Mission-Driven Social Enterprise: Integrating Income and Impact

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"Why Nonprofits Should Get Out of Commercial Ventures" jumped out from the cover of the latest Stanford Social Innovation Review. Inside, economist Burt Weisbrod tells stories of the YMCA "health-and-fitness goliath" under attack by private health clubs for unfair competition; of the disastrous 1997 licensing agreement between the American Medical Association and Sunbeam Products that cost the AMA over $11 million in legal settlements, lost membership, and executive turnover; and of nonprofits like St. David's Health Care System that lost its tax-exempt status as a consequence of its partnership with for-profit Columbia/HCA Healthcare.

Weeks later, in Harvard Business Review, leaders from The Bridgespan Group nonprofit strategic consulting firm asked "Should Nonprofits Seek Profits?" Apparently not, or not as often as they are, given Bridgespan's experiences with their clients. For example, a youth-service organization thought it was earning a 35-cent profit on each bottle of salad dressing its youth made and sold for $3.50, only to have a Bridgespan analysis determine that the true cost per bottle was $90, yielding a staggering $86.50 loss on each item sold. Another client, a nonprofit job training agency, used philanthropic funds to build an industrial kitchen and launch a café, catering operation, and wholesale food business. Despite dismal results – losing more than $250,000 per year while placing only 10 students a year in jobs, with only a couple of those related to culinary arts – the nonprofit continued to operate the kitchen and businesses because "it was the part of our story that most excited donors about our operations."

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Has the nonprofit sector gone too far in pursuing "earned income"? Perhaps. The picture painted by Foster and Bradach, of burgeoning interest in earned income amongst nonprofits, often in response to financial challenges, at the urging of funders or board members, or with unrealistic expectations (especially given their limited business experience), certainly resonated with me. CASE is regularly contacted by nonprofits seeking help with exploration, planning or execution of social enterprise strategies. Unfortunately, we don't have the capacity to get involved with these organizations. But all too often, I detect a sense of desperation on their part. And most of them seem to be approaching the topic from a financial, rather than a strategic or mission, perspective.

So I would have to agree that there is somewhat of a “problem” with the current climate in which some nonprofits seem to be desperately seeking revenue-generating opportunities, sometimes at the behest of stakeholders and expense of mission impact. Social enterprise does seem to have been oversold as a solution to the challenges of raising government and philanthropic funds. And these articles’ accounts of disappointing and sometimes disturbing nonprofit forays into commercial activity offer significant opportunities for lessons learned - about maintaining mission focus, managing risks, protecting reputations, understanding costs, and resisting the pressures donors and other stakeholders can place on nonprofits. Publicizing them provides a good counterbalance to the success stories often heralded by social enterprise proponents. However, other than appreciating some of the examples, there is very little in Weisbrod’s article which I find constructive. On the other hand, despite their critical tone, Foster and Bradach make several observations and recommendations that should be helpful to the field.

Weisbrod proposes changing the tax code to encourage more individual charitable donations and simultaneously restrict all forms of commercial activity by nonprofits. By providing greater incentives for individual donors to contribute money and disincentives for nonprofits to pursue revenues from any type of commercial transaction, he seeks to create more “pure” nonprofits, those relying exclusively on contributions, gifts, or grants.

First of all, it’s inconceivable that individual donations could come anywhere close to filling the gap that would be left if nonprofits were encouraged to abandon earned income. Even if the potential was there, wouldn’t nonprofits’ increased, aggressive, and competitive pursuit of individual donors have just as much, if not more, potential of wasting resources and distracting organizations from their missions? Regardless, it seems premature at best for Weisbrod to argue for policy change based primarily on anecdotal evidence and confusing data on the behavior of nonprofits and for-profits competing in health care industries. For instance, he cites studies of hemodialysis centers and nursing homes that demonstrate higher quality service by nonprofits when compared to for-profits, yet these high quality nonprofits are typically heavily dependent on fees. Could they maintain quality or even operate if they were restricted to philanthropic funding only? It seems unlikely. He offers no systematic evidence that “purity” of funding improves quality or impact. Moreover, Weisbrod’s focus on “purity” reveals an ideological bias, a hearkening back to a “mythical golden age of nonprofit purity” (to quote nonprofit scholar Lester Salamon) that is both unrealistic and fundamentally anti-business and which blinds him to any of the potential social and mission benefits of appropriate earned income strategies.

