacity and challenges in the field of social purpose business development, a number of crosscutting lessons and conclusions were also generated from this process. These general lessons are presented below:

Social purpose businesses fall along a continuum of activity ranging from those that are primarily market-driven to those that are primarily mission-driven. Nonprofit organizations may fall on a number of points along this continuum, but the key issue is that those involved in such ventures understand where they are on that continuum.

In "Enterprising Nonprofits,"[5] Gregory Dees presents a continuum of social enterprise ranging from the Purely Philanthropic to the Purely Commercial. Organizations fall along this continuum at a number of levels. For example, under a Purely Philanthropic model the beneficiaries of the organization would pay nothing for the services they received, while a Purely Commercial venture would charge beneficiaries market-rate prices for services.

It is interesting to note that organizations participating in the VFI did indeed reflect points along this continuum. In the experience of VFI participants,those operating ventures in the six target cities were doing so either to provide transitional or permanent employment to individuals outside the mainstream labor market or to generate revenue to support the parent organization's social mission. While they are all social purpose businesses, organizations pursuing revenue generation tend to be more fully market-directed than are those that must also pursue market opportunities with a strong social mission. For example, an organization interested in revenue generation may establish a for-profit subsidiary corporation that, while not violating the fundamental mission of the parent nonprofit, may operate more freely from the constraints and challenges of those who also seek to employ a target population with multiple barriers to employment.

Nonprofit organizations that operate businesses that are both profitable and provide transitional employment are thought of as "hybrid" organizations that may encompass the strengths and limitations of both commercial and social purpose business and may therefore represent greater overall risk in

operation and management. This is due in part to the fact that organizations concerned primarily with revenue generation may be market-driven but not fundamentally social mission-driven, while organizations pursuing profitability and employment goals must be both market and social mission-driven.

An important lesson from across all six cities in the Initiative was that groups operate along a continuum; it is not a question as to which is best or where one should be on that continuum, as much a question of needing to know where one really is along that continuum. *Many nonprofits appear to believe they are more fully market-driven than they actually are.*

The nonprofit organizations involved in the VFI process also engaged in a variety of types of planning and pre-development to prepare for launching their ventures. Some organizations had engaged in a significant amount of business and organizational planning prior to launching their venture activity, while others had simply "happened upon" what was perceived as a business opportunity and moved to act on that opportunity. On the whole, it is clear that many organizations need assistance in developing and executing more effective planning with regard to the ventures in which they are engaged and the enunciation of most effective strategies for managing those ventures.

Part of the enterprise audit process involved an assessment of business plans, organizational development and other documents that were used to gauge the capacities and challenges of organizations pursuing nonprofit ventures. While many organizations had such plans in place and made use of them to guide their work, a majority of the organizations operated with only marginal business plans and had done virtually no marketing or other studies that could inform their strategy.

On balance, the organizations that had such business plans in place operated with greater success and competence than those that did not. In short, having a business plan does not guarantee success, but not having one usually contributes to failure. Many of these organizations, however, have the potential to develop business strategies that are adequate to their needs and would contribute significantly to the future success of their efforts.

The boards of directors of many nonprofit organizations pursuing venture-development efforts are evolving, creating diverse ways to effectively oversee and plan for the future expansion of their organizations' ventures.

As might be expected, organizations surveyed demonstrated a wide range of board capacity and involvement in the enterprises being operated in the field. Some boards have made effective use of outside business expertise, while others could develop significantly greater ability to leverage such input. Many boards appear to be addressing the challenge of how to balance their responsibility for fiscal oversight and guidance with the need for operating committees and others charged with overseeing the execution of those policies and strategies. Larger organizations, which tend to have more clearly defined roles and responsibilities, appeared to do better addressing this challenge than smaller organizations, where there tended to be more potential for overlap and possible conflict or confusion with both operations managers and advisors.

The structures of board oversight and involvement in enterprise development are clearly evolving. The challenges addressed by any nonprofit board become all the more complex when that board is overseeing and balancing the potentially competitive demands of core program areas and social purpose businesses. While some are effectively managing these challenges,others are clearly in need of additional training, guidance and support as they move from traditional nonprofit structures of the past to the hybrid structures of the future.

Many cities have a wealth of potential technical assistance support that could benefit those operating social purpose businesses, but this support is often fragmented and not readily accessible to nonprofit practitioners and managers. This fact is compounded by the diversity of the nonprofit organizations operating ventures in any given city, representing a wide range of organizational capacity, culture and managerial skills.

Each of the cities was able to identify a wealth of potential and actual support that could contribute to the success of nonprofit ventures. These resources may be found in the business-academic, mainstream-business

and foundation communities. In virtually every case, when presented with information regarding the number of practitioners in a given city, individuals within these communities expressed both an interest and ability to participate in direct partnerships with nonprofit ventures. There is significant potential to directly link community resources more effectively with practitioners and managers in need of their technical assistance and support.

However, it is also clear that many managers lack the time or networks to identify, negotiate with and secure the support of these potential sources of technical guidance and support. Many managers focus on operations and have little time available to secure the technical and other assistance often available in their own community.

This time shortage is compounded by the fact that organizations operating social purpose businesses have a wide range of capacity and need. They do not easily fit a single "mold" and therefore require individual assessment and evaluation in order to identify specific areas requiring assistance, as well as support in identifying the most appropriate potential technical assistance providers and other possible partners.

The potential for growth and a significant increase in the sustainability of social purpose business is clear. However, for these ventures to be successful, they must receive a variety of supports. The way that assistance is provided will play a major role in their potential for future success.

The success of efforts to provide consultation and assistance to any corporation (whether for-profit or nonprofit) often hinges on how that assistance process is framed and on how a number of very complex issues are addressed. Specifically, the following factors appear to be critical:

- Participating organizations must at the outset be open to critique and must be amenable to input on the assessment, operation and ongoing management of their enterprise.

