

Social Enterprise's Expanding Position in the Nonprofit Landscape



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Executive Summary

In today's economic climate, nonprofit organizations are seeking means to generate additional income to supplant a declining economic stream of traditional revenue. Social Enterprise activities offer nonprofit organizations the opportunity to generate earned income which in turn will provide consistent cash flow to further the mission of the organization. Social Enterprise activities can enhance the brand/reputation of the organization. A direct benefit of Social Enterprise activities for nonprofit organizations, can be the enhancement of management and overall business capacity of the organization. Planning should be incorporated from the onset of any Social Enterprise. As funding sources decrease, Social Enterprise activities are becoming a viable opportunity for an increasing number of nonprofit organizations.



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What is Social Enterprise?

There is considerable confusion among both experts and the general public as to what “social enterprise” actually is. At the heart of this puzzlement is a repeated attempt on the part of some to draw a distinction between “social enterprise” and “earned income.” These individuals claim that it is possible to generate earned income without engaging in social enterprise. To them, social enterprise is about nonprofit organizations generating revenue that has nothing to do with mission.

This definition confuses the legal structure of social ventures with their financial structure. It is spawned by the unfounded fear of some nonprofit organizations that if they generate earned income that is not directly attached to their mission, they will summarily lose their 501 (c) (3) tax-exempt status. Yet, all earned income generated by nonprofits has something to do with their mission. This relationship is merely either *direct* (i.e. the earned income activity plainly benefits the mission by employing the “unemployable,” selling the art of client artists, etc.) or *indirect* (i.e. the earned income activity provides revenue for acquiring resources that enable pursuit of the mission). Furthermore, even if the earned income activity in question is not directly related to mission, there is always the option to pay the Unrelated Business Income Tax (UBIT). In order to better understand the realities of social enterprise, it is necessary to put it into its larger context and to define the term “earned income.”

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Social enterprise is a subset of the larger set of activities known as “social entrepreneurship.” The seminal definition of social entrepreneurship was developed by J. Gregory Dees, the man who is widely considered the father of the field of the same name. Dees states that:

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 created¹.*

From this definition we can see that social entrepreneurship involves the direct application of business entrepreneurship mindset, tools, techniques, and processes to the pursuit of a social mission.

A social enterprise is a vehicle for pursuing social mission that utilizes, among other things, an earned income strategy.

Part of being entrepreneurial and operating an entrepreneurial nonprofit is to innovate – to find new ways of doing things. Among these innovations are new ways to finance the organization’s activities. Traditional nonprofits rely exclusively on philanthropy for this purpose, but philanthropy, alone, is not sustainable. This reality has driven some nonprofits – those that are entrepreneurial – to innovate by pursuing various forms of earned income activity as a vehicle for generating crucial cash flow and, thereby, assuring that their organizations will be sustained now and in the future. When this happens, the leaders of these nonprofits are behaving as social entrepreneurs. They have transformed their traditional nonprofits into social enterprises. Thus, a social enterprise is a vehicle for pursuing social mission that utilizes, among other things, an earned income strategy.

What is “earned income?” It is any revenue generated by the social enterprise that is obtained through the sale of goods and services – a business transaction. It is “earned” through the industry of the enterprise, as opposed to revenue from a donation or a grant which is a gift from another.

¹Dees, J. G. (1998/2001). The meaning of ‘social entrepreneurship’ [Working Paper] (pp.4). Kansas City, MO: Ewing Marion Kauffman Foundation.

Generating earned income is part of what makes a social enterprise a “social enterprise.”

In light of this, there is no useful distinction to be drawn between earned income activities and social enterprise. Generating earned income is part of what makes a social enterprise a “social enterprise.” Social enterprises, by definition, are pursuing a social mission. Therefore, whether it is directly or indirectly linked to mission, earned income activity *is* social enterprise.

The only useful distinctions to be drawn, here, are among the various types of earned income activity, based on the amount of earned income they generate and their level of alignment to the subject social enterprise’s mission. Wei-Skillern, *et al* provides a useful graphic for thinking about these relationships (see Figure 1)².

