

TROPMAN REPORT

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PROFIT MAKING IN NONPROFITS: *An Assessment of Entrepreneurial Ventures in Nonprofit Organizations*

Driven by increased competition for funding at all levels, nonprofit organizations are looking for new ways to diversify their revenue streams, and they are turning with increasing frequency to various types of business ventures as a means for generating unrestricted "earned" revenue. This trend has spawned a new term describing the marriage of mission and entrepreneurial activity as a "social enterprise" or even "social entrepreneurship."

In the business sector, return on financial investment (ROI) is the widely used measure of success. Within the new realm of social enterprise, the term "double bottom line" refers to outcomes that are both mission-oriented and financial. With the creation of this new vocabulary comes the need to define success and develop strategies that can help organizations succeed if they chose to pursue a social venture.

There is a growing body of research on social enterprise, but the emphasis has been on developing anecdotes of success — case studies of nonprofit organizations that have creatively designed and managed for-profit ventures. The effort so far has been to develop a set of "best practices" for nonprofits to follow when they enter the risky world of social enterprise.

In Pittsburgh, one of the anecdotes of success has been the work of Bill Strickland, CEO of the Manchester Craftsmen's Guild and Bidwell Training Center on the Northside. Strickland has launched a wide variety of social enterprises to generate earned revenue, and his entrepreneurial strategy has attracted national attention and praise. Also, the new Social Enterprise Forum, a partnership of several foundations, will soon provide technical assistance and expert advice to selected nonprofit social enterprises.

These promising programs are more likely to succeed if we have some basic research on the actual experiences of Pittsburgh nonprofits with this new method of revenue generation.

- What are the most promising practices in the field of social enterprise?
- Do nonprofits in Pittsburgh use these promising practices when launching revenue-generating enterprises?
- Do these promising practices have an impact on the success or failure of revenue generating enterprises?

The Forbes Funds commissioned Olszak Management Consulting, Inc. (OMC) to answer these questions. The OMC team reviewed the literature on social enterprise to catalogue the wide array of recommendations for how to plan, launch, and manage a social enterprise. They also identified 52 organizations in Pittsburgh that are experimenting with entrepreneurial ventures and obtained survey responses from 25 of these organizations. The focus of the survey was to examine their experience with this approach and to document the extent to which they actually follow the "best practices" recommended in the literature. Finally, in-depth case studies were conducted with six organizations to gather additional insights on what works and what doesn't in the realm of social enterprise.

THE FORBES FUNDS

Envisioning Pittsburgh's nonprofit sector as innovative, informed, and engaged, The Forbes Funds advance capacity-building within and among the region's nonprofit organizations.

THE COPELAND FUND FOR NONPROFIT MANAGEMENT

The mission of The Copeland Fund for Nonprofit Management is to strengthen the management and policymaking capacity of nonprofit human service organizations to serve better the needs of their communities.

- Management Enhancement Grants
- Emergency Grants
- Cohort (Professional Development) Grants

THE TROPMAN FUND FOR NONPROFIT RESEARCH

The mission of The Tropman Fund for Nonprofit Research is to support applied research on strategic issues that are likely to have profound effects on nonprofit management and governance, especially among human service and community development organizations.

- Applied Research Projects
- Annual Research Conference

THE WISHART FUND FOR NONPROFIT LEADERSHIP

The mission of The Wishart Fund for Nonprofit Leadership is to encourage pioneering nonprofit leadership by promoting public learning and discussion about issues critical to ethical and effective management, as well as by celebrating exemplary practices.

- Leadership Roundtables
- The Frieda Shapira Medal
- Alfred W. Wishart, Jr., Award for Excellence in Nonprofit Management

LESSONS

The Forbes Funds is committed to using the results of this and other studies to help organizations responsibly explore their options in the realm of social enterprise.

Nonprofit organizations must remember that even in the private sector about half of all new businesses fail. In the private sector, venture capital may be at risk, but in the nonprofit sector, charitable community assets are at risk. Thus, nonprofits are bound by their fiduciary responsibility for good stewardship to take the steps necessary to mitigate those risks.

The Yale study proposes three types of services (see pg.4) needed to help nonprofit organizations plan, create and manage profitable business venture. Given the findings in the Pittsburgh study, it is easy to see how their suggestions could be applicable here.

- Investments in human and organizational capacity to help ensure that the proper skills, processes, and structures are in place to manage a revenue-generating enterprise.
- Educational opportunities for nonprofit executives to acquire the skills they need and to develop networks with other executives who are experimenting with social enterprise models.
- Tools and models that serve as market standards.