- The process by which input is solicited and received must be owned by participating organizations.

- Participating organizations must fundamentally believe that the process, while entailing a commitment of time and resources on their part, will ultimately be of real benefit to the organization and its staff.

- Participating organizations must know that an end goal of engaging in the process will be the potential to receive additional capital to underwrite the pursuit of their strategies.

- While accessing additional financial support is a critical element, practitioners often feel that of equal importance is the potential to access additional, non-financial resources to augment grants and assure the development of greater organizational capacity to successfully execute agreed-upon strategies.

- In order to address the above factors, significant time needs to be invested in the process at the start to ensure clarity of all parties' expectations. In addition, the various nonprofit terms, which govern the relationships between significant stakeholders (nonprofits, foundations, technical assistance providers, mentors, etc.), must be clearly understood by all.

While these factors may appear essential if a successful initiative is to move forward, many nonprofits have built their success on funding and other relationships that are primarily "arm's-length" relationships, whereby funders and others are not often informed of significant operational concerns that managers and key Board members have. Yet, if the goal of an initiative is capacity building and support, open and honest communication with regard to the true weaknesses and limitations of an organization is critical to its receiving appropriate and meaningful technical assistance.

Traditional approaches to funding make many potential grant recipients leery of a funder's knowledge of an organization's weaknesses. They fear that they will not be viewed in a positive light and may lose critical funding. If future support is to be secured and effectively applied to assist social purpose business efforts, that support will no doubt require a different approach to the funding relationship.

Furthermore, the traditional approach toward capacity building that entails providing an organization with a grant to hire a consultant to guide it through its process is also less effective in this area of practice. What organizations express (and what both the six-city inquiry and the experience of the Roberts Enterprise Development Fund have shown) is that while groups certainly do need access to technical assistance, the assistance must be founded on knowledge-transfer aimed at genuinely increasing the nonprofit's capacity to engage in the task on its own in the future. It must also be understood that technical assistance without networking, staff development, capital funding and for-profit business mentors is much less effective in social purpose business development than technical assistance in the form of traditional consultation and guidance, as is the current mainstream practice.

The challenge for the field is how to mobilize the array and type of support needed to best achieve long-term goals for development and sustainability. Such frameworks are available and may be designed based on regional needs and opportunities. However, such frameworks must be supported for the field of social purpose business development to achieve its real potential for success.

Many cities have a significant number of nonprofit organizations operating social purpose businesses of various types. Most of these organizations have self-financed the start-up of these ventures or launched them with extremely limited grant support. These organizations have brought their ventures through the initial stages of start-up, but now lack access to financial resources to adequately capitalize their venture for expansion or achievement of market sustainability. Some funders may already understand the following information. However, for those that are not familiar with for-profit financing strategies, a "primer" may be of assistance.[6] It should be understood that there are a number of ways for-profit small businesses meet their needs for the capital investment required to "bootstrap" the start-up and expansion of their venture. One classic scenario follows:

> *An individual with vision sees an opportunity in the marketplace and has an idea for some product or service offering she feels will be better than other offerings presently available. She approaches friends and family members for support, offering either a loan payback (with a fixed rate of return) or an equity position (an unsecured investment with some type of owner share in the business provided in exchange for the requested funds). This is known as "first-stage" or start-up financing.*
>
> *As the business grows, the owner will require additional equipment, space or access to cash flow. This is commonly referred to as "stage-two financing" or "mezzanine financing." Two sources of funding may be available at this point. The owner may find a "business angel" (usually an individual with significant personal wealth he or she invests in promising start-ups). This "angel" may not only provide the funding required, but also offer technical assistance and access to his or her own business networks to leverage additional contracts and industry contacts. A second source of funding is available through a variety of small-business loan programs. For example, the owner may apply for 7A lending (loans awarded through local banks but secured by the Small Business Administration), or, depending on her credit rating, the owner may pursue a traditional small-business loan from a bank or credit union. These two types of financing are not mutually exclusive and may be undertaken together.*
>
> *Finally, many larger businesses will further diversify their funding by issuing bonds, stock offerings or other, more sophisticated forms of debt and equity to underwrite capital requirements. Even if the business remains "privately held" (i.e., does not offer its stock to the general public), an array of equity options may be offered to individual investors. With access to this final stage of financing, most businesses in America become fuly matured in the capital market and are able to finance capital requirements through a variety of investment and loan instruments that trade financial risk for the promise of some level of future financial return. If the capital instrument is a loan, it is tied to a fixed rate of return and usually secured with some underlying asset of the corporation. Those capital requirements that are beyond what may be directly underwritten with an asset may be met*

through additional equity offerings that, while usually unsecured, offer an ownership position in the business and the possibility of greater financial returns with no fixed rate of return on investment.

It is important to understand that, depending on the type of business and the overall industry in which it operates, there are usually certain percentages of "debt to equity" that are considered prudent and reasonable. Banks, in assessing whether a given corporation is credit worthy, will assess such issues as the debt-equity ratio in order to evaluate the relative risk present in any given loan proposal. Taken together, the amount of debt and equity present in a business that underwrites the financing requirements of the corporation is referred to as the "capital structure" of the business.

Financing the growth of any small business is not easy. It takes tenacity and often requires the owners to undertake significant financial risk to ensure the creation of their vision. The potential and promise of financial return is what makes the risks worthwhile. However, financing social purpose businesses may be even more difficult, due to two main reasons. First, there are usually very limited assets available with which to secure (or underwrite) loans. Many nonprofit organizations are grant-driven, with funds being made available annually in return for the fulfillment of commitments made by the organization to provide certain services or programs to the community—often to "markets" which do not have the funds to otherwise pay for those services. Youth programs, food banks and low-income health centers are all examples of such programs, and the nonprofit sector is populated with many other examples.