Figure 1

Managing Earned Income

Mission Alignment	High	Supplementary	Integral
	Low	Disposable	Sustaining
		Low	High
		Level of Earned Income	

Note. From *Entrepreneurship in the social sector*, by J. Wei-Skillern, J.E. Austin, H. Leonard and H. Stevenson, 2007, pp. 140-143. Copyright 2007 by Sage. Reprinted with permission.

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As the figure illustrates, earned income activity that makes a low contribution to mission and to the economic viability of the social enterprise can be thought of as “disposable” income. It is extra spending money that is nice but nonessential. An example might be the sale of tee shirts with the enterprise’s logo printed on them. Earned income activity that contributes significantly to mission but generates little income is supplemental in nature. When a social enterprise charges a nominal fee to its clients in order to teach them about business transactions, as do some organizations that train individuals to be successful business people, it is producing a supplement to its other revenue-generating activities. This income will not sustain the enterprise, but it will help to pay the bills.

An earned income activity that creates substantial revenue, but little mission achievement, is said to be “sustaining.” That is, it maintains the economic viability of the social enterprise. Pura Vida is a nonprofit organization whose mission is to provide assistance to low income households in Central America. It owns a chain of retail coffee

²Wei-Skillern, J, Austin, J.E., Leonard, H., & Stevenson, H. (2007). *Entrepreneurship in the social sector*. (p.p. 140-143). Thousand Oaks, CA: Sage.

 Newman's Own, Inc. is a good example. Its mission is essentially to generate profits from its food business, all of which it gives to charity.

 Social Enterprise is needed to support a rapidly growing nonprofit sector while the traditional sources of funds, philanthropy, is showing a decline.

houses. The money generated by those coffee retail outlets, while not directly related to Pura Vida's mission, allows the enterprise to support and sustain its activities.

Finally, an ideal social enterprise is one whose earned income efforts are both highly aligned with its mission and a major source of cash flow and financial sustainability. Wei-Skillern, *et al* call this kind of earned income "integral." Newman's Own, Inc. is a good example. Its mission is essentially to generate profits from its food business, all of which it gives to charity. The more profit it produces, the more it can make in charitable donations. This represents the perfect balance between mission achievement and earned income.

Why is there a need for Social Enterprise?

The nonprofit sector has traditionally relied on philanthropic and government grants for financial support. However, the current economic downturn has significantly decreased the amount of this traditional funding and is challenging the way in which nonprofits fund themselves.

Social Enterprise is needed to support a rapidly growing nonprofit sector while the traditional sources of funds, philanthropy, is showing a decline after minimally keeping pace with economic growth. While charitable contributions by individuals, foundations and corporations in the U.S. reached \$284.99 billion in 2008—the inflation-adjusted amount fell an estimated 5.6 percent in real dollars³. During the current economic downturn, foundation assets have dropped an estimated 21.9 percent in 2008. As assets decrease, the amount of available funding also decreases—2009 foundation giving decreased by an estimated 8 to 13 percent and the outlook in 2010 remains unclear but it is likely that foundation giving will decline further⁴. The decrease in assets of individual donors, together with the proposed regulations to impose new limits on charitable tax deductions, could have a negative impact on future charitable contributions. Given the scarcity of philanthropic and government dollars, more organizations are now searching for earned income generating activities to augment their budgets and achieve financial sustainability.

³ [Giving USA](#). (2009).

⁴ Foundation Center. (2009). Highlights of foundation year book [PDF file]. Retrieved from http://foundationcenter.org/gainknowledge/research/pdf/fy2009_highlights.pdf

Consistent cash flow is extremely important because without sufficient working capital, the organization cannot pay its bills.

There are over 1.5 million nonprofit organizations operating in the United States today⁵. Competition for the limited funds of foundations, corporations, individuals and government has grown more intense as a result of the economic downturn. Nonprofits, struggling to survive in an increasingly competitive environment, are working to become more self-sustaining and efficient by diversifying their revenue streams beyond conventional foundation, individual and government support and by adapting business models to their organizational needs.

While most for-profit companies can anticipate a source of revenue year-round, many nonprofit organizations must manage cash flows that are not consistent as their traditional funding sources are subject to a variety of factors. Consistent cash flow is extremely important because without sufficient working capital, the organization cannot pay its bills. Creating various forms of earned income activity can generate crucial cash flow which can help sustain the organization.