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In contrast, Foster and Bradach take a far more pragmatic stance, translating some of their lessons learned into advice for practitioners, promoters, and supporters of nonprofit earned income strategies. They observe that currently, many nonprofits seem to discount the unique challenges of operating a commercial venture, underestimating and under-allocating the true

costs while being overly optimistic about the true benefits, be they social, financial, or both. Thus, Foster and Bradach pose a series of questions designed to foster realistic expectations, place mission first, and ensure that nonprofits do not waste too many valuable resources by relentlessly pursuing less than promising earned income opportunities. In promoting this approach, and simultaneously highlighting the pressure from funders and others for nonprofits to be "entrepreneurial" and move towards "sustainability," they frame the discussion of earned income not around financial potential but around mission contribution.

Foster and Bradach's focus on mission is right on target. Yet they fail to acknowledge that in some instances, earned income actually enhances mission impact. Thus, despite the authors' emphasis on mission, readers may be left with the impression that the primary benefit from earned income ventures that are aligned with an organization's mission is money – whether or not the venture is profitable, the need for philanthropic support is reduced. But with truly mission-driven social enterprise, income is actually integral to achieving social impact. Nonprofit ventures can help integrate disadvantaged populations into society and the market economy or provide underserved markets with access to vital goods and services. When mission-appropriate, even simply charging fees for programs may enhance impact through empowering clients, increasing their commitment, and pressuring nonprofits to provide truly valuable services. For instance, when Habitat for Humanity requires its new homeowners to pay a modest mortgage, it instills a sense of ownership, responsibility, and dignity that would not exist if the houses were simply given as an act of charity. While Foster and Bradach would probably not disagree, their article could be misleading in placing so much emphasis on the risks to mission posed by earned income while ignoring the potential direct mission benefits.

Nonetheless, Foster and Bradach's "mission-first" approach is exactly what is needed by the sector at this time. It should help reign in the pressures on and expectations of nonprofits, and they have done the field a service by publishing a provocative yet constructive article in a high profile publication. However, we must be careful that these articles questioning the role of commercial activity in the nonprofit sector do not put a damper on true innovation, thoughtful experimentation, and creative thinking around social enterprise. By highlighting only negative examples, neither article presents an unbiased exploration of the social and financial costs and benefits of earned income. Additionally, neither one of them adequately addresses many of the inefficiencies of other forms of raising money. Imagine what a full-cost accounting of more "traditional" fundraising might yield?

Ultimately, both of the articles inadvertently point to the critical need for further research into social enterprise. While the practice of social enterprise is not new, our understanding of it is still extremely limited, and most arguments for or against it draw almost exclusively on a select number of confirming examples. Now is the time for a research agenda that explores in depth both successes and failures and seeks to understand the practice of social enterprise not as a fundraising tool, or even as a path to "self-sufficiency" or "sustainability," but rather as a strategic, organizational approach to maximizing social impact. Until then, it is wise to avoid

universal claims or sweeping policy recommendations, to learn from our experiences, and to encourage thoughtful, mission-driven social enterprise.

Further reading:

"The Pitfalls of Profits," by Burton A. Weisbrod, Stanford Social Innovation Review, Volume 2, Number 3, Winter 2004.

"Should Nonprofits Seek Profits," by William Foster and Jeffrey Bradach, Harvard Business Review, February 2005.

"Don't Give Up in Charity-Run Businesses," by Evan Hochberg and Alfred Wise, The Chronicle of Philanthropy, March 3, 2005.

"Enterprising Nonprofits," by J. Gregory Dees, Harvard Business Review, January 1998.

Social Enterprise Typology, by Kim Alter, Virtue Ventures

See also publications, organizations, and initiatives on earned income strategies highlighted on the CASE website.