Indeed, in many ways the very nature of charitable activities is driven by the fact that there is no primary financial market capable of supporting such work—this is what makes them "charitable." Therefore, most nonprofits operate with "weak" balance sheets, carry few assets (such as buildings or other hard holdings that might be used to underwrite loans) and are often without large endowments that might be available to fund enterprise activities. Those organizations that do have a building or other real estate asset with which they might secure a loan have often already made use of that asset to secure lines of credit to support the operating cash flow of the agency itself. This strategy is often necessary due to the risky nature of supporting an organization with grants, but has the secondary effect of making those assets unavailable to finance a start-up or expansion of a social purpose business.

A second barrier to providing "mezzanine financing" is the lack of equity options available to nonprofit organizations. Nonprofits are established under strict Internal Revenue Service codes as charitable organizations that may not provide private inurement to outside individuals (e.g., investors). In the event a nonprofit "goes out of business," all its assets must be distributed to other existing nonprofit organizations to continue the pursuit of charitable works. Remaining assets may not be sold or given to outside investors (though in the event of bankruptcy, they may be sold off to cover the outstanding debts of the organization). Since there is no possibility of providing individual investors with the same financial return they might receive in the for-profit sector in exchange for taking on a significant degree of financial risk, "angel" investors or other individuals who might otherwise fund various stages of a business start-up are not interested in such a high-risk, no-reward proposition. Therefore, even though a nonprofit may have some access to loan dollars through buildings or other assets, it usually has no ability to secure true equity investments—the lifeblood of any business enterprise. The gap in financing represented by this lack of equity is termed the "equity gap" in the nonprofit sector, and it stands as a critical challenge for most nonprofits attempting to pursue their social mission through market-based enterprise activities.

There are a variety of efforts presently underway in the nonprofit sector to try and address the "equity gap" through what may be referred to as "equity equivalents." Through the legal and creative use of charitable dollars, foundations and individual donors may provide long-term charitable "investments" which can provide organizations with the type of funding required to support the expansion of their social ventures. Program-Related Investments, whereby a foundation makes a below-market rate loan available to a nonprofit organization, is one strategy. PRIs are usually secured loans in that they are tied

to some underlying asset, but they often take a subordinate position to a banking or other institution's first loan position.

Another such strategy is the provision of cash guarantees, whereby a foundation, loan fund or donor places funds in a bank account which is then tied to a line of credit extended to a nonprofit that would not otherwise qualify for a loan. Over time,as the nonprofit pays back the line of credit, the original funds that served as a cash guarantee are returned to the original source while the nonprofit develops both a successful credit record and its own independent commercial-lending relationship with the bank institution. Finally, a third example of addressing the "equity gap" is that of "recoverable grants," a type of PRI, but one that is not tied to any underlying asset and therefore serves as a direct equity equivalent in that it is fully at risk.

In the for-profit community, the challenge of adequately capitalizing business enterprises has received literally centuries of attention, and a variety of capital markets have developed to address it. In the nonprofit community, while there are limited options and emerging models for structuring such capital investments, accessing such funds, having adequate funds available and educating funders as to the variety of funding options available to support charitable work remains a significant challenge. While the for-profit capital market is fairly well defined and organized, the nonprofit capital market remains fragmented and under-capitalized.

Many private-sector funders (corporate, community and family foundations) have supported a wide array of nonprofit ventures in recent years and continue to be interested in understanding how their support may better contribute to the success of nonprofit venture development. However, there is a wide disparity of understanding and skill in the foundation community with regard to its ability to act in the role of "informed investor" and community partner.

While the traditional "generalist" program officer approach has, on the whole, served both the nonprofit and foundation communities well, it makes it difficult for program officers to participate as fully or with the depth of expertise that may be required in areas of specific interest (for example, social purpose business development). In many cases, while a foundation program officer is able to participate in the basics of initial due diligence, it is often more difficult for him or her to assess the perceived and actual risks of enterprise creation and long-term business development strategies. In light of this fact, the inability of many funders to literally "understand the deal" limits their effectiveness in the capitalization of such deals,thereby limiting the potential for expanding foundation support of the field and its practitioners.

In addition, while many foundations become committed to a certain area of interest and are good at enunciated areas of priority giving, many foundations have funding timelines that often entail six months or more of proposal review, followed by a grant commitment of one to three years. Again, while this approach has generally served community interests well, it makes it difficult for funders to support such long-term investments as are often required in the area of social purpose business creation. These investments often require the presence of not only a long-term funding partner, but also a funder willing to support what are often the dual strategies of both business and organizational development.

There are increasing numbers of foundation and individual donors interested in supporting the work of emerging social entrepreneurs. However, existing resources tend not to be well coordinated, are often presented in a form that makes them unavailable to many potential grantees and have evolved into a nonprofit capital market that is often fragmented and inefficient. If the foundation community is to get the best return on its grant-making activities in this area, coordinated funding strategies that support and leverage existing community resources will have the highest potential for leveraging these limited dollars most effectively. Indeed, over the course of the six-month Venture Fund Initiative, a number of funders stated that it would be of great assistance if they had access to minimum standards for the field and generic social purpose business proposal formats and were provided with appropriate guidance with regard to how to make grants in this program area.

It is a given that many practitioners are finding their way through the evolving field of

social purpose business development, which is neither fully business nor nonprofit, drawing on skills based in both traditions. However, on the whole, the field is populated with individuals whose skills are more entrepreneurial than managerial and who appear to be grounded to a greater degree in vision than practical expertise.

