

Key Strategies for Viable Nonprofit-led Social Enterprise

Eve Pytel 24 April 2017

Many Illinois nonprofits are employing social enterprise models to earn the income needed to accomplish their mission and achieve meaningful impact. While some of these social enterprises are considered to be thriving when defined by budget size, number of employees, and years in operation, many nonprofit-led social enterprises (NPSE) are not.

In an effort to better understand the current state of nonprofit social enterprise in Illinois, Delta Institute in partnership with Forefront undertook an effort to collect information from Illinois NPSE via an online survey, interviews, and research which culminated in our 2015 report, [*“Current Conditions for the Nonprofit-Led Social Enterprise Community in Illinois.”*](#) Using data from that report, we will discuss similarities and differences among thriving NPSE and highlight what these enterprises need in order to strengthen their capacity for growth.

This analysis defines NPSE as a nonprofit or for-profit organization (founded by a nonprofit) that accomplishes its mission through the sale of goods and services. In this

article, we associate strength, or thriving, with budget size and number of employees.

Facing Inherent Challenges

At their core, NPSE are businesses that compete with the private sector. However, often the factors of production (land, labor, capital, and entrepreneurship) used by NPSE in order to make an economic profit are more constrained than those of their private sector peers. For example, an NPSE may be executing a service using workforce trainees with barriers to employment, operating in a particularly challenging location, or working within the limits of restricted funding.

In addition to competing with their relatively unrestrained private sector peers, NPSE also compete with traditional nonprofits when they strive to diversify revenue sources with grant funding and donations. Often, NPSE begin by operating in a lean, startup mode, and they lack the support they need to effectively and simultaneously garner revenue from both retail sales as well as grants and individual donations. In addition, NPSE that rely in part on government funding, such as through the State of Illinois, are challenged by the uncertainty associated with government funding.

While civic leaders and innovators look to social enterprise models to accomplish their mission, the market-based sale of goods and services is not a

panacea. The strongest NPSE acknowledge weaker footing in competing with the private sector and plan for it.

Striving for Revenue Diversity

Data collected from our 2015 survey point to the importance of revenue diversity. Of the NPSE with 2014 budgets over one million dollars, 75 percent had at least four sources of revenue, which typically included foundation grants, government grants, and the sale of goods or services. Of the NPSE with budgets under one million dollars, 68 percent had one revenue source and 25 percent had two sources. Additionally, those organizations with more diversified funding streams typically had more full-time and part-time employees than those who had fewer funding sources. By having more diversified funding sources, NPSE were more prepared to weather challenging funding constraints.

While many NPSE strive for and achieve revenue diversification, many costs associated with the mission of the NPSE will never be covered by the sale of goods and services. While an NPSE may be able to charge more for its products and services due its social impact story, it likely will not be able to cover the cost of case management, training, and other infrastructure and requirements it would not have were it using a more typical labor force.

At the same time, there was no difference in 2014 budget and employee numbers between organizations with diversified funding at the start of the social enterprise and those without diversified funding sources. In most cases, startup funding came from private foundation grants to either the parent nonprofit or the newly-incorporated nonprofit, a program-related investment (PRI) from the parent nonprofit, or individual donations. It should be noted that venture capital, lines of credit, and angel investments that so often are core to for-profit startups were rarely reported. We believe the reason why diversified startup funding may not influence current budget or employee size is that the amount of seed funding may be more important than the type of funding.

Accounting for Programming Costs

Budget levels are heavily influenced by the type of programming. Enterprises with missions including youth development, workforce development, and education had the largest number of employees and the largest budgets. 75 percent of the NPSE with budgets over one million dollars had mission areas that highlighted youth development, while 58 percent listed either education or employment as the primary focus.

It is important to note that youth development, education, and workforce development programs tend to be inherently expensive to operate. The three disciplines involve significant labor and material expenses, case

management, and administrative expenses. In addition, these programs frequently include payments to participants, transportation stipends, and other direct expenses that may not be present for other NPSE. Enterprises should be realistic in accounting for the full programming costs.

Planning for Success

From our research, it appears that the strongest NPSE prioritized investments for long-term success.

NPSE with budgets over one million dollars often had greater stability, and while they did not have all the resources they wanted, they could operate within means and have some ability to weather challenges. One group had evolved to 85 percent earned income with only 15 percent from grants, memberships, and personal contributions; another was on pace to eliminate a deficit within three years; and another had embraced a capital campaign to invest in a better facility that allowed for additional revenue through product sales.

In fact, all of the stronger NPSE had expansion plans to be accomplished within 18 to 36 months. These plans included replicating their work by adding locations or spreading to new locations and adding staff. Some looked to invest in significantly larger facilities that would enable them to scale up and increase their sale of products and services. These expansions are anticipated to require

investments of \$250,000 up to three million dollars.

Learning Lessons

Despite the success of these NPSE, they all felt there were things they wished they had done differently in their early development phase. On the topic of resources, many enterprises wished they had secured more funding, diversified funding, and individual donor support and had established a reserve fund. Many wished their board of directors better fulfilled their needs in terms of fundraising and understanding of the business of social enterprises. Organizations felt they could have been stronger operationally and had a greater vision for their impact.

Similarly, the strongest NPSE's leadership felt they could have been more aggressive with fundraising and made different hiring and strategic choices. One CEO felt that she should have more aggressively expanded the individual donor base, built a "war chest" with one full year's funding, and recruited a stronger board. Other leaders wished they had hired stronger candidates to operate and grow the business, hired a strong development manager early, and reduced the number of programmatic staff who could not grow the business. Other leaders felt they could have made better strategic choices acknowledging that "the ability to scale can be hindered by a lack of proper groundwork at the beginning."

Supporting NPSE Growth

While our research identified tactical choices made by NPSE that helped them to be successful, the NPSE field needs support.

NPSE compete with the private sector, but they are at a strategic disadvantage in terms of land, labor, capital, and entrepreneurship. While they face this uneven landscape, the NPSE does more than selling a good or service. Their products and services are executed in ways that maximize the benefit to people, communities, and society in general. The societal benefit of the NPSE represents the significant cost and challenge to the NPSE in its competition with the private sector, and, therefore, NPSE success relies on an ecosystem that values that contribution.

Moving forward, we see many ways that different types of organizations can help NPSE to grow and increase their impact. NPSE are one part of the social enterprise ecosystem that includes foundations, lenders, investors, local and state government, businesses, universities, and other nonprofit partners.

Every part of this ecosystem can act to strengthen NPSE:

- Funders and lenders can provide specialized and early-stage grant and loan opportunities and remove administrative burdens for NPSE.

- Local, state, and federal governments can create preferential purchasing opportunities to prioritize the use of services and products from NPSE.
- Similarly, businesses can commit to purchasing goods and services from NPSE or hiring workers from employment and workforce focused NPSE.
- Local governments can provide additional support by providing access to unutilized property and creating a local economic cluster.
- Universities can support local NPSE by investigating specific research questions and publishing studies that can help bolster the need for NPSE services.
- Funders, universities, or nonprofit associations can provide trainings related to NPSE board relations, recruitment, and engagement.
- The nonprofit community can better facilitate collaboration and resource-sharing across the sector.

While we believe that more strategic support and collaboration could invite significant growth potential for NPSE of all shapes and sizes in Illinois, we think it is critically important to community of practice to embrace the challenges and weaknesses of NPSE models in solving or mitigating some of society's most challenging problems.