These and other resources are available in Pittsburgh. Also, The Forbes Funds web site (www.forbesfunds.org) contains tools and links to other sites on social entrepreneurship. We urge nonprofits to make full use of available resources and expertise before placing charitable assets at risk with revenue generating enterprises.

PROMISING PRACTICES IN SOCIAL ENTERPRISE

Based on a thorough review of the literature, Olszak identified seven “promising practices” and 34 specific activities that ostensibly are associated with successful social enterprises.

Pre-Planning — focuses on the organization’s readiness to take on a social enterprise. This should include a systematic assessment of internal management practice, available resources, organizational culture, and commitment to addressing the risks and demands associated with a venture. Specific pre-planning activities include:

- Secure staff/board support for pursuing a venture
- Review the mission of the organization to provide clear direction
- Thoroughly assess and develop organizational capacity to undertake a social venture
- Ensure that the CEO or a key staff member are able to devote a significant amount of time to the start-up effort
- Anticipate the changes and challenges that accompany a social enterprise (organization, management, resources, culture, funding and community response)
- Produce a well-defined strategic plan and associated financial plan
- Allocate enough time to venture planning to help strengthen organizational and operational systems

Venture Planning — this phase includes organizing the planning effort, conducting a “venture audit,” generating ideas, assessing opportunities and culminates in the selection of a venture. Specific activities include:

- Access technical and business expertise, in-house legal and tax advice AND secure senior mentors from the business community with general and specific management expertise
- Involve the entire management team and all appropriate staff in the planning and development process
- Identify a social enterprise leadership team
- Generate enterprise ideas that match resources with market demand
- Establish and apply a set of criteria to identify promising social enterprise ideas

Feasibility Study and Market Analysis — a wide-ranging effort to investigate and quantify the market opportunity for the venture’s products and services. Specific actions include:

- Research other ventures providing a similar product or service
- Determine the competitive advantage(s) of your organization in selling the product or service
- Focus research on the segment of potential customers that would be likely to make up the vast majority of sales
- Seek information about customer needs/wants through direct interaction and focus groups
- Evaluate the findings against the stated goals of the venture
- Conduct a preliminary feasibility study allowing factual information, not hunches or guesswork, to inform decisions

Venture Design — this is a comprehensive plan for meeting the financial, human resource, development, marketing and operational requirements of the venture, taking into account risks, contingencies and assumptions. Specific actions include:

- Determine the resources that are needed, when they will be needed, how long each will last and how they will be acquired (financial, management, consultants, research & development and equipment)
- Determine the requirements to operate the venture (start-up and on-going marketing, operations, production/service delivery and pricing, etc.)
- Define the capabilities required for success (include administrative capabilities)
- Design an operating structure that capitalizes on organizational strengths

- Calculate resource gaps and established targets for closing them
- Identify milestones for testing crucial assumptions
- Develop a contingency plan for unexpected outcomes

Financial Analysis — a rigorous effort to develop reasonable and compelling assumptions that underlie the projected financial position of the proposed venture and its impact on the organization. Specific actions include:

- Identify and quantify sources of financial support for the venture for a period of time (usually three to five years)
- Develop a pro forma budget and cash flow needs
- Conduct a breakeven analysis
- Establish pricing strategies
- Use common financial ratios to gauge the viability of the venture
- Establish a minimum profit margin or return on investment (ROI)

Business Plan — development of a document that communicates the venture’s design, management and physical structure, market potential, resource demands and potential for success (financial impact and other consequences). The purpose of the business plan is to convert the information collected in the venture design phase into steps that can be implemented once the plan is approved.

- Complete a comprehensive business plan

Assessment — regular review of the venture’s progress and the validity and reliability of the underlying assumptions. Specific actions include:

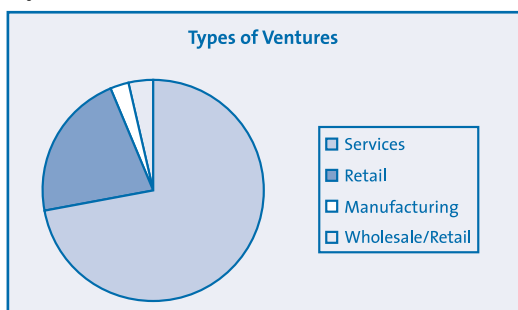
- Conduct a regular review of the venture’s planned versus actual performance
- Review the financial, management, marketing and operational plans on an annual basis and adjust assumptions based on new conditions