While the number, size and scope of social purpose businesses currently in operation or in planning are impressive, one is struck by the degree to which many ventures are operated on "a wing and a prayer," and are not grounded in solid managerial expertise and practice. Often the success or failure of an enterprise hinges on the talent and commitment of a single person or small management team working to achieve the venture's goals and objectives. While this managerial strength is what has enabled the field to grow impressively over recent years, it also points to a critical issue for many social purpose businesses: a lack of managerial depth and successor strategies.

If the field is to benefit from both the investments that have already been made and the high level of effort undertaken by these "social entrepreneurs," more effective networking, training and other support systems will be essential. In some cases, it may be only a question of providing the opportunity for practitioners in a given region or sector to come together and share their experiences. In other cases, a more formalized strategy will be necessary. In any case, the potential for adding greater value for this expertise and the potential to use these experiences to strengthen the overall managerial capacity of the nonprofit sector are significant.

The field of social purpose business development is an emerging one with no formalized knowledge base. There is a real need for ongoing and appropriate training for mid-level staff of social purpose businesses, specifically in the areas of financial management and accounting.

Significant attention has been paid to the role and emergence of "New Social Entrepreneurs" and others who are guiding the shifts presently taking place in the nonprofit sector. However, it must also be recognized that the organization's capacity to succeed at these strategies only begins at the level of the executive director or enterprise manager. Organizations need assistance in providing targeted training opportunities to mid-level managers as well, for these are the individuals who will operationalize the business and other strategies being pursued by the nonprofit corporation. Such training may entail workshops in business fundamentals, but must also be tailored to address challenges unique to social purpose business, such as issues related to social return on investment, supported employment, mission drift and other factors that affect the potential for the organization to achieve its goals.

The issue of compensation is related to training support for mid and upper-level managers. In addition to requesting assistance in defining the appropriate compensation packages for individuals with both business and nonprofit expertise, the role of bonus and commission incentive programs was found to be an area of need. Finally, opportunities to address the impact of compensation on the overall nonprofit culture need also be addressed. While many employees understand the need for and support an organization's movement toward the creation of social purpose business, the reality of newer, business-connected staff receiving higher compensation than program personnel can be a challenging one for all involved. Assistance could be provided to many organizations with regard to the creation of both a process and a policy for fairly compensating all staff.

The successful operation of any enterprise requires effective information management systems to track program activities, accounting and business operations. These systems are critical in that they generate information that may then be used by managers to make strategic and operational decisions. Most nonprofit organizations have never received the investments necessary to develop management information systems adequate to their needs or appropriate for what is required as they move into the development of social purpose businesses.

Many funders are exploring a move toward achieving greater accountability for their grant dollars and attempting to execute "outcome" evaluations. However, most nonprofit organizations have not been supported

in the development of management information systems adequate for tracking and generating the basic client and program data required to respond to this shift in the foundation community. Such systems are critical to any effort at comparing the relative costs and benefits of various program strategies. In addition,they are central to the organization's ability to engage in long-term retention documentation. These data are necessary if funders are to engage in any effort to calculate a true social return on investment and they require the development of common standards and valuation assumptions upon which such calculations may be made.

In addition to program and business information systems adequate to the task, many nonprofit organizations operate with only the barest type of accounting system—a system largely unable to handle either the complexity of business transactions or provide operations managers with the "real time" information needed to make informed decisions based on accurate financial evaluation. The nonprofit community needs accounting models and systems that a wide range of practitioners and funders could use. In addition, greater access to industry-standard information based on specific sectors (such as retail, co-packaging, landscaping, etc.) should be developed. This information would include the "social sector equivalents" for those enterprises operated by those in the nonprofit sector.

While many social purpose businesses have access to competent, pro bono legal consultation, additional legal expertise is required to successfully negotiate the field of social purpose business development.

For years, nonprofit organizations have benefited from meaningful, pro bono assistance provided by both individual attorneys and law firms. Although that support has been extremely effective, as organizations move out of traditional arenas of nonprofit law and into new pastures, access to competent, knowledgeable legal consultation is critical. In addition to the traditional, generalized guidance they have received to date,nonprofits also require access to what is often strategic, short-term legal advice with regard to Unrelated Business Income Tax, mergers and acquisitions, and general issues regarding tax exposure. Connecting nonprofit boards and managers with individuals who have such expert knowledge is important and critical to the organizations "doing the right thing" when it comes to pursuing both social and financial goals.

As social purpose businesses achieve increasing success in moving from start-up to sustainability, they confront the challenge of moving from the "grants market" to the "customer market." Many social purpose businesses find that even with competent management and a quality product or service, gaining access to and credibility within the mainstream business community remains a major barrier to long-term success.

Most successful nonprofit managers are well networked for success in the foundation funding and government worlds. Yet, they find as they position themselves and their organizations to become partners with the business community they are often relegated to the office of community relations instead of outsourcing and procurement. Achieving meaningful market penetration means becoming part of traditional business networks and being viewed as a credible business partner. Social purpose business managers are not asking for any special treatment or benefit, but they are asking to compete at appropriate places in the deal stream.

To realize this goal, nonprofit managers must conduct and have access to meaningful market analysis in order to be better informed partners with other businesses they target for sales and general business relationships. Second, they must have the ability to tap the networks of business people who make purchasing and other decisions. This is not simply a question of having the endorsement of a given corporation's CEO, but must involve developing relationships with upper and mid-level managers who are making actual purchase and other operational decisions on a daily basis. Third, managers must be positioned to develop job opportunities for those individuals within the social purpose business looking to move up and out into the mainstream of the labor market. While many corporations have made commitments to participation in welfare-to-work and related initiatives, the full potential of social purpose busi-

ness has yet to be effectively leveraged in support of the hiring needs of America's business community. Many individuals working in social purpose businesses have the potential to contribute directly to the success of for-profit companies and should be more strategically connected to those employment opportunities.

