Social enterprise, the purposeful exchange of a product or service to help sustain a nonprofit’s charitable mission, has been a technique employed for hundreds of years. Monks sold wine and cheese to local villagers; guests paid a fee to enjoy Shakespeare’s works at the Globe Theater; and tuition has been a mainstay of institutions of higher education for centuries. So what’s the big deal? Why are articles about social enterprise showing up in increasing number and why are social enterprise seminars offered at more and more professional conferences?

Publicity helps! The media is paying more attention to highly successful models such as the Greyston Foundation in Yonkers, NY, featured earlier this year on “60 Minutes”. The creation and growth of membership and advocacy organizations such as the Social Enterprise Alliance, and even an emerging social enterprise lexicon helps audiences communicate with one another meaningfully for the first time. But the real answer lies elsewhere — in the growing awareness that the old paradigms of nonprofit financing and management just don’t work.

As the nonprofit sector continues to grow, employing one in eleven U.S. workers and representing a significant seven percent of the Gross Domestic Product, managers realize that traditional financial supports — spelled “fundraising” — are insufficient to underwrite the ever-increasing number of needy organizations. Foundations are stretched to the limit, and government spending on health, education, environment and social programs continues to fall. If charitable organizations are to survive and more importantly to have a genuine impact on their communities, they must discover new, diversified, and sustainable sources of revenue.
Securing adequate funds is one of the biggest challenges facing nonprofits today.

New, or arguably just improved, revenue strategies have emerged as we work to expand and diversify our funding streams. Some studies have shown that fee-for-service now represents more than half the income of the nonprofit sector, more than private donations and government funds combined. All kinds of partnerships and ventures are bringing in the most coveted dollars of all: unrestricted funds.

What are the consequences?

While the financial motive is clear, nonprofits must also consider the implications of social enterprise on policy, operations, and ideology. Policy implications range from tax liabilities to incentives for private sector investment to the creation of a “fourth” sector. In this issue, Patty O’Malley walks through the important tax issues for nonprofits engaging in social enterprise. Gar Alperovitz, Steve Dubbin and Ted Howard highlight policies used to support community development corporations that provide lessons on how to best support social enterprise efforts.

The implications for the operations and staffing of nonprofits are also considerable. The nonprofit sector has undergone real change in recent years. Much of this change has made the nonprofit sector more like the private sector, even without social enterprise project per se. For example, the sector’s workforce has become more professional and specialized; there is a growing emphasis on evaluation and outcomes; and nonprofits have formalized marketing, planning, and other functions formerly associated with the private sector. Bringing income generating projects into nonprofits takes this change to a new level. The findings from a Community Wealth Ventures’ survey of existing social enterprise projects address issues such as staffing, planning, and revenue generation.

In addition, the Viewpoints presented on pages 8-12 begin to address some of the pros and cons of social enterprise operations.

Arguably, the greatest concern about social enterprise is an ideological one. In his Viewpoint, Mark Rosenman addresses the limits and potential negative consequences of social enterprise. Are we drifting from our mission, valuing quick results over long-term social goals, or turning away from the responsibilities of civil society? Or, as Kirsten L. Gagnaire argues, does social enterprise require innovation and effectiveness that benefits the nonprofit sector and the communities it serves?

I would argue that both are correct, and that the diversity of our sector ensures that organizations are addressing both sides of this debate. This is certainly one case where our differences make us stronger. We need organizations using all available strategies if we stand to achieve and sustain our ambitious goals.

Erica Greeley
Director of Strategic Policy Planning
Policy Support for Social Enterprise Development

BY GAR ALPEROVITZ, STEVE DUBB, and TED HOWARD

Although the term “social enterprise” is relatively new, nonprofit organizations with dual social and economic functions are not. In fact, there is a substantial history of previously “un-named” social enterprise development in the United States. It is a history that suggests some important lessons, and possible policy directions, for current social enterprise strategy.

As discussed elsewhere in this issue, social enterprises are nonprofit organizations that develop businesses both to secure resources and further their mission. Many combine service and business functions in innovative ways. TROSA (Triangle Residential Options for Substance Abusers), for instance, makes its businesses integral to its drug rehabilitation programs in North Carolina. Moreover, business earnings provide one-third of the group’s funding. Golden Gate Community, Inc., of San Francisco runs three businesses that provide jobs and skills for at-risk youth while generating sixty-four percent of gross revenues. Pioneer Human Services in Seattle employs over seven hundred people (most of whom are former drug addicts, ex-convicts, or homeless) in eight businesses, including a metal fabrication plant; annual revenues exceed $55 million.

Like these social enterprises, both the classic community development corporation (CDC) and community development financial institutions (CDFIs) blend nonprofit social and profit-making business functions. Beginning with only a handful forty years ago, today there are over four thousand CDCs and seven hundred CDFIs in the United States.

Promotion of CDCs with public funds first became federal policy in 1967, as race riots rocked urban America. Comprehensive, nonprofit, community development corporations, which combined local control, service programs, and community enterprise were seen as a way to move away from an America that the Kerner Commission in 1968 would describe as “two societies, one black and one white — separate and unequal.”