The need for earned income is the result of various pressures and trends which affect the sustainability of most nonprofits including; a downturn in the economy, a decrease in funding, an increase in competition for funds, and the need for consistent cash flow. If implemented correctly, social enterprise and earned income activities can enhance the likelihood of long-term business success while contributing toward stability and sustainability.

What Are the Benefits of Social Enterprise and Earned Income?

Creation of social enterprise and earned income generating activities offer numerous benefits to nonprofits organizations.

Sustainability

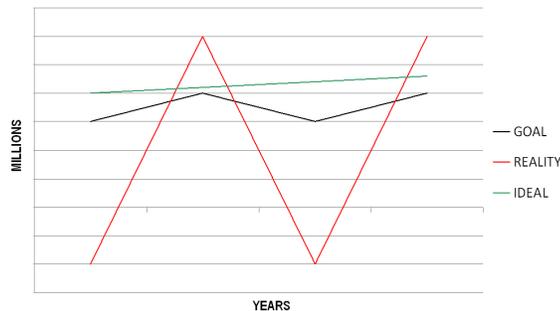
Social enterprise can support the long-term business success of the organization through the achievement of consistency and financial self-sufficiency. The generation of sustainable sources of income reduces the organization's dependence on contributions and grants.

⁵ National Center for Charitable Statistics. (2009). Business master file. Available from <http://nccs.urban.org/database/overview.cfm#BMF>

Consistent Cash Flow

Earned income provides the organization with consistent cash flow and enhances the overall financial health of the organization.

Overarching Picture of Nonprofit Cash Flow 



Unrestricted Use of Funds

Earned income activities generate greater amounts of funds which are unrestricted. This flexible funding is difficult to obtain through other means and gives the organization significant flexibility to spend its revenues as it deems appropriate.

Diversification of Revenue Base

Earned income helps to diversify the income base which reduces the organizations dependence on grants and donations as sources of revenue and provides a more reliable funding base.

Increased Management and Business Capacity

The introduction of earned income activities often enhances the overall management and business capacity of the organization. The management becomes more accountable which increases the organization's efficiency and effectiveness in the following ways:

- improves financial management
- improves management capabilities
- improves time efficiency
- increases market discipline which can lead to enhanced program quality and efficiency
- fosters a more enterprising/entrepreneurial mindset which promotes innovation within the organization


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Greater Publicity/Enhanced Image

Social enterprise can give the organization's name more visibility and legitimacy, and this enhanced image can have a positive impact on the organization's mission. This publicity can lead to increased donor support as successful earned income activities can augment the appeal to foundations, corporations and individuals.

New Employment Opportunities

Earned income activities have the potential to create employment opportunities as the organization may require staff with specialized management and marketing skills as well as additional support personnel. As the social enterprise increases in scale, new employment opportunities will arise. Currently, more than 1.5 million nonprofit organizations in the U.S. generate over \$1.4 trillion in revenue⁶. If just one new job per nonprofit is created as a result of social enterprise, 1.5 million new jobs will be created.

Expand Mission

Earned income activities provide revenue for acquiring resources that enable pursuit and expansion of the mission.

⁶ National Center for Charitable Statistics. (2007). NCCS core files. Available from <http://nccs.urban.org/database/overview.cfm#core>

Potential Challenges and Ways to Minimize Risks

When seeking to develop a social enterprise venture, it is important to conduct thorough research and plan for potential challenges as well as apply good business practices. Potential challenges to an organization when engaging in social enterprise activities include but are not limited to mission creep, IRS limitation on earnings, financial, and organizational. As in any activity, there is an element of risk. Risk exists in riding a bike, purchasing a home, or having children; but the element of risk should not hinder the pursuit of the activity. Rather it should empower the individual(s) to gather the necessary skills to effectively approach the activity. Subsequently, we will take an in-depth look at the potential challenges to social enterprise activities. These activities, when incorporated into the planning process, can serve as flag posts to the venture, making sure the organization does not move off kilter in unplanned directions. Planning is essential when embracing a social enterprise effort.

 Social enterprise activity should not take away from the mission of the organization, rather it should enhance it.