And, finally, many social purpose business managers would benefit from being connected directly with mentors from within the business community, both those with general business expertise and those with expertise specific to a given industry sector. The potential and opportunities for the creation of more meaningful partnerships between the for-profit and nonprofit sectors are many. Such partnerships can only contribute greater value to partners in both communities of interest.

Implications for Sector-Wide Support of Social Purpose Business Development

In the course of assessing the local capacity and challenges for engaging in social purpose business development, it became clear that all of the cities shared a variety of needs. It is therefore logical that local resources and activities could be most effectively leveraged if certain needs were addressed through a national support network of some sort. Such a network could be housed out of an existing organization and could serve a variety of convening, coordination and brokering roles in support of each city's local efforts. This is not to say, however, that a program grant should just be awarded to some existing player in order to provide this support. Social purpose business development is a fairly focused discipline, and no known national organization could simply step to the plate to meet this need at this time.

This report does not suggest a specific vehicle to address these commonly shared areas of interest, but rather acknowledges that such areas of common interest exist and presents some of the issues that might best be addressed collectively. The intent of such a network might be to support the strategic development of the field of social purpose business as a whole by initially building on the potential represented by the six cities involved in the Venture Fund Initiative.[7]

A national support network might address the following capacity-building needs:

- Sharing/Information Network between and among social purpose business practitioners

The field of social purpose business development is growing rapidly, with many new entrants engaging in a variety of activities. While there are existing and evolving networks that speak to the general needs of emerging "social entrepreneurs," the practitioners in this six-city initiative are involved in a focused effort to grow their ventures and successfully overcome the challenges they face. Direct relationships between the more than 40 nonprofit groups participating in this effort would greatly facilitate information-sharing regarding the most effective strategies for pursuing a "double bottom-line." In addition, those individuals and organizations charged with facilitating the efforts of local practitioners would also benefit from periodic opportunities to meet with their peers to discuss the challenge of providing immediate, real-time support to organizations involved in the ongoing operation of business ventures.

- Technical assistance to regional conveners/facilitators to support development process

Providing technical assistance to local practitioners is not simply a question of identifying a qualified consultant. Such support requires the brokering of relationships between the business community, academic institutions and other stakeholders. The existence of a national network to provide advice, consultation and support to local facilitators would be of valuable assistance to both practitioners and those involved in the provision and delivery of services to them.

- Research, documentation and dissemination of best practices and resources

In the Appendix, the reader will find a brief list of issues and areas of interest that might be the focus of future research in the field of social purpose business development. At present, the knowledge base concerning this field is relatively limited, consisting of a small number of books and articles on the subject. As increasing numbers of practitioners engage in this work and greater numbers of funders seek to assess the impact of their charitable "investments," it will be imperative that appropriate research and documentation of practitioner efforts be undertaken.

Furthermore, as these and other studies are concluded, assuring adequate and timely dissemination of such information will also be critical. While such a national network would not seek to fund and track all relevant research in this broad field of interest, it could act to identify existing research in need of greater dissemination, as well as to identify and support areas in need of further analysis by appropriate researchers already active in the field.

- Broker training and other resources from existing national organizations to local conveners in areas of board development, financial management, and development of MIS

If nonprofit organizations are to be successful in their efforts to "re-invent" themselves to successfully manage the challenge of operating earned-income ventures, those involved in their guidance and management must receive appropriate training to develop improved business and other skills. Ranging across a wide area of possibilities (including board management, financial management and development of appropriate information management systems), there are a variety of areas to be addressed. A national network could identify existing training programs of value to nonprofits as well as work with expert trainers to develop new programs of use to those involved in social purpose business development.

- Represent local practice at national level to philanthropic, public policy, governmental, regulatory, industry and other sectors presently concerned with the development of the field

Finally, the vision, experience and learnings of those in the field are significant and worthy of promotion. However, there are also many institutions and organizations that are concerned with the possible implications of this field of practice. These range from business to public sector to regulatory organizations that do not accurately understand the field and need information regarding what is actually taking place across the country. A national network would provide an informed voice, to both interpret the work of the field and engage such concerned parties in dialogue regarding how best to work together for the benefit of our nation and various communities of concern.

In addition, such a national support network might address a range of possible capital requirements:

- Loan administration and services

As described in the Capital Resources section above, social purpose businesses require access to capital beyond that of basic grant support and of different structure. Loans ranging from $25,000 to over $250,000 are the logical next step in building the capital structure of many nonprofit enterprises. How to best address this capital requirement is debatable. In some cases, existing community development financing institutions might have adequate capacity to provide lending support to social purpose business. In other cases, that support may not be possible, and a national fund of some type might be more effective. The reality is that many cities may only require a few such transactions annually—which argues against establishing six loan pools and possibly in favor of partnering with existing loan funds to try and accommodate the specific needs of social purpose business organizations. At the same time, a consolidation of loan origination, servicing and general administration could possibly be greatly facilitated through the creation of a single, national fund accessible by all six sites. Indeed, it is interesting to note the number of "equity" funds presently being organized by a

number of national initiatives with seemingly very compatible goals, virtually all of which are targeting for-profit business development needs. Greater discussion of the capital requirements of these groups and how they may best be addressed is required before any single solution is embraced.

- Raise grant funds for match with local funds

The pursuit and practice of nonprofit enterprise must be supported first and foremost at the local level. Local practitioners must execute their business development strategies to the benefit of local communities. And,naturally, their work provides significant opportunities for local funders to invest (on both a charitable and loan basis) in supporting these efforts. However, many communities may require additional funds from outside the region and many local funds may provide an excellent partnering opportunity for national funders interested in supporting local efforts.