Although CDCs have undergone a complicated development process since that time, a variety of policies have helped them evolve into capable providers of affordable housing, commercial and retail development, business lending, technical education, and support services. Government backing has shifted over time from an approach that focused on direct grants to selected organizations to one that emphasizes local initiative and which has pushed community-based organizations to strengthen institutional capacity (O’Connor 1999: 112).

Several critical policies suggest possibilities that might be adopted by modern social enterprises. Initial CDC development was supported through War on Poverty direct grants during the late 1960s, and through Title VII of the legislation creating the program. Grants from the Special Impact Program, initially operated out of the Office of

Foundations Weigh In

What are the primary reasons for providing support to earned income projects?

To answer this question, the Social Enterprise Alliance reached out to more than 100 funders across North America. Among the principal motivators for funding earned income projects were:

- To maximize philanthropic investments
- To build nonprofit capacity
- To increase public awareness of the organization
- To keep jobs in depressed markets
- To provide a platform for sharing “best practices” across sectors


(CONTINUED ON PAGE 4)
Economic Opportunity, provided funding for more than thirty urban and rural CDCs between 1968 and 1981. Another source of support came from the Urban Development Action Grant program of the Department of Housing & Urban Development (HUD) in the late 1970s and early 1980s (Clarke and Gaile 1998: 45, 91 and O’Connor 1999: 112). While these programs no longer exist, many CDCs continue to benefit from HUD’s Community Development Block Grant (CDBG) program, which provides federal support to cities for community economic development projects. Although the Nixon administration devised the program to redirect resources away from Great Society poverty alleviation efforts, since 1990, Congress has mandated that at least seventy percent of CDBG funds be spent in low and moderate-income neighborhoods (Stoutland 1999: 146).

Another important policy which may have implications for modern social enterprise development is the Community Reinvestment Act or “CRA.” Passed after a major community mobilization effort in 1977, CRA not only made the common practice of “red-lining” (that is, failing to lend to minority neighborhoods) more difficult, but placed an affirmative obligation on banks to finance projects that benefited minority and low-income communities. Even more important were the creation of the National Low Income Housing Tax Credit in 1986 and the HOME Investment Partnerships Program of 1990, each of which set aside funds to support projects led by nonprofit organizations, in ways that helped CDCs greatly increase their production, as well as earn developer fees. More recently, the New Markets Tax Credit legislation, signed into law in December 2000, provides $15 billion in tax credits over seven years to support commercial development projects in low-income neighborhoods. Such precedents clearly might be adapted to provide broader social enterprise support.

CDFI is a broad term that includes for-profit community development banks, nonprofit community development credit unions, microenterprise and community loan funds, and a mix of for-profit and nonprofit community development venture capital funds. Early innovators include the South Shore Bank of Chicago (now “ShoreBank”), founded in 1973, and Self-Help of North Carolina, founded in 1980. Up through the early 1990s, assets controlled by these institutions totaled roughly $2 billion.

CDFIs have developed more recently than CDCs, but policy support has followed similar lines. Two policies were critical: First, in 1994, the federal government created the CDFI Fund, which has provided between $50 and $118 million in competitive equity grants a year, enabling awardees to secure matching private funds several times that amount. Second, in 1995, the federal government ruled that investments in CDFIs would be a legitimate way for banks to meet their community investment obligation under CRA. As a result, CDFI assets increased from $2 billion in 1994 to over $14 billion by 2003. According to the CDFI Data Project industry survey, in 2002, the CDFI industry employed over four thousand people nationwide, provided financing for more than 30,000 affordable homes, and helped local micro-enterprises create or maintain 34,000 jobs.

Those concerned with the future of social enterprises might draw upon the experiences of CDCs and CDFIs to speed the process of policy development by modeling a range of proposals on some of the precedents their history offers. Key features of policy successes have included:

a) linking government support to tangible product or service “deliverables” (as with the HOME and tax credit legislation);

b) the creation of incentives for private sector investment (as in the Community Reinvestment Act);

c) the development of government programs that leverage additional investments from the private sector (true both of the tax credit legislation and the CDFI Fund).

These policies also help achieve public policy goals by promoting community involvement, both by facilitating public scrutiny of bank investments in CRA and by requiring CDC boards to have a majority of community members to qualify for HOME allocations.

Gar Alperovitz is the Lionel R. Bauman Professor of Political Economy at the University of Maryland and the author of “America Beyond Capitalism.” Steve Dubb is a Senior Research Associate of The Democracy Collaborative. Ted Howard is the Executive Director of The Democracy Collaborative.

REFERENCES


Community Wealth Ventures, a consulting firm focusing on helping nonprofit earned income activity, has conducted a survey of seventy-two nonprofit organizations representing 105 business ventures. Their goal was to find out what are key elements for success in social enterprise. For example, whether having a venture closely aligned with the group’s mission affects its chances of success and what roles these ventures play in the nonprofit’s financial picture. CWV warns that the results are not conclusive, but the data show some of the current trends in the field.