Mission

The relationship a Social Enterprise venture has to the mission of the organization is critical. The mission of the organization reinforces the reason for the nonprofit's existence. Ideally, the social enterprise venture should grow at the same rate as the organization thus avoiding mission creep. As discussed in the Wei-Skillern matrix, there is a direct relationship to the mission of the organization and how the social enterprise activity aligns with the organization's mission. If an organization starts to lose its direction, and all of the organization's resources are involved with the social enterprise venture, the organization is no longer fulfilling its mission. Mission creep can be subtle and grow over a period of time. Social enterprise activity should not take away from the mission of the organization, rather it should enhance it.

Financial

Social Enterprise is an investment of time, physical, strategic and branding alliances, and intellectual resources. With any investment, the returns may be short-term as well as long-term. Careful research should be conducted to assess the

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viability of the business and assurance of return on the investment of the existing/new/future human, physical and monetary assets. Financial projections should be developed to support the viability of the project. Organizations considering social enterprise ventures should look at every possible scenario of the enterprise. A social enterprise activity should not deplete the nonprofit of the financial means to forward the mission of the nonprofit organization. Mission of the organization must be maintained or open to change/modification, and the viability of the venture should be ensured. Ideally, the social enterprise venture should align and support the mission of the nonprofit.

Earnings

IRS limits exist on excessive earnings from activities related to the nonprofit's purpose and taxes on earnings unrelated to the nonprofit's purpose. The amount of earnings a nonprofit can gain through a social enterprise is not carved in stone, however. The relationship of the social enterprise venture to the mission of the nonprofit can have an affect on the range of allowable earnings. An effective way to minimize risks would be to seek legal counsel at the onset of the venture.

 After examining the potential risks when entering a social enterprise program, it is important to understand that there are ways to minimize risks, *most importantly* via planning.

Organizational

During the start-up phase, staff members may spend more time on the new venture, taking away from their designated responsibilities to the organization. Conflict could arise if there is not a well managed organizational structure. Additionally, compensation for work committed to the social enterprise venture should be considered. Staff members may be asked to take on additional responsibilities and grow their skill sets. As noted above, the opportunity exists for social enterprise programs to create new employment opportunities.

Planning

After examining the potential risks when entering a social enterprise program, it is important to understand that there are ways to minimize risks, *most importantly* via planning. An organization considering social enterprise should create and implement a business plan. The business plan should address the feasibility of the venture and

realistically examine the organization's capabilities in executing the enterprise. The planning process allows the flexibility to examine different types of ventures, and how these ventures relate to the organization, perception of individuals supporting the organization, Board and reputation/brand. A well-planned Social Enterprise initiative should enhance a nonprofit's brand presence while extending its mission.

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Research

Students are taught this adage—“knowledge is power.” The truth of this statement resounds outside the four walls of the classroom. Research produces knowledge. Research in the beginning of the venture may be more general and, as the venture grows, may become more specialized. Research can affect the direction of the venture, if certain incentives exist within an industry.

Libraries, universities, government agencies, trade organizations, internet sites, personal contacts, industry leaders/opinion leaders can be effective research resources. *It is important to understand any competition in a given field and also the reasons why competition may not exist.* Research can be conducted by outside individuals, or a nonprofit can create a specialized internal committee to conduct research. Board members can be excellent resources and may want to participate in the research process.

Utilizing Consultants

Nonprofit management and stake holders may want to incorporate consultants in the planning and implementation of a social enterprise venture. Consultants can offer specialized knowledge and business know-how in niche fields. Conversely, consultants can function as objective resources. Consultants are not hindered by an emotional or financial attachment to the venture that stake holders and entrepreneurs may have.

Conclusion

Social enterprise is the pursuit of earned income revenue streams by nonprofit organizations, whether this earned income is directly or indirectly related to mission. It has become a vital activity of entrepreneurial nonprofits, due to the decline in philanthropic dollars and the increased competition for that money.

The pursuit of social enterprise can be a very rewarding endeavor in many ways, not the least of which is the benefit of improved cash flow and the organizational stability and sustainability that brings. Engaging in social enterprise is not without risks, but those risks can be managed with careful research, planning, and guidance from qualified experts.