- Loan/cash guarantees

The ability to access revolving charitable dollars so they may be available to support future work in the field is of key importance. By making available cash guarantees that may in turn secure lines of credit extended to social purpose businesses, funders have an opportunity to pursue the broadest impact of their dollars placed in support of these strategies. Perhaps based on the experience of a national network or association of practitioners, a national fund could make loan/cash guarantees available to local banking institutions to help ensure that, as these funds are repaid,the loan recipient is then positioned to develop independent banking and other lending relationships with mainstream, commercial lending institutions.

- National holding company for buildings/equipment leasing to nonprofit participants at below-market rates

A significant percentage of funds raised to assist the expansion of nonprofit enterprises are used to finance the acquisition of buildings and equipment. Many funders are hesitant to provide such capital support due to reservations regarding the perceived risk such ventures entail and concern that, in the event of failure, those assets would be lost to the larger market. A national body might consolidate those resources into a single fund that would make such purchases and acquisitions itself, leasing the property and equipment back to practitioners at below-market rates. In this way, funders would be assured that even if the venture was not ultimately successful in pursuing its strategy, in the event of a liquidation those resources would not be completely lost but would be sold off with any funds generated returned to the national initiative.

Next Steps and Future Action

The experience of the Venture Fund Initiative participants has led to several clear conclusions:

- The United States is experiencing a virtual explosion in the number of individuals who identify themselves as "social entrepreneurs" and the number of organizations seeking to pursue their social mission through the operation of social purpose businesses.

- The field as it stands today is highly fragmented, with many regions benefiting from the good work of individual organizations and leadership, but with little opportunity to leverage either the collective attributes of those individual players or the larger resources (whether business academic, business community or foundation) in each area.

- The historic approach to supporting the practice of social purpose business development has been for individual funders to provide isolated grants to specific organizations. While that support has been successful in assisting a small number of groups, such grants tend to be made without benefit of a larger business or organizational development strategy. The result of this is that while there have been definite successes in the field, practitioners have been unable to take their work to the next level of success—whether defined in terms of scale or sustainability.

- While many groups have benefited from the contributions of individual consultants or advisors, they remain significantly under capacity and without access to meaningful networking or technical assistance opportunities that speak to their particular needs and potential. What they lack is a holistic approach to their development that addresses organizational capacity-building, technical assistance, market penetration and capitalization in a strategic manner presently not possible given the dominant approaches to consulting and technical assistance.

- There is a unique opportunity for the field to be substantially "moved" to the next level of development. Numerous regional markets have sufficient numbers of nonprofit players, business academic and mainstream business community members who are willing to provide guidance and support. The foundation community has already shown,through its grant making to date, an interest in and willingness to invest in innovative, market-based strategies of assisting nonprofit organizations in achieving their enterprise, community and social goals. The organizations are gathered, the initial investments have been made and the actors are ready for the next act.

What is lacking in this situation is an enunciated investment strategy for growing both individual players and the field as a whole. While the specific funds proposed in this document are not the complete answer to the challenge of market fragmentation, they represent unique and thoughtful opportunities for foundations and other investors to support locally defined strategies for building on the successful grants of the past and the lessons learned from practitioners across the nation. The participants in the Venture Fund Initiative look forward to continuing the collective efforts to refine the vision for these funds, establish them as "lighthouses" for the field and attain the true potential represented by those involved in social purpose businesses employing people on the margin of the labor market and generating new sources of revenue to help sustain U.S. communities.

An Enterprise Audit Outline

By Jerry J. Salama
New York City Venture Fund Initiative

A. Background and Resources

1. Briefly describe the business venture or ventures operated by your organization and the two or three major accomplishments of each business or the businesses collectively. In addition, describe any new business ventures planned by your organization.

2. Describe the organizational mission/culture of the parent non-profit organization and how it relates to the goals of the for-profit business. List issues or concerns to be resolved.

3. Provide an organization chart for each business, showing the key members of the management team, together with salaries, benefits, tenure and comparable compensation in similar businesses. If the parent non-profit organization provides support or administrative staff, identify that staff with the same information. Highlight relevant staff vacancies or needs in either the business or parent organization.

4. List three primary strengths and weaknesses for each key member of the management team.

5. List the business' advisors by name and address [members of the Board of Directors, advisory board (if applicable), accountants, lawyers, consultants]. Identify the contributions and strengths and weaknesses of each key advisor. Highlight advisor needs or opportunities.

6. List any proprietary rights (patents, patents pending, royalty, license, franchise or distribution rights) and contracts which are key to the business as well as the significant terms of these rights and contracts.

7. Describe the physical facilities used by the business and whether they are owned or leased and the terms/value of each. Describe any significant fixtures, furniture and equipment. Highlight any future space and equipment needs. Identify any capacity or other limitations of the current operation.

B. Relation to Market and Business Plan

1. Describe how the product sold or service provided is satisfying the market in a unique way and describe the marketplace that exists for the company. List customer needs and how the product or service satisfies them.

2. List the company's target markets and the expected revenue from each. List the company's product lines and the expected profit margin for each one.

3. Describe any advantage or disadvantage which the business has over the competition.

4. List the company's top ten clients and the percentage of total sales attributable to each. List the company's top ten vendors and the percentage of total purchases attributable to each.

5. Explain the methods for penetration of target markets and the cost of each market penetration strategy as compared to that of competitors and industry standards. Describe product development and marketing efforts of the business.

6. Describe existing corporate partnerships and identify corporations that the business would like to target for contracting or procurement relationships.

C. Financial Assumptions and Budgets

1. Describe the financial accounting systems used by the business. Provide copies of the most recent monthly reports produced by these systems (e.g. balance sheet, statement of operations, cash flow, etc.). Highlight needs and plans for financial system changes.