The Nonprofit Organization Running Ventures

Mission Focus
Nonprofits running ventures represent a diverse group in terms of mission and services, with most offering some type of social service to at-risk populations in their communities (as compared to educational, religious, or arts organizations). Many organizations serve multiple missions, but the largest category of respondents (forty percent) was nonprofits with an employment-training mission, often using their ventures as job training programs. Community and economic development organizations (twenty-eight percent) and children and youth organizations (twenty-six percent) represent the next two most common missions.

Age of Organizations
Eighty percent of the organizations surveyed were at least nine years old. Forty percent of respondents were at least twenty-six years old. Only four percent of those surveyed were less than three years old, suggesting that ventures are generally not a part of an organization’s initial plan.

Size and Scope of Nonprofits
Running a venture is not just for large nonprofits: One-third of the organizations surveyed have an annual operating budget of under $1 million, and another third have a budget of $1 million to $5 million. Nearly half (forty-six percent) are community based, thirty-eight percent operate regionally, and fourteen percent operate nationally.

Multiple Ventures
Nearly half (forty-six percent) of the organizations surveyed operate multiple ventures. In fact, one fourth of the organizations are running at least three ventures. These data suggest that once a venture has proven to be a viable source of revenue or job training, the organization understands the internal capacity needs and benefits of running a venture and pursues new opportunities. Additionally, larger organizations are more likely to operate multiple ventures. Of the organizations with annual operating budgets of more than $1 million, fifty-six percent operate two or more ventures.

(Continued on page 6)
Data from the Field
(CONTINUED FROM PAGE 5)

Business Venture Characteristics

Type of Venture
While the types of ventures that nonprofits operate range across a spectrum of industries, the most common — retail/thrift store, employee training, clerical services, and light manufacturing — provide employment training, which relates to the mission of forty percent of the groups surveyed.

Tying the Venture to the Mission
Overwhelmingly, nonprofits report that their business activities relate to their mission. Eighty-nine percent of respondents indicated that their ventures relate either directly or nearly so (rated either a four or a five on a five-point scale) to the nonprofit parent’s mission.

How Ventures Relate to the Mission of the Parent Organization

Venture Revenues
Most business ventures appear to generate modest revenues. About one-third of the organizations surveyed generate annual gross revenues of $100,000 to $500,000. It is interesting to note that annual gross revenues from the ventures appear to correlate with the size of the parent nonprofit organization. For smaller organizations (under $1 million operating budget), ventures generate average annual gross revenues of $167,000. For $1 million to $5 million organizations, annual gross revenues from their ventures average about $600,000. For organizations with annual budgets over $5 million, the ventures tend to be much larger. About twenty-five percent of these organizations reported annual gross revenues of $5 million or more.

Venture Profits
Sixty-nine percent of the organizations surveyed reported that their ventures either make a profit or break even. The chart below shows the breakdown of venture profitability.

Of the forty-two percent that were profitable, sixteen percent netted less than $25,000, and thirteen percent generated more than $50,000. However, more successful ventures may be underrepresented in this survey since there is a greater likelihood that busy managers of larger operations will opt out of this sort of interview. In addition, ventures that are not profitable may be less forthcoming with financial results.

How Long It Took to Become Profitable
It took organizations with profitable ventures an average of 2.5 years to break even. This is consistent with conventional wisdom about most small business startups and underscores the need to capitalize to survive for the longer term.

Start-Up Considerations

Initial Investment
While initial capitalization for the ventures averaged $200,000 (with a mean of $90,000), investment levels varied widely across the organizations surveyed. However, the survey bears out the old adage, “You must spend money to make money.” Forty-six percent of the organizations with ventures earning annual profits of $25,000 or more invested $100,000 or more to start the venture. Primary sources of start-up capital included the parent nonprofit’s operating budget, fundraising, board members, foundations, and the government. It appears clear that while
social enterprise may be an established practice in the nonprofit sector; there are still limited capital markets available to help nonprofits fund start-up ventures. Organizations with annual operating budgets greater than $5 million are twice as likely to take advantage of more traditional business lending resources, such as commercial loans (twenty-six percent vs. thirteen percent). However, organizations with annual operating budgets of less than $1 million tend to rely more heavily on foundation grants (sixty-seven percent of smaller organizations vs. twenty-four percent of larger organizations).

Legal Structure
Nonprofit organizations overwhelmingly keep their ventures within the organization's operating structure. Eight-nine percent of the nonprofits surveyed operate their ventures as a department or a division within the organization. Only one in ten sets up its venture using for-profit corporations, limited liability partnerships, limited liability companies, joint ventures, affiliates, or other structures.