- About 3/4 of the organizations are running some type of service-related ventures (e.g. curriculum development, literacy training, office/meeting space rental) the remainder are mostly retail operations, with one organization engaged in manufacturing.
- Most of the social enterprises in Pittsburgh were established after 1995, but several have been in operation prior to 1980.
- Half the organizations staffed their ventures with existing staff, the other half used a combination of full-time, part-time or outside staffing.
- The most common source of start up funds were foundation grants. Once started, some derive operating funds from sales, but many (41%) cover operating costs with foundation money.
- Half the organizations expected to lose money or break even in the current year, but most say they expect to make a profit next year.
- Keeping in mind the “double bottom line,” the majority of respondents believe their social enterprise is a good “fit” for the organization’s skills and resources, and that it helped them move closer to mission fulfillment.
- Only about half the respondents believe the venture generated enough income to justify the time and effort spent launching it.
- Respondents indicated that their social enterprise has “halo” effects for the organization, including increased visibility and reputation in the community.

THE LOOK OF SOCIAL VENTURES IN PITTSBURGH

Olszak’s survey of social enterprise activities reveals some interesting patterns:

Type of Venture. Most (72%) of the ventures surveyed are engaged in providing services. Some examples of the types of services provided include: literacy training, multi-media production, office/meeting space rental, and curriculum development. Retail ventures constituted 22% of those surveyed. There was one small manufacturing venture and another that combined wholesale and retail operations.



- Most of the organizations in this study started their social enterprise either to enhance program delivery or to generate unrestricted net revenue. Several wanted to do both.

USE OF PROMISING PRACTICES OF SOCIAL ENTREPRENEURSHIP

The researchers learned that nonprofit organizations in Pittsburgh are following some, but not all, of the “promising practices.” Organizations seem to be using the early stages of planning and venture design to their best advantage, but fall short when it comes to the more rigorous analysis and actual development of a business plan. Two practices highly recommended in the literature — market research and financial analysis — are the practices that are most infrequently used. Very few organizations use common business planning tools such as breakeven analysis to account for fixed and variable costs and fewer than half the organizations report that they completed a written business plan prior to launching their social enterprise.

From the six case studies, some significant concerns surfaced regarding the accuracy of financial projections and estimates. These findings confirmed for the researchers that financial analysis is a weak link in the management of social enterprises and raised questions about the validity of profit projections reported by the 25 organizations that completed the survey.

Overall, nonprofit leaders seem to place value on the practices they relied upon the most, but the investigators could not verify that there was a correlation between those practices and success.

THE ROLE OF AN INTERNAL “PRODUCT CHAMPION”?

The business literature extols the value of so-called “product champions” — a staff person whose sole responsibility is to take all the appropriate steps necessary to ensure the success of a new venture or new product. Although Olszak and her colleagues did not explicitly address this question, their impression is that

product champions in nonprofit organizations can be instrumental in the success of an entrepreneurial revenue-generating enterprise. In general, this person may or may not be the CEO, but must be someone with strong business skills and determination to lead the venture.

COMPARISONS WITH NATIONAL RESEARCH

The findings of this study are similar to those in a recently released national study conducted by Yale School of Management – Goldman Sachs Foundation Partnership on Nonprofit Ventures. In a study of 519 social ventures, they found similar social returns reported by their survey, but more significantly their study found that sound business planning has a significant impact on the success of the venture. While they could correlate business planning to success, their study revealed that, more often than not, nonprofit organizations are not applying standard business protocols when initiating a business venture; only about half of their respondents reported completing a written business plan. The Yale study does offer one caveat regarding business planning for social ventures. They make the case that in the nonprofit sector, operating a business is not only about making money. As a result, they caution that business planning for nonprofit ventures needs to proceed using multiple lenses.

This TROPMAN REPORT is one of a series of briefing papers generated by The Tropman Fund for Nonprofit Research. TROPMAN REPORTS in this 2002 series are:

1. Capacity-building in the Nonprofit Sector: *A Comparison of Resources and Practices in Pittsburgh and Denver*
2. How Do Nonprofits Compare with For-profit Providers? *An Application of Customer Value Analysis*
3. Leveraging Human Capital: *How Nonprofits in Pittsburgh Recruit and Manage Volunteers*
4. New Economy Entrepreneurs: *Their Attitudes on Philanthropy*
5. **Profit Making in Nonprofits: An Assessment of Entrepreneurial Ventures in Nonprofit Organizations**
6. Recruitment and Retention of Managerial Talent: *Current Practices and Prospects for Nonprofits in Pittsburgh*
7. Social Services in Faith-Based Organizations: *Pittsburgh Congregations and the Services They Provide*
8. Staying Ahead of the Curve: *An Assessment of Executive Training Needs and Resources in Pittsburgh*
9. Strategic Planning: *Positioning Identity, Values and Aspirations*

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To read the full text of this study, log onto The Forbes Funds' web site at www.forbesfunds.org.