2. Provide an actual operating budget for 1996 and 1997 and a projected budget for 1998, listing detailed revenues and expenses for the business and identifying break-even production or service levels. Describe the pricing structure.

3. Describe the cash flow situation of the business in the last two years and the expected cash flow in 1998. List sources of working capital.

4. Describe the existing capitalization of the business (its constraints on the business,if any) and the expected capital needs for the next three years, together with the assumptions for these needs. List existing banking relationships and potential sources of additional capital.

5. Describe the company's management and fiscal control procedures and systems. List areas that need to be improved.

6. Compute all the "ratios" for the business: Current Ratio, Quick Ratio, Inventory Turnover Ratio, Debt Ratio, Return on Total Assets, Return on Equity, Profit Margin on Sales (with and without subsidy), Gross Margin, Subsidy to Wage Ratio and Percentage Enterprise Subsidy. List the issues and concerns raised in an analysis of these ratios for the business.

7. Describe how you presently track and quantify a social Return on Investment. List the Social/non-monetary goals and mission of your businesses.

D. Relation to Employees

1. Describe the strategy of the business in relation to employees (job training for a business with the goal of outplacement versus staff training for a business with a preference for internal promotion). Describe job training efforts, if any, and the source of most employees. List challenges and needs for job training.

2. Identify and describe any organizational problems relating to the unreliability of the company's work force and any limitations on the company's ability to make output commitments because of such employee unreliability.

3. Describe job placement efforts and record, if any. List key organizations and types of organizations with commitments for outplacement of trained staff or commitments sought.

4. Describe any strategies for employee empowerment, management control or employee ownership (e.g. ESOP).

E. The Future

1. Identify the opportunities for business expansion and the key obstacles to growth. List potential resources to overcome these obstacles.

2. List the three primary benefits you hope to receive from participation in the Venture Fund Initiative.

3. Describe the replicability of the businesses run by your organization. List the key elements required to successfully replicate these businesses.

Footnotes

1 The "Regional Marketplace" reports were written by the convener in each site. All other sections of this report, unless otherwise noted, were written by Jed Emerson with input and feedback from Venture Fund Initiative participating organizations.

2 The terminology used in this field varies and includes social or nonprofit entrepreneurship, nonprofit business, affirmative business and social purpose business. This report uses the term "social purpose business" because it is a positive term and reduces confusion about the existence or lack of profits.

3 The Foundation's report was distributed nationally in September 1996 and, along with other resources for social entrepreneurs, is now available on-line at the Roberts Enterprise Development Fund web Site: www.redf.org.

4 Complete reports are available from the convening organization in each site.

5 "Enterprising Nonprofits," Gregory Dees, Harvard Business Review, January/ February 1998.

6 Chapter 10, "*The U.S. Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and Funding Instruments*" presents this same discussion in greater detail. The following paragraphs are taken from that chapter.

7 While the primary focus is, of course, on these six cities, other sites (such as San Francisco) may also have an appropriate pool of practitioners interested in participating in such a network.

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Chapter 13

Leadership of the Whole: The Emerging Power of Social Entrepreneurship

Leadership of the Whole: The Emerging Power of Social Entrepreneurship

By Jed Emerson

Executive Director
The Roberts Enterprise Development Fund

One need only look at successful high-tech businesses to see that great entrepreneurs launch movements, not just companies. Steven Jobs at Apple, Bill Gates at Microsoft, Scott McNealy at Sun Microsystems offer a worldview, a passion for a cause that transcends the specific attributes of their product. Many social sector leaders, on the other hand, see that their organizations already represent a movement— for healthy communities, effective schools, physical or spiritual wellbeing— but lack the resources of our most dynamic businesses. The challenge for all innovators is to understand how leaders can build movements, not simply organizations, which may advance the broader elements of their missions.

One of the most significant movements of recent years is social entrepreneurship. Its potential to transform society makes it an important asset for communities and a powerful laboratory for leaders of all sectors. Gregory Dees of Stanford University and the Kauffman Center for Entrepreneurial Leadership offers a useful definition of this embryonic movement:

Social entrepreneurs play the role of change agents in the social sector, by:

- Adopting a mission to create and sustain social value (not just private value),

- Recognizing and relentlessly pursuing new opportunities to serve that mission,
- Engaging in a process of continuous innovation, adaptation,and learning,
- Acting boldly without being limited by resources currently in hand, and
- Exhibiting a heightened sense of accountability to the constituencies served and for the outcomes created.

These five capabilities can benefit private, public or social-sector institutions and have been central to the creation of hybrid strategies that blend elements of each. For example, The Roberts Foundation portfolio of social purpose enterprises—bakeries and cafes, janitorial and landscaping companies, screen printing businesses, retail and business services—were all launched as social purpose enterprises by nonprofit organizations in the San Francisco Bay Area to train and employ people in need, and ultimately sustain themselves in the marketplace.

In furthering social mission in new ways, social entrepreneurs are pioneering a form of leadership centered less on the actions of individual leaders advancing a national agenda than on a process of "Leadership of the Whole"—in which practitioners themselves (as opposed to those commonly viewed as "national leaders") build a movement and leverage individual resources for broad social benefit.

Historically, leaders of movements were able to combine their personal vision with an ability to maintain their place at the center of fragmented, though like-minded, groups—drawing such groups together to achieve a common purpose. For the past decade or more, the same has been true of social entrepreneurship. "National leaders" were recognized as leaders largely because of their individual vision and ability to work across regions and borders—connecting people to become a part of this newly evolving whole. While social entrepreneurship draws from a wide variety of disciplines (social and community work, business, philanthropy, public policy), its national leaders have been those who could connect players previously unable to find one another. As they traveled the nation "spreading the gospel," these leaders have been supported by their own organizations, which have given them a platform from which to operate and upon which they could develop a greater understanding of the emerging movement.