Start-Up Staffing
Slightly less than a third of the organizations surveyed (thirty-one percent) felt they had extensive business experience at launch, while thirty-nine percent reported they had little to no experience, indicating that many nonprofit organizations tend to bootstrap new program launches. Most nonprofits that start business ventures look within their organization for initial staffing: Forty-three percent of those surveyed used existing staff members on a part-time basis, and twenty-six percent permanently reassigned staff to the venture on a full-time basis. Only forty-four percent of the organizations surveyed hired part-time or full-time staff from outside the organization at launch. However, about half of the organizations with ventures earning more than $25,000 a year hired outside staff at launch, suggesting a correlation between the use of outside expertise and financial success of the venture. Perhaps it follows, then, that a majority of nonprofits report shifts in venture management since start-up. Fifty-three percent of the organizations surveyed reported that the senior management currently running the venture is not the same as when they opened their doors for business. Not surprisingly, this is especially true of older ventures (seventy-three percent of ventures that are six years or older) and larger ventures (sixty-one percent of ventures with revenues in excess of $500,000).

Planning and Research
Nonprofit organizations interested in social enterprise believe that planning and research are important. Half of the organizations we surveyed conducted a feasibility study, other market research, or financial analysis before launching their ventures. In addition, of the range of possible planning activities available to them, sixty-five percent of the nonprofits we surveyed conducted some level of planning, even minimal, tended to find the process useful. Fifty-four percent of those that did a financial analysis found it valuable, while fifty-two percent benefited from feasibility studies, forty-four percent from business and marketing plans, and forty-nine percent from an internal organizational assessment. Interestingly, larger organizations (with annual operating budgets greater than $5 million) found the internal assessment most useful, with sixty-four percent reporting that this form of planning was “extensively valuable.”

Impact of Venture
It is not surprising that overall, nonprofit organizations reported that the greatest impact of running a social enterprise was in creating a more entrepreneurial culture. However, many also reported that it helped the nonprofit attract and retain staff, attract and retain donors, and achieve greater self-sufficiency. Within these statistics, organizations running larger ventures (with annual revenues greater than $5 million) and those with ventures more than six years old were more likely to report a significant impact on creating an entrepreneurial culture. Additionally, organizations with ventures more than five years old were more likely to report a greater contribution to the self-sufficiency of the organization (with fifty-six percent). Younger organizations were more likely to report that engaging in social enterprise was very important in attracting and retaining donors, with nearly two thirds (sixty-five percent) indicating the significant impact their venture has had on their ability to do so.

This article is excerpted from Powering Social Change: Lessons on Community Wealth Generation for Nonprofit Sustainability, Copyright © 2003, Community Wealth Ventures. This information appears with the permission of Community Wealth Ventures; the full report is available online at www.communitywealth.com.
The commercialization of charities has been a concern for decades since it was noted that the sector could easily be cleaved in two: groups that relied principally on donative support v. those that approximated for-profit businesses relying principally on fee-for-service revenues. That simple categorization has become considerably more complex in recent years.

Charities have been spurred by funders and others to seek more income from both mission-related and unrelated business operations, to start up social ventures, to pursue social entrepreneurship, and to seek profit-generating partnerships with businesses. Although many would use the term social enterprise to embrace all of these schemes, I think nonprofit commercialism speaks to a more essential and troubling truth.

Some welcome social enterprise developments, and certainly there is much that ought be welcomed. Yet, as a broader trend this commercialism creates grave challenges for nonprofit organizations and for the larger society. Beyond the dangers of what happens when you overlay market thinking, models, language and operating values on the social arena, there is a more fundamental question of how our society seeks to finance solutions to public problems. We used to be told to hold bake sales; now they tell us to open bakeries. Both are wrong.

First a few words on this fundamental issue: building on the harmful agenda begun during the Reagan presidency, the Bush administration has led a retreat of government from responsibility for public problems. With a single-minded determination to shrink the size, revenue and regulatory authority of government, they created our nation’s largest deficit to drive major cuts in funding for social investment and nonprofit programs. Federal tax revenue is now at the lowest rate against GDP since the late 1950s — factor out payroll taxes and make that the 1940s. Government spending is not out of control, as tax-and-budget-cutting conservatives would have us believe; even with overseas wars and homeland security, it remains well below where it has been against GDP most of the time since 1980.

The reason nonprofits have to scramble to find new schemes to finance their programs is because of a political agenda that favors tax cuts for the wealthy over resources to meet basic needs for the rest of us. That’s not campaign rhetoric; it’s reality. For instance, if conservatives are successful in their continuing effort to permanently repeal the estate tax, a tax paid only by the very wealthiest 2% of Americans, it will deny the Treasury over $200 billion in needed funds over the next decade. Devastatingly, according to the nonpartisan Congressional Budget Office, repeal will decrease charitable contributions by $12 billion to $24 billion dollars a year. How many social enterprises will the nonprofit sector need to generate $24 billion a year? How many enterprises are needed to offset the $200 billion that likely will be cut from the discretionary domestic programs so vital to nonprofit funding streams and those they serve?

Rather than focusing nonprofits’ attention on the real issues of the day, authorities first counseled charities to seek technocratic solutions to improve efficiencies, cost-benefit ratios and program effectiveness, to pursue management fixes to offset funding cuts. Then mechanistic and reductionistic benchmarking, outputs, deliverables, and quantifiable outcomes measures were promoted to help charities do more with less. Next, the search for magic answers turned nonprofits to collaborations, consolidations, mergers, even to death-with-dignity as it was declared we have too many charities. And now, we are to believe that salvation may come through compassionate social enterprises that further the commercialization of charity?

Certainly there’s value in all of those things, but there’s also so much wrong that it’s hard to cover it briefly. A big question is whether the nonprofit sector is losing essential qualities that distinguish its role and value to society: today about 60% of nonprofit revenues come from fees-for-service, directly from “clients” or through what in effect are third-party payments for them by government. Even human service agencies increased “consumer” fee revenues by over 600% in the last couple of decades.

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Social Enterprise: A Viable Solution for Meeting Social Needs

BY KIRSTEN L. GAGNAIRE

In Washington, D.C., the D.C. Central Kitchen makes nearly 4,000 meals per day to feed the hungry. In Seattle, Northwest Center employs three hundred people with disabilities in a variety of industries to generate sixty-two percent of the annual revenue for the organization. Across Africa, ApproTech is offering new low-cost technologies to help establish highly profitable businesses for local entrepreneurs. PATH is creating sustainable solutions through health technologies to improve global health and well-being in large and small communities around the world. What do all of these programs have in common? They all use social enterprise as a means for reaching their social mission.

The practice of social enterprise has been around since the earliest days of nonprofit formation. Goodwill, established in 1902, is one of the most recognizable examples of social enterprise. Since its inception, Goodwill has been meeting and funding its social mission, in large part, by engaging in revenue-generating activities, such as generating sales through their thrift stores. As a newly recognized field, social enterprise is gaining momentum not only in the United States but globally as a valid and effective means for addressing the world’s difficult and complicated social issues in an era where government and philanthropic funding continues to decrease.

Mr. Rosenman asks “isn’t it the (nonprofit) sector’s purpose to make things better for the larger society by also working for changes in the ways institutions and systems operate for all of us, to improve the ways governments and the market serve the public interest—to get to the root causes of structural problems rather than trying ourselves simply to market more services to more people?” Absolutely, and this is exactly where the success of social enterprise lies.

Business is not inherently evil and nonprofits are not completely pure. The idea that nonprofits should focus solely on mission without regard to accountability in traditional fiscal and management practices or that business should focus solely on profit making without regard to social consequences is myopic, not sustainable and inherently dangerous. At its core, social enterprise provides a framework for addressing social issues using best practices from both the business and nonprofit worlds. Nonprofits are businesses—businesses whose “product” is contribution to social mission. They are entities that require innovation, effective management techniques, delicate budget balancing, cash flow management and accountability for results to their customers—be they funders, clients, board members, community members or other stakeholders.

Social enterprise encompasses a spectrum of earned-income activity. For some organizations, such as Seattle-based Passages Northwest which generates twelve percent of its revenue through earned income, it represents a very small portion of their overall funding and is not a significant part of their organizational culture. Alternately, for Pioneer Human Services, social enterprise is embedded into every aspect of their organization, is the method they use to serve their clients and represents ninety-nine percent of their funding. Most nonprofits, however, fall somewhere in the middle of this spectrum with income generating activities such as fees for services, retail businesses, and manufacturing operations that represent only one of several funding streams on which they rely to sustain their social mission.

According to a study conducted in 2002 by the Yale School of Management/Goldman Sachs Foundation Partnership for Nonprofit Ventures, of the nonprofits surveyed, forty-two percent were currently operating ventures and another twenty-three percent had interest in doing so. As these numbers grow, it is increasingly important that the field of social enterprise be recognized and supported by funding and legislation that encourages the educated development of these ventures. Social enterprise provides nonprofits with the ability to sustainably address the very delicate and difficult task of balancing BOTH social mission and profitability.

Far from being a “danger” — the results that happen when you apply business methodologies to the social sector are powerful and represent a true opportunity to combine the

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By depending on user-fees and other kinds of income-generating social enterprises, organizations build an imperative to think of their products as commodities for which they must first attract and then sell individual “customers.” But isn’t the nonprofit sector’s purpose broader than that? Doesn’t the role of the sector go well beyond the palliative, beyond providing services to individuals who need or just want them, who can afford them if only with subsidy? Isn’t it the sector’s purpose to make things better for the larger society by also working for changes in the ways institutions and systems operate for all of us, to improve the ways governments and the market serve the public interest — to get to the root causes of structural problems rather than trying ourselves simply to market more services to more people?

There are lots of other ways in which the commercializing influences of social enterprise are likely to erode what distinguishes charities from the other sectors.

Sector Mission — The sector is to serve public purposes and advance the commonwealth, to strengthen civil society. Inculcating the values of altruism, promoting the practice of participatory democracy, building community, improving on distributive justice and other care-taking that serves the public good are all part of that. The self-interested behavior of social enterprises’ commercialism often conflicts with such concern for the commonwealth.

Losing the High Ground — Nonprofits are becoming marketing enterprises, replete with mall shops and executive perks. Some seek competitive edge and market share by touting upscale programs to attract wealthy users. Glitzy fund-raising extravaganzas and support appeals — selling jobs — make charitable solicitations a joke. Charities appear to grant product endorsements and “do private deals” with the highest bidders without much accord for the public interest or a truly shared concern for the people served.

Public Goods v. Commodities — It is profoundly more difficult to measure a collective outcome than an individual one and its attainment takes considerably longer. Some funders may be patient with work of broad public benefit; corporate partners are not. The difficulty of producing a social good is compounded in an enterprise that measures success in quarterly profit and loss statements.

Quick and Lower Results — When market-valued production ascends over public purposes, it creates an imperative to go after low-hanging fruit, to cream in order to appear as successful as possible by aiming for easier and quicker results, to measure efficacy against immediate deliverables instead of against longer-range goals.

Power Issues — A shift in power toward the pecuniary interests of commercial partners accompanies social enterprises. They control resources and wield sufficient political influence to direct their charitable partners. Commercialization shifts power from stewards of the public interest to those who often insist on accountability, outcomes and efficiency in market terms.

Mass Marketing — Social enterprise creates imperatives to serve more clients at lower cost and higher profit. “Going to scale” demands standardization, development of operating methods which differ little person-to-person or community-to-community, and often fail to credit or honor diversity.

Public Representation — What happens to the public interest advocacy voice of nonprofits when they need to challenge social enterprise collaborators? What happens to nonprofits’ role as mediating institutions moderating the adverse impact of the market and of government when those sectors fail to serve the public interest? What happens to change agents when their pecuniary interests and those of others become closely intertwined?

Civil Society or What — Social enterprises’ commercialism brings a discouragement of voluntarism and of altruism, of public purpose. Nonprofit organizations may well lose the support of those on whom they have depended as people learn that there is less and less to distinguish charities from commercial enterprises. What happens to volunteers, donors, board members, and staff, once they recognize that an organization is charging increasing fees, and otherwise “making a profit” in part through their altruism?

How can the nonprofit sector hope to promote civic engagement, build social capital and change society for the better when it increasingly operates within the opportunity and reward structure, within the values, of the market? How can it continue to engage people in altruistic and community-focused efforts if charities take on the characteristics of for-profit businesses?

There is a choice to be made.

Mark Rosenman is Distinguished Public Service Professor, Union Institute & University
Social Enterprise — A Viable Solution for Meeting Social Needs

(Continued from Page 9)

rigor and innovation from the profit sector with the compassion and drive of the social sector to create sustainable social change. Social enterprises all over the world are providing entrepreneurial solutions to some of society’s toughest problems—addressing the root causes and structural issues facing our society by mobilizing governments, business leaders, academics and the brightest minds in the nonprofit sector as well as otherwise untapped financial and volunteer resources.

The emerging field of social enterprise is not simply a passing fad. The Schwab Foundation on Social Entrepreneurship, based in Geneva, Switzerland, each year brings the world’s top social entrepreneurs to the World Economic Forum to stimulate dialogue with political and business leaders and to increase understanding and support of social enterprise. The Social Enterprise Alliance provides an opportunity for social entrepreneurs in North America to share best practices, connect to technical assistance, peer support and to fine-tune their skills to make a greater social impact. Since 1981, privately funded Ashoka has invested in over 1,500 individual leading social entrepreneurs in over fifty countries creating a solution based network that addresses systemic social issues facing our world.

Is social enterprise offering a rewards structure that focuses nonprofits on monetary results, shifting them away from their social mission? No. Is social enterprise a viable, powerful and effective model for leveraging resources and applying innovative solutions to meet social needs as other traditional funding sources dwindle? Absolutely.

Kirsten L. Gagnaire is Founder and Principal of the Social Enterprise Group, LLC

Counterpoints:

RESPONSE TO MR. ROSENMAN

By Kirsten L. Gagnaire

I agree with Mr. Rosenman’s fundamental points:

1) The continuing decrease in government responsibility for public problems is a primary social issue that must be addressed.

2) The continuing increase in poverty, the decline of the middle class and the inequitable distribution of wealth all reflect the same issues that have reduced government services for individuals and the nonprofits who serve them.

To clarify, I believe that social enterprise is one of a number of effective solutions available for organizations who address complex social issues. Used as part of a diverse funding mix

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knowledge that our government intentionally continues to decrease available resources exactly because of tax cuts and other actions (such as weakening regulatory safeguards) that preference wealthy businesses and super-rich individuals while hurting the rest of us, social enterprise advocates tend simply to assert that it has the power to address the root causes of structural problems — while they and many of nonprofits’ enterprise partners concurrently ignore or deny this most essential of such problems.

I believe that the continuing increases in the scope, depth and breadth of poverty, that the expanding decline of middle class life, and that the growing inequity in the distribution of wealth in our nation all are a reflection of the same forces that create the scarcity in government funding for the affected people and for nonprofits addressing these and other issues. That is not a dynamic which ought to be accepted uncritically, as social enterprise seems to do.

Those extolling the discipline of the market perpetuate a false dichotomy when they offer the over-simplified notion that nonprofits, as contrasted with businesses, focus on mission with little or no regard for accountability. While indeed nonprofits “require innovation, effective management techniques, delicate budget balancing, cash flow management and accountability for results to their customers,” it is not only through social enterprise and partnerships with businesses that charities manifest such capabilities.

While some small fraction of social enterprise might seek to address true structural problems by “mobilizing governments, business leaders, academics and the brightest minds in the nonprofit sector...,” such effort certainly is not new to charities and that history ought to be recognized and honored. As I noted in my original piece, there is value in some of what social enterprise and similar practices offer to enhance nonprofit organizations, and though charities always have manifest these capabilities, continuing improvement serves the public interest. So, too, does a diversified funding base. However, to over-sell these approaches in ways that befog the fundamental realities facing this nation and the globe serves established interests and obscures the true challenge to the nonprofit sector. ◆
However, no discussion of taxes is simple. Individuals and businesses have a seemingly never ending set of exceptions for almost every rule, and nonprofits suffer from the same circumstances.

Nonprofits are always looking for ways to increase income. If the nonprofit organization engages in a trade or business that is regularly carried on but is not substantially related to its exempt purpose, it will often be subject to tax on those activities as an unrelated trade or business. The Internal Revenue Services (IRS) requires that a Form 990T be filed for any year in which gross receipts from unrelated sources is $1,000 or more.

### WHAT TO CONSIDER

To determine if an activity is unrelated, several terms must be understood.

A **trade or business** is generally an activity that generates income from the sale of goods or the performance of services. This definition holds true for both nonprofit and for profit organizations. Determining whether the activity is related or unrelated to the nonprofit’s purpose relies on several points.

A trade or business must be **regularly carried on** to be taxable. The activity must occur with frequency and in a continuous fashion. It must be pursued in a manner similar to commercial activities that are used by for profit organizations.

The activity must also **not be substantially related** to the nonprofit organizations’ exempt purpose. In this case, if the activity does not contribute importantly to the organization’s ability to accomplish its exempt purpose other than the production of income, it will be taxable.

### How do you determine what contributes importantly to the accomplishment of your organization?

First, look to the extent of the activity involved and to its size in relation to the nature and extent of the exempt function being served. If the activity is of a scale that is greater than is reasonably needed to perform the exempt function, then it does not contribute importantly to the accomplishment of the exempt function. There are several principles that apply.

The first applies to the **sale of products of exempt functions**. Is the activity the result of the performance of exempt activities? For example, many organizations sell products that have been produced through programs that provide jobs for the disabled. If the product is sold in the condition created through the efforts of the program’s participants, it will not be taxable. However, if a product is then further refined to produce additional products prior to sale, the income generated from these sales would probably be taxable.

Another factor to consider is the **dual use of assets or facilities**. For example, a school may use its sporting facilities in connection with educational programs during the year. This activity is not taxable. However, if the same facilities are used to provide sports programs to the general public during the summer, that activity would generally be taxable.

The third factor is the **exploitation of exempt functions**. There are often opportunities to exploit the goodwill or intangibles created by exempt activities in a commercial way. The fact that the income is generated in part by the performance of an exempt activity does not change the commercial nature of the activity generating the income. Unless the income can be shown to contribute importantly to the accomplishment of an exempt purpose, the income will be deemed to be unrelated.

Travel tours can fall in this category. Many organizations arrange travel tours for its members that have essentially the same agenda and programs as commercially run operations. The exempt organization receives many benefits from this arrangement, including income, goodwill and promotional opportunities, but the tour is not an activity that is related to its exempt function.

An environmental organization might offer a study or work tour on the
And that’s where social enterprise comes in. As nonprofit leaders consciously awaken both to the existence of dormant assets and to the opportunity to reconfigure those assets in a fashion consistent with and in full support of their charitable purpose, an amazing vista opens — a vista with many challenges no doubt, but one with great promise as well. Social enterprise represents a different vision of the future, a future that replaces a culture of dependency with an entrepreneurial spirit of calculated risks and organizational accountability.

The journey of social enterprise usually begins with recognition of need, but let’s be clear — there are lots of good reasons for pursuing earned income, but desperation isn’t one of them. The process is just too important to rush, and short-term results are typically insignificant in financial terms. Most new businesses consume cash rather than produce it, and nonprofit ventures are no different.

So what are the key components of a successful earned income venture? First and foremost is the existence of a champion within the nonprofit — someone who has a fundamental belief in the need, purpose and methods of social enterprise,
Social enterprise represents a different vision of the future, a future that replaces a culture of dependency with an entrepreneurial spirit of calculated risks and organizational accountability. Coupled with a burning desire to put them in place. It’s been said that “good ideas are a dime a dozen; it’s the people who can carry them out who are truly valuable.” Nowhere is this more true than in the pursuit of social enterprise.

Recognition of the profound cultural changes required to implement earned income ventures within a nonprofit organization is also required. Are we selling out?! Some consider any movement into the commercial marketplace of supply and demand to be inherently contradictory to the nature and purposes of a nonprofit. Changing a corporate culture takes time, and it’s seldom peaceful. The departure of professional colleagues, board members, even key contributors who object deeply to the pursuit of earned income is a painful, but often inevitable, price to be paid.

It’s an exciting prospect when a nonprofit begins to realize that its assets are not just found on its balance sheet, but consist instead of virtually everything it owns, knows or does. A nonprofit’s expertise often constitutes intellectual property; proven education or intervention services frequently have a commercial outlet. Property and equipment may lie dormant at periodic or regular intervals and can generate unexpected revenue from others in need. When backed by evidence of market “pull”, that is, feasibility and market studies that reveal a genuine and sufficient demand for a product or service, the basic foundation of social enterprise has been set.

Much planning is still required, of course, often supported by business volunteers from outside the organization who bring qualified expertise and a strong dose of reality to the table. And this in turn is followed by the recruitment and/or development of necessary skill sets in the areas of marketing, pricing, production and more, as well as the creation of infrastructure support systems.

The appetite for such business training among nonprofit executives is growing rapidly as evidenced by the fact that the most recent Gathering of the Social Enterprise Alliance sold out after attracting over 600 nonprofit leaders, funders and technical assistance providers from across North America, the UK and Eastern Europe. Business schools coast to coast are expanding curricula to address the emerging field of social entrepreneurship. They reveal a growing awareness that good business practices and social benefit are not contradictory pursuits.

Today, the scope and scale of social enterprise is hard to over-estimate. Multi-million dollar enterprises abound, and self-generated revenues (including fees, program and commercial income) have become the largest single source of income for nonprofits according to federal tax reports. Commercial revenue alone was conservatively estimated in excess of $40 billion for U.S. nonprofits in 2001.

The diversity of ventures is equally impressive, ranging from retail operations to services of all kinds. Nonprofits have leveraged in-house expertise into consulting businesses; intellectual property has been licensed and sold. And most importantly, the diverse missions of these organizations has been fully integrated into business operations as people with disabilities manufacture airplane components to the highest quality standards, people struggling to overcome addictions learn discipline through temporary labor assignments, and disenfranchised youth gain self-confidence through web design for commercial customers.

Case in point, the Enterprising Kitchen, Inc., a nonprofit corporation created to provide job training and gainful employment to women who are living in poverty in Chicago. The Enterprising Kitchen emerged as a winner of the Social Enterprise Alliance 4th Gathering business competition based largely on its innovation and outcome. Within the context of a small business that produces gourmet foods and high quality hand-made soaps, women receive comprehensive assistance ranging from paid employment, work and life skills training, and a variety of other support services. The Enterprising Kitchen enables women to maximize their individual potential while generating the revenues needed to sustain and expand the program to serve even more.

While the challenges of purposefully and skillfully pursuing any of these earned income ventures must never be overlooked, neither should nonprofits ignore the power and freedom that comes with diversified revenue streams that have “no strings attached”. Discretionary dollars fuel growth, enable risk-taking, and allow a nonprofit to pursue its mission free of political consequence. This is the true essence of nonprofit sustainability and the source of long-term social change.

Jim McClurg is a Partner at the Social Enterprise Alliance
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RESOURCES on SOCIAL ENTERPRISE

MEMBERSHIP ASSOCIATIONS

Social Enterprise Alliance
www.se-alliance.org

The Social Enterprise Alliance mobilizes communities of nonprofit organizations and funders to advance earned income strategies.

Social Venture Partners
www.svpl.org

The SVP model brings together grant making, volunteerism, nonprofit capacity building, and philanthropic education; the website includes list of regional SVP organizations.

RESEARCH AND PUBLICATIONS

Harvard Business School
www.hbs.edu/socialenterprise/index.html

The Social Enterprise homepage provides links to programs and resources.

Social Enterprise Research Directory
http://db.olszak.com

A searchable directory of links and references for research papers, articles, books, websites, forums, programs and materials related to social enterprise. Developed by Olszak Management Consulting, Inc. in partnership with the Social Enterprise Alliance. The search requires registration, which is available at no charge.

CONSULTING GROUPS

Community Wealth Ventures
www.communitywealth.com

CWV helps nonprofit organizations develop business ventures and corporate partnerships; founded by Billy Shore of Share Our Strength.

Social Investors Forum
www.socialinvestorsforum.org

The Social Investors Forum connects social enterprises to prospective funders.

National Center on Nonprofit Enterprise
www.nationalcne.org

NCNE helps managers and leaders of nonprofit organizations make wise economic decisions.

FOUNDATIONS THAT SUPPORT SOCIAL ENTERPRISE PROJECTS

Fannie Mae Foundation
www.fanniemaefoundation.org

Kaufman Foundation
www.kauffman.org

Meyer Foundation
www.meyerfoundation.org

Roberts Enterprise Development Fund
www.redf.org

W. K. Kellogg Foundation
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