However, it appears that this kind of national leadership of movements is fading. In its place we see a new form of leadership reflected less in the activities of individuals *talking* about their personal vision and experience, than in the collective force of practitioners and their stakeholders *acting on* a common agenda. Increasingly, practitioners are representing their own best interests, connecting directly with each other, and building a movement across disciplines and regions. As this leadership shift occurs, it is useful to step back, assess the forces that make traditional national leadership less relevant, and understand the implications of this shift for others.

Forces Supporting the Emergence of "Leadership of the Whole"

While a variety of market and other forces drive the creation of social entrepreneurship itself, there are six forces contributing to the evolution of its new, networked model of leadership.

Learning partnerships. At the core of social entrepreneurship is the passion for a cause. This passion is most often pursued through the application of skills associated with business, political organizing, organizational development and a host of other disciplines. There is no single framework or model for understanding the practice. Therefore, those who pursue social entrepreneurship must invariably learn from others; they must forge relations with "fellow travelers" sharing their vision and moving through similar experiences. These partnerships are

primarily centered on the work of practitioners but have also come to involve funders, academics, business people, and others who rely on a process of mutual learning to inform their efforts. This learning occurs through forums, conferences, Internet list-serves and most importantly, the day-to-day work of a project.

Interlocking networks and strategic alliances. Learning partnerships have often operated in isolation from each other. Fortunately, an emerging set of networks, drawing on many fields of thought, is breaking that isolation. Today's community leaders find themselves working with established social service agencies, advocates of earned income strategies,managers of social purpose business enterprises as well as for-profit corporations, and still others practicing cause-related marketing. Each network informs its own practice by connecting with the efforts of others involved in discretely distinct, but related work.

These interlocking networks evolve naturally to further the creation of strategic alliances that are nationally grassroots in nature. For example, ServiceMaster, an international corporation with over $6 billion in annual sales,has developed a national alliance with local nonprofit organizations providing supported employment to homeless and disabled individuals. Similar alliances have connected social innovators with academic institutions, faith-based organizations or individuals, and regional groups of other social entrepreneurs.

An understanding of appropriate scale. A third driver of this process of changing leadership has been the shift in understanding of the value and form of "scale." Historically, attaining significant scale has been a major challenge for organizations, whose leaders wondered, "How do we take our program national?" or "How do we expand on our demonstrated success?" However, the evolving notion of achieving appropriate scale is focused upon helping organizations become more viable and effective, not just larger.

Those seeking appropriate scale are less concerned with how to go national than with how to "go deep" within a community, an area of practice, or an individual organization. Appropriate scale means doing more with regional resources, developing greater capacity to engage wider segments of a core market or community, and strengthening key relationships. National impact comes through the example set by one's work and the development of strategic alliances with others advancing the field in other parts of the nation and world. It is increasingly through the interlocking networks described above that such groups achieve "scale" in their work.

The speed of change. In times of crisis–as when funding priorities in Washington began to change—some leaders look for others to devise a new model thought to bring success. These putative leaders believe they can simply "implement the model" to achieve a degree of program and funding success.

In recent years, however, it has become clear that "the model" is now dead. The hard fact of the matter is that there are few universal, easily transferable models of strategy or anything else. Even a model that works in one setting is unlikely to keep up with change and finds itself outdated in weeks or months, not years. Innovation occurs at the fringe of the mainstream, most often when regional and local players analyze a challenge, draw from an array of potential approaches and resources, take what they feel is most relevant from each, and then create a new strategy for execution in the regional market place. In this ever-transforming environment, the emerging role of effective leadership in all sectors is not to replicate structures and strategies but to take a conceptual framework,idea or set of best practices and apply it effectively to suit local needs.

Advancing technologies. Finally, with the rise in advancing technologies, practitioners now have in their hands the very brokering and communication tools that historically have been the base of strength for the "national leader" of old. Just a few years ago, an agency director in South Dakota would have to await her association's quarterly newsletter or annual conference for word of what others were doing. With the advent of the Internet, she can surf the Web and learn about related efforts from around the world. She can engage in debate through a list-serve, an on-line chat room or a long-distance tele-conference call. She has immediate, real-time access to the latest in strategy development. Increasingly, technology acts as a democratizing force to allow ideas to be considered on their merits.

And, as if to seal the coffin on the traditional charismatic leader of the past, the power of advancing technologies to expand the horizon of a local practitioner becomes the glue that connects her to the larger field, nation and world. She is her own leader, connected directly to other community leaders; together they act to change the face of societies. They lead as a body of the whole.

The Rise of "Leadership of the Whole"

The forces supporting the emergence of a "leadership of the whole" greatly reduce the traditional role for a "national leader" as gatekeepers of relationships and information. Indeed, "national leaders" will increasingly play a supporting role to local practitioners. In the words of Dan Sherman, they will become "learning facilitators:" guiding others toward new resources, facilitating the flow of digital dialogues and acting as hosts of a variety of connected forums serving the purpose of expanding the practitioner experiential knowledge base.

In a globalized society, in business as in social movements, regional voices will set the national agenda. And that national agenda will be directed through an array of networks operating in chaotic concert. The new leaders' value will be found in the spirit of their words, their ability to inspire new constituents to join the parade, and their ability to bring cool water, in the form of new resources, to those who march. It is a new role for those used to competing for a single spotlight. In the end, however, the power of community, the potential to capture the full impact of our social and economic investments, and the passion of those who carry the local burden of our nation's social agenda may move closer to fruition. The question is not whether the new "Leadership of the Whole" will be allowed to move to the fore, but rather how those presently engaged in shaping a field of practice may most effectively act to assure its advance.

This chapter was originally published in "Leader to Leader" Magazine, July 1